

CHARLES FUSSELL & Co
SOLICITORS

Peter Clokey Esq
B&B Independent Valuer
c/o PwC LLP
1 Embankment Place
London
WC2N 6RH

By Courier

12th February 2010

Dear Mr Clokey,

BRADFORD & BINGLEY plc ("B&B")
SUBMISSIONS ON BEHALF OF B&B's FORMER SHAREHOLDERS

As you are aware, we act on behalf of the Bradford and Bingley Action Group, which represents the former shareholders and current bondholders of Bradford & Bingley Plc ("B&B"). This letter is written on behalf of our clients and with the support of the UK Shareholders Association ("UKSA").

The purpose of this letter is to set out submissions on behalf of the former shareholders of B&B in relation to the valuation you are currently conducting in light of the nationalisation of B&B in September 2008. We enclose a tabbed bundle of documents, to which we refer in this letter.

We will be writing to you under separate cover in relation to the position of the bondholders in light of the nationalisation of B&B.

INTRODUCTORY REMARKS

Prior to setting out our clients' specific submissions in relation to the valuation exercise, we will first set out our understanding of the statutory framework relating to the nationalisation of B&B and the compensation regime and the relevant factual circumstances surrounding the nationalisation.

1. The Statutory Framework

- 1.1. B&B was nationalised on the morning of 29th September 2008 pursuant to powers contained in the Banking (Special Provisions) Act 2008¹ (the "Act")². The order nationalising B&B is contained in the Bradford & Bingley plc Transfer of Securities and Property etc Order 2008³ (the "Transfer Order"), which was made at 7.40am and came into force at 8.00am on 29th September 2008⁴.

¹ The powers are contained in sections 3 (transfer of securities) and 6 (transfer of property, rights and liabilities)
² See Tab 1
³ SI 2008/2546
⁴ See Tab 2

Tel: +44 20 7520 9323
Fax: +44 20 7520 9324
www.charlesfussell.com

Adam House
7-10 Adam Street
London WC2N 6AA

Sole Principal: Charles Fussell
Charles Fussell & Co is regulated by the Solicitors Regulation Authority
SRA Number: 461877

- 1.2. Under paragraph 3 of the Transfer Order the shares of B&B were transferred to the Treasury. Pursuant to paragraph 16 of the Transfer Order certain assets of B&B, including its retail deposit book and retail branch network, were transferred to Santander for a consideration of £612,000,000.
- 1.3. Section 5 of the Act requires the Treasury to make a scheme for determining the amount of any compensation payable by the Treasury to holders of securities immediately prior to nationalisation.
- 1.4. Section 5(4) of the Act states that in determining the amount of any compensation payable by the Treasury it must be assumed that (a) all financial assistance provided by the Bank of England or the Treasury to the deposit-taker in question has been withdrawn and (b) that no financial assistance would in future be provided by the Bank of England.
- 1.5. The compensation requirements of section 5 of the Act are contained in the Bradford & Bingley plc Compensation Scheme Order 2008⁵ (the "Compensation Order"), which was made on 18th December 2008⁶.
- 1.6. Paragraph 3 of the Compensation Order provides:-
 - (1) *The amount of any compensation payable by the Treasury to persons who held shares in Bradford & Bingley immediately before they were transferred by the Transfer Order shall be determined in accordance with this paragraph.*
 - (2) *The amount of compensation payable to a person shall be an amount equal to the value immediately before the transfer time of all shares in Bradford & Bingley held immediately before the transfer time by that person.*
- 1.7. "Transfer Time" is defined in paragraph 2 of the Compensation Order as "8.00am on 29th September 2008."
- 1.8. Paragraph 6 of the Compensation Order provides for the appointment of an independent valuer by the Treasury, who is tasked with determining the amount of any compensation in accordance with the Compensation Order.
- 1.9. Paragraph 9 of the Compensation Order provides that the valuer may make such rules as to the procedure in relation to the assessment of any compensation (including the procedure for the reconsideration of any decisions relating to the assessment of compensation) as he considers appropriate.

⁵ SI 2008/3249

⁶ See Tab 3. The Compensation Order is in identical terms to the equivalent instrument made in respect of the nationalisation of Northern Rock (the "Northern Rock Compensation Order"), save in one material respect. The Compensation Order requires the valuer to value the shares of B&B immediately prior to nationalisation but without the assumptions contained in paragraph 6 of the Northern Rock Compensation Order that the bank is (a) unable to continue as a going concern and (b) is in administration. These assumptions are currently under challenge by the former shareholders of Northern Rock in judicial review proceedings

- 1.10. The Compensation Order was amended by the Bradford & Bingley plc Compensation Scheme (Amendment) Order 2009⁷ (the “Compensation Amendment Order”), which was made on 25th March 2009⁸. The Compensation Amendment Order inserts a new paragraph 8A into the Compensation Order which provides that the court may, on an application by the valuer, make an order requiring the provision of information that is reasonably required for the purpose of assessing the amount of any compensation payable by the Treasury. Paragraph 8C provides that any such information shall not be disclosed by the valuer to any third party without the consent of the person from whom the information was obtained.
- 1.11. You were appointed under the Compensation Order as the independent valuer on 24th June 2009 (the “Independent Valuer”).

2. The Background to the Nationalisation of B&B

- 2.1. We have been able to piece together the events in the period prior to the nationalisation of B&B from a number of publicly available documents, including Hansard and from correspondence between us and the Financial Services Authority (the “FSA”) and the Treasury. A summary of the key events, as we understand them, is as follows:-

- On 15th August 2008 B & B closed a rights issue in which it raised £400 million of fresh capital⁹.
- On 15th September 2008, Lehman Brothers went into administration.
- On Saturday 20th September 2008, the Telegraph reported that the FSA and/or the Treasury were searching for a buyer to take over B&B¹⁰.
- On Tuesday 23rd September 2008, the credit rating agencies, Fitch and Standard & Poors, downgraded B&B’s credit ratings¹¹. This was followed by a sharp drop in the share price.
- On Thursday 25th September 2008, B & B put out a press release stating that it is well capitalised and has a business fit for purpose going forward¹². Before the Treasury Select Committee (“TSC”) on 18th November 2008, Richard Pym, B&B’s Chief Executive, confirmed that this release was approved by the FSA and the Bank of England¹³.
- On Friday 26th September 2008, depositors withdrew £90 million from B&B (according to evidence given by Richard Pym before the TSC on 18th November 2008).

⁷ SI 2009/790
⁸ See Tab 4
⁹ See Tab 5
¹⁰ See Tab 6
¹¹ See Tab 7
¹² See Tab 8
¹³ See Tab 19

- By 11.30am on Saturday 27th September B&B about £200 million in deposits and online had been withdrawn from B&B – again according to evidence given by Richard Pym before the TSC.
 - At 10.15am on Saturday 27th September, the Executive Committee of the FSA commenced a meeting concerning the future of B & B¹⁴.
 - At 11.30am on Saturday 27th September, the board of B & B were contacted by the FSA and informed that it had been determined that the bank no longer met its threshold conditions to act as a deposit taker. A First Supervisory Notice purporting to vary the bank's Part IV permissions, was issued under section 45 of Financial Services and Markets Act 2000 ("FSMA") (the "Supervisory Notice")¹⁵.
 - At 6.33am on Monday 29th September 2008, Hector Sants, the Chief Executive of the FSA, confirmed that the timing of the effect of the determination set out in the Supervisory Notice issued on Saturday 27th September would be extended from 7am to 9am¹⁶.
 - At 8:00am on Monday 29th September 2008, the Transfer Order came into force.
- 2.2. The Treasury issued a statement on 29th September 2008 explaining its decision to exercise its powers under the Act to transfer certain assets of B&B to Santander and to nationalise the remainder of the business¹⁷. The material parts of the statement are as follows:-

"3. Following recent turbulence in global financial markets, Bradford & Bingley has found itself under increasing pressure as investors and lenders lost confidence in its ability to carry on as an independent institution. The FSA determined on Saturday morning that the firm no longer met its threshold conditions for operating as a deposit taker under the Financial Services and Markets Act 2000 and FSA Rules.

4. The Government, on the advice of the FSA and the Bank of England, acted immediately to maintain financial stability and protect depositors, while minimising exposure to taxpayers. It has worked over the weekend to bring about the part public, part private, solution which best meets those objectives.

.....

8. The FSCS was triggered following the determination by the FSA that Bradford & Bingley was unable or likely to be unable to satisfy claims against it, prior to the making of the Transfer Order.

.....

¹⁴ See the letter from the FSA dated 22nd January 2009 at Tab 9
¹⁵ See Tab 10
¹⁶ See Tab 10
¹⁷ See Tab 11

14. The Treasury with the other Tripartite Authorities, acting in their respective capacities, sought a range of private sector solutions before taking this action. However, with its financial advisor, HM Treasury concluded that this option best delivered its objectives of maintaining financial stability, protecting consumers and protecting taxpayers."

- 2.3. The statement that the FSA determined on Saturday morning that B&B no longer met its threshold conditions and that B&B would be unable or unlikely to be able to satisfy claims against it prior to the making of the Transfer Order has been repeated in Parliament by The Chancellor, Lord Myners and The Economic Secretary, Mr Ian Pearson¹⁸. In addition, identical press releases were issued by the FSA and the Bank of England on Monday 29th September 2008¹⁹.
- 2.4. On 8th October 2008, just 8 days after the nationalisation of B&B, it was announced by the Treasury that it was proposing to inject up to £50 billion of capital into the UK banking system²⁰.

3. Provision of Information Concerning the Nationalisation

- 3.1 We and our clients have made a number of requests to the Treasury, the FSA, the Bank of England and others, including pursuant to the Freedom of Information Act 2000, for information and documentation surrounding the nationalisation of B&B. However, apart from a copy of the First Supervisory Notice²¹ and Mr Sants' email of 06.33 on 29th September 2008, our clients have received no other material information from the Treasury, the FSA or the Bank of England in relation to the nationalisation of B&B²².
- 3.2 One particular concern our clients have is the fact that pursuant to the Amended Compensation Order you may be able to obtain material, which is relevant to the valuation exercise but which is not made available to our clients. This will make our clients' assessment of your valuation particularly difficult and, in our opinion, makes it extremely difficult for them to properly exercise their rights of appeal (if necessary) under the Compensation Order. Our clients wrote to the Chancellor in relation to this issue on 19th April 2009²³. Regrettably, no response was ever received.
- 3.3 We consider that a fair valuation process requires equal access by all interested parties to all relevant material and documentation considered by the Independent Valuer. In this instance

¹⁸ See, for example, the debates on the Transfer Order in the House of Commons and the House of Lords at Tabs 12-13

¹⁹ See Tab 11

²⁰ See Tab 14

²¹ We should point out that a copy of the Supervisory Notice has not, as far as we are aware, been made available to the public. We would refer to comments of Viscount Eccles in the debate in the House of Lords on the Transfer Order on 13th November 2008 where he noted that the FSA had informed the librarian of the House that its determination was not available to the public or Parliament for "commercial reasons" (see Tab 16). This is inconsistent with the FSA publishing the equivalent determinations for the Icelandic Banks, Kaupthing and Heritable on its website (see Tabs 17 and 18)

²² Copies of the relevant correspondence are at Tab 9

²³ See Tab 15

Tel: +44 20 7520 9323

Fax: +44 20 7520 9324

www.charlesfussell.com

**Adam House
7-10 Adam Street
London WC2N 6AA**

**Sole Principal: Charles Fussell
Charles Fussell & Co is regulated by the Solicitors Regulation Authority
SRA Number: 461877**

one interested party, namely the Treasury, will clearly have access to material which is presently being denied to our clients.

- 3.4 Whilst we appreciate that this is a matter which is essentially beyond your control our clients nevertheless wish us to flag it for you at this stage. We have been asked to reserve their right to challenge the valuation scheme under the Compensation Order (as amended) on the basis of unfairness if this proves necessary. We may also write to you about this issue in greater detail in due course.

SPECIFIC ISSUES RELEVANT TO THE VALUATION EXERCISE

We set out below a number of specific factual and legal points our clients have asked us to draw to your attention which they regard as being of significant importance to the valuation of B&B. Where possible we have provided supporting documentation or otherwise referred to publicly available information.

4. B&B's Part IV Permissions at the Transfer Time

- 4.1 It is apparent from the above timeline that immediately prior to the nationalisation of B&B it still maintained its permissions to act as a deposit-taker in accordance with Part IV of the FSMA. Had it not done so the Treasury would have been unable to exercise its powers under the Act²⁴.
- 4.2 In this regard, you will note that it was necessary for Hector Sants of the FSA to extend the operative time for removal of B&B's permissions set out in the Supervisory Notice of 27th September 2008 to a time after the coming into force of the Transfer Order. This point is also confirmed in the Treasury's letter to us of 22nd December 2008²⁵.
- 4.3 Accordingly, at the Transfer Time, B&B was an authorised UK deposit-taker and, our clients would say, was therefore a going concern.

5. B&B's Retail Deposit Book and Branch Network at the Transfer Time

- 5.1 We have advised our clients that your valuation of B&B must include all the assets of B&B transferred to Santander pursuant to paragraph 16 of the Transfer Order.
- 5.2 The reason for this is that under paragraph 16(2) of the Transfer Order, the transfer of B&B's assets to Santander "takes place immediately after the first transfer time". The "first transfer time" is the transfer of B&B's shares to the Treasury pursuant to paragraph 3(1) of the Transfer Order which, according to paragraph 3(2) takes place at the time the Transfer Order comes into force.

²⁴ Sections 3 and 6 of the Act apply to an "authorised UK deposit-taker" only. This is defined in section 1 of the Act as "a UK undertaking that under Part 4 of FSMA 2000 has permission to accept deposits."

²⁵ See Tab 9. Interestingly, the Impact Assessment for the Transfer Order (at Tab 2) states that it was made in circumstances where the FSA "...had determined..." that a deposit-taker no longer met its threshold conditions under FSMA

- 5.3 Therefore, the Transfer Time, being the time immediately prior to which your valuation must be determined, is a point in time prior to B&B's retail deposit book and branch network having been transferred to Santander.
- 5.4 In addition, the liability of B&B to the Financial Services Compensation Scheme (the "FSCS") and the Treasury, pursuant to paragraph 30 of the Transfer Order, should, for the same reasons, be disregarded by you.
- 5.5 We submit that these issues also go to whether or not B&B was a going concern at the Transfer Time and points very much to the conclusion that it was.

6. The Decision to Nationalise B&B

- 6.1 It is apparent from the public statements issued by the Treasury immediately after nationalisation that the decision was taken after the FSA had "*determined on Saturday morning that the firm no longer met its threshold conditions for operating as a deposit taker under the Financial Services and Markets Act 2000 and FSA Rules.*"
- 6.2 The Supervisory Notice issued by the FSA on Saturday 27th September provides under the heading "Reasons for Action" as follows:-

"2.1 The FSA has concluded that the Firm is failing to satisfy the threshold conditions set out in Part 1 of Schedule 6 to the Act (the "threshold conditions") in that, in the opinion of the FSA, it has not satisfied the FSA that its resources are adequate in relation to the regulated activities that the Firm carries on. In particular having regard to all the circumstances in the opinion of the FSA the Firm's capital resources and liquidity resources are inadequate."

- 6.3 It is apparent, therefore, that the FSA reached the conclusion on the morning of Saturday 27th September that B&B had inadequate capital and liquidity resources to continue to operate as an authorised deposit taker. However, whilst the FSA also appears to have concluded that "in the interests of consumer protection and market confidence" B&B should not be permitted to accept new deposits, it was prepared to "suspend" the operation of this decision until Monday morning. In this regard, paragraph 1.2 of the Notice provides:-

"This Notice will not take effect if the Firm is transferred into public ownership prior to [9am on Monday 29 September 2008].²⁶"

- 6.4 We take the view that at the time of the FSA's intervention on Saturday 27th September, which we understand followed a meeting of the Executive Committee which commenced at 10.15am²⁷, the FSA already had the use of the Treasury's powers under the Act to nationalise B&B very much in mind. Had this not been the case there could be no possible justification for

²⁶ The Notice, in paragraph 1.1 states that B&B must not accept new deposits from 7am on Monday 29th September. This was varied to 9am by Hector Sants at 6.33am on Monday 29th September

²⁷ See the letter from the FSA to Charles Fussell & Co dated 22nd January 2009 at Tab 9

the decision to remove B&B's Part IV permissions not coming into force with immediate effect²⁸.

- 6.5 We are supported in this view by the fact that the management of B&B apparently did not challenge the FSA's conclusion. This is notwithstanding, as we will demonstrate in the next section, the board's clear belief that B&B was in fact well capitalised and had adequate liquidity. In our submission, had the board of B&B believed that there was any option other than nationalisation they would almost certainly have challenged the FSA's purported decision²⁹.
- 6.6 It is also apparent from the evidence given by Messrs Pym and Kent before the TSC³⁰ that they viewed the Press's involvement as being significant in the fate of B&B immediately prior to nationalisation³¹. In this regard, Mr Kent made specific reference to Robert Peston's blog on the BBC's website.
- 6.7 We note that at 4.50pm on Friday 26th September, Robert Peston posted an article on his BBC blog, headed "B & B will be rescued soon"³². At 8.17am on Saturday 27th September, Robert Peston posted a further article on his BBC blog headed "How will B & B be rescued?" In an update at 9.37 am, Robert Peston stated "*....officials from the Treasury and the FSA and executives from B & B are working this weekend to find a way to put the bank on a more stable footing...*"
- 6.8 At 9.41pm on Saturday 27th September, Robert Peston posted a further article headed "B & B to be nationalised", in which he sets out full details of the nationalisation proposal³³. This includes the statement that "*B & B experienced significant withdrawals of cash from its branches and its online bank today, because of customers concerns about the health of the bank.*"
- 6.9 It is apparent from the content of Mr Peston's comments that he was in possession of privileged information concerning the Treasury's proposals for B&B. In addition, how could Mr Peston have known about the significant outflows of funds online on Saturday 27th unless he was being briefed by someone with inside knowledge?
- 6.10 We note that when asked by the TSC, during their examination of the press on 4th February 2009, to reveal the identity of his source Mr Peston refused to do so³⁴.
- 6.11 Our clients take the view that it is no coincidence that Mr Peston's entries on his BBC blog coincided with an increase in the rate of withdrawal of depositors' funds from B&B. In this

²⁸ This would be contrary to one of the FSA's core principles, which is to protect consumers, see section 2(2)(c) of FSMA

²⁹ We would also refer to Messrs Pym and Kent's evidence before the TSC on 18th November where they said they were asked by the FSA to let them know within the hour whether or not they intended to appeal (see the answer to questions 277 and 278)

³⁰ See Tab 19

³¹ See the answer given by Mr Pym to questions 264 and 281

³² See Tab 20

³³ See Tab 20

³⁴ See the answers given by Mr Peston to questions 617 to 621 at Tab 21

Tel: +44 20 7520 9323

Fax: +44 20 7520 9324

www.charlesfussell.com

**Adam House
7-10 Adam Street
London WC2N 6AA**

**Sole Principal: Charles Fussell
Charles Fussell & Co is regulated by the Solicitors Regulation Authority
SRA Number: 461877**

regard we would point to Mr Kent's evidence before the TSC on 18th November 2008 where he stated in answer to a question from John McFall MP:-

"Question: So you retired to bed on Friday night thinking it was going to be the usual Saturday?"

Mr Kent: It could have been. It could have been, but then there was a rapid acceleration of customer activity on Saturday morning and over the weekend....."

- 6.12 Our clients take the view that this may have been the factor which caused or at least contributed to the FSA intervening on the morning of Saturday 27th September 2008. Our clients believe that Mr Peston was being passed information relating to the Government's "rescue" plans for B&B by a senior official at the Treasury. This view is clearly shared by members of Parliament, including Michael Fallon MP³⁵.

7. The Apparent Conflict between the FSA and B&B's Management

- 7.1 The FSA's conclusion about B&B's capital and liquidity resources on the morning of Saturday 27th September 2008 flies in the face of public statements made by the management of the bank on the morning of Thursday 25th September, just two days before³⁶:-

"The changes we have announced today focus the business as a strong savings bank, reduce the size of our lending activities, and increase our capacity in arrears collection.

We are a strongly capitalised bank now undertaking a complex transition with regrettable job losses, but we are planning to put the problems of the past behind us and have a business which is fit for purpose going forward."

- 7.2 We would further point out that even adjusting for the structured products write down of circa £253 million announced on 25th September, B&B's Tier One Capital ratio was, at that point in time in excess of the new EU guidelines.
- 7.3 We would also point out that in his evidence before the TSC Mr Pym stated that the press release had been approved by the FSA and they had seen it in draft from its earlier versions the previous week³⁷.
- 7.4 The FSA's conclusion is also at odds with statements put out by B&B's management and confirmed by its auditors in the weeks prior to nationalisation. For example, in a statement issued with the bank's interim results for the half-year ended 30th June 2008 on 29th August (the "Interim Results")³⁸, which was just 4 weeks prior to nationalisation, it was recorded:-

"The Board's priority has been to ensure that we can continue to fund our business safely and we have achieved this. With a strong capital base following our rights issue, our new

³⁵ See Tab 21
³⁶ See Tab 22
³⁷ See the answer given to Q257
³⁸ See Tab 23

Chief Executive, Richard Pym, will review our plans for the business to enable us to operate effectively in these economic conditions.

Completion of £400m Rights Issue; Bradford & Bingley is one of the best capitalised banks in the UK.

.....

We have witnessed unprecedented financial dislocation, with wholesale medium-term funding markets being difficult to access since last summer. Despite this widespread dislocation, we have successfully funded the bank.

At the end of June, total customer deposits of £24.5bn funded 58% of customer loans (1H 2007: 58%). Retail savings balances increased by £1.2bn since the end of the year to £22.2bn. The investment and focus on our branch based deposits has been effective, with balances increasing by 13% to £16.2bn during the first six months and 22% since June 2007."

- 7.5 The Interim Results showed total shareholders equity, after the Rights Issue, of £1.54 billion and a Core Tier 1 Capital Ratio of 9.1%. The condensed set of Financial Statements in the Interim Results were signed off by B&B's auditors, KPMG³⁹.
- 7.6 Very positive statements, endorsed by KPMG, were also made in relation to the Rights Issue, in the Rights Issue prospectus (the "Prospectus")⁴⁰ and the Supplementary Rights Issue prospectus (the "Supplementary Prospectus")⁴¹. In particular in the Trading Statement for the first four months of the year, contained in Part VII of the Prospectus, it is stated:-

"The Group has continued to fund its operations successfully and remains funded into 2009 despite continuing difficulties in the wholesale money markets. During 2008 we have seen significant growth in the Group's retail deposit base, with a net inflow of £2.0 billion to 24 May 2008. Although funding markets remain competitive, the strength of the Group's franchise enables it to attract retail balances, while its high quality mortgage collateral enables ongoing access to secured wholesale funding. The Group has not yet drawn the £2bn committed secured facilities agreed earlier this year.

.....

The Board believes the fundamentals of the Group's Savings and Lending businesses remain sound."

- 7.7 Both the Prospectus and the Supplementary Prospectus were approved by the FSA under FSMA⁴².

³⁹ See KPMG's statement on page 15 of the Interim Results:-

"Based on our review, nothing has come to our attention that causes us to believe that the condensed set of Financial Statements in the half-yearly Financial Report for the six months to 30 June 2008 is not prepared, in all material respects, in accordance with IAS 34 as adopted by the EU and the DTR of the UK FSA."

⁴⁰ See Tab 24

⁴¹ See Tab 25

⁴² See the Rules made under Section 84 of FSMA

Tel: +44 20 7520 9323
Fax: +44 20 7520 9324
www.charlesfussell.com

Adam House
7-10 Adam Street
London WC2N 6AA

Sole Principal: Charles Fussell
Charles Fussell & Co is regulated by the Solicitors Regulation Authority
SRA Number: 461877

- 7.8 In the evidence given by Messrs Pym and Kent before the TSC on 18th November, a number of positive statements which appear to contradict the FSA's conclusion were also given. For example, in answering an accusation from John McFall MP that B&B was bust, Mr Kent stated:-

"That is not correct. At the time when we were transferred into public ownership we were both solvent and well above our regulatory minimum on capital, we were still well capitalised."

- 7.9 In addition, in relation to solvency, Mr Pym made it clear, based upon an analysis conducted by Moody's that even assuming the most negative outlook the total loss on the entire loan portfolio was less than the bank's available capital reserves at that point in time⁴³.
- 7.10 In our view it is very difficult to reconcile the statements made by the management of B&B and the auditors in the period close to nationalisation and those made by Messrs Pym and Kent before the TSC on 18th November with the conclusion drawn by the FSA on the morning of 27th September. In addition, no further details concerning the FSA's conclusion about capital and liquidity resources have been released. As we have noted above, the FSA and the Treasury have been very reluctant generally to release information to our clients concerning the decision to nationalise the bank.
- 7.11 However, from the publicly available information it is apparent that the FSA's conclusion on the morning of 27th September was wrong and that B&B did in fact have adequate capital and liquidity to meet the threshold conditions under FSMA. In this regard we would point to the following:-
- B&B had just raised £400 million of fresh capital from the rights issue, which closed in August 2008;
 - B&B had reduced its exposure to GMAC in September 2008;
 - B&B had otherwise taken steps to reduce its costs and had reduced its structured finance portfolio, thereby reducing the risk to its balance sheet from such investments;
 - Only about £350 million had been withdrawn by retail customers in the week prior to the FSA's intervention on Saturday 27th September, which in the context of a £22 billion odd retail deposit book is insignificant.

8. City Analysts' Views Prior to Nationalisation

- 8.1 Our clients have undertaken a review and analysis of the contemporaneous City analysts reports in the months prior to B&B's nationalisation. We set out some of the main points from those reports below⁴⁴.
- 8.2 On 2nd April 2008, Morgan Stanley held a conference on European Banks and other financial institutions⁴⁵.

⁴³ See Mr Pym's answer to question 336

⁴⁴ Copies of the reports are at Tabs 26 to 28

Tel: +44 20 7520 9323
Fax: +44 20 7520 9324
www.charlesfussell.com

Adam House
7-10 Adam Street
London WC2N 6AA

Sole Principal: Charles Fussell
Charles Fussell & Co is regulated by the Solicitors Regulation Authority
SRA Number: 461877

8.3 The presentation made the following observations:-

- A solid savings franchise with good opportunity for growth.
- £2 billion of undrawn committed secured funding.
- A healthy funding and capital position.

8.4 Collins Stewart published a research note on 3rd June 2008⁴⁶, shortly after the re-negotiation of the Rights Issue. At that point in time Collins Stewart were proposing a target price for B&B stock of 60 pence per share. However, Collins Stewart estimated B&B's book value at 112p per share with an estimated 116 per share for 2009.

8.5 An in-depth analysis by Citi Investment Research, dated 5th September 2008⁴⁷, noted concerns over rising arrears and delinquency rates but predicted a return to profitability in 2010. They also state that "despite our conservative assumptions, we do not expect tangible book value to fall below 80p per share in the next three years."

8.6 Keefe, Bruyette & Woods Limited ("KBW") published a research note on 2nd June 2008 which estimated a net asset value per share of 112p for 2008, increasing to 117p in 2009 and 123p in 2010⁴⁸.

8.7 The consensus of opinion from the City analysts looking at B&B in the months leading up to its nationalisation is clearly that the bank had substantial value, albeit that it was going through a difficult period. Our clients are unable to accept that all of these reports are wrong, and that the management of B&B so drastically misled the public in the period both before and after the nationalisation.

9. The Special Liquidity Scheme

9.1 We would like to raise a specific issue in relation to the Bank of England's Special Liquidity Scheme ("SLS"), which was purposely brought into operation in April 2008 to assist banks such as B&B.

9.2 Our clients submit that if there was a genuine concern about the bank's liquidity then funding from the SLS should have been made available to it rather than the Treasury exercising its powers under sections 3 and 6 of the Act. B&B had not at any time taken funding from the bank of England under the SLS.

9.3 We would remind you that funding under the SLS is deemed to be "ordinary market assistance" within the meaning of section 5(4)(b) of the Act and therefore, you are able to take into account future financial assistance provided to B&B by the Treasury or the Bank of England under the SLS in your valuation.

⁴⁵ We enclose a copy of the presentation at Tab 26

⁴⁶ See Tab 27

⁴⁷ See Tab 28

⁴⁸ See Tab 29

- 9.4 This point was confirmed by Lord Myners in the House of Lords debate on the Compensation Order on 15th December 2008, where he stated⁴⁹:-

“When taken into public ownership in February 2008, Northern Rock had been in receipt of substantial institution-specific financial assistance for over five months, in the form of both loans from the Bank of England and the provision of Treasury guarantee arrangements. By contrast, no such guarantee arrangements had been provided to Bradford & Bingley, and the Bank of England had provided no loan facilities to it that were not also open to all qualifying institutions. As a result, it is right to impose no further assumptions beyond the mandatory assumptions under the Banking (Special Provisions) Act 2008. It will be for the valuer to assess the implication of those assumptions.”

10. Potential Bidders for B&B Prior to Nationalisation

- 10.1 In our submission, an indicative valuation of B&B can be obtained from consideration of bids made for the bank in the period leading up to nationalisation. In this regard, we would refer to the bid that was proposed by Resolution Group and the support offered by TPG just a few months prior to nationalisation.
- 10.2 Although TPG backed away from investing in the restructured rights issue due to “debt downgrade” issues, the adjusted valuation that they ascribed to B&B prior to their withdrawal was £778m. This was very close to prevailing analyst estimates of 50p per share (adjusted for the increase in equity) as a discounted fair value – this figure reflecting the loan loss risks on the mortgage book. The point of TPG’s injection was of course to generate a return for their shareholders and purchasing B&B at a discount to book value of some 50% at the height of the crisis was, our clients’ would argue, a fair ‘open market’ assessment of a ‘willing buyer’.
- 10.3 The Resolution bid, which would have resulted in a shareholding of 49% in exchange for a capital injection of £400 million at 72p per share, produces an effective value of B&B of £800m (circa 52p per share). In Resolution’s announcement of its bid, dated 25th June 2008, it is stated:-

“Resolution would enter into a relationship agreement to cover:

- the right of Resolution to nominate up to three non-executive directors to the Board of Bradford & Bingley*
- confirmation by Resolution of its expectation that it will inject further capital into Bradford & Bingley to facilitate follow-on transactions or the re-capitalisation of Bradford & Bingley as necessary*
- at the request of the Board of Bradford & Bingley, Resolution would make available, as appropriate, experienced, senior personnel to assist in the stabilisation and growth of the enlarged group during its consolidation and restructuring phase on an arm’s length basis”*

⁴⁹ A copy of the debate as recorded in Hansard is at Tab 12

- 10.4 The Resolution bid was, as is widely known, rejected by B&B's board on the basis that it lacked a "control premium" as the bid was deemed to trigger a change of control issue. We would argue that, as with most takeovers, a control premium is typically added to an acquired entity.
- 10.5 We are also aware that in the days prior to nationalisation the Treasury, which appears to have taken it upon itself to effect a sale of all or part of B&B, received bids from other entities apart from Santander. Reference has been made to this by Mr Ian Pearson, the Economic Secretary to the Treasury, in the House of Commons debate on the Compensation Order on 15th December 2008⁵⁰. He said as follows:-

"I can confirm that we contacted a number of banks and building societies and assessed bids received on the basis of how far they met our objectives of financial stability, protecting depositors and protecting taxpayers. That was not a political process. All bids were submitted confidentially so I cannot comment on them,"

- 10.6 We take the view that all offers for B&B should be considered as part of the valuation exercise. In this regard, the Treasury confirmed in its letter to us of 25th June 2009⁵¹ that it received two bids for B&B, including the bid from Santander. However, the Treasury have refused to provide us with details of the other bid, including the identity of the bidder, on the basis that section 29(1)(a) of the Freedom of Information Act 2000 applies.

THE APPROPRIATE VALUATION METHODOLOGY

Our clients have asked us to set out their views on the appropriate, and perhaps more importantly the inappropriate, valuation methodologies that could be applied to reach a valuation of B&B immediately Prior to the Transfer Time.

Our clients have not, at this stage at least, undertaken a valuation of B&B and so we do not give an indicative valuation of the business.

11. General Comments

- 11.1 Ordinarily a business would be valued on the basis of what a "willing purchaser" was prepared to pay a "willing seller" in "normal market conditions". When it comes to valuing a quoted company, often the current share price will provide a key indicator of the value of the company in question.

12. B&B's Share Price

- 12.1 At the close of the markets on 26th September 2008, B&B's share price stood at 19.75p. The share price had dropped dramatically in the months prior to nationalisation. Whilst it is impossible to determine the precise drivers for any share price movement we believe it is fair to say that at least a significant part of the fall in B&B's share price related to external factors, including the general financial crisis then prevailing. In addition there was the threat of nationalisation of the bank which clearly overhung the market for some weeks prior to the actual event of nationalisation, but particularly in the few days beforehand. This threat was

⁵⁰ See Tab 13

⁵¹ See Tab 9

particularly adverse because of the previous nationalisation of Northern Rock where the Government avoided paying any compensation to shareholders whatsoever (or at least has done so to date). This was not a “normal market” therefore.

- 12.2 The workings of the stock market are such that effective ‘vacuums’ can exist in share prices, where there is no meaningful ‘willing buyer/willing seller’ activity and prices can move erratically on low volumes – the principal players in B&B stock at this time were of course the hedge funds shorting the stock. We would also point out the volume of trading in the week prior to nationalisation was at very low levels and it is apparent that the major institutional shareholders were holding their stock.
- 12.3 In summary, our clients are firmly of the view that B&B’s share price as quoted on the London Stock Exchange immediately prior to nationalisation is not a reliable guide to the bank’s underlying value and substantially underplays its true worth.

13. The Future Profits or Cash Flow of the Business

- 13.1 Obviously an alternative approach would be to take a more fundamental approach, as is typically used for unlisted companies, that might look at the future profits and cash flows of the business. In addition the assets of the business are typically examined, particularly in the case of banks, or where profits going forward are questionable or difficult to determine. We cover the Asset position below. We do suggest that an examination of the future profits, and comparisons to comparable quoted companies, and cash flows (using a discounted cash flow basis) be examined as part of your valuation process. But you should bear in mind that the bank credit crisis has been temporarily distorting the values of other comparable banks so again we would argue that the market for banks has been very distorted of late. There may be “forced sellers” who would not normally sell at the prices being offered in normal markets. But this is only a temporary phenomenon which you should be ignoring so as to determine a fair valuation.

14. B&B’s Assets

- 14.1 As noted above, the most recent figures prior to nationalisation for B&B’s net assets were those set out in the Interim Results. This gave an estimate of £1.144 billion prior to taking into account the £400 million net funds raised in the Rights Issue. This figure is the difference between B&B’s total assets of £52.250 billion and its total liabilities of £51.105 billion. This net asset position equates to over £1 per share, after taking into account the enlarged number of shares following the Rights Issue.
- 14.2 Our clients appreciate that when valuing a bank an assessment needs to be made of the quality of the underlying assets, i.e. the bank’s loan portfolio. B&B had a high concentration of buy to let and self-certified mortgages and a contract with GMAC under which the bank was obliged to take on low quality mortgages. However, in September 2008 B&B renegotiated its contract with GMAC and halved the number of mortgages it was obliged to take on.
- 14.3 As to the possible loss on the loan book, Mr Pym explained the latest analysis by the bank and by Moody’s during his evidence before the TSC on 18th November 2008:-

Tel: +44 20 7520 9323
Fax: +44 20 7520 9324
www.charlesfussell.com

Adam House
7-10 Adam Street
London WC2N 6AA

Sole Principal: Charles Fussell
Charles Fussell & Co is regulated by the Solicitors Regulation Authority
SRA Number: 461877

“The last estimate of total loss on the loan book – and the loan book is around £40 billion – was between £600 million and £800 million. The Moody’s estimated stress loss in the latest Moody’s rating report was a total loss over the cycle, for the whole book, of £1.2 billion; and that compares to capital resources in the bank, shareholders funds, of £1.7 billion.” At the current time it looks as if the capital of the bank exceeds the likely loss on the book.”

- 14.4 In our clients’ submission, a net asset valuation would only be appropriate in extreme circumstances. Usually, as stated above, a business will be valued upon its anticipated future profitability. Valuing a business on its net asset value excludes the value of the goodwill, such as its brand, the businesses infrastructure and staff knowledge and skills. In this regard we would point to B&B’s very well-known brand and the popularity of its retail deposit business.
- 14.5 However, even accepting that the circumstances surrounding the nationalisation of B&B were exceptional, our clients believe, based upon the latest available financial figures for B&B that a book value in excess of £1 per share is supportable.
- 14.6 Our clients would also point to the sale of Alliance & Leicester to Santander in July 2008 which was at approximately net asset value. However, this transaction has been viewed as exceptionally undervalued.

15. Summary

- 15.1 Our clients take the view that given the highly exceptional circumstances surrounding the nationalisation of B&B, which in turn led to a significant amount of press speculation and informed comment about the bank, the prevailing share price does not give an accurate or reliable guideline to the valuation of the business.
- 15.2 The net asset value of B&B, based upon the latest publicly available data, gives a value per share in excess of £1. However, this does not take into account any value added by the goodwill or “intellectual” assets of the business.
- 15.3 Finally, whilst many market commentators, including the rating agencies and some analysts, were predicting very high rates of delinquency in the loan book, the actual position, which has emerged after nationalisation, has shown that the more optimistic predictions by B&B’s board were more apposite.

CONCLUDING REMARKS

Our clients are firmly of the view that the nationalisation of B&B was unnecessary and the intervention of the FSA on the morning of Saturday 27th September, ostensibly on the basis that B&B lacked sufficient capital and liquidity, was without foundation. In addition, our clients take the view that splitting up the bank and selling off the retail deposit business to Santander and replacing the retail deposits with loans from the Treasury and the FSCS was wholly unnecessary and wrong. This approach to “rescuing the bank” effectively rendered it unable to continue as a going concern and placed a huge burden on the bank in the form of the £18 billion “Statutory Debt”.

To the extent that there was a “run on the bank”, which may have caused concern about B&B’s liquidity, that was caused or at least substantially contributed to by press rumours about the Tripartite

Tel: +44 20 7520 9323
Fax: +44 20 7520 9324
www.charlesfussell.com

Adam House
7-10 Adam Street
London WC2N 6AA

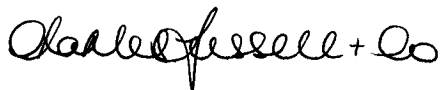
Sole Principal: Charles Fussell
Charles Fussell & Co is regulated by the Solicitors Regulation Authority
SRA Number: 461877

Authorities seeking a purchaser for the bank in the week prior to nationalisation. It is also clear that the BBC was responsible for leaking the fact and the details of the Treasury's plans for nationalisation which appears to have accelerated the outflow of depositors' funds on the Friday and Saturday immediately prior to nationalisation and may have prompted the FSA to intervene. This was certainly the view of B&B's senior management at the time and was confirmed by Messrs Pym and Kent when they gave evidence before the TSC on 18th November 2008. Furthermore, our clients believe that leaks to Mr Peston and others may have been deliberate and sanctioned at a very high level within the Treasury.

Our clients do not accept that B&B lacked adequate capital or liquidity prior to its nationalisation and are firmly of the view that it was a going concern at the Transfer Time and that it should have been allowed to continue to act as a viable business as an alternative to nationalisation. As such, the bank had substantial value immediately prior to the Transfer Time and the use by the Treasury of its powers under the Act, and the purpose for which these powers were used, looks highly questionable.

If you have any questions in relation to the contents of this letter please do not hesitate to contact Charles Fussell of this firm. Finally, we will be sending you shortly a further submission on behalf of the bondholders and must reserve the right to make further submissions in due course if necessary.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Charles Fussell + Co', written in a cursive style.

Charles Fussell & Co

Encs.

Tel: +44 20 7520 9323
Fax: +44 20 7520 9324
www.charlesfussell.com

Adam House
7-10 Adam Street
London WC2N 6AA

Sole Principal: Charles Fussell
Charles Fussell & Co is regulated by the Solicitors Regulation Authority
SRA Number: 461877