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THE BRITISH BANK NATIONALIZATIONS: AN INTERNATIONAL LAW PERSPECTIVE

N JANSEN CALAMITA*

Abstract The British Government's nationalization of the shares of Northern Rock plc and Bradford & Bingley plc in 2008 raises important issues about the standard of protection owed to the banks' non-UK investors and the manner in which compensation should be calculated. The United Kingdom is party to numerous bilateral investment treaties as well as the European Convention on Human Rights, which adopt an international standard of protection for foreign investors and require the payment of 'market value' compensation for the property taken. As the analysis in this article shows, the compensation scheme established by the British Government appears to fall short of these obligations.

On 18 February 2008, the Government of the United Kingdom nationalized Northern Rock plc, a bank publicly traded on the London Stock Exchange. Thereafter, on 12 March 2008, the Government brought into effect the Northern Rock plc Compensation Scheme Order 2008 (CSO), which established a framework for determining the amount of any compensation payable to former shareholders of the now nationalized Northern Rock. The CSO framework places significant restrictions on the permitted manner of valuing the nationalized shares in the company. Instead of providing for payment of the market value of the shares at the time of nationalization, the effect of the CSO is to require that the shares be given a liquidation value (which by most accounts will likely be zero). The CSO makes no distinctions between foreign investors and UK investors in applying this valuation methodology. All are treated alike for purposes of compensation under the Order.

While the structure of the CSO may have appeared equitable to the creators of the Scheme—treat foreign investors in the same way as British investors—the CSO framework raises questions with respect to the United Kingdom's obligations under international law. The United Kingdom is party to numerous bilateral investment treaties (BITs) as well as the European Convention on Human Rights, all of which adopt an international standard for the payment of compensation to *foreign investors* in cases of nationalization. That standard

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requires that the United Kingdom provide compensation in an amount equal to the 'market value' of the property taken from the foreign nationals. The CSO, however, seems to prohibit the payment of market value compensation by placing restrictions on the permitted manner of valuing Northern Rock's shares. As a result, the compensation process established under the CSO appears to run contrary to the UK BITS and the rules of customary international law.

Northern Rock is not the only bank to have been nationalized by the British Government. On 29 September 2008, the UK Treasury announced the nationalization of another bank, Bradford & Bingley plc. The terms of compensation for Bradford & Bingley's shareholders are not yet known. As of this writing the UK Treasury has not brought forth an order to establish a compensation scheme for Bradford & Bingley shareholders. It remains to be seen, therefore, whether the compensation scheme applicable to Bradford & Bingley shareholders will raise the same issues as the Northern Rock scheme has done.

Part I provides a brief background to the financial difficulties in which Northern Rock found itself in the latter half of 2007 and the beginning of 2008 and outlines the terms of the UK nationalization and the shareholder compensation framework set up by the CSO. Part II looks at the standard of compensation required by the UK BITS and the European Convention on Human Rights for the expropriation of property owned by foreign nationals. Part III looks at the question of valuation under the UK BITS and the Convention.¹ Part IV addresses the circumstances of the Bradford & Bingley nationalization and whether the financial crisis of September 2008 has given rise to conditions of necessity which might justify a temporary departure from the ordinarily applicable rules of international law.

I. THE NATIONALIZATION OF NORTHERN ROCK

On Sunday 17 February 2008, the UK Government announced that it would bring forward legislation to nationalize all shares in Northern Rock.² It was a remarkable change in fortune for the company. Northern Rock had been the United Kingdom's fifth-largest mortgage bank.³ Just one year earlier the company had reported profits of over £400 million and underlying assets worth £100 billion.⁴ On 6 February 2007, the share price of Northern Rock closed on the London Stock Exchange at a record high: £12.58 per share.⁵ One

¹ The focus of this paper is on the international legal aspects of the nationalization. The legality of the CSO under principles of UK administrative law is not considered except to the extent that the international principles discussed herein may have bearing on the application of UK domestic law. See, eg The Human Rights Act 1998.

² UK Treasury, *Northern Rock plc* Press Release 16/08 (17 Feb 2008).

³ Northern Rock plc, Annual Report and Accounts 2006 2.

⁴ *ibid* 103.

⁵ Thompson Datastream.

year later, however, at the time of the nationalization of its shares, the company had taken on billions of pounds of debt in facilities arranged with the Bank of England and the UK Treasury, and there were concerns about its ability to remain solvent.⁶ On its last day of trading, Friday, 15 February 2008, shares in Northern Rock closed at 90 pence per share.⁷ The company had gone from a market capitalization of £7.8 billion in February 2007 to just £559 million one year later.

A. Nationalization

On Monday, 18 February, following the UK's Government's Sunday announcement, the UK Financial Services Authority (FSA) suspended trading in shares of Northern Rock prior to the opening of the London Stock Exchange.⁸ Later that week, on 21 February 2008, the Banking (Special Provisions) Act 2008 came into force, providing the UK Treasury with the authority to bring Northern Rock into government ownership.⁹ On Friday, 22 February 2008, the Treasury issued the Northern Rock plc Transfer Order 2008, which effected the nationalization of all shares in Northern Rock.¹⁰

B. The Northern Rock Compensation Scheme

In addition to providing authority for the Treasury to take the shares of Northern Rock into public ownership, the Banking (Special Provisions) Act required that the Treasury make an order establishing a 'a scheme for determining the amount of any compensation payable by the Treasury to persons who held the securities immediately before they were so transferred.'¹¹ The Banking (Special Provisions) Act contained specific guidance to the Treasury as to the terms under which a Northern Rock compensation scheme would operate. In particular, section 5(4) of the Act 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 here, Northern Rock, has been withdrawn (whether by the making of a demand for repayment or otherwise), and

⁶ For an overview of Northern Rock's difficulties, particularly during the period from September 2007 through January 2008, see House of Commons Treasury Committee, *The Run on the Rock*, Fifth Report of Session 2007–08, Vol I (24 Jan 2008). See also the synopsis in Northern Rock plc, Annual Report and Accounts 2007.

⁷ See Northern Rock plc, *Strategic Review Update* Press Release (18 Feb 2008). Share price data available from Thompson Datastream.

⁸ UK Financial Services Authority, *Notice of Temporary Suspension of Listing from the Official List* (18 Feb 2008).

⁹ Banking (Special Provisions) Act 2008 (c 2).

¹⁰ SI 2008/432, section 2(1).

¹¹ *ibid* s 5(1)(a).

- (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).¹²

On 13 March 2008, the Treasury issued the Northern Rock plc Compensation Scheme Order 2008.¹³ Under the CSO, an ‘independent valuer’ is to be appointed by the Treasury to determine the amount of any compensation payable by the Treasury to the former shareholders of Northern Rock.¹⁴ Although the valuer is characterized as ‘independent,’ in keeping with the terms of the Banking (Special Provisions) Act, the CSO strictly limits that independence with respect to two of the valuer’s most important tasks: (a) the establishment of the legal standard under which compensation shall be awarded and (b) the determination of the valuation method by which such compensation shall be calculated.

The CSO provides that ‘[t]he amount of compensation payable to a person shall be an amount equal to the value immediately before the transfer time of all shares in Northern Rock held immediately before the transfer time¹⁵ by that person.’¹⁶ This broad statement, however, is subject to an important caveat. Under section 6 of the CSO:

In determining the amount of any compensation payable by the Treasury to any person . . . it must be assumed (in addition to the assumptions required to be made by section 5(4) of the [Banking (Special Provisions)] Act (compensation etc. for securities transferred etc.)) that Northern Rock—

- (a) is unable to continue as a going concern; and
(b) is in administration.

The CSO further requires that the valuer ‘shall determine’ the amount of any compensation payable by the Treasury in accordance with these assumptions.¹⁷

At the time of the Transfer Order, there were 421.2 million ordinary shares of Northern Rock outstanding.¹⁸ In addition, there were 200 million shares of preference stock outstanding.¹⁹ Financial information resources suggest that while most shareholders appear to have been UK nationals, large amounts of Northern Rock’s shares also appear to have been held by non-UK nationals, although because information about the identity of the shareholders of

¹² *ibid* s 5(4).

¹³ SI 2008/718.

¹⁴ *ibid* s 7.

¹⁵ Under section 2, ‘the transfer time’ means the beginning of 22nd February 2008.

¹⁶ S 3(2).

¹⁷ S 7(2).

¹⁸ Northern Rock plc, Annual Report and Accounts 2007 84.

¹⁹ *ibid*. In addition, 100 million ‘Foundation Shares’ were held by The Northern Rock Foundation, a charitable organization established in 1997 at the time Northern Rock became a public limited company, *ibid* 24. According to the company’s 2007 Annual Report, the Foundation shares ‘carried no rights to dividends but ranked *pari passu* with the Ordinary Shares in respect of other distributions and in the event of a winding up.’ *ibid* 85.

Northern Rock is not a matter of public record much of this information is far from precise.²⁰

The valuation process established under the CSO makes no distinction between the compensation payable to UK investors in Northern Rock, on the one hand, and foreign investors on the other. Given international principles of non-discrimination against foreign nationals, this is perhaps not surprising. However, merely providing foreign investors with the same treatment as national investors does not insulate the State from claims that the treatment on offer falls below an international minimum standard or standards guaranteed under treaties. In the debates in the House of Lords introducing the CSO, it was put to Lord Davies, the Government Deputy Chief Whip, that the existence of treaties between the United Kingdom and other states might require that higher standards of compensation would need to apply to the treatment of foreign investors, resulting in foreign investors receiving greater compensation for their Northern Rock investments than domestic investors.²¹ In response, Lord Davies offered the following view:

The Government are determined that all shareholders shall be equal with regard to the position of Northern Rock. I have heard the reflections, which were also made in the other place, that certain international treaties will safeguard shareholders based abroad and give them more favourable treatment than other shareholders. *First, that is not so. Secondly, in all equity, it ought not to be so.* I cannot think of anything being less fair to the ordinary small shareholder Nothing could be more offensive to the small shareholder than the idea that someone based abroad would be able to take advantage of bilateral treaties that were designed to—and this has been accurately reflected in discussion today—safeguard, on the whole, British taxpayers regarding regimes that can act on occasion in an extremely arbitrary and unfair manner.²²

Contrary to the implication of Lord Davies' comments, however, the standard of protection for foreign investors in cases of expropriation is set by principles of public international law, not national law alone. This is true whether the investor is protected by one of the United Kingdom's numerous bilateral investment treaties (BITs), the European Convention on Human Rights, or customary international law. For foreign investors, therefore, the CSO is not the last word, even though for national investors it is likely to provide as much protection as they can reasonably expect to receive.²³

²⁰ Large non-UK shareholders seem to have included UBS AG (Switzerland), Toronto Dominion Bank (Canada), Bank of America (US), Lazard Limited (Bermuda), Société Générale (France). See, eg FAME database of UK and Irish companies, Bureau van Dijk Electronic Publishing. Northern Rock's two largest shareholders at the time appear to have been SRM Global Master Funder LP, a Cayman Islands-based limited partnership (approx 11.5 per cent) and RAB Capital plc, a UK company (approx 7 per cent).

²¹ *Hansard* HL Deb cols 1473–74 (Baroness Noakes) (11 Mar 2008).

²² *ibid* cols 1481–82 (emphasis added).

²³ As discussed below, the European Convention on Human Rights does place some limits on the manner in which the United Kingdom may treat domestic investors. These limits, however,

Whether one considers this a case of foreign investors being treated too well or Parliament not treating UK investors well enough, the international law on the subject seems relatively clear. While the United Kingdom has great sovereign discretion to determine how it treats investors with UK nationality, the international agreements to which the United Kingdom is a party place limits on that sovereignty with respect to foreign investors. Of course if the CSO provided compensation that was in accord with international standards, there would be no problem. However, as the analysis below suggests, the CSO appears to fall short under international standards and to leave the United Kingdom in breach of its international obligations.

II. OF BITS AND HUMAN RIGHTS—THE STANDARD OF COMPENSATION FOR NORTHERN
ROCK SHAREHOLDERS

*A. The Standard of Compensation for Expropriation under the UK BITs:
‘Prompt, Adequate and Effective’ Compensation*

The United Kingdom has concluded over 100 bilateral investment treaties (BITs)²⁴ with other states, of which 91 are in force.²⁵ All contain provisions addressing the standard of compensation to be used in the event that the property of an investor from one of the contracting states is nationalized by the other contracting state. These treaties create obligations for the United Kingdom in international law and limit the United Kingdom’s capacity to make unilateral determinations as to the manner in which foreign investors should be treated, particularly in cases of nationalization or expropriation and, importantly, regardless of the way in which the United Kingdom decides to treat its own nationals. Because the United Kingdom has historically been a capital-exporting state, the UK BITs will have been negotiated on the assumption that UK investors would be the ones to benefit from the protections contained therein.²⁶ Nevertheless, the BIT standards apply reciprocally.

Generally speaking, all of the United Kingdom’s BITs use substantially similar language to indicate the level of protection owed to foreign investors

are rather minimal and the Court of Human Rights’ standard of review in such cases is very deferential to the State’s decisions.

²⁴ In the special parlance of the Foreign & Commonwealth Office, the UK BITs are referred to as Investment Promotion and Protection Agreements (IPPAs). This article will use the more commonly used international term—BITs—when referring to these agreements.

²⁵ According to the United Nations Conference on Trade and Development (UNCTAD), as of 1 June 2007, the UK had signed 103 BITs, ninety-one of which were in force. See http://www.unctad.org/sections/dite_pcbb/docs/uk.pdf.

²⁶ As noted by Lord Shawcross, one of the originators of the ill-fated OECD Draft Convention on the Protection of Foreign Property: ‘The *quid pro quo* for the borrowing States’ undertaking is, in fact, in the English vernacular, the provision of the *quids*, that the capital importing countries in return for agreeing to abide by the generally recognized procedures of international law, will receive more private investment and with the capital, the benefits of the technical and commercial skills which go with them than would otherwise be the case.’ Quoted in E Snyder, ‘Protection of Private Foreign Investment: Examination and Appraisal,’ (1961) 10 ICLQ 469, 492.

in cases of expropriation.²⁷ In nearly all UK BITs the standard of compensation payable to a foreign investor whose property has been expropriated or nationalized is to be judged against the classic Hull formula:²⁸ expropriation may only be undertaken in the ‘public interest’ and only upon the payment of ‘prompt, adequate and effective’ compensation.²⁹ In adopting the language of the Hull formula, the UK BITs are in accord with a vast number of the more than 2,500 BITs which have been concluded worldwide.³⁰

1. When is compensation ‘adequate’? The significance of variations in the UK BITs

The Hull formula’s use of the term ‘adequate’ of course begs the question of what compensation will be considered adequate. In an effort to answer this question, many BITs, including virtually all of those to which the United Kingdom is a party, provide, in addition to the invocation of the Hull formula, elaboration on the measurement of adequate compensation. The 1975 UK-Singapore BIT, for example, provides:

Such [prompt, adequate and effective] compensation shall amount to the *market value of the investment* expropriated immediately before the expropriation or impending expropriation became public knowledge.³¹

In more recent UK BITs, the reference to ‘market value’ has been replaced by the phrase ‘genuine value.’ The 1992 UK-United Arab Emirates BIT thus provides:

Such [‘prompt, adequate and effective’] compensation shall amount to the *genuine value of the investment* expropriated immediately before the expropriation or before the impending expropriation became public knowledge, whichever is the earlier³²

²⁷ See E Denza & S Brooks, ‘Investment Protection Treaties: United Kingdom Experience’ (1987) 36 ICLQ 908. The text of the current UK Model BIT (2005) is reprinted in R Dolzer & C Schreuer, *Principles of International Investment Law* (OUP, Oxford, 2008) 376.

²⁸ In 1938, in an exchange of diplomatic notes with the Government of Mexico, US Secretary of State Cordell Hull wrote that ‘under every rule of law and equity, no government is entitled to expropriate private property, for whatever purpose without provision for prompt, adequate and effective compensation.’ The diplomatic exchanges between Mexico and the United States which led to the articulation of the Hull formula are excerpted at length in A Lowenfeld, *International Economic Law* (OUP, Oxford, 2002) 397–403.

²⁹ In a small number of BITs, the United Kingdom has agreed to different formulations of the standard of compensation, see eg, UK-China BIT, TS No 33 (1986), Art 5 (‘reasonable compensation’ amounting to the ‘real value’ of the investment); UK-Hong Kong, BIT, TS No 9 (2000), Art 5 (‘compensation’ amounting to ‘real value’); UK-India (1995), Art 5 (‘fair and equitable compensation’ amounting to ‘genuine value’).

³⁰ See (70) and accompanying text.

³¹ UK-Singapore BIT, TS No 51 (1975), Art 5(1). This formulation is followed in relevant part in over 28 other UK BITs.

³² UK-United Arab Emirates BIT, TS No. 24 (1994), Art. 6(1). This formulation is followed in relevant part in over 47 other UK BITs.

Some commentators have questioned whether the provision in one BIT for compensation amounting to the ‘market value’ of the investment might call for a different appraisal of compensation than that provided in another BIT indicating that compensation shall amount to the ‘genuine value’ of the expropriated investment.³³ It is a question worth asking. In addition to these variants, one could also note the formulation used in the UK-Russia BIT, requiring ‘adequate and effective compensation’ amounting to the ‘real value of the investment,’³⁴ or the UK-Bangladesh BIT, requiring ‘prompt, adequate and effective compensation’ amounting to the ‘full value of the investment.’³⁵ Must these all mean the same thing?

Generally speaking, the interpretation of compensation standards under BITs has not been the most nuanced of exercises. There is a definite trend in the Western commentary to give short shrift to variations in language describing the level of compensation so long as the BIT is taken as referring in sum and substance to the Hull formula. Thus, terms like ‘market value’, ‘genuine value’ and ‘full value’ when used in BITs have largely been treated as synonymous with each other and with the Hull formula.³⁶

This conclusion seems sound, at least where, as with the majority of UK BITs, terms like ‘market value’ and ‘genuine value’ are used in conjunction with a textual inclusion of the Hull formula’s ‘prompt, adequate and effective’ standard this conclusion seems sound.³⁷ Under the Vienna Convention on the Law of Treaties, the terms of a treaty are to be interpreted in accordance with their ordinary meaning in the context in which they occur.³⁸ As a result of its frequent articulation as a standard of customary international law,³⁹ and its inclusion in numerous BITs, the Hull standard of compensation in cases of expropriation has developed a precise meaning in international law. In particular, the ‘adequacy’ of compensation under the Hull formula has come

³³ See M Sornarajah, *The International Law of Foreign Investment: Second Edition* (CUP, Cambridge, 2005) 242–43; CF Amerasinghe, ‘Issues of Compensation in the Taking of Property in the Light of Recent Cases and Practice’ (1992) 41 ICLQ 22, 30.

³⁴ UK–Russia BIT, TS No 3 (1992), Art 5(1).

³⁵ UK–Bangladesh BIT, TS No 73 (1980), Art 5(1). See also UK–Malaysia BIT, TS No 16 (1989), Art 4(1) (‘prompt, adequate and effective compensation’ reflecting the ‘value of the investment’).

³⁶ See, eg Lowenfeld (n 28) 482, R Dolzer & M Stevens, *Bilateral Investment Treaties* (Martinus Nijhoff Publishing, The Hague, 1995) 109–110; Irmgard Marboe, ‘Compensation and Damages in International Law: The Limits of “Fair Market Value”’ (2006) 7 J World Trade & Invest 723, 730 (2006); M Ball, ‘Assessing Damages in Claims by Investors Against States’ (2001) 16 ICSID Rev For Invest LJ 408, 414. Accord UNCTAD (2004) Key Terms and Concepts in *IAs: A Glossary* 73.

³⁷ For those BITs which do not include the Hull formula, however, and merely refer to ‘reasonable compensation’ or ‘real’ or ‘genuine’ value, it is an open question whether one should automatically equate such language with ‘market value.’ See, eg E Denza & S Brooks, ‘Investment Protection Treaties: United Kingdom Experience,’ (1987) 36 ICLQ 908 (discussing the negotiation of the UK–China BIT).

³⁸ Vienna Convention on the Law of Treaties, Art 31(1). See *Competence of the General Assembly for the Admission of a State to the United Nations* [1950] ICJ Rep 4, 8.

³⁹ See Part II.

to refer rather concretely to the payment of ‘market value’ as compensation for expropriated property.⁴⁰ Thus, for example, the World Bank in its *Guidelines on the Treatment of Foreign Direct Investment* states that ‘[c]ompensation will be deemed “adequate” if it is based on the fair market value of the asset as such value is determined immediately before the time at which the taking occurred or the decision to take the asset became publicly known.’⁴¹ UNCTAD has taken a similar position,⁴² and arbitral tribunals have reached the same conclusion as well.⁴³

Given that ‘adequate’ compensation under the Hull formula means ‘market value’ compensation, it is reasonable to use that meaning to inform the interpretation of ambiguous terms like ‘genuine,’ ‘real’ or ‘full’ found in certain UK BITs. This view finds support in the decision of the arbitral tribunal in *CME Czech Republic BV (Netherlands) v Czech Republic*. There, the Netherlands-Czech Republic BIT provided that in the event of an expropriation, the expropriating state would be required to make ‘payment of just compensation’ amounting to ‘the genuine value of the investment affected.’⁴⁴ Reflecting upon whether the use of the phrases ‘just compensation’ and ‘genuine value’ contemplated a standard of compensation different from that of the Hull formula and the standard of ‘market value,’ the Tribunal concluded that it did not. In the tribunal’s view the terms were synonymous with the Hull formula; full market value was required.⁴⁵ Here, it is not necessary to stretch the interpretation that far. The UK BITs expressly include the Hull formula in their terms. The standard of compensation to be paid, therefore, is market value compensation.⁴⁶

⁴⁰ See Marboe, ‘Compensation and Damages in International Law: The Limits of “Fair Market Value”’ (2006) 7 J of World Trade & Invest 723.

⁴¹ World Bank, *Guidelines for the Treatment of Foreign Direct Investment* (1992) Art IV, s5 2 & 3, reprinted in 31 ILM 1363, 1379.

⁴² UNCTAD, *International Investment Agreements: Key Issues* (2004) Vol 1 239.

⁴³ See, eg *American Int’l Group, Inc. v Islamic Republic of Iran* Award No 93-2-3, 4 Iran-US CTR 96, 106 (19 Dec 1983) (applying customary international law).

⁴⁴ *CME Czech Republic BV (Netherlands) v Czech Republic*, Final Award (14 March 2003), para 496.

⁴⁵ *Ibid* para 497. See *Compañía del Desarrollo de Santa Elena SA v Costa Rica*, ICSID Case No ARB/96/1, Award (17 Feb 2000), paras 69–70; *Southern Pacific Properties (Middle East) v Egypt* (1992) Award ICSID Case No ARB/84/3, Award (20 May 1992), para 197.

⁴⁶ In any case, the operation of most-favoured-nation (MFN) clauses found in the UK BITs may make academic any debate about the linguistic equivalence of ‘genuine value’ and ‘market value’ or ‘just compensation’ and ‘prompt, adequate, and effective compensation.’ MFN clauses act to ensure that the parties to an agreement treat each other in a manner at least as favourable as they treat third parties on matters coming within the scope *ratione materiae* of the MFN. The MFN clauses in the UK BITs are drafted in uniformly broad terms and should apply with respect to the provisions addressing compensation for expropriation. See eg, UK-Hong Kong BIT, TS No 9 (2000), Art 3; UK Model BIT, Art 3(3). Most-favoured-nation clauses like those contained in the UK BITs have been invoked to define the applicable standards of protection and compensation in investor-state cases. Thus, in the *CME* arbitration, the tribunal, in addition to viewing ‘genuine value’ as linguistically synonymous with ‘fair market value,’ also relied upon the MFN clause contained in the Netherlands-Czech Republic BIT to conclude that ‘fair market value’ was the appropriate measure of compensation. The BIT between the United States and the Czech Republic

2. *The significance of BIT standards to covered Northern Rock investors*

Neither the CSO, nor the Banking (Special Provisions) Act sets a clear standard for the compensation that is to be paid to the owners of nationalized Northern Rock shares. Instead, both instruments refer obliquely to ‘any compensation payable.’ The UK BITs, however, set a standard of compensation applicable to the investments of nationals from the States which are parties to them. These BITs set the standard of compensation in terms of the market value of the property taken immediately before the expropriation or before the impending expropriation became public knowledge, whichever is the earlier. That is the level of compensation which the United Kingdom is obligated to pay investors covered by the UK BITs. As a result, regardless of the ambiguity created by Parliament’s reference to ‘any compensation payable,’ regardless of the valuation assumptions imposed by the CSO and the Act, and regardless of Lord Davies’ comments, with regard to those investors covered by UK BITs, the United Kingdom has an obligation to follow the standard forth in those BITs. The fact that UK nationals will not benefit from this international standard and will be processed instead under the CSO’s vague standard is the United Kingdom’s decision to make. As to foreign investors, however, the United Kingdom bargained that discretion away when it entered into the BITs.

B. The Standard of Compensation under the European Convention on Human Rights: Different Degrees of Protection for Nationals and Non-Nationals

The European Convention on Human Rights provides an additional source of protection in cases of expropriation. Unlike the UK BITs, the Convention applies to all investors in Northern Rock: UK nationals, nationals of one of the Convention’s Contracting States, and nationals of States who are not parties to the Convention. However, the standard of protection provided by the Convention is not the same for all investors. In its case law the European Court of Human Rights has indicated that the standard of protection for property rights, including the compensation required for expropriation, differs significantly depending upon the nationality of the claimant. Thus, where interference with property rights is at the hands of the claimant’s own state of nationality, the standard of compensation will be assessed according to the

provided in terms for compensation to be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken and the Dutch investor could rely upon that provision. *CME Czech Republic* para 500. See also *Bayindir Insaat Turizm Ticaret Ve Sanayi AS v Pakistan Decision on Jurisdiction*, ICSID Case No ARB/03/29 (14 Nov 2005), paras 231–232; *MTD Equity Sdn Bhd v Chile*, ICSID Case No ARB/01/7, Award (25 May 2004), para 187. For a critical appraisal of the application of MFNs in investor-state arbitrations, see J Kürtz, ‘The Delicate Extension of Most-Favoured-Nation Treatment to Foreign Investors: *Maffezini v Kingdom of Spain*’ in T Weiler (ed) *International Investment Law and Arbitration* (Cameron May, London, 2005) 523.

Court's rather deferential European human rights jurisprudence, whereas when the interference is at the hands of a state other than the claimant's own, customary international law will provide the standard. As shown below, for UK investors this means that the Convention provides a lesser standard of protection for their investments than it does for the investments of foreign nationals.

1. *The two-tier system of protection*

Compensation for the expropriation of property was a controversial issue in the Council of Europe's negotiations on the European Convention on Human Rights.⁴⁷ While there was wide agreement that in the event of expropriation compensation must be paid, the negotiating States were unable to agree on how to formulate a standard for that compensation.⁴⁸ This was not a matter of States disagreeing about the standard which ought to be applicable to the treatment of foreign investors. Instead, the disagreement concerned what restrictions, if any, States would be willing to place upon their treatment and compensation of their *own* nationals. As a result of the disagreements on the treatment of domestic claims, the language ultimately included in Article 1 of Protocol No 1 makes no reference to compensation at all. Instead, Protocol No 1 provides in relevant part: '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.'⁴⁹ To have been more specific would have meant losing the agreement of the negotiating States.

Although Protocol No 1 contains no direct reference to compensation for the expropriation of property, the European Court of Human Rights has interpreted it to include a kind of guarantee of compensation, albeit one which varies depending upon the nationality of the applicant. The differing standards of treatment are a result of the way in which the Court has interpreted Protocol No 1's guarantee that 'no one' shall be deprived of property except as subject to 'general principles of international law.' In *James v United Kingdom*, and again in *Lithgow v United Kingdom*, the Court treated the reference to 'general principles of international law' in Protocol No 1 as referring to the principles of customary international law on state responsibility, and concluded, on that

⁴⁷ On the negotiating background of the European Convention's protection of property, see generally T Allen, *Property and the Human Rights Act 1998* (Hart Publishing, Oxford, 2005).

⁴⁸ See Council of Europe, Collected Edition of the 'Travaux Préparatoires' of the European Convention on Human Rights: Recueil des Travaux Préparatoires de la Convention Européenne des Droits de L'Homme (1975–85) Vol 7 194 ('fair compensation which shall be fixed in advance'); 222–24 ('such compensation as shall be determined in accordance with the conditions provided for by law'); 206–08 (simply 'compensation').

⁴⁹ Protocol No1, Art. 1(1). The full text of Article 1(1) provides: '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.'

basis, that those principles were incorporated into Protocol No 1 only with regard to those acts to which they are normally applicable, namely, acts of a State in relation to non-nationals.⁵⁰ Thus, where the applicant is a non-national, the level of protection will be determined by international law. However, where the applicant is a national of the expropriating State, the level of protection will be determined under the Court's specialized Convention jurisprudence—international legal standards will not be applicable.

In response to the argument that this interpretation would render the reference to international law redundant—because non-nationals already were covered by international law prior to the Convention—the Court in *James* and *Lithgow* noted two reasons for the inclusion of the reference. First, the Court reasoned, the reference 'enables non-nationals to resort directly to the machinery of the Convention to enforce their rights on the basis of the relevant principles of international law.'⁵¹ And secondly, the reference prevents any confusion that the entry into force of the Protocol might have somehow diminished non-nationals' property rights under international law.⁵²

The Court's conclusion that under Protocol No 1 non-nationals continue to be protected by international law while nationals only have the Convention to protect them, raises the question of whether such a two-tier system of protection is incompatible with Article 14 of the Convention by differentiating between nationals and non-nationals. The Court has concluded that it is not:

Especially as regards a taking of property effected in the context of a social reform or an economic restructuring, there may well be good grounds for drawing a distinction between nationals and non-nationals as far as compensation is concerned. To begin with, non-nationals are more vulnerable to domestic legislation: unlike nationals, they will generally have played no part in the election or designation of its authors nor have been consulted on its adoption. Secondly, although a taking of property must always be effected in the public interest, different considerations may apply to nationals and non-nationals and there may well be legitimate reason for requiring nationals to bear a greater burden in the public interest than non-nationals . . .⁵³

As a result of the *James* and *Lithgow* cases, it is clear that for Northern Rock shareholders, the level of protection available to them under the Convention very much depends upon whether they are UK nationals or not. And, as shown below, with respect to the protection afforded under the European Convention on Human Rights, it is better not to be British, at least with respect to

⁵⁰ See *James v United Kingdom* (1998) Series A No 98, 8 EHRR 123, paras 60–61; *Lithgow v United Kingdom*, Series A 102 (1986), 8 EHRR 329, paras 113–14. See also *Gudmundsson v Iceland* (1960) Y B Eur Conv on HR 394, 422–424 (Eur Comm'n on HR).

⁵¹ *James*, para 62; *Lithgow*, para 115.

⁵² *ibid.*

⁵³ *James*, para 63; *Lithgow*, para 116. The Court also noted that the *travaux préparatoires* of the Protocol indicated that the reference to general principles of international law 'was subject to several statements to the effect that they protected only foreigners.' *James*, para 64; *Lithgow*, para 117.

obtaining compensation from the UK Government for nationalized shares in Northern Rock.

2. Protection for nationals under the European Convention: The loose requirements of proportionality and the wide margin of appreciation

For a national claimant the Convention provides limited protection in cases of nationalization. Guided by the principle of proportionality, the Court has held that with respect to the standard of compensation Protocol No 1 simply requires that the expropriating State strike a fair balance between the demands of the community's general interests and the requirements of the protection of the individual's right to peaceful enjoyment of his property.⁵⁴ Protocol No 1 'does not . . . 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.'⁵⁵ Moreover, the Court's review of the compensation provided by the State in such cases is limited 'to ascertaining whether the choice of compensation terms falls outside the State's wide margin of appreciation in this domain'.⁵⁶

The *Lithgow* case demonstrates how the Court has applied this standard.⁵⁷ There, the applicants were UK nationals (individuals and companies) whose shares in various companies had been nationalized under the Aircraft and Shipbuilding Industries Act 1977. All of the complaints concerned shares in unlisted companies. The UK Government had awarded compensation for these unlisted shares by calculating a hypothetical share price over a six-month period set some three and a half years before the actual date of the nationalization. The applicants argued that this method was inappropriate for the closely held companies at issue because it undervalued their shares. In some cases, for example, the amount of compensation did not even equal the cash reserves of the companies. To produce a more accurate valuation, the applicants argued, the UK Government should have utilized a valuation methodology that would have accounted for the premium usually paid to acquire a controlling block of shares, such as a one based upon the model of a sale by private agreement between a willing seller and a willing buyer. And, moreover, even if a hypothetical share price model had been used, the

⁵⁴ '[T]here must also be a reasonable relationship of proportionality between the means employed and the aim sought to be realised 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.' *Lithgow*, para 120.

⁵⁵ *James*, para 54.

⁵⁶ *ibid.*

⁵⁷ For a detailed analysis of *Lithgow*, see Maurice Mendelson, *The United Kingdom Nationalization Cases and the European Convention on Human Rights* (1986) 57 Brit YB of Int'l Law 33 (1986).

valuation date should have been set at the time just before the nationalization, not at a far earlier period.

The Court rejected these arguments. Relying upon the ‘wide margin of appreciation’ available to States under the Convention, the Court stated that it would ‘be artificial in this respect to divorce the decision as to the compensation terms from the actual decision to nationalize, since the factors influencing the latter will of necessity also influence the former.’⁵⁸ Accordingly, it would accept ‘the legislature’s judgment in this connection unless that judgment was manifestly without reasonable foundation’.⁵⁹ Given such a deferential standard of review, it seems that the applicants in *Lithgow* never really had much of a chance. Tom Allan has rightly observed of the Court’s decision:

[T]he combination of the relaxed view of proportionality and the wide margin of appreciation make it apparent that the shareholders were given very little protection: in the abstract, the rules for determining compensation only had to be ‘reasonably related’ to the value of the property, and in practice, the application of the rules could leave some owners with less than the value of their shares; and even so, a challenge would be successful only if the rules were ‘manifestly without reasonable foundation.’ In the end, it is difficult to imagine how any set of valuation rules could have been challenged, so long as some compensation had been provided.⁶⁰

The Court of Human Rights’ deference does not bode well for UK nationals seeking to challenge the CSO under European standards in the Northern Rock case.

3. Protection for non-nationals under the European Convention: application of ‘General Principles of International Law’

Although in *James* and *Lithgow* the Court of Human Rights confirmed that non-nationals would continue to be protected by ‘general principles of international law’ under Protocol No 1, the Court did not elaborate its view on the level of protection provided by these principles. It is clear, however, that the Court assumed that international law provides a greater degree of protection for non-nationals than the Convention provides for nationals. Thus, in *James*, the Court observed that the reference to ‘general principles of international law’ in Protocol No 1 ‘ensures that the position of non-nationals is safeguarded, in that it excludes any possible argument that the entry into force of Protocol No. 1 has led to a diminution of their rights.’⁶¹ Apart from this one

⁵⁸ *Lithgow*, para 122.

⁶⁰ Allen (n 47) 182. See Mendelson, *The United Kingdom Nationalization Cases*, 74 (‘The broad scope given to the Government’s ‘margin of appreciation’ apparently leaves it open for governments to pay compensation at whatever level they feel is compatible with the social objectives of the nationalizing legislation, without much fear of condemnation from Strasbourg.’).

⁶¹ *James*, para 62.

⁵⁹ *ibid.*

statement, however, the Court's jurisprudence has been notably silent on the extent of protection available under 'general principles of international law.'⁶² Indeed, the Court has not addressed the application of Protocol No 1 to foreign nationals since the *Lithgow* and *James* cases. Thus, a claim brought by foreign Northern Rock investors under the Convention would raise an issue of first impression for the Court: what standard of compensation is owed under international law for the expropriation of alien property?

a) The customary international law standard of compensation for expropriation in the age of BITs

For many years the question of the standard of compensation for the expropriation of foreign investments has been one of the most debated areas of customary international law. The main points of the debate are well known, and there is little to be gained from a recitation here.⁶³ Suffice it to say, in overview, that on one side of the debate have been States and academic commentators who have taken the view that international law generally follows the Hull formula of 'prompt, adequate and effective' compensation.⁶⁴ According to this view, as we have seen above, in order to be 'adequate' such compensation would require, at the least, the payment of the market value of the property that has been expropriated. Against this view, on the other side of the debate, have been developing States and other academics who have argued instead for a standard of 'appropriate compensation,'⁶⁵ articulated as a flexible standard that permits a State to take into account factors such as the profits made by the foreign investor, the duration of the period during which profits were made, the social purpose of the expropriation, and similar factors in assessing the compensation, all of which tend to produce valuations below market value. At the high point of the debate, the positions of States and academics on the issue came to be seen as a proxy in the wider struggle between socialism and capitalism, between

⁶² In a dissent filed to the Court's recent decision in *Anheuser-Busch v Portugal*, Judges Caffisch and Cabral Barreto took the view that 'general principles of international law' includes 'the rule requiring prompt, adequate and effective compensation.' (2007) 45 EHRR 36, para O-II9. The decision of the Court, however, did not reach the issue.

⁶³ For relatively concise, and certainly contrasting, overviews of the debate, compare Lowenfeld (n 28) Chs 13–15 and Somorajah (n 33) Ch. 10. See generally T Wälde, 'A Requiem for the "New Economic Order"—The Rise and Fall of Paradigms in International Economic Law and a Post-Mortem with Timeless Significance' in G Hafner et al (eds), *Liber Amicorum Professor Ignaz Seidl-Hohenveldern* (Kluwer Law International, Leiden, 1998) 771.

⁶⁴ See, eg *Third Restatement of US Foreign Relations Law*, Vol 2 (1987), para 712: 'The Executive Branch and the Congress of the United States have held resolutely to the view that international law requires compensation that is "prompt, adequate and effective."'

⁶⁵ See eg GA Res 1803, (XVII) 'Permanent Sovereignty over Natural Resources,' 17 UN GAOR Supp (No 17) UN Doc A/5217 (1962); GA Res. 3281, 'Charter of Economic Rights and Duties of States,' 29 UN GAOR Supp (No 31) 50, U.N. Doc. A/9631 (1974).

capital-exporting and capital-importing States, between ‘the haves and the have-nots.’⁶⁶

The rise of BITs and regional free trade agreements like the NAFTA and the Energy Charter Treaty has taken much of the heat out of the debate, as States have chosen to avoid the contentious application of customary law by memorializing in treaties the standard of compensation that will be applicable between them in the event of the expropriation of the property of one of their nationals.⁶⁷ Nevertheless, for treaties which refer simply to ‘international law,’ like the European Convention on Human Rights at issue here, or Article 42 of the ICSID Convention,⁶⁸ the debate about the content of international law remains important for defining the level of protection available to foreign investors.

It is not the purpose of this article to wade too deeply into the ongoing debate in this area. One observation which is worth making, however, is that the consideration of customary international law today takes place against a radically different background than the debates of the 1960s, 70s, 80s, and even the early 1990s.⁶⁹ As of 2008 there are over 2,500 BITs in force throughout the world, most of which adopt the Hull formula or some close variant on the issue of compensation for expropriation.⁷⁰ Significantly, this formula has been adopted not only in BITs between capital-importing and capital-exporting States, but also in second generation BITs between capital-importing States—the have-nots.⁷¹ These second generation BITs are the fastest growing category of BIT and now account for over 45 per cent of all BITs in force.⁷² In these agreements—negotiated and entered into between developing States—the parties are routinely, consistently and overwhelmingly adopting the Hull formula or some similar market value variant as the standard of compensation for expropriation.⁷³ Thus, when one looks to the question of

⁶⁶ Cf Amerasinghe, ‘The Quantum of Compensation for Nationalized Property’ in R Lillich (ed) *The Valuation of Nationalized Property in International Law* (1975) Vol III ch IV.

⁶⁷ See generally E Lauterpacht, ‘Issues of Compensation and Nationality in the Taking of Energy Investments’ (1990) 6 *J of Energy & Nat’L Resources Law* 241 (1990).

⁶⁸ Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Art 42, ICSID Basic Documents (Jan 1985).

⁶⁹ See Stephen Schwebel, ‘The Reshaping of the International Law on Foreign Investment by Concordant Bilateral Investment Treaties’ in Steven Charnovitz, et al (eds), *Law in the Service of Human Dignity: Essays in Honour of Florentino Feliciano* (2005) 241.

⁷⁰ UNCTAD, World Investment Report (2007) 16–19.

⁷¹ UNCTAD, International Investment Agreements: Key Issues, Vol I (2004) 244; UNCTAD, Bilateral Investment Treaties 1995–2006: Trends In Investment Rulemaking (2007).

⁷² UNCTAD, World Investment Report (2003) 89.

⁷³ For a few examples, see Africa: Common Market for Eastern and Southern Africa (COMESA) Treaty (1994), Art 159(3) (‘adequate compensation’); South Africa–Madagascar BIT (2006), Art 6 (‘adequat et effectif’); Botswana–Egypt BIT (2003), Art 6 (‘prompt, adequate and effective’); Cameroon–Guinea BIT (2001), Art 6 (‘effective et adéquate’); Eritrea–Uganda BIT (2001) Art 4 (‘prompt, adequate and effective’); Ethiopia–Sudan BIT (2000), Art 4 (‘prompt, adequate and effective’); Mauritius–Burundi BIT (2001), Art 7 (‘effective et adéquate’); Asia: ASEAN Agreement for the Promotion and Protection of Investments (1987), Art VI (‘adequate compensation’); Democratic People’s Republic of Korea–Thailand BIT (2002), Art 6 (‘prompt,

whether the standard of compensation adopted across this great mass of BITs might be said to have come to represent customary international law, it is no longer possible to discount that development on the ground of unequal bargaining power between capital-exporting and capital-importing States.⁷⁴

The principle that treaty-based rules may 'become generalized through the conclusion of other similar conventions containing identical or similar provisions'⁷⁵ is well recognized in international law. The question that arises with respect to the standard of compensation for expropriation is whether the conclusion of so many BITs carries with it the *opinio juris* classically necessary for a customary rule to emerge.⁷⁶ As early as 1981, when BITs were still in their relative nascence, and still almost exclusively between developed States and developing States, Mann argued that '[w]here these treaties express a duty which customary international law imposes or is widely believed to impose, they give very strong support to the existence of such a duty and preclude the Contracting States from denying its existence . . .'⁷⁷ While Mann was perhaps premature with his assessment of the law at the time, it does not seem as though he would be today. Twenty-five years on and we find over 2,500 BITs in force between States of all levels of development, all types of political orientation and covering all geographic regions. And across these agreements we find that States have adopted overwhelmingly the Hull formula

adequate and effective'); Bangladesh–Philippines BIT (1997) Art IV ('just compensation' amounting to market value); Azerbaijan–Pakistan BIT (1995), Art 3 ('prompt, adequate and effective'); Kyrgyzstan–Pakistan BIT (1995), Art 4 ('prompt, adequate and effective'); Vietnam–Thailand BIT (1991), Art 6 ('adequate' and 'effective[.]'); Central and South America: Dominican Republic–Central American Free Trade Area (DR-CAFTA) Treaty (2005), Art 10.7 ('prompt, adequate and effective'); Colonia Protocol on the Reciprocal Promotion and Protection of Investments within Mercosur (1994), Art 4 ('*previa, adecuada y efectiva*'); Costa Rica–Paraguay BIT (1998), Art 7 ('*adecuada, pronta y efectiva*'); Dominican Republic–Ecuador BIT (1998), Art 4 ('*pronta, adecuada y efectiva*'); Panama–Argentina BIT (2004), Art 3 ('*pronta, adecuada y efectiva*'); Honduras–Chile BIT (1996), Art VI ('*inmediata, adecuada y efectiva*'); Nicaragua–Chile BIT (1996), Art 6 ('*inmediata, adecuada y efectiva*'); Bolivia–Ecuador BIT (1995), Art VI; Colombia–Peru BIT (1994), Art 7 ('*pronta, adecuada y efectiva*'); Middle East and Europe: Yemen–Indonesia BIT (1998), Art IV ('prompt, adequate and effective'); Egypt–Albania BIT (1993), Art 4(2) ('prompt, adequate and effective'); Jordan–Algeria BIT (1996), Art 5 ('appropriate and actual compensation' equal to market value); Ukraine–Indonesia BIT (1996), Art. IV ('prompt, adequate and effective'); Armenia–Lebanon BIT (1994), Art 5 ('adequate and effective'). Recent Chinese BITs, although not using the Hull formula as such, nevertheless require the payment of compensation which will place the investor 'in the same financial position as that in which they would have been if the measures . . . had not been taken.' Compare, eg China–Argentina BIT (1994), Art 4 with UK–China (1986), Art 5 ('reasonable compensation' amounting to the 'real value' of the investment).

⁷⁴ See Sornorajah (n 33) 241–45.

⁷⁵ Report of the International Law Commission Covering the Work of Its 12th Session, (1960) YB of Int'l Law Comm'n 145 UN Doc A/4425.

⁷⁶ North Sea Continental Shelf Cases (*Federal Republic of Germany v Denmark*) (*Federal Republic of Germany v Netherlands*) (1969) ICJ Rep 3 para 71.

⁷⁷ FA Mann, 'British Treaties for the Promotion and Protection of Investments' (1981) Brit YB Int'l L 241, 249.

or some similar market value variant as the standard of compensation in cases of expropriation.

To paraphrase Mann, can it really be said that the adoption of a similar standard in such a large number of BITs involving States across the spectrum ought not give indication of what we think the customary international law on the subject is? One would think not.⁷⁸ Particularly when set against the background of the active and contentious debate on the customary law standard which dominated much of the 20th century, it is hard to treat the *volte-face* of so many developing States in BITs as merely *lex specialis*. Instead, it seems much more reasonable to conclude that the trend represented by BITs and other investment agreements which have adopted the Hull formula or some variant indicates coalescence by States on a particular standard of treatment. Indeed, it would seem that the *lex specialis* here is to be found in those few BITs in which the States have chosen to depart from the Hull formula or a market value variant. This does not mean that customary international law is becoming fixed for all time, or that every BIT provision has come to represent customary international law, but it does reflect what appears to be a global consensus which has not previously existed in the customary international law debate on the standard of compensation for expropriation.

The decisions of the tribunals charged with interpreting and applying these BITs have come to the same conclusion: BIT provisions on the standard of protection in cases of expropriation reflect customary international law.⁷⁹ Thus, in the *CME Czech Republic* award, for example, the tribunal concluded that the Hull formula had become ‘truly universal’ as a consequence of the essential agreement on the standard found in (what was then) some 2,200 BITs and similar multilateral investment treaties.⁸⁰ Other tribunals have come to the same conclusion.⁸¹ It is fair to say, therefore, that for purposes of the European

⁷⁸ For a contrary view, see Guzman, ‘Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties’ (1998) 38 *Va J Int’l L* 639, 685–86 (‘the repetition of common clauses in bilateral treaties does not create or support an inference that those clauses express customary law ... To sustain such a claim of custom one would have to show that apart from the treaty itself, the rules in the clauses are considered obligatory’). Sornarajah at least acknowledges that it is ‘possible that if there is concordance of standards in [BITs], such standards on which there is consistent agreement evidenced by such treaties could become international law’, but concludes that this has not happened. Sornojah (n 33) 226–27.

⁷⁹ As a result of the background of active debate and controversy as to the position of the Hull formula in customary international law prior to the widespread adoption of the standard in BITs, it is quite possible that expropriation and the standard of compensation for it are unique examples. Other commentators, however, and some arbitral tribunals, have taken a broader view of the kinds of BIT protections which are also said to now represent customary law. See, eg *Mondev Int’l Ltd v United States*, ICSID Case No ARB(AF) 99/2, Award (11 Oct 2002) para 117 (concluding that the ‘fair and equitable treatment’ standard has attained a customary character). See also A Lowenfeld, ‘Investment Agreements and International Law’ (2003) 42 *Colum J Transnat’l L* 123. The author takes no position in this article on such an expansive interpretation of the effect of BITs on customary international law.

⁸⁰ *CME Czech Republic* (no 44) para 497.

⁸¹ See *Biloune and Marine Drive Complex Ltd v Ghana Investments Centre and the Government of Ghana*, Award on Jurisdiction and Liability (27 Oct 1989) 95 *ILR* 183, 211.

Convention on Human Rights, the Hull standard reflects the ‘general principles of international law’ which the Court would and ought to apply.

B. The UK and European View on the Customary Standard

Beyond the arguments on the current state of customary international law, it is hard to imagine that, in an actual case before the European Court of Human Rights, the United Kingdom would take a different view on the protection available to a foreign investor under ‘general principles of international law.’ The United Kingdom’s position on the customary international law standard for compensation in cases of the expropriation of alien property has been the same for more than fifty years and is not in any doubt. As a major exporter of investment capital, the United Kingdom has consistently taken the view that in order for an expropriation to be lawful it must be made against prompt, adequate and effective compensation. Thus, in the *Anglo-Iranian Oil Case*, for example, the British pleadings before the International Court of Justice took the view that ‘it is clear that the nationalization of the property of foreigners, even if not unlawful on any other ground, becomes an unlawful confiscation unless provision is made for compensation which is adequate, prompt and effective.’⁸² Similarly, in the *BP* arbitration, the British protest to the Government of Libya took the position that ‘[a]n act of nationalization is not legitimate unless . . . it [is] followed by the payment of prompt, adequate and effective compensation.’⁸³ Indeed, even in the *Lithgow* case, where such a standard might well have worked against the United Kingdom (had the Court interpreted Protocol No 1 differently), the United Kingdom maintained its position that customary international law requires the payment of compensation in accordance with the Hull formula.⁸⁴ While such declarations may not be dispositive with respect to the standard applicable under the ‘general principles of international law’ provision of Protocol No 1,⁸⁵ it is hardly imaginable that the UK Government would take a different position if this issue were to arise before the European Court of Human Rights in the context of the Northern Rock nationalization.

Moreover, the United Kingdom is not alone among parties to the European Convention on Human Rights in taking the view that customary international law requires ‘prompt, adequate and effective’ compensation for expropriation. While it is difficult to be comprehensive because of the vagaries involved in identifying individual states’ positions the view taken by commentators on

⁸² *Anglo-Iranian Oil Case* (1952) ICJ Pleadings 105–106.

⁸³ (1974) 53 ILR 297, 317. *United Kingdom v Iran*.

⁸⁴ Applications Nos 9006/80, 9006/80, 9262/81, 9263/81, 9265/81, 9266/81, 9313/81 and 9405/81, *Sir William Lithgow v United Kingdom* (1984) Report of the European Commission of Human Rights, para 254.

⁸⁵ Cf *Case Concerning Military and Paramilitary Activities in and against Nicaragua* (*Nicaragua v United States*) (*Merits*) [1986] ICJ Rep 14, para 184.

Protocol No 1 is that ‘the States signing up to the Protocol in 1950 would have said that right of protest arises where an alien’s property is taken without prompt, adequate and effective compensation.’⁸⁶ By way of illustration, the example of Portugal’s accession to the European Convention on Human Rights in 1978 may be given. In that situation, Portugal decided to submit a reservation to Protocol No 1 upon its ratification, the purpose of which was to reserve to Portugal the right to make expropriations without compensation.⁸⁷ In response, France, Germany and the United Kingdom took the unusual step of making declarations which affirmed that regardless of Portugal’s reservation, general principles of international law as referenced in Protocol No 1 required the payment of prompt, adequate and effective compensation with respect to the expropriation of foreign property.⁸⁸ The Portuguese might do as they wished with respect to their own nationals, but as to foreign nationals the ‘general principles of international law’ applied and could not be varied by the reservation.

In summary, then, under international law the standard of protection owed to investors in Northern Rock is relatively straightforward. For non-UK nationals, the standard of protection is to be set either by the provisions of an applicable BIT which the United Kingdom has entered into with the investor’s home state or by the customary international law standard as incorporated into Protocol No 1 of the European Convention on Human Rights. These standards require the payment of market value compensation and apply as a trump to the treatment set out in the CSO, notwithstanding Lord Davies’ comments in the House of Lords. For UK investors, however, the situation is very different. There is no significant international check on the CSO’s provisions. Apart from the very modest review available under European human rights law, UK investors are likely to be left to the mercies of the process set forth under the CSO and such protections as may be available under UK administrative law.⁸⁹

III. APPLYING THE INTERNATIONAL STANDARD OF COMPENSATION—THE QUANTUM OF MARKET VALUE

It is not enough to look at the standard of compensation provided by international law. The payment of compensation requires that a quantum be calculated.⁹⁰ A figure must be reached that a court or tribunal can apply. In order

⁸⁶ See Allen (n 47) 167–68.

⁸⁷ (1978) 21 YB Eur Conv on HR 16 (cited in HR Fabri, ‘The Approach Taken by the European Court of Human Rights to the Assessment of Compensation for ‘Regulatory Expropriations’ of the Property of Foreign Investors’ (2002) 11 NYU Envir LJ N148, 162–63).

⁸⁸ (1979) 22 YB Eur Conv on HR 16–22. In the event, Portugal withdrew its reservation in 1987 without comment.

⁸⁹ Whether there may be remedies available to Northern Rock investors under UK administrative law is beyond the scope of this paper.

⁹⁰ Since BITs generally recognize the permissibility of expropriation in the public interest against payment of prompt, adequate and effective compensation, the question of restitution does

to have operational meaning, a qualitative standard like ‘adequate’ compensation must be paired with a valuation methodology capable of producing a quantum.⁹¹ Even where the value to be calculated is articulated in terms closely associated with a quantitative determination, such as the ‘market value’ standard applicable in the UK BITs and customary international law, there still may be a number of possible bases on which a valuer may make a valuation due to the nature of the property being valued.⁹² Investment treaties only infrequently refer to specific methodologies for the determination of value.⁹³ The UK BITs are not among those that do.

The selection of a compensation methodology requires in the first place a determination of the property or investment which is to be valued. In the case of Northern Rock, nationalization has been effected through the transfer to the State of all of the shares of Northern Rock. Instead of nationalizing the company itself and taking its assets after dissolution, the United Kingdom has taken the shares of the company and claims that the legal existence of the company has not been the subject of any modification. Only the ownership of the company has changed. In such a situation, it is the shares of Northern Rock that must be valued.⁹⁴

A. The Valuation Assumptions of the CSO and Their Likely Effect on the Quantum of Compensation—The Valuation Date Problem

Under international law, the value of expropriated property is to be determined by looking at the value of the property as of or just immediately before the date on which the expropriation occurred or the decision to expropriate became publicly known⁹⁵ without reference to the effects of the expropriation itself or any acts related to that expropriation.⁹⁶ The significance of establishing the market value of expropriated property ‘as of’ (or just before) the date of the act of expropriation lies in its bearing on the factors that may

not often arise. See C Schreuer, ‘Non-Pecuniary Remedies in ICSID Arbitration’ (2004) 20 *Arb Int'l L* 325.

⁹¹ T Stauffer, ‘Valuation of Assets in International Takings’ (1996) 17 *Energy LJ* 459, 459.

⁹² See A Hicks & A Gregory, ‘Valuation of Shares: A Legal and Accounting Conundrum’ (1995) *J Bus L* 56, 67–68.

⁹³ See North American Free Trade Agreement (NAFTA), Art 1110(2)–(6): ‘Valuation criteria shall include going concern value, asset value, including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.’

⁹⁴ See M Mendelson, ‘International Law and the Valuation of Nationalized Shares: Two French Decisions’ (1985) 34 *ICLQ* 284, 284.

⁹⁵ This is true both as a matter of customary international law and treaty practice. See, eg UK–Singapore BIT, TS No 51 (1975), Art 5(1); UK–United Arab Emirates BIT, TS No 24 (1994), Art 6(1); World Bank Guidelines Art IV 3.

⁹⁶ See *Saghi v Islamic Republic of Iran* Award No 544-298-2, 29 *Iran-U.S.C.T.R.* 20 (1993), para 79; *Starrett Housing Corp v Islamic Republic of Iran*, Award No 314-24-1, 16 *Iran-U.S.C.T.R.* 112, 202 (1987).

properly be taken into account in assessing the market value of the property. Factors which relate to the act of expropriation ought not to be considered.

Ordinarily, the governmental action which the valuation-date rule seeks to exclude is governmental action taken before the expropriation has actually occurred. In a situation like the one arising under the CSO, however, there is reason to think that the valuation-date rule should also apply to exclude the blighting effects of governmental action taken *after* the expropriation. While it is strange to think of governmental action taken after the expropriation as having a retroactive effect on the *market value* of an investment at the effective date of the expropriation that is precisely what the CSO seeks to do. Even though section 3 of the CSO states that ‘the amount of any compensation payable’ to Northern Rock shareholders ‘shall be an amount equal to the value immediately before’ the expropriation occurred,⁹⁷ other provisions of the CSO make clear that this value ‘must’ reflect four key assumptions mandated by the CSO itself, ie after the expropriation occurred. These are that:

- (a) Northern Rock is unable to continue as a going concern;⁹⁸
- (b) Northern Rock is in administration;⁹⁹
- (c) All financial assistance provided to Northern Rock by the Bank of England or the Treasury has been withdrawn;¹⁰⁰ and
- (d) No financial assistance would be provided to Northern Rock by the Bank of England or Treasury in the future (except for such ordinary assistance offered by the Bank of England).¹⁰¹

The inclusion of these mandatory ‘assumptions’ in the CSO is fairly remarkable. Notwithstanding the financial difficulties experienced by Northern Rock in late 2007/early 2008, there is considerable evidence in the public record indicating that at the time immediately prior to the nationalization—ie the valuation date required by international law and the UK BITs—none of the ‘assumptions’ required by the CSO was true. Northern Rock in fact was not in administration. By the Government’s own account, Northern Rock was solvent and a going concern.¹⁰² Financial assistance from the Treasury and the Bank of England had not been withdrawn.¹⁰³ And there was no suggestion one

⁹⁷ CSO, s 3(2).

⁹⁸ CSO, s 6(a).

⁹⁹ *ibid* s 6(b).

¹⁰⁰ Banking (Special Provisions) Act 2008, s 5(4)(a), as incorporated by CSO, s 6.

¹⁰¹ *ibid* s 5(4)(b).

¹⁰² See Testimony of Alistair Darling, Chancellor of the Exchequer, before House of Commons Treasury Committee, 18 Dec 2007, at Q 1710; HC Deb, 19 Nov 2007, col 960 (Alistair Darling); Testimony of Alistair Darling, Chancellor of the Exchequer, before House of Commons Treasury Committee, 25 Oct 2007, at Q 848; Bank of England, News Release, *Liquidity Support Facility for Northern Rock plc* (14 Sep 2007).

¹⁰³ Northern Rock originally entered into a support facility with the Bank of England on or about 14 September 2007. See Bank of England, News Release, *Liquidity Support Facility for Northern Rock plc* (14 Sep 2007). On 9 October, the Bank of England announced that ‘additional facilities’ would be available to Northern Rock through the Bank of England with support of the UK Treasury. See Bank of England, News Release, *Northern Rock plc deposits* (9 Oct 2007); Northern Rock plc, Annual Report and Accounts 2007, 42. No details of the amount borrowed

way or the other how the Treasury or the Bank of England would act in the future with respect to further financial assistance to Northern Rock. In essence, the CSO requires a rewriting of history. As a result, it is difficult to see how a valuation based upon the CSO assumptions can be characterized as independent of the effects of the UK's expropriating measures. To the contrary, the valuation 'methodology' mandated by the CSO seems to require a lack of independence by the Government-appointed valuer and render impossible a valuation free from the effects of the expropriating measure.¹⁰⁴

B. The Generally Accepted Manner of Determining the Market Value of Shares in a Publicly Traded Company—The 'Market Value' Problem

It seems apparent that the assumptions imposed by the CSO will not produce a market valuation of the Northern Rock shares. Under the CSO assumptions the likely result is that shareholders will receive no more than liquidation value for their shares. The term 'going concern' has an established meaning for accountants and valuation experts, and where a business is not classified as a going concern, liquidation value is generally the methodology employed.¹⁰⁵ Liquidation value refers to 'the amounts at which individual assets comprising the enterprise or the entire assets of the enterprise could be sold under conditions of liquidation to a willing buyer less any liabilities which the enterprise has to meet.'¹⁰⁶ While it is not possible in this article to measure with precision the quantum of compensation which application of the CSO methodology will produce—the information necessary for such an exercise is not in the public record—it is widely expected that the quantum produced by a liquidation value methodology will fall far short of the 90p market price at

under these facilities (or their essential terms) have been made public. See HC Deb, 19 November 2007, col. 960 (Alistair Darling, Chancellor of the Exchequer) (declining to provide information to the House). Nevertheless, Northern Rock itself reported that by the end of 2007 the total amount borrowed was £26.9 billion, Northern Rock plc, Annual Report and Accounts 2007, 31, and it may be assumed that the total amount borrowed by the time of the nationalization in February 2008 was substantially higher. Notably, even with these high levels of borrowing, throughout the time prior to the nationalization the UK Government repeatedly confirmed its belief that Northern Rock was solvent and a going concern. See (n 102).

¹⁰⁴ It might be argued that the assumptions mandated by the CSO and the Banking (Special Provisions) Act do no more than require that any valuation reflect the financial circumstances in which Northern Rock found itself at the time of the nationalization. As such, the argument might go, the nationalization, although technically an expropriation, actually caused no loss or damage to the investors. See *Biwater Gauff (Tanzania) Ltd (UK) v United Republic of Tanzania*, ICSID ARB/05/22, Award (24 July 2008), para 803. This seems to miss the point. The valuation issue in the cases of Northern Rock and Bradford & Bingley is the market value of the *shares* of those companies. As discussed below, whatever the financial circumstances faced by those companies at the time of their nationalizations—the relevant date for valuation purposes—the shares had a real market value as determined on the London Stock Exchange.

¹⁰⁵ See M Kantor, *Valuation for Arbitration: Compensation Standards, Valuation Methods and Expert Evidence* (2008) 91–92.

¹⁰⁶ *World Bank, Guidelines for the Treatment of Foreign Direct Investment*, Art IV.

which those shares were trading on the London Stock Exchange immediately before the expropriation became public knowledge. Indeed, Northern Rock shareholders believe that the value produced by the CSO methodology will be nil or nearly so.¹⁰⁷

While the UK Government may legally have the discretion to pay liquidation value to investors of UK nationality,¹⁰⁸ with regard to non-UK investors the United Kingdom must meet the market value standard set by international law and its BIT obligations. In a case such as this—almost by definition—liquidation value is unlikely to equate to market value.

1. The market valuation of shares in publicly traded companies

As a general rule, the market value of a share in a company, like the market value of most things, comes down to what a willing buyer would pay a willing seller.¹⁰⁹ Where there is no public market for shares, ie where the company is closely held, ascertaining a market value can be exceptionally challenging.¹¹⁰ In essence, as Lord Ashbourne observed, a feat of imagination is necessary:¹¹¹ a hypothetical market value of the shares must be created. In such cases, the choice of methodology and its application can be both complex and contentious.¹¹²

Where, however, shares are quoted on an active public exchange, such as the London Stock Exchange, the best indicator of the market value of those shares is the price at which they are trading in the actual market.¹¹³ It is not necessary to construct a hypothetical share price because there is a real share price in the market. Current market prices reflect the market's assessment of the underlying present value of the future profits of quoted shares.¹¹⁴ As one

¹⁰⁷ See W Lawson, Chairman, Northern Rock Shareholders Action Group, *A Note on the Northern Rock Legal Action by Shareholders* (13 June 2008) 7, available at http://www.uksa.org.uk/NRK_Legal_Case.pdf.

¹⁰⁸ See (n 58–60) and accompanying text.

¹⁰⁹ See Nigel Eastaway, Harry Booth & Keith Eamer, *Practical Share Valuation* (4th edn, 1998) 10.

¹¹⁰ *ibid.*, 245.

¹¹¹ *A-G (Ireland) v Jameson* [1905] 2 IR 218, 226.

¹¹² In deriving a market value for shares for which there is no public market, there are three basic methods of valuation to which financial experts generally turn: net asset value; discounted cash flow; and price-earnings multiples. See R Pike & B Neale, *Corporate Finance and Investment* (5th edn, 2006) 89. Dividend valuation is noted by Ferran as a fourth method of valuation. See E Ferran, *Company Law and Corporate Finance* (1999) 54. There has been ongoing discussion in the legal literature about which of these methods is the most appropriate when determining the compensation due for an expropriation. For a concise overview of the discussion, see Irmgard Marboe, 'Compensation and Damages in International Law: The Limits of 'Fair Market Value'' 7 *J World Trade & Invest* 723, 730 (2006).

¹¹³ N Eastaway, H Booth & K Eamer, *Practical Share Valuation* (4th edn, 1998) 245. See *Southern Pacific Properties (Middle East) Ltd v Egypt*, ICSID Case No ARB/84/3, Award (20 May 1992), para 197 (contrasting market prices in an efficient capital market with a situation in which the number of transactions is limited and there is no public market).

¹¹⁴ See, eg T Koller, M Goedhart & D Wessels, *Valuation: Measuring and Managing the Value of Companies* (4th edn, 2005) 70; R Brealey, S Myers & F Allen, *Principles of Corporate*

tribunal has noted, where share prices are quoted on a public market, the valuation process ‘can be a fairly easy one,’ since the price of the shares is determined under conditions which, *a fortiori*, meet the definition of ‘market value.’¹¹⁵ Simply put, ‘[i]nternational jurisprudence supports finding fair market value by reference to a share trading price when available.’¹¹⁶

The conclusion that the market price of a share reflects its value is based upon the principle of capital market efficiency, which posits that market prices reflect the value of shares because an active public stock exchange with low transaction costs is able to respond quickly to available information, including temporary and artificial factors, in reaching a share price.¹¹⁷ ‘So long as the market is reasonably efficient, the market price can be trusted as a fair assessment of value.’¹¹⁸ Valuation experts suggest, however, that where the shares under consideration represent a controlling interest in a company, a ‘control premium’ of some amount above market price should be added to reflect the fact that ownership of a controlling number of shares brings with it rights that minority share owners do not possess, such as the right to appoint the managers of the company.¹¹⁹ The justification for this view is based upon economic studies of control transactions in the market, which provide evidence that control premiums are ordinarily paid by purchasers of controlling quantities of shares.¹²⁰ Adding a control premium above the quoted market price for valuation purposes reflects the fact that the quoted price of a share on a public exchange is the product of numerous minority transactions, not transactions involving the trading of controlling interests in the company. Accordingly, the market price serves as a base onto which the premium should be added in cases in which a control premium is appropriate.¹²¹

Finance (2006). See also T Stauffer, ‘Valuation of Assets in International Takings,’ 17 *Energy LJ* 459, 472 (1996) (‘[T]he market value, where there is a transaction, was most probably determined as the result of discounted cash flow valuations undertaken both by buyer and seller. This is true for acquisitions and mergers, it true for project investments and is also generally true in the case of stock market valuation of listed companies.’).

¹¹⁵ *CMS Gas Transmission Co v Argentina*, ICSID Case No ARB/01/8, Award (12 May 2005), para 403.

¹¹⁶ *Reineccius v Bank of International Settlements*, Partial Award (Permanent Court of Arb. 2002), para 163. See *Khosrowshahi v Islamic Republic of Iran*, Award No. 558-178-2, 30 Iran-U.S.C.T.R. 76, 92 (1994). *Accord ACSYNGO v. Compagnie de Saint-Gobain (France) SA*, 82 ILR 127, 137 (Belgium Comm. Ct. 1986) (case arising out of the French bank nationalizations).

¹¹⁷ See H Houthakker & P Williamson, *The Economics of Financial Markets* (1996) 130; T Koller, M Goedhart & D Wessels, *Valuation: Measuring and Managing the Value of Companies* (4th edn, 2005) Ch. 4; J van Horne, *Financial Market Rates & Flows* (1994).

¹¹⁸ R Pike & B Neale, *Corporate Finance and Investment* (5th edn, 2006) 89.

¹¹⁹ See S P Pratt, *Business Valuation: Discounts and Premiums* (2001) 18. See generally B Black, ‘Bidder Overpayment in Takeovers’, 41 *Stan L Rev* 597 (1989); Lawrence A Hamermesh, ‘Premiums in Stock-for-Stock Mergers and Some Consequences in the Law of Director Fiduciary Duties’, 152 *U Pa L Rev* 881 (2003).

¹²⁰ See M Jensen & R Ruback, ‘The Market for Corporate Control: The Scientific Evidence,’ 11 *J Fin Econ* 5 (1983).

¹²¹ S P Pratt, *Business Valuation: Discounts and Premiums* (2001) 5–9.

The use of control premiums has been acknowledged in the corporate law of numerous jurisdictions. To date, however, it has not featured prominently in the valuation decisions of international arbitral tribunals. In part this may be because control premiums are most appropriately applied in cases in which the shares being valued are publicly¹²² traded and most cases of expropriation have not involved publicly traded shares. Where, however, as in the Northern Rock situation, or the Bradford & Bingley situation discussed below, the expropriated investment consists of publicly traded shares, the principles of valuation would indicate that a control premium ought to apply when evaluating the adequacy of the State's compensation. Had the State wished to purchase a controlling block (or all) of these shares in the market, such a premium would likely have been required. Accordingly, if the standard of compensation to be paid is meant to be the 'market value' of the investment, then it should represent not only the share price at the relevant time, but also the relevant premium.

IV. THE NATIONALIZATION OF BRADFORD & BINGLEY: QUESTIONS AT THE OUTSET

Like Northern Rock, Bradford & Bingley plc was a publicly held bank, whose shares were traded on the London Stock Exchange.¹²³ Like Northern Rock as well, Bradford & Bingley confronted a worsening financial position as a result of tightening in the global credit markets in 2007 into 2008.¹²⁴ When global credit markets froze in September 2008, Bradford & Bingley faced unprecedented margin and liquidity pressure, and on Saturday 27 September 2008, the UK Financial Services Authority (FSA) determined that the company no longer met its threshold conditions for operating as a deposit taker under the Financial Services and Markets Act 2000 and FSA rules.¹²⁵ Thereafter, on Monday 29 September 2008, the UK Treasury brought forward an order nationalizing all shares in Bradford & Bingley and selling certain Bradford & Bingley assets to Abbey National plc, a subsidiary of Banco Santander SA (the 'Bradford & Bingley Transfer Order').¹²⁶ Like the Northern Rock

¹²² The standard valuation technique for non-publicly traded companies is discounted cash flow analysis (DCF). Pratt observes that because DCF analysis 'should represent the full value of the future cash flows of the business, excluding synergies, a company cannot be worth a premium over the value of its future cash flows. Thus, it is improper and illogical to add a control premium to a DCF valuation.' See S P Pratt, *The Lawyer's Business Valuation Handbook* (2000) 359.

¹²³ On 2 January 2008, Bradford & Bingley shares closed at £2.79. On 26 September 2008, the last day on which Bradford & Bingley shares were traded, the closing price was 20p per share.

¹²⁴ See Bradford & Bingley plc, Interim Management Statement (22 Apr 2008); *ibid*, Interim Financial Report (29 August 2008). See also P Trowbridge & B Livesey, *Bradford & Bingley Is Seized; Santander Buys Branches*, Bloomberg.com (29 Sept 2008), available at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ajlkm9fWTtRI>

¹²⁵ Financial Services Authority, News Release, *Bradford & Bingley plc* (29 Sept 2008).

¹²⁶ The Bradford & Bingley plc Transfer of Securities and Property etc Order 2008, SI 2546/2008.

nationalization, the authority for the Bradford & Bingley nationalization was the Banking (Special Provisions) Act 2008.

In material respects, the Bradford & Bingley Transfer Order tracks the provisions of the Northern Rock Transfer Order. As of this writing, however, the terms of compensation for Bradford & Bingley's shareholders are unknown. The Treasury has not yet brought forth an order establishing a compensation scheme for Bradford & Bingley shareholders, although it has said that it will do so in due course.¹²⁷ It remains to be seen, therefore, whether the compensation scheme for Bradford & Bingley shareholders will raise the same issues as the Northern Rock scheme.

Even so, one difference between the Bradford & Bingley and the Northern Rock transfer orders is worth noting preliminarily, and that is the emphasis in the Bradford & Bingley Transfer Order on the circumstances under which the nationalization has taken place. Whereas the Northern Rock Transfer Order contains perambulatory language indicating that the purpose of the Order was to 'protect the public interest' in circumstances in which the UK Treasury had provided financial assistance to Northern Rock, the preamble to the Bradford & Bingley Transfer Order indicates that the purpose of the Order was to 'maintain[] 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.' This difference seems significant. The latter phrasing is evocative of the doctrine of necessity, and suggests that on the UK Treasury's view the nationalization of Bradford & Bingley was a necessary action taken in order to prevent a serious threat to the UK economy from materializing. As a consequence, it is conceivable that the United Kingdom could seek to rely on necessity to justify the payment of no compensation to Bradford & Bingley shareholders or compensation which is less than market value.

A. The Doctrine of 'Necessity' in International Law

Under customary international law as reflected in Article 25 of the International Law Commission's (ILC) Articles on State Responsibility, necessity may be relied upon by a State as a ground to derogate from its international obligations in circumstances in which to do so would otherwise be wrongful. In order to establish a defence of necessity, however, the State must meet a number of stringent criteria:

- (a) the act or measure sought to be justified must have been occasioned by a threat to an 'essential interest' of the State;
- (b) the measure taken must have been 'the only means' of safeguarding that interest;

¹²⁷ UK Treasury, News Release 97/08, *Bradford & Bingley plc* (29 Sept 2008), para 16.

- (c) the measure must not have seriously impaired an essential interest of the State towards which the obligation existed; and
- (d) the State seeking to rely upon the defense must not have ‘contributed to the occurrence of the state of necessity.’

These criteria are cumulative;¹²⁸ all must be satisfied in order for the defence to be established.

The ILC’s elaboration of the doctrine of necessity suggests the limited circumstances in which the doctrine is available and the high degree of proof required to make out the defence. Arbitral tribunals deciding claims brought under BITs containing specific treaty language dealing with circumstances of necessity have confirmed that the doctrine is ‘an exceptional remedy subject to very strict conditions because otherwise it would open the door to elude any international obligation.’¹²⁹ A review of those decisions suggests some of the difficulties which may be faced by the United Kingdom.

1. The Argentina financial crisis cases

The financial crisis experienced in Argentina in the late 1990s and early 2000s prompted a large number of claims against Argentina under various BITs. In a number of those claims, Argentina argued that the measures it had taken, particularly Emergency Law 25,561 of January 2002, had been necessary in light of the financial turmoil being experienced by the country. At the time the Emergency Law was adopted, the unemployment rate in Argentina exceeded 20 per cent and millions of people were in poverty.¹³⁰ There were large scale instances of public disorder occurring throughout the country.¹³¹ By some measures, the Argentine state itself was under threat.¹³²

Yet despite the gravity of the situation in which Argentina clearly found itself, two of three ICSID tribunals which heard Argentina’s claim of necessity rejected it. In *CMS v Argentina*, for example, the tribunal concluded that while an economic crisis could certainly implicate the essential interests of the State, the State was still required to show that the measures adopted constituted the ‘only way’ for the State to protect that interest:

[T]he Tribunal is persuaded that the situation was difficult enough to justify the government taking action to prevent a worsening of the situation and the danger of total economic collapse A different issue, however, is whether the measures adopted were the ‘only way’ for the State to safeguard its interests. This is indeed debatable The International Law Commission’s comment to the

¹²⁸ Gabčíkovo-Nagymaros Project (*Hungary v Slovakia*) [1997] ICJ Rep 7, paras 51–52.

¹²⁹ *Enron v Argentina*, ICSID Case No. ARB/01/3, Award (22 May 2007), para 304.

¹³⁰ See *LG&E Energy Corp v Argentina*, ICSID Case No ARB/02/1, Decision on Liability (3 Oct 2006), para 234.

¹³¹ *ibid*, para 235.

¹³² *ibid*, para. 231.

effect that the plea of necessity is ‘excluded if there are other (otherwise lawful) means available, even if they may be more costly or less convenient,’ is persuasive in assisting this Tribunal in concluding that the measures adopted were not the only steps available¹³³

Moreover, even if Argentina had been able to show that the measures it adopted were the ‘only way’ to safeguard its essential interests, it still would have been necessary to show that Argentina had not substantially contributed to the situation of necessity. As the *CMS* tribunal again observed:

In spite of the view of the parties claiming that all factors contributing to the crisis were either endogenous or exogenous, the Tribunal is again persuaded that similar to what is the case in most crises of this kind the roots extend both ways and include a number of domestic as well as international dimensions. This is the unavoidable consequence of the operation of a global economy where domestic and international factors interact.

The issue, however, is whether the contribution to the crisis by Argentina has or has not been sufficiently substantial. The Tribunal, when reviewing the circumstances of the present dispute, must conclude that this was the case. The crisis was not of the making of one particular administration and found its roots in the earlier crisis of the 1980s and evolving governmental policies of the 1990s that reached a zenith in 2002 and thereafter. Therefore, the Tribunal observes that government policies and their shortcomings significantly contributed to the crisis and the emergency and while exogenous factors did fuel additional difficulties they do not exempt the Respondent from its responsibility in the matter.¹³⁴

The rejection of Argentina’s necessity plea suggests how difficult it may be for the United Kingdom to establish the plea in the situation under consideration here.

For the United Kingdom, the argument must be that while the *CMS* and *Enron* tribunals correctly identified the required elements of the necessity defense, they erred in failing to accord the State a sufficient margin of appreciation to determine for itself whether the measures taken were the ‘only means’ of safeguarding the State’s interest. In *LG&E Energy Corp v Argentina*, the tribunal accepted Argentina’s plea of necessity in significant part because it considered that Argentina had been in the best position to know what measures were truly necessary to meet the crisis it faced. Thus, even though there may have been alternative measures which Argentina could have taken to address the crisis, the Tribunal would not second-guess the State:

This was not merely a period of ‘economic problems’ or ‘business cycle fluctuation’ as Claimants described. Extremely severe crises in the economic, political and social sectors reached their apex and converged in December 2001, threatening total collapse of the Government and the Argentine State Claimants

¹³³ *CMS*, paras 322–324. Accord, *Enron*, paras 305–309.

¹³⁴ *CMS*, paras 328–329. Accord, *Enron*, para 312.

contend that the necessity defense should not be applied here because the measures implemented by Argentina were not the only means available to respond to the crisis. The Tribunal rejects this assertion . . . A State may have several responses at its disposal to maintain public order or protect its essential security interests. In this sense, it is recognized that Argentina's suspension of the calculation of tariffs in U.S. dollars and the PPI adjustment of tariffs was a legitimate way of protecting its social and economic system. The Tribunal has determined that Argentina's enactment of the Emergency Law was a necessary and legitimate measure on the part of the Argentine Government.¹³⁵

The different approaches taken to the doctrine of necessity by the Argentina tribunals represent a wider debate in international law about the applicability of a European-style margin of appreciation in the judicial and arbitral review of State action.¹³⁶ While it is beyond the scope of this article to address this emerging debate in detail, it is clear that how a tribunal or court resolves this basic question of approach may significantly affect the availability of the necessity plea.

Lastly, it should be noted that even if the United Kingdom were able to establish a necessity defense with regards to the Bradford & Bingley nationalization, the condition of necessity only justifies the *temporary* non-performance of international obligations.¹³⁷ Once the conditions establishing the necessity have passed, the State must resume performance of its obligations. Accordingly, even if a situation of necessity attached to the Bradford & Bingley nationalization, ultimately the obligation on the United Kingdom to make market value compensation will need to be met.

V. CONCLUSION

Litigation regarding Northern Rock has begun. On 8 May 2008 an application for judicial review of the CSO was filed in London on behalf of a group of individual shareholders from the United Kingdom.¹³⁸ On the same day, SRM Global Master Fund LLP, a Cayman Islands hedge fund (and Northern Rock's largest shareholder), also filed an application for judicial review of the CSO.¹³⁹ RAB Capital plc, a London-based hedge fund, filed its own application on 16 May 2008, and on 23 May, Legal & General Group,

¹³⁵ *LG&E*, paras 231 & 239–40.

¹³⁶ See, eg Y Shany, 'Towards a General Margin of Appreciation in International Law,' 16 *Eur J Int'l L* 907 (2006).

¹³⁷ Art 27, International Law Commission, Draft Articles on Responsibility of States for Internationally Wrongful Acts, in Report of the International Law Commission on the Work of Its Fifty-third Session, UN GAOR, 56th Sess., Supp. No. 10, at 43, UN Doc. A/56/10 (2001), reprinted in J Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries* (2002).

¹³⁸ See W Lawson, Chairman, Northern Rock Shareholders Action Group, *A Note on the Northern Rock Legal Action by Shareholders* (13 June 2008), available at http://www.uksa.org.uk/NRK_Legal_Case.pdf.¹³⁹ *ibid.*

another UK-based institutional investor, joined the proceedings as an ‘interested party’.¹⁴⁰ Thus far, however, none of Northern Rock’s non-UK based shareholders have brought challenges against the CSO.¹⁴¹ Indeed, the ‘independent valuer’ called for by the CSO was only appointed in September 2008.¹⁴²

It remains to be seen, therefore, whether the issues raised by the CSO and the Bradford & Bingley nationalization will ever come before a court or a tribunal¹⁴³ and whether the United Kingdom will be called upon to answer the questions of international law raised by its actions. As the foregoing analysis indicates, there may well be a case to answer.

¹⁴⁰ Thomson Financial News, *L&G joins SRM, RAB Cap in proceedings against Northern Rock as interested party* (23 May 2008).

¹⁴¹ In its action for judicial review, SRM has sought to show, inter alia, that the CSO violates the protections of Protocol No 1 as it applies to nationals of the expropriating State, viz the proportionality standard set out in *Lithgow* and *James*. See *A Note on the Northern Rock Legal Action by Shareholders* at 7–8. SRM apparently has not sought to make the argument that residents of the Cayman Islands—a British Overseas Territory—ought to be considered as non-UK nationals for purposes of the European Convention on Human Rights; *ibid*.

¹⁴² Somewhat remarkably, the UK Government did not begin seeking to fill the position until 8 June 2008, nearly four months after the nationalization.

¹⁴³ Even if they do, it will take some time. Before an action in the European Court of Human Rights may be brought, local remedies in the United Kingdom must first be exhausted. See European Convention on Human Rights, Art 35. And while, generally speaking, a BIT arbitration would avoid the ‘exhaustion of local remedies’ rule, as a practical matter foreign investors will not seek recourse to BIT procedures until a concrete valuation has been produced under the CSO mechanism. See *Helnan International Hotels A/S v Arab Republic of Egypt*, ICSID Case No ARB/05/19, Award (3 July 2008); *Generation Ukraine, Inc v Ukraine*, ICSID Case No ARB/00/9, Award (16 Sept. 2003) (finding the failure to pursue any local remedies relevant to the determination of whether there was an expropriation at all).