



# Forensic Update

Comment from the Forensic Accountancy Services Team

## In this issue

The spectre of  
CDO litigation

Shipping confidence  
levels dive

New appointments

English law accepts  
compound interest

Insurable interest

Profile: James Wise

Shooting Stars!

## New expert model on show

In the dicta of Stuart-Smith LJ in *Loveday v Renton* [1990] 1 Med LR 177 at 125, he provided a clear description of the process the Court has to undertake in order to evaluate an expert's evidence. One of his key factors is the care with which the expert has considered the subject and presented his evidence. On that basis the review of the model form of expert's report by the Judicial Committee is important. This body of seven senior judges exists to assist in the promotion and improvement of standards within the judicial system.

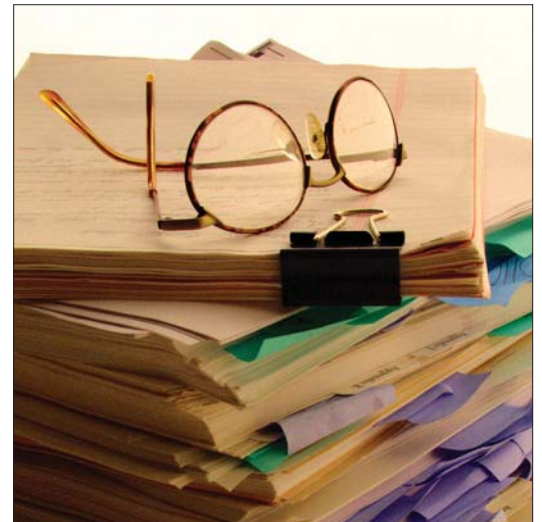
While the model clearly states that it should not be regarded as a "standard", it provides a useful checklist for solicitors, barristers and experts to gauge the quality of a report. One presumes the changes to the model indicate areas where these eminent judges felt that reports needed improvement.

Stuart-Smith LJ said a court needs to examine the care with which an expert has considered the subject and presented his evidence, and the extent to which they are reluctant to re-examine their views in the light of later evidence, whether the expert demonstrates a flexibility of mind, which may involve changing or modifying opinions previously held, and whether or not an expert is biased or lacks independence. The model now requires the expert to present the range of possible expert opinion where feasible with the sources and reasons for any qualifications in those views. In my experience it requires a very able individual to maintain the flexibility of mind required to recognise the full range of possible opinions on a given subject.

In relation to the evidence examined, the model suggests only the principal documents should be listed and every effort should be made to limit the number of documents that are appended to the report. While I concur with the judicious use of appendices, in my view it is worth listing all the sources examined, as this provides a check when new evidence is presented.

Where texts or published material are mentioned, copies or extracts should be included in the appendices. The model says this should include at least the preceding and succeeding pages and be sufficient for the quote to be read in context. In my view it is always wise to go to the original document (the Judgment or any other authority) rather than to rely on a quote or commentary from a textbook, just in case it has been misquoted.

The Committee felt they should state that assumptions should be justified and if an expert believes any are unreasonable, they should say so.



Also, we are reminded that the expert should check with their instructing solicitor whether privilege needs to be considered when setting out the instructions. While on the subject of difficult areas, the model also requires experts to disclose any limitations in their own expertise!

The new Expert's Declaration in the model was introduced on 11 June 2008. It now requires confirmation that any conflicts of interests have been disclosed and that these do not affect the witness's ability to give evidence. Understandably there is now reference to Part 35 of the CPR and the accompanying practice direction, and there is also a new version of the Declaration that complies with the relatively new Part 33 of the Criminal Procedure Rules.

All in all, a useful update and reminder to experts and those instructing them of points to watch. If you would like a copy of the model, please contact me.

## The spectre of CDO litigation

The Financial Times has rightly predicted that the prospect of CDO litigation has European banks "shaking in their boots". At issue in this wave of potential litigation will be, they say, "What really happened at the big banks when the sub-prime mortgage market started to go sour".

The sub-prime mortgage market collapse began long before 14 September 2007 when Northern Rock depositors started to queue plaintively in the streets: the first of many SEC investigations into CDO's began in April 2007.

The first high-profile CDO case has already kicked-off in New York. As has been widely reported, HSH Nordbank, a state-controlled German bank, has commenced proceedings in New York in relation to a \$500 million portfolio of complex CDO's linked to the US sub-prime market which it alleges were mismanaged by UBS. The defendant has thus far put on a brave face and claimed that it is "rather serene" about the litigation.

In the meantime, a great many other CDO lawsuits are waiting in the wings. Most notably, the Securities Regulator for the State of Massachusetts has publicly accused Merrill Lynch of defrauding the City of Springfield with sub-prime linked investments. The New York Attorney General has also announced that he has opened an investigation into how asset-backed securities backed by sub-prime mortgages were sold.

In other words, the old prediction that when market conditions suddenly and unexpectedly change litigation usually follows seems to be holding well. The current prediction is that sub-prime losses are likely to reach US\$400 billion, leaving a great many CDO purchasers reaching for the small print and asking difficult questions which the banks may not be able to answer satisfactorily.

But what exactly are CDOs? They are Collateralised Debt Obligations which are sold to investors pursuant to Security and Exchange Commission Rule 144. That rule provides for five conditions as follows:

1. **Holding Period:** Before you may sell restricted securities in the marketplace, you must hold them for at least one year.
2. **Adequate Current Information:** There must be adequate current information about the issuer of the securities before the sale can be made.
3. **Trading Volume Formula:** After the one-year holding period, the number of shares you may sell during any three-month period can't exceed the greater of 1% of the outstanding shares of the same class being sold, or if the class is listed on a stock exchange or quoted on Nasdaq, the greater of 1% or the average reported weekly trading volume during the four weeks preceding the filing of a notice of the sale on Form 144.
4. **Ordinary Brokerage Transactions:** The sales must be handled in all respects as routine trading transactions,



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and brokers may not receive more than a normal commission.

5. **Filing notice with the SEC:** At the time you place your order, you must file a notice with the SEC on Form 144 if the sale involves more than 500 shares or the aggregate dollar amount is greater than \$10,000 in any three-month period.

In the volatile sub-prime market which erupted in 2007, one only has to say "sold to investors" to hear the echo "mis-sold to investors", such is the scope for mis-selling. As one perceptive commentator has already noted: "To the extent that owners of CDO securities did not change their valuations when market conditions changed, they could be subject to regulatory action. They could also be open to investor lawsuits alleging improper management of the portfolios..."

In these circumstances, litigation on both sides of the Atlantic – and indeed in all major financial markets – is inevitable.

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### Shipping confidence levels dive

The latest Moore Stephens Shipping Confidence Survey, issued this month, has revealed a significant drop in overall confidence levels in the market, and an increased expectation that rates in the tanker, dry bulk and container ship sectors will fall in the next twelve months.

On a scale of 1 to 10, the average confidence level reported by respondents was 5.6, compared to 6.8 in the previous survey in June 2008. Confidence levels fell across all sectors and regions and the greater divergence between respondents suggests greater uncertainty across market participants. Demand trends, the cost and availability of finance and competition are now clearly respondents' key concerns.

Ship managers replaced ship owners as the most likely to make a major investment during the coming year, but their expectation level of 5.6 out of 10 (against an average overall score of 5.2) was still significantly down.

There was a fall from 66% to 60% in the number of respondents who expected finance costs to rise over the next twelve months. It follows that the proportion of respondents expecting lower finance costs rose from 9% to 19%.

In the freight markets, there was evidence of a significant shift in expectations towards lower rates, most strongly in the tanker and container ship sectors.



## New appointments

Forensic Accountancy Services has been appointed to a compulsory purchase case by a major UK retail chain – a result of the team's work in a similar case decided by the courts in 2007.



Charles Lazarevic

"It defined a new way of valuing retail stores being compulsorily purchased," explains Charles Lazarevic. He has also been appointed to deal with compensation claims arising from the £16 billion Crossrail project, currently the largest engineering project in Europe.

"These new appointments come as a direct result of our success in that case." Given the amount of UK city centre development underway, and the numerous plans for road and rail development, Charles anticipates that

compulsory purchase cases will prove a growing area of work. Meanwhile the FAS team is involved in a number of oil disputes. One involves the sharing of profits arising from trading oil into Iraq, and another concerns the acquisition of an oil field in Siberia. FAS have also been drawing on the Moore Stephens International association.

"We have involved the Turkish member firm in a case involving compensation payable to landowners whose land had unauthorised mining," Charles says. That case involved giving evidence before arbitrators in Geneva.

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## Insurable interest

The Forensic Accountancy Services team is very active in the insurance industry, where it works closely with the Moore Stephens Insurance Industry Group. So we will be watching with interest the response to a call by the Law Commission for proposals on reforming the law of insurable interest, following its review of insurance contract law.

It is interesting to note that one unintended consequence of the passing of the Gambling Act 2005 has been that, in England, most contracts of indemnity insurance without an insurable interest are now valid. The Commission therefore concludes that "there would be no merit in re-introducing a requirement for insurable interest for indemnity contracts".

The closing date for submissions on the proposals was 11 April 2008.

## English law accepts compound interest

In July of last year, the House of Lords delivered its judgment in the case of *Sempra Metals Ltd v Inland Revenue Commissioners*, rewriting the English law of interest in the process.

Sempra were claiming the notional interest lost as a result of having to make payments of advanced corporation tax (ACT) which the company would have been able to defer had it been a member of a group of solely UK-resident companies.

Following a ruling by the European Court of Justice that ACT was in breach of the EC Treaty, the High Court had made an award of compound interest. In 2005 the Court of Appeal upheld the decision, resulting in the Inland Revenue's appeal to the House of Lords.

Prior to the law lords' decision, the broad position under UK law was that a claimant could recover damages arising from a breach of contract or tort with one notable exception; the claimant had no general right to recover interest on amounts due to them during the period prior to judgment.

Furthermore, the court was considered to have no power to make an award of compound interest on a "claim for restitution of a sum of money paid by mistake or following an unlawful demand".

In their decision, the law lords said that it will be open to a claimant to plead and prove his actual interest losses caused by late payment of a debt. This would suggest that where a claimant has been left temporarily out-of-pocket then, subject to the usual remoteness tests, they will now be entitled to reclaim any compound interest losses, for example; overdraft interest suffered.



In cases where debts have been outstanding for longer periods, claimants' entitlement to compound interest will result in significantly larger claims. Furthermore, the complexities of calculating interest on a compound basis and the unsettled nature of the law in this area, will make the services of a forensic accountant all the more valuable.

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## Who to contact

If you would like to know more about any of the issues covered in Forensic Update, please contact the partner responsible for your affairs.

## Profile: James Wise



James Wise joined the Moore Stephens Forensic Accountancy Services team last year. Prior to that he had worked for 23 years with another leading firm of accountants, where, in 1996, he had his first taste of forensic accountancy. A specialist at that time in banking, James was appointed in what turned out to be a two-year-long case involving a negligence claim against a firm of auditors.

Thereafter, in 1999, James was seconded for three years to the Financial Services Authority as part of its Risk Review Team

where, together with other experts – mainly accountants and bankers – he helped provide the practical industry experience which the FSA and its supervisors were looking for at that time. In 2002 James returned to his forensics practice, building on his wide experience in claims and disputes and in valuations.

In early 2007, James decided it was time for a change, and joined Moore Stephens. He does not regret it. He says, "I have come into a different environment – more rewarding and challenging. The cases tend to be smaller than some of those I have worked on in the past. As a result, there is much more opportunity and scope to work on one's own, albeit with access to the resources of a vastly experienced back-up team, and to see things through to the end."

James enjoys the great variety of work at Moore Stephens. His recent appointments have included those in connection with the acquisition of a cement business in Turkey, the valuation of a

headhunting business operating in a number of West European countries, and an insurance claim involving a major utility provider. James also has some experience of expert work, having assisted in an expert determination involving a private health business, and attended court as an observer on a number of other occasions.

James foresees a continuing need for the services of forensic accountancy experts. "It is not something which is hugely dependent on the economic climate," he explains. "People will always do deals, will always buy and sell businesses. And there will always be disputes."

Outside the office, James enjoys spending time with his wife and fifteen-year-old daughter. When he gets the opportunity, he likes to sail his 16ft catamaran on Rutland Water. "It is a little scruffy and battered," he says, "and in need of some TLC." Other than that, he enjoys gardening and walking his two labradors, one of which he describes as "old and wobbly", and the other as "young and bouncy".

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## Shooting Stars!

### Moore Stephens' 11th Annual Clay Shoot at Bisley

The popularity of this event increases every year which, as always, is held at the National Shooting Centre at Bisley in Surrey.

Although the competition was more difficult this year it did not affect the standard of shooting or the final scores. Shooting for Moore Stephens were Julian Wilkinson, Phillip Sykes, Charles Lazarevic, David Rolph, Bill Beach and Nick King. The winning team, but with only a five clay advantage, was led by David Rolph, and team-mates Martin Chapman (HSBC), Alexander Ulm (Reynolds Porter Chamberlain), Mark Thompson (SITA UK) and Nick King (Moore Stephens).

The individual prize winners were High Gun – Tony Temple QC (4 Pump Court) and Low Gun – Steve Cottee (Lawrence Graham).



Tony Temple QC – receiving his prize from Julian Wilkinson