Hogan Lovells

Real Estate Quarterly

Autumn 2010

Real Estate

Contents

CVAs and guarantee stripping – "Son of Powerhouse" defeated

Daniel Norris and Mathew Ditchburn look at the recent *Sixty UK* case on the contentious topic of guarantee stripping and the increasing popularity of CVAs over other insolvency processes.

In July, the High Court of England and Wales revoked a company voluntary arrangement (CVA) promoted by retailer Miss Sixty in a damning judgment that called into question the conduct of the practitioners involved. The case of *Mourant & Co Trustees Limited v Sixty UK Limited (in administration)* [2010][1] could end so-called guarantee stripping.

WHAT IS A CVA?

A CVA is an insolvency procedure where a struggling company proposes an agreement to its creditors to compromise its debts and liabilities. Provided the CVA is approved by 75% (or more) in value of unsecured creditors present and voting in person or by proxy, it binds all creditors irrespective of how or whether they voted. There is no requirement, unlike the position under a Companies Act scheme of arrangement, for creditors with different interests to be placed into separate classes for voting purposes. The result is that it is possible for a CVA to be passed by a majority of creditors who stand to lose least or gain most from it. The result in such circumstances can therefore be that a CVA is imposed on other creditors whose rights are most adversely affected by its terms.

Disgruntled creditors may apply to court within 28 days to seek a revocation of the CVA for unfair prejudice or material irregularity.

WHAT IS GUARANTEE STRIPPING ?

Guarantee stripping occurs where a CVA purports to discharge guarantees given by a third party to the creditor such as where another company in the tenant's group has guaranteed the tenant's liabilities to the landlord. The judgment provides powerful ammunition to landlords seeking to negotiate future CVAs with tenant companies trying to procure the release of those guatantees.The points made by the judge will also be of general application in any CVA that purports to deprive creditors of ostensibly valuable third party benefits.

RECENT CVA USE

CVAs have become popular amongst retailers as a means of compromising future leasehold liabilities, enabling them to close down underperforming stores. CVAs promoted by JJB Sports, Focus DIY and Blacks Leisure were all passed by creditors keen to ensure the survival of the business, whatever their view of the "fairness" of the arrangement. Recent CVAs have taken an even bolder approach, with Flannels, SRG and Textiles Direct securing reduced rents for some premises which continued to trade.

Not all CVAs have been successful. Stylo Barratt's proposal was voted down in 2009 because landlords would not accept a wholesale conversion to turnover rents. CVAs have also troubled the courts before, notably in the case of *Prudential Assurance Co Limited v PRG Powerhouse Limited* [2007][2]. In that case, a group of landlords, represented by Hogan Lovells, successfully challenged a CVA which purported to discharge guarantees given by a solvent parent company in exchange for a payment that was calculated without any proper weight being given to the value of the guarantees being surrendered.

SIXTY UK – "SON OF POWERHOUSE"

The guarantee stripping in *Powerhouse* was deemed unfair on the facts, but the court did not find that it was unlawful in principle. It left open the question of what would constitute "fair" guarantee stripping. The issue came before the court in *Sixty UK*, dubbed "Son of Powerhouse".

Sixty UK's CVA sought amongst other things to determine the leases of two units in a Liverpool shopping centre and to release guarantees given by the company's solvent Italian parent, Sixty SpA. In exchange, the landlord was paid £300,000, said to represent its losses of a year's rent plus a three month rent free period. It emerged that the administrators appointed by Sixty UK to supervise the CVA had received professional advice that a figure of at least £1 million would be appropriate, taking into account other items such as dilapidations, cash incentives and professional fees. The landlord argued at court that it was unfair in principle to compromise a guarantee in exchange for a cash payment. Alternatively, it said the CVA was unfair because the payment was far too low. Neither Sixty UK nor its administrators attended the hearing.

THE JUDGEMENT

Mr Justice Henderson revoked the CVA, finding that the landlord had been left in a worse position than on a liquidation, where its rights against Sixty SpA under the guarantees would not be affected. He did not say that guarantee stripping would always be unfair but he did say that in times of market uncertainty, when it would be difficult or impossible to determine what sum would fairly compensate the landlord for the loss of the guarantee, a landlord should not be forced to accept a cash sum.

In any event, Henderson J found that the £300,000 figure was not a genuine pre-estimate of the landlord's losses. It had been dictated by Sixty SpA, which stood to benefit from the release of the guarantees. The Judge's remarks about this were particularly scathing. He held that the CVA was "fatally flawed", "impossible to justify", based on a "cynical calculation" and observed that it "should never have seen the light of day".

The administrators were singled out for personal criticism. The Judge said that they had "abdicated their responsibilities" by siding with Sixty SpA against the interests of other creditors and compounded their "dereliction of duty" by "falsely representing" the advice they had received and allowing Sixty SpA to dictate the terms of the CVA. Unusually, the Judge ordered a referral to the administrators' professional bodies on the basis that there was a prima facie case of misconduct.

COMMENT ON MISS SIXTY

Powerhouse dealt a major blow to guarantee stripping. *Sixty UK* goes further by making it clear that guarantee stripping can only be justified if there is a payment to landlords based upon a thorough evaluation and genuine pre-estimate of their losses. Anyone promoting such a CVA must therefore be very sure indeed that they have accurately calculated and compensated landlords fully for their losses. That is likely to be impossible in difficult times when the future is uncertain – precisely when CVAs are used. Guarantee stripping may be appropriate where the guarantee is of limited value because the guarantor is itself insolvent, but in that case the guarantor will probably be part of the insolvency process. Solvent guarantors should expect to pay full value for the removal of guaranteed rights.

The case highlights the importance of the checks and balances within the CVA and scheme procedures to protect struggling companies and their creditors from third parties who seek to use the procedures for their own financial gain. It is a salutary reminder to practitioners of their obligations to be seen to act independently and to make full disclosure in any CVA proposals to which they put their names.

Having seen increasingly radical CVAs in recent months, landlords and other creditors are likely to rely upon *Sixty UK* to negotiate for more favourable treatment and if they consider a CVA has been unfairly prepared or formulated to challenge its terms in court accordingly.

POPULARITY OF CVAS

It will remain to be seen whether *Sixty UK* slows the trend towards using CVAs for guarantee stripping but CVAs are evidently the process of choice at the moment. Less value destructive than administration or liquidation, CVAs also attract a less negative stigma and, as a consequence, are better for brand protection. Their increased popularity is borne out by data published in August by the Insolvency Service (the statutory body with oversight of insolvency processes in the UK and also the regulator of insolvency practitioners).

The statistics show that in Q2 2010 on a non-seasonally adjusted basis there were 47.8% more CVAs than in Q2 2009, a staggering increase. The data also shows that the popularity of the CVA has come at the expense of other processes, with administrations down 24% and receiverships down 12% (non-seasonally adjusted), and compulsory liquidations down by 19% (seasonally adjusted), for the same periods.

THE FUTURE – A BUSINESS RESTRUCTURING MORATORIUM?

The government has been assessing the impact of the financial crisis on businesses and particularly the ability to negotiate a restructuring of debt, given the current paucity of credit and tightening of lending criteria. The government is concerned that businesses which are sound at core may get pushed into an insolvency process because negotiations to restructure complex lending arrangements take too long and are impacted upon negatively by the economic climate.

As a result there is currently a public consultation underway on proposals for a business restructuring moratorium. In short, a business seeking a solvent restructuring of its debts (not necessarily through the formality of a CVA or a Scheme of Arrangement) may avail itself of a moratorium which would effectively prevent any third party bringing proceedings against it (for instance for non-payment of rent) without the leave of the court.

To safeguard creditors from abuse of the process the business would have to satisfy eligibility and qualifying tests, assessed by an insolvency practitioner, and the moratorium would have to be sanctioned by the court.

The general market view is that this is likely to find its way onto the statute books. If the moratorium is extended from smaller companies (which have it already) to be available for all CVAs and schemes of arrangements as well as negotiated compromises arrangements it is hard to see the CVA becoming anything other than more popular over other insolvency processes.

Daniel Norris
T +44 20 7296 5590
daniel.norris@hoganlovells.com

Mathew Ditchburn
T +44 20 7296 2294
mathew.ditchburn@hoganlovells.com

1 EWHC 1890 (Ch)
2 EWHC 1002 (Ch)

RICS and the art of mediation

Richard Webber and Caroline Murray-Lyon consider how mediation can assist on lease renewals and how it compares to other methods of dispute resolution.

The field of lease renewal seems set to become increasingly active over the next few years with the anticipated expiry of many long term leases granted in the 1980s coinciding with an inevitable increase in turn-around of the short term lease favoured by today's businesses[1]. With such large numbers of renewals on the horizon, it is hardly surprising that the market is generally dissatisfied with the statutory procedure for lease renewal which stipulates that if the parties cannot agree the terms of a new lease, then an application to the court must be made. The court process is time consuming, expensive and rigid, and it is just conceivable that a County Court judge may not fully understand all the factors affecting rental value.

One possible answer to this problem is for the parties to adopt PACT (Professional Arbitration on Court Terms)[2]. Another is mediation[3] and RICS has recently announced an initiative to help solve the renewal issue by championing the use of mediation. This initiative arose from a discussion Max Crofts, RICS Past-President, had with Nicholas Cheffings, Partner in Hogan Lovells International LLP, as to whether a simple clause could be devised to offer to the market in respect of mediation. Further to that discussion, RICS has produced the following precedent lease mediation clause which it hopes will be taken up by the market generally:

PRECEDENT RICS MEDIATION CLAUSE

1. DISPUTES

1.1 The parties agree to seek to resolve any dispute which arises during the continuance of this [Lease] [Agreement] or upon or after its determination amicably and in good faith by negotiation in the first instance.

1.2 If the dispute continues to be unresolved then the parties agree to attempt to settle it by mediation and will jointly source the mediator from the list of accredited mediators approved by the President of the Royal Institution of Chartered Surveyors.

1.3 If the identity of a mediator cannot be agreed by the parties the mediator may be nominated by the President of the Royal Institution of Chartered Surveyors on the application of either party.

1.4 If the dispute is not settled at mediation in accordance with this clause within a period of [20] working days or such longer period as may be mutually agreed after the appointment of a mediator either party shall be entitled to resort to any other process for resolution that is expressly or impliedly provided for in this [Lease] [Agreement] or litigation.

WHAT IS RICS MEDIATION?

RICS mediation is a voluntary, non-binding and private dispute resolution process in which a trained, neutral person – the RICS accredited mediator – helps the parties try to reach a negotiated settlement. The RICS accredited mediator assists the parties in themselves coming to and managing their own settlement of the dispute. RICS accredited mediators will not offer any evaluation of the parties' positions unless all parties expressly agree to seek it; nor will they advise on the merits of any settlement. They are facilitators.

ADVANTAGES OF MEDIATION

Control – As the parties have an opportunity to negotiate their own settlement in mediation, they have control over the outcome of the dispute. Parties themselves retain ownership of and responsibility for any settlement that is reached and, unlike a court, there is no imposed decision. As well as having control over the outcome of the dispute, it is the parties who dictate the management of the process, rather than the court.

Flexibility – Settlement by mediation allows the parties to reach solutions that the court cannot offer. For example, the parties may agree a new contracted out lease or a turnover rent. This type of compromise might suit both parties but it could not be ordered by the court in any circumstances.

Cost and time efficient – Mediation is often more cost and time efficient than litigation. It often leads to rapid settlement – more than 70% of disputes settle either on the day or shortly afterwards – which reduces the time and cost that would otherwise be involved in achieving resolution. Mediation also avoids the uncertain timetable for court proceedings and the time – consuming arrangements for hearings.

Protects relationships – Mediation protects relationships and helps to look at wider business affairs than just the present dispute because it looks at the future rather than the past which can be very important in an ongoing landlord and tenant context.

Expertise – Unlike a County Court judge, a RICS accredited mediator is a trained property professional who will be very experienced in the subject matter of the dispute.

Confidential – Court actions are matters of public record, whereas in mediation, both the existence of the dispute itself and the terms of any settlement may remain confidential. Therefore, parties need not be concerned about adverse publicity.

WHEN IS MEDIATION LESS SUITABLE?

Uncertainty – As settlement during mediation is voluntary, there is an element of uncertainty of obtaining a resolution to the matter. In this case, the matter may end up in court anyway, and the mediation process will have delayed the final decision being made.

Not suitable for all disputes – While mediation has very many applications, it is less likely to assist in certain matters, such as a simple rent review dispute. Even then a mediation could result in an agreed lease extension or a variation in the lease that could not be achieved simply by pressing the rent review to a conclusion.

Anticipation – It may be that not all parties will want to commit themselves at the outset to one particular process of settling a dispute. As mediation is a voluntary process, some businesses may prefer to decide at the time of renewal rather than including a mediation clause in the lease.

Precedent – a party wishing to set a precedent in order to influence the outcome of similar disputes will need a court decision in order to do so.

CONCLUSION

Although mediation, like PACT, will not be suitable for all scenarios particularly as it is a voluntary process, like PACT, it provides a cheaper alternative to the statutory process and therefore the promotion of it by RICS should be welcomed by those who desire a simpler and more cost-effective alternative. As Lord Woolf recently put it: "The availability and use of mediation is always important but the present financial situation has made its use, whenever possible, essential. No one can afford to ignore the benefits it offers".

Richard Webber
T +44 20 7296 5985
richard.webber@hoganlovells.com

Caroline Murray-Lyon
T +44 20 7296 5651
caroline.murray-lyon@hoganlovells.com

	RICS mediation	**PACT**	**Court proceedings**
Control	Parties dictate the process, timescale and outcome.	Parties dictate the process and timescale, with input from arbitrator/independent expert, and arbitrator/expert dictates the outcome.	Court dictates the process and timescale, with input from the parties, and court dictates the outcome.
Flexibility	Full flexibility – wide range of solutions available to the parties.	Mostly flexible – arbitrator's/expert's decision is imposed on the parties, but the parties can work it into a wide range of solutions.	Limited range of outcomes – eg court cannot order a contracted out lease.
Cost	Usually cheaper than court processes, although it does no more than add an extra layer of cost if it does not work.	Usually cheaper than court processes, although parties have to pay for arbitrator/expert.	Usually more expensive as the parties must spend time and money complying with more onerous litigation steps.
Time efficiency	Often leads to rapid settlement, although it does no more than add an extra basis for delay if it does not work.	Usually quicker than court processes.	Usually takes several months.
Relationship between parties	Collaborative process.	Partly collaborative and partly adversarial process.	Largely adversarial process, which can lead to the parties becoming entrenched.
Expertise	Process assisted by expert in the field.	Outcome determined by expert in the field.	Outcome determined by judge, who may not be an expert in the field and who will make a decision by evaluating the expert opinions put forward by the parties.

1 The BPF's recent annual Lease Review revealed that the average length of commercial leases in 2008/9 was 5 years.

2 For further information see How to have an imPACT on lease renewals by Richard Webber in the summer 2010 edition of the Real Estate Quarterly and the article on PACT by Max Crofts published in the Dispute Resolution Service newsletter on 26.08.10

3 Mediation is the most commonplace form of Alternative Dispute Resolution ("ADR"). For more information on mediation and ADR generally, please see our client note "Alternative Dispute Resolution" available at www.hoganlovells.com on the news and publications page.

A tall storey about rights of light!

Paul Tonkin and Dellah Gilbert examine a recent case which highlights the need for developers to resolve rights of light claims at an early stage.

The case of *HKRUK II (CHC) Limited v Heaney*[1] involved the redevelopment of a six storey office building in Leeds. HKRUK purchased the building in 2007 with the benefit of planning permission which permitted the addition of two further floors. HKRUK indentified at an early stage that the construction of the additional floors would infringe rights of light enjoyed by the neighbouring building owned by Heaney and sought to engage him in correspondence with a view to reaching an early settlement of his rights of light claim. These early discussions floundered and, although Mr Heaney's solicitors made threats to issue proceedings for an injunction if works commenced, those threats were not followed through. Works began in September 2008 and were completed in June 2009. The new seventh floor was then let to a tenant on a 10 year lease from 1 August 2009.

Unusually, and presumably in a bid to obtain certainty, HKRUK started court proceedings for a declaration that Mr Heaney was not entitled to relief for any infringement of his rights of light caused by the additional storeys. Mr Heaney counter-claimed for an injunction requiring the additional storeys to be pulled down insofar as they infringed his rights of light.

In a decision which is likely to send a shiver down the spines of developers, the court granted Mr Heaney an injunction and ordered HKRUK to reconfigure the two additional storeys so as to avoid infringement of Mr Heaney's rights of light. This was despite the fact that it would cost £1m - £2.5m to carry out the works and would involve relocating the seventh floor tenant.

The court's starting point was that, once an infringement had been established, Mr Heaney was entitled to an injunction unless HKRUK could persuade it to exercise its discretion to award damages instead. Although this is in itself uncontroversial, it has generally been assumed that, in exercising that discretion, the court will take into account a variety of factors including, for example, whether the injured party has delayed in seeking to assert his legal rights (which Mr Heaney almost certainly had) or whether he was using the threat of an injunction to ransom the developer. However, the judge appeared to consider that his discretion was considerably narrower than this. He held that, unless all four of the tests set out in the leading case of *Shelfer v City of London Electric Lighting Company*[2] were met then he was, in effect, bound to grant an injunction.

According to *Shelfer*, an injunction ought not be granted where:

(a) the injury to the claimant's rights is small;

(b) that injury is capable of being estimated in money;

(c) the injury can be adequately compensated by a small money payment; and

(d) an injunction would be oppressive.

Even though the loss of light affected less than 1% of Mr Heaney's building, the Judge was not prepared to say that the injury was small. HKRUK therefore fell at the first hurdle.

The judge went on to say that, even if he was wrong on this, he did not think that the injury could be compensated by a small monetary payment and did not think that an injunction would be oppressive. Whilst he accepted that it would be expensive and disruptive for the additional stories to be reconfigured, he was influenced by the fact that HKRUK had proceeded to build with a view to profit in full knowledge of the fact that they would be infringing Mr Heaney's rights.

In our view, the case applies an unnecessarily strict approach to what should be a broad judicial discretion and we understand that permission to appeal has been sought. However, the decision highlights the need to identify and resolve rights of light issues at an early stage and the potential financial consequences of starting works while issues remain unresolved.

This case is the latest in a trend which has strengthened the bargaining position of those with the benefit of rights of light. Whilst some may welcome these constraints on developers, the extent of the detrimental impact should not be overlooked. Councils are finding it increasingly difficult to regenerate town and city centres because land owners and developers are having to factor in greater sums to pay off beneficiaries which in turn may make uneconomical an otherwise profitable development. As such, there has been growing unrest, which will only be galvanised by this decision, if it is not overturned on appeal. Is this now the time for a change in the law?

Paul Tonkin
T +44 20 7296 2456
paul.tonkin@hoganlovells.com

Dellah Gilbert
T +44 20 7296 2563
dellah.gilbert@hoganlovells.com

1 (Unreported) Leeds District Registry, 3 September 2010
2 [1895] Ch 135

Case round up

Paul Tonkin summarises recent case law

SUB – TENANTS AND CONSENT FOR ALTERATIONS
Eaton Mansions (Westminster) Limited v Stinger Compania De Inversion SA [2010] EWHC 1725 (Ch)
Stinger was the sub-tenant of two flats in a block, of which Eaton was the landlord. Eaton was itself a tenant under a headlease. Stinger erected various pieces of air-conditioning plant on the roof of the block without Eaton's consent. Eaton sought damages for trespass. Stinger resisted the claim arguing that Eaton was not in a position to reasonably refuse consent to the air-conditioning plant.

The court awarded damages to Eaton. It found that the erection of the air-conditioning plant constituted a potential breach of Eaton's headlease and therefore it would not have been unreasonable in withholding consent. The court was critical of Stinger's conduct, finding that it had behaved in a high-handed manner and had resorted to trespass when it had been unable to achieve its aims lawfully.

LEVEL OF DAMAGES FOR TRESPASS
Stadium Capital Holdings v St Marylebone Properties Co Plc [2010] EWCA Civ 952
Stadium had erected on the wall of its building an advertising hoarding which overhung into the airspace above Marylebone Properties' adjoining building. Marylebone claimed damages for trespass. The judge at first instance found that the hoarding did constitute a trespass and awarded Marylebone damages equivalent to the whole of the income which Stadium had earned from the hoarding during the period of the trespass. Stadium appealed.

The Court of Appeal allowed the appeal. It held that the damages awarded by the judge were at the very top end of an award for damages for trespass and should be reserved for the most serious of cases. In most cases, damages should be based upon a reasonable fee for occupation of the land by the trespasser. The case was remitted to the judge for reconsideration of damages.

EXTENT OF OWNERSHIP AND TRESPASS
Bocardo SA v Star Energy Onshore Limited [2010] UKSC 35
Star Energy was an oil company. It had established a drilling operation whereby a drill went into the ground on its land but in fact retrieved oil which was up to 2,900 feet beneath the surface of adjoining land owned by Bocardo.

Bocardo claimed damages for trespass. At first instance, the judge found that there was a trespass and awarded substantial damages of over £600,000 based on the ransom value which Bocardo could have demanded in return for granting Star Energy the right to drill for oil under its land. Star Energy appealed to the Court of Appeal. The Court of Appeal agreed that the drilling did constitute a trespass but reduced the damages payable to just £1000. This was on the basis that Star Energy would have been entitled to compulsorily acquire the right to drill under Bocardo's land by relying on certain statutory rights, for which it would only have had to pay nominal consideration. Bocardo appealed to the Supreme Court.

The Supreme Court dismissed the appeal. It agreed that the drilling constituted a trespass and reaffirmed that a person's ownership of land extends to the sub-strata and the minerals which form part of it. The Supreme Court did however accept that statements to the effect that ownership extends "to the centre of the Earth" went too far as there would come a point when physical features such as pressure or temperature rendered the concept of ownership absurd. On the question of damages, the Supreme Court also agreed with the Court of Appeal. The fact that Star Energy had a statutory right to acquire the right to drill at a very small price would clearly be relevant to the parties' bargaining position and would have prevented Bocardo from extracting a ransom payment if the parties had engaged in a negotiation for the right to drill.

DAMAGES FOR DILAPIDATION
PGF II SA v Royal & Sun Alliance Insurance Plc [2010] EWHC 1459 TCC
Royal & Sun Alliance was PGF's tenant at an office block in the City of London. PGF claimed substantial damages against Royal & Sun Alliance for dilapidations at the end of the term.

In reviewing the law the judge set out what he considered to be the correct approach to assessing a claim for damages for dilapidations. First, the landlord's damages should be assessed at common law. This involved assessing the cost of the works which the tenant should have carried out at lease expiry and then deducting any items which would have been rendered valueless by reason of the landlord's intended refurbishment works. Where the landlord had not at lease expiry decided what to do with the building (ie repair, refurbishment or demolition) the court should apply a test of reasonabless and where, in effect, one course of action was inevitable damages should be awarded on the basis that the landlord would act reasonably and adopt this course of action. Having assessed the damages at common law on this basis, the court should then apply the cap under section 18(1) of the Landlord and Tenant Act 1927, capping the landlord's common law damages at the difference between the value of his reversionary interest in the premises in or out of repair.

UNLAWFUL USE OF EQUIPMENT
New Northumbria Hotel Limited v Maymask (148) LLP [2010] EWHC 1273 (Ch)
New Northumbria ran a hotel business under an informal arrangement with the tenant of the hotel premises.
The freeholder of the hotel was placed into administration and, during the administration, no rent was paid by the tenant, causing substantial arrears to build up. The administrators sold the freehold to Maymask and also assigned to them the right to collect the arrears of rent and the benefit of a debenture which the tenant had granted to the freeholder over its assets. Maymask made a demand under the debenture and proceeded to appoint administrators over the tenant. Before the administrators were properly appointed they agreed to give Maymask possession of the hotel premises. Maymask took possession, ordered New Northumbria's staff to leave and began operating the hotel business. New Northumbria issued proceedings, claiming that it owned various items of equipment at the hotel which Maymask was using unlawfully.

Continued...

The court was extremely troubled by Maymask's conduct and found that there was a triable issue over the ownership of the equipment. However, except in relation to the tills, the court was not prepared to grant an interim injunction ordering Maymask to deliver up the equipment. This was on the basis that any unlawful use of the equipment by Maymask could be adequately compensated in damages. The tills were different because they were not simply machines, rather they held valuable historic data. Maymask was ordered to deliver up the tills to New Northumbria or, alternatively, provide reasonable access to allow the data to be extracted.

VALIDITY BREAK NOTICE AND NAME CHANGE
Hexstone Holdings v AHC Westlink Limited [2010] EWHC 1280 (Ch)
AHC was Hexstone's tenant. The lease contained a break option giving AHC the option to determine the lease on 31 October 2009 by serving six months' notice in writing.

In August 2008 AHC sent a circular to all of its suppliers (including Hexstone) announcing that it had merged with the Eddie Stobart group and would, from 1 July 2008, be known as Eddie Stobart Ltd. The change of name did not in fact occur and the tenant remained known as AHC Westlink. By a letter dated 23 April 2009, AHC purported to serve notice to determine the lease. That notice was on the headed paper of Eddie Stobart Limited (AHC's parent company) and signed "for and on behalf of Eddie Stobart Limited". Hexstone challenged the notice on the basis that it had not been given by or on behalf of the tenant.

The court held that the break notice was invalid and the lease therefore continued. The requirement for the notice to be given by the tenant (ie. AHC) was a strict one and this had not happened. The notice had been given by Eddie Stobart Limited and, on the evidence, this was in fact what the draftsman of the notice had intended (on the basis that the operations at the premises were controlled by Eddie Stobart Limited). There was no evidence that Eddie Stobart Limited had served the notice as agent for AHC and the court was not prepared to infer this.

BREAK NOTICES MUST BE SERVED ON SPECIFIED PARTIES
Hotgroup Plc v Royal Bank of Scotland Plc [2010] EWHC 1241
Hotgroup was RBS's tenant of office premises pursuant to a 10 year lease. The lease contained a break clause entitling Hotgroup to terminate at the end of year five. The notices provision in the lease provided that notices were required to be served on RBS's named managing agent, as well as RBS itself. Hotgroup sought to exercise the break option. It served notice on RBS within the required timeframe but failed to serve on the managing agent until after the latest date for service of notice. RBS challenged the validity of the notice.

The court agreed with RBS. The words of the notices provision clearly stated that any notice must also be served on the managing agent. The notice was accordingly invalid because it had not been served on the managing agent in time and the lease would continue.

TERMINATION OF CONTRACT FOR SERIOUS BREACHES ONLY
Dominion Corporate Trustees v Debenhams Properties Limited [2010] EWHC 1193 (Ch)
Dominion entered into an agreement for lease with Debenhams for a retail unit yet to be constructed. The agreement obliged Dominion to construct the unit and also provided for Dominion to make three staged payments to Debenhams at specific points during the project. The agreement stated that if either party failed to perform any of its obligations under the agreement then the other party could terminate by serving notice. Dominion failed to make the second staged payment on time and Debenhams served notice to terminate two days later. Dominion immediately attempted to make payment which Debenhams refused to accept on the basis that time was of the essence and that it had been entitled to terminate the contract following Dominion's failure to pay on time.

The court found that Debenhams was not entitled to terminate the agreement. Although the wording of the termination clause suggested that any breach would entitle the other party to terminate, the agreement contained a multitude of obligations, some of which were very minor and it could not have been intended that any breach, no matter how minor, would entitle the other party to terminate. A reasonable commercial person would understand the clause to relate only to serious breaches of the agreement. The court also commented that Dominion had been upfront with Debenhams and had explained that the payment was likely to be late and that Debenhams had not given Dominion any warning of its intention to terminate in the event of late payment.

NEGLIGENT VALUATION
K/S Lincoln v CB Richard Ellis Hotels Limited [2010] EWHC 1156
CB Richard Ellis acted for K/S Lincoln in providing valuations of hotels which Lincoln subsequently purchased. The hotels were leased to operators under leases which provided for rental increases to be related to turnover. However, there were also provisions relating to shortfalls in turnover which meant that the rent might not actually increase for some years. Although CBRE referred to the shortfall provisions in its valuation, its forecasts showed that rent would increase and did not take the shortfall provisions into account.

Lincoln sued CBRE in negligence. It argued that it would not have bought the hotels had it appreciated the effect of the shortfall provision. It further argued that the yield percentages of 6.25% put forward by CBRE had been too low, leading to an overvaluation of the hotels.

The court found for CBRE. It held that, although CBRE should have prepared the forecasts with reference to the shortfall provisions, Lincoln had not relied upon the forecasts as it had been given (and understood) separate advice relating to the effect of the shortfall provision. It had accordingly suffered no loss as a result of the forecasts. In relation to the yield, the court agreed that the yield was too low and that an accurate yield would have been 6.6%. However, what ultimately mattered was the valuation not the yield. The valuation itself was within 10% of the correct figure and was therefore within a reasonable margin of error and not negligent.

NO IMPLIED SURRENDER IN ABSENCE OF UNEQUIVOCAL INTENTION

QFS Scaffolding v Sable [2010] EWCA 682

Mr Sable granted a lease of a building yard to L Limited, who carried on two businesses at the yard. L Limited was placed into administration and QFS was then formed, with a view to it acquiring one of the businesses from L Limited. Sable and QFS entered into negotiations for the grant of a new lease but no agreement was reached. The administrators of L Limited then executed a deed of assignment, purporting to assign L Limited's lease to QFS. Mr Sable sought possession of the yard, arguing that the original lease to L Limited had been surrendered by operation of law as a result of the negotiations for the new lease and that QFS occupied as a tenant at will only.

The Court of Appeal held that there had been no surrender by operation of law. Although a surrender would have occurred on the grant of a new lease to QFS, mere negotiations for a new lease would not have this effect. In the absence of unequivocal conduct by L Limited evidencing an intention to surrender, there would be no implied surrender and the lease to L Limited remained in existence. It was accordingly L Limited and not Mr Sable who was entitled to possession of the premises.

SERVICES OF NOTICES

Michael Gerson (Leasing) Limited v Greatsunny Limited 17 June 2010 (unreported)

Greatsunny was the freeholder of premises which it had let to a third party tenant, K. K leased various items of equipment from Gerson which it installed at the premises. Greatsunny and Gerson agreed between themselves that "in the event that the lease is determined we [Greatsunny] will give you [Gerson] notice of the termination and thereafter 28 days in which to remove the equipment". K went into administration and Greatsunny determined the lease. It informed Gerson of this orally but Gerson took no steps to recover the equipment within 28 days. Greatsunny relet the premises and equipment to a third party. Gerson argued that the oral notice was insufficient and that its 28 days had accordingly not yet started to run.

The court found in favour of Greatsunny. The starting point was that once the equipment was installed at the premises it become a fixture and was therefore part of the premises and could only be removed in accordance with the contractual arrangements agreed. There was nothing express in the agreement which required notices to be in writing and nor was there any general presumption of this as a matter of law. In particular, the effect of the service provisions set out in section 196 of the Law of Property Act 1925 was not to impose a requirement for service of notice in writing where the contract did not otherwise require this.

LIMITED DUTY OF CARE OWED TO NON-VISITORS

Harvey v Plymouth City Council [2010] EWCA Civ 860

Mr Harvey, aged 21, had spent the evening drinking. He took a taxi but, when running away from it to avoid paying his fare, he fell down a sheer drop on the council's land. He was seriously injured and sued the council, arguing that it had been reasonably foreseeable that youths might fool around on that area of land, possibly whilst under the influence of alcohol, and that the council therefore had a duty to take reasonable care for his safety under the Occupiers Liability Act 1957.

The Court of Appeal found for the council. The duty under the 1957 Act was to make premises reasonably safe for use for the purposes for which the visitor was permitted by the occupier to be there. When a local authority allowed the public to use its land for recreational purposes, it was consenting to normal recreational activities, carrying normal risks. An implied licence for general recreational activity could not be stretched to cover any form of activity, however reckless. The council's implied licence had not extended to what Mr Harvey had been doing on its land. He was accordingly not a "visitor" for the purposes of the 1957 Act and it therefore did not apply.

TIMING OF INTENTION TO REDEVELOP

Somerfield Stores Limited v Spring (Sutton Coldfield) Limited (In Administration) [2010] EWHC 2084 (Ch)

Somerfield was Spring's tenant of supermarket premises. Somerfield's lease enjoyed security of tenure under the Landlord and Tenant Act 1954 and it accordingly served a section 26 notice at lease expiry requesting a new tenancy under the Act. The landlord served a counter notice stating that it opposed the grant of a new tenancy on the ground that it intended to redevelop the premises.

The tenant applied for summary judgment, arguing that because the landlord company had since gone into administration there was no reasonable prospect of it establishing an intention to redevelop. The Court at first instance dismissed the tenant's application. Whilst it accepted that the landlord could not presently establish an intention to redevelop, it found that Somerfield had not established that there was no reasonable prospect of the requisite intention being established at the trial date, which was when intention needed to be shown.

Somerfield appealed arguing that, on a summary judgment application, the relevant date for establishing intention should be the date of the summary judgment hearing itself. The Court of Appeal rejected this argument affirming that, in all cases, the relevant date is the date of trial. The alternative would put landlords in an impossible position as they would have no idea when a tenant might "ambush" them with a summary judgment application.

Paul Tonkin
T +44 20 7296 2456
paul.tonkin@hoganlovells.com

No word of a lie – misdescriptions and misrepresentations

In the first of two articles Katie Nixon looks at the consequences of not looking at your particulars properly

With headlines predicting a double dip in house prices and a stuttering commercial property market, agents and those in the property business are keener than ever to ensure that what properties are available achieve maximum returns. To this end, effective marketing can help realise maximum potential. However over-enthusiastic marketing can come with a hidden price tag in the form of fines and criminal sanctions if the marketing material oversteps the criteria set out by statute to protect the purchaser.

Such was the case in 1991 when an estate agent from Bedford was found guilty under the Property Misdescriptions Act 1991 for describing Shuttle Cottage, Goldington Road in sales particulars as 'detached' whereas it was attached to what was formerly a stable block which formed part of a light-industrial estate.[1] As liability under the Act is strict there was no need for the prosecution to prove any intention to mislead on the part of the agent. The prosecutor had only to show that the relevant statement was in itself false or misleading.

The scope of the Act is far-reaching as its purpose is to outlaw false or misleading statements in the context of the marketing and disposal of property and falling foul of its provisions is a criminal offence. In *Lewin v Barratt Homes Ltd*[2] the court held that a show house carried an implicit "statement" that future houses with the same model name would be built to the same design and in *George Wimpey UK Ltd v Brown*[3] a statement that adjoining properties which did not belong to Wimpey would be demolished formed the basis of a civil action.

WHAT IS THE OFFENCE UNDER THE ACT?
Under the Act it is an offence to make a false or misleading statement about certain aspects of a property (called "prescribed matters") in the course of an estate agency or property development business. It does not apply to statements made by private individuals.

ESTATE AGENCY BUSINESS
Although many commercial property agents may not consider themselves to be estate agents, estate agency business is defined by reference to the 1979 Estate Agents Act and effectively means taking instructions from a client with a view to introducing a potential purchaser or vendor and then acting to secure for that client the disposal or acquisition of an interest in land which would include the grant of a lease. As can be seen this definition is much wider reaching than might be imagined and an offence can be committed at any time from receipt of instructions to completion of the disposal although will not apply where a business disposes of its own property.

PROPERTY DEVELOPMENT BUSINESS
A statement is made in the course of a property development business if:

(i) the statement was made in the course of business concerned wholly or substantially with the development of land; and

(ii) the statement was made for the purpose of, or with a view to, disposing of an interest in land consisting of or including a building, or part of a building, constructed or renovated in the course of the business.

This is intended to catch property and construction companies who carry out and dispose of their own developments and refurbishments.

FALSE OR MISLEADING?
Under the Act a statement is "false" if it is false to a material degree, and a statement is "misleading" (though not false) if what a reasonable person may be expected to infer from it, or from any omission from it, is false. Although there was no clear indication of what would be excluded as trivial when the Act was first introduced, the estate agent selling Shuttle Cottage was also found guilty for describing a house as "eighteenth century" when in fact it was built in 1835 and therefore nineteenth century.

A misleading statement is not necessarily false in itself but is misleading if a reasonable person draws a false inference from what is omitted from the statement. For example, to state that a property has "views over open country" without mentioning the cement works a few fields away is an omission which might be held to make the statement misleading. Likewise, to mention that a property has the benefit of planning permission without mentioning that the planning permission is only for part of the property could be misleading.

It is worth noting that a statement need not be limited to the spoken or written word as with sales particulars, measurements and advertisements, but can extend to plans, models, photographs and artists' impressions. Where site advertisements and models are available at an early stage it is important to ensure their accuracy. In the Barratt Homes case, The High Court found that Barrat Homes were liable as they had been aware that they would be unable to build the houses to the design shown in the pictures and indicated by the show house.

WHAT ARE PRESCRIBED MATTERS?
All 33 prescribed matters are set out in the Property Misdescriptions (Specified Matters) Order 1992 and the list is extensive, essentially covering anything relating to the property. Included in the list are the property's location, outlook, services, fixtures, condition, fitness for purpose, age, price, terms of lease (if leasehold), planning and covenants and easements affecting the property.

Given the extent of the prescribed matters, it is wise to assume that they cover all aspects of the marketing and disposal of the property.

ARE THERE ANY DEFENCES?
The "due diligence" defence
It is a defence to show that the accused took all reasonable steps and exercised all due diligence to avoid committing the offence.

A person cannot rely on the due diligence defence by relying on information provided by someone else unless he shows that it was reasonable in the circumstances to do so. And this must be measured against the steps taken to verify the information and whether he had any reason to disbelieve the information.

An estate agent or property developer should therefore be wary about taking information supplied by third parties at face value, expecting to be able to rely on the due diligence defence. There is a difference between relying on the client's assurance that a property is in good condition and those of a qualified engineer who confirms he has tested the central heating system and confirms it is in good working order.

Disclaimers?

Unfortunately the Act is silent on the use of disclaimers (it neither permits nor prohibits their use), although government guidance suggests that disclaimers might be effective in the same way and under the same principles applied by the courts to disclaimers under the Trade Descriptions Act 1968. Consequently, any disclaimer must be as bold, precise and compelling as the statement to which it relates, be effectively brought to the notice of anyone to whom the property may be sold, and equal the description in the extent to which it is likely to "get home" to prospective purchasers. Unsurprisingly, a disclaimer will not be effective where it is applied to a statement which the maker of the statement knows is false.

Until the effectiveness of disclaimers under the Act is tested in the courts, they should be treated with caution. Nonetheless, government guidance states that disclaimers may have a useful role where an estate agent or property developer considers that an unqualified statement could be misleading. For example, a statement that a house had full central heating could be misleading if the estate agent knew that that system had not been used for some years and therefore had reason to believe that it might not be in working order. The guidance states that in such circumstances it might be considered prudent to state that the condition of the system was not known.

Time limits

There are time limits for bringing a prosecution being:

(i) the end of the period of three years beginning with the date of the commission of the offence; or

(ii) the end of the period of one year beginning with the date of the discovery of the offence by the prosecutor.

REMEDIES FOR THE AGGRIEVED PURCHASER?

Enforcement of the Act is by local Trading Standard Officers who have powers to enter business premises and seize and copy documents if they reasonably believe an offence has been committed. A prosecution can be brought against both the person by whom the estate agency or property development business is carried on, the employee who makes the statement and also the director or other officers of the company.

A person found guilty of an offence is liable on conviction to a fine **but** unfortunately for an aggrieved purchaser, the Act specifically states that no contract will be void or unenforceable, and there is no right of civil action in respect of any loss.

This means that even though an estate agent or property developer may have committed a criminal offence, this alone does not give an aggrieved purchaser the right to claim any compensation. Once contracts are exchanged the buyer may be able to bring an action for misrepresentation or breach of contract otherwise the chances of disappointed purchasers getting any recompense remain slim. The good news is that a conviction under the Act may well be compelling evidence in an action for misrepresentation where damages can be awarded.

CONCLUSION

Although there have been any number of cases brought for misdescription under the Act by local Trading Standard Officers, few have been appealed at higher level and therefore are often not reported. It only needs one high profile case to highlight the scope and impact of the Act and developers and agents would be well advised to ensure that everything said or written about any properties for sale or let are accurate to the last detail.

Katie Nixon
T +44 20 7296 5481
katie.nixon@hoganlovells.com

1 As reported in The Independent, 4 June 1994
2 [2000] 03 EG 132
3 [2003] SLT 659

Managing the risks of development – a brief guide

Dion Panambalana considers the principles of development management and how it allocates the various risks inherent in construction projects.

Development management has been around for as long as there have been developers. Some property companies are specialist development managers. Others use it as part of their commercial strategy. In essence development management does exactly what the name suggests which is to manage the development rather than take on the full development risk.

The principle of development management, in its purest sense, is to offset, but not necessarily to underwrite, the risks to the owner/developer in delivering the development product. Typically, development management specialists may not be keen on taking the full developer risk or indeed the ownership risk but are happy to provide the resource and talents within their organisation to get the project to completion.

Although development managers manage the risk for the owner/developer, they may choose to take on more risk as long as that is reflected in their fee. A pure development management role may result in a percentage fee based on construction costs, time and cost reductions or it may involve staged payment of fees based on project milestones relating to letting and final valuation.

There are many different models that have developed over the years. The bank workout programme which involves different property companies taking on development management roles in order to assist the bank in restructuring stressed and distressed property assets has highlighted a number of different approaches.

Some of the newer schemes may involve, for an appropriate level of return, taking on development risk and offering other services as part of the purchase. A more "traditional" development management model might involve the risks and offsets set out in the table below.

Dion Panambalana
T +44 20 7296 2316
dion.panambalana@hoganlovells.com

"TRADITIONAL" DEVELOPMENT MANAGEMENT RISKS ANALYSIS

Obligation	Risk	Borne by	Off-set
Design	Faulty building	Owner	**Partly** offset by Development Manager (DM) appointing a consultant or contractor correctly, but DM will not be liable for consultant or contractor's negligence.
Materials	Faulty building	Owner	**Partly** offset by DM appointing a consultant or contractor correctly, but DM will not be liable for consultant or contractor's negligence.
Workmanship	Faulty building	Owner	**Partly** offset by DM appointing a consultant or contractor correctly, but DM will not be liable for consultant or contractor's negligence.
Letting	no (more) tenants	Owner	**Partly** offset by DM appointing a consultant or contractor correctly, but DM will not be liable for consultant or contractor's negligence (or market failure)
Time	Investment completed late or not at all	Owner	**Partly** offset by DM appointing a consultant or contractor correctly, but DM will not be liable for consultant or contractor's negligence.
Warranties for 3rd parties	1. Construction finance does not start 2. Subject to (1), investment not completed or penalties due	Owner	**Mainly** offset by DM appointing a consultant or contractor correctly, and then enforcing the appointment.
Liability to 3rd parties	Subsequent building faults	Owner	Offset **mainly** by collateral warranties subject to warrantor failure
Signing off the Works	Subsequent building faults	Owner	Offset **mainly** by collateral warranties, subject to warrantor failure
Size	Investment not completed or less valuable	Owner	Offset **mainly** by appointing contractor and measurer correctly and imposing offset penalties for failure to achieve target size
Costs overruns	More working capital needed	Owner	**Partly** offset by development management process
Insolvency	Insolvency contractor/consultant team OR tenants	Owner	Once appropriate and substantial teams appointed, **no offset at all**.
Variations	Cost overrun if not allowed for in 3rd party agreements, or in consultants' appointments	Owner	Offset **mainly/totally** by correctly appointing consultants/contractors

Q&A

Removal of unwanted restrictive covenants and service of notices under the 1987 Landlord and Tenant Act form the basis of this edition's Q&A

Q: My land is subject to an old restrictive covenant which was imposed some 50 years ago. I believe that it will affect the value of my land on a possible re-sale. Is there any way that I can get it removed?

A. There are four possible ways in which you may be able to deal with the restrictive covenant.

- The party with the benefit of the covenant may agree to give an express release by entering into a Deed of Release which is then sent to the Land Registry. The land must be clearly identified and all the parties having an interest would need to join into the Deed of Release. The Land Registry would note the Deed on the title although may not remove the actual covenant unless you can show that all those parties with the benefit have joined in the deed.

- Depending on the nature of the covenant, you may wish to obtain restrictive covenant indemnity insurance. This will usually be available where the party having the benefit of the covenant cannot be identified, which may well be the case here as you say that your covenant is very old and may be for the benefit of a particular party or estate which no longer exists. Under this method insurance monies will be paid out if the covenant is subsequently enforced.

- One of the most well-known ways of dealing with unwanted restrictive covenants is through an application to the Lands Tribunal[1]. The Lands Tribunal has the power to discharge or modify restrictive covenants in whole or in part. You must establish one of four key grounds before the Lands Tribunal will exercise this discretion[2].

  These include showing that the restriction has become obsolete due to "changes in the character of the property or the neighbourhood". If your covenant states, for example, that you can only use the land for residential purposes and the surrounding area has come into business or mixed use, you may well be able to establish this ground;

  Second, you may be able to show that the covenant impedes a reasonable use of the land and has no practical benefit/is contrary to the public interest and that money would be adequate compensation for the loss suffered if it were discharged;

  Further you may be able to establish that those entitled to the benefit of the covenant have agreed "by their acts or omissions" to the discharge or modification; and finally

  You may succeed if you can establish that the proposed discharge or modification will not adversely affect those entitled to the benefit of the covenant.

  The Lands Tribunal will look at the development plan for your area and they will also look at any pattern for the grant or refusal of planning permission in the area. It may well require compensation to be paid to any party that has the benefit of the covenant if it is discharged or modified.

- Finally, an application can be made to the court for a declaration that the covenant is no longer effective.

  To advise you further we would need to look at the exact wording of the covenant, when and why it was imposed, whom (if anyone) is benefitting from it now and whether the character of the site and the surrounding area has changed. It may well be possible to have it removed or modified.

  As an application to the Lands Tribunal or the court could prove both time-consuming and expensive, it may be simpler to opt for restrictive covenant indemnity insurance, depending on the covenant's nature.

Q: I am a landlord letting a single retail unit within a residential/commercial mixed-use building. The commercial tenant insists that I serve notices under the Landlord & Tenant Act 1987 on all of the residential tenants offering them a pre-emption right before entering into the new lease. Is this really necessary?

A. Under the 1987 Act, a landlord is guilty of a criminal offence if, without reasonable excuse, the landlord makes a "disposal" (which would include a letting) without first having complied with the requirement to serve "Offer Notices" on qualifying tenants of the residential flats in the building.

The Act applies to premises where two or more flats in the building are held by qualifying tenants, and where the number of flats held by the qualifying tenants exceeds 50% of the total number of flats in the building. A person is a qualifying tenant if he is the tenant of a flat under a tenancy although various exceptions apply under the Act. Whilst the Act does not apply to wholly commercial premises it does apply to mixed use buildings where the commercial elements account for less than 50% of the total floor area. So, for example, high street premises where the ground floor is a retail unit and the upper levels comprise residential flats may be caught by the Act[3].

Although the criminal sanctions only apply to the landlord, the retail tenant is justified in insisting on service of the notices before it signs up to the new lease. If the retail letting were to go ahead without the notices having been served, the residential tenants would have the following rights against the tenant (and any of its successors in title):

a) the right for a requisite majority of tenants (i.e those qualifying tenants who have more than 50% of the available votes) to obtain information about the disposal from the tenant by way of an "information notice".

b) the requisite majority of tenants may also serve a "purchase notice" to appoint a nominated purchaser to step into the retail tenant's shoes under the lease. The retail lease will

Continued...

then have effect as if it had been entered into with the person nominated by them, and not with the retail tenant.

Where a prospective tenant is taking on a new or an existing lease and is in doubt about whether the landlord has complied with the Offer Notice provisions on the original letting, it should serve on those tenants an "Information Notice" asking the tenants to confirm:

a) whether the landlord has served the Offer Notice,

b) whether the tenants know of any reason why they would not be entitled to an Offer Notice, and

c) whether they would serve a "Purchase Notice" if such an Offer Notice were to be served on them.

If less than 50% of the tenants respond within two months, or if more than 50% of the tenants do respond stating that they are not entitled to a notice or else would not respond positively to such a notice, then the purchaser can proceed on the basis that the premises will be treated as if the 1987 Act did not apply to them and the tenants will lose their pre-emption rights under the 1987 Act.

As has been expressed in the legal press, previously there was a view that disposing of the commercial element (or part of it) within a mixed use building to which the Act applied did not amount to a relevant disposal for the purposes of the Act provided that it did not include any common parts which the residential tenants had the right to use. However, in the *Dartmouth*[4] case the judge appears to have accepted a proposition that the disposal of a retail unit within an affected building would in fact be caught by the Act[5]. As such, it pays to tread very carefully in this area.

Ingrid Stables
T +44 20 7296 5252
ingrid.stables@hoganlovells.com

Ed John
T +44 20 7296 2532
ed.john@hoganlovells.com

1 The Lands Tribunal, which is the Lands Chamber of the Upper Tribunal, is an independent and specialist judicial body set up to resolve certain disputes concerning land.

2 These grounds are set out in the Law of Property Act 1925, s.84, as amended by the Law of Property Act 1969

3 For further information see the Autumn 2008 edition of Real Estate Quarterly "Disposals under Dartmouth: developers beware!" by Sheena Ray

4 Dartmouth Court Blackheath Limited v Bensworth Limited [2008] EWHC 350

5 Commercial Leases – April 2009 – pages 1439-1441

Contacts

This newsletter is written in general terms and its application in specific circumstances will depend on the particular facts.

If you would like to receive this newsletter by e-mail please pass on your email address to one of the editors listed below.

If you would like to follow up any of the issues, please speak to one of the contacts listed below, to any real estate partner at our London office on +44 20 7296 2000, or to any real estate partner in our worldwide office network.

Jane Dockeray
(Editor, Real Estate Quarterly)
jane.dockeray@hoganlovells.com

Ingrid Stables
(Editor, Real Estate Quarterly)
ingrid.stables@hoganlovells.com

Michael Stancombe
(Co-chair, Global Real Estate)
michael.stancombe@hoganlovells.com

www.hoganlovells.com

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