REPRINT

CD corporate disputes

REAL ESTATE DISPUTES

REPRINTED FROM:
CORPORATE DISPUTES MAGAZINE
OCT-DEC 2018 ISSUE

www.corporatedisputesmagazine.com

Visit the website to request
a free copy of the full e-magazine

WALKER MORRIS

Published by Financier Worldwide Ltd
corporatedisputes@financierworldwide.com

www.corporatedisputesmagazine.com

EXPERT FORUM

REAL ESTATE DISPUTES

PANEL EXPERTS

Danielle Drummond-Brassington
Partner
CMS Cameron McKenna Nabarro Olswang LLP
T: +44 (0)20 7367 2768
E: danielle.drummond-brassington@cms-cmno.com

Danielle Drummond-Brassington is a partner and the head of the firm's real estate disputes team. She provides support to the wider real estate team on transactions dealing with issues such as interpretation of deeds and boundary and restrictive covenant queries. She is also recognised as a safe pair of hands to have on board in contentious situations, pulling on her extensive experience in all manner of property disputes, ranging from landlord and tenant issues to boundary disputes and from rights of light issues to property insolvency related issues.

Robert J. Ward
Partner
Schulte Roth & Zabel LLP
T: +1 (212) 756 2166
E: robert.ward@srz.co

Robert J. Ward focuses his practice on commercial and securities litigation. He has represented major corporations, commercial banks, investment banks, private equity firms, hedge funds and other business entities in complex commercial and securities litigation, in federal and state courts, in New York and elsewhere. He has defended and prosecuted claims of breach of contract, fraud, accountant's liability, securities fraud, breach of fiduciary duty and negligence by corporate officers and directors, breach of covenants not to compete, professional malpractice and intellectual property infringement.

Malcolm Simpson
Partner
Walker Morris LLP
T: +44 (0)113 283 4064
E: malcolm.simpson@walkermorris.co.uk

Malcolm Simpson is managing partner and has overall responsibility for the firm. He has nearly 30 years' experience handling commercial disputes, often in the real estate sector acting for developers, house-builders and landowners. As well as being an accomplished trial lawyer, he is frequently involved in arbitrations, mediations and expert determinations. He is a Fellow of the Chartered Institute of Arbitrators (FCIArb) and a CEDR accredited mediator. He has been recognised as a leading litigation lawyer by Chambers, the Legal 500 and Best Lawyers for many years.

CD: How would you describe the extent of disputes currently surfacing in the real estate sector? Could you outline the scale and value of the disputes being seen?

Drummond-Brassington: We are currently seeing the full spectrum of real estate disputes. In particular, development-related disputes are back as more complicated development sites are put together when space is at a premium. The retail sector is also particularly active, with the spread of company voluntary arrangements (CVAs) dominating the headlines recently. Retail is clearly under huge strain at the moment as the power of e-commerce is being increasingly felt.

Simpson: The range of disputes affecting the sector is hugely varied, with many high value contractual and development disputes, as well as lease renewal and portfolio management issues. The longevity of many development agreements and joint venture (JV) arrangements is giving rise to disputes, as parties' circumstances and market conditions change. These disputes increasingly involve 'good faith' arguments. While the market is strong or even benign, many clients have the funds and appetite to renegotiate or litigate options, conditional contracts and promotion agreements. We are also seeing a willingness on the part of developers to bring claims against infrastructure-providers with whom they have contracted. We anticipate significant activity in this emerging area. As well as a regular throughput of ransom and covenant disputes, including mines and minerals and right to light issues, we always see significant claims by landowners and developers against professional advisers – solicitors in respect of title defects and engineers in relation to structural issues, often involving remediation and stability issues.

Ward: Lately, there has been a relative lull in commercial real estate litigation. As a general rule, distressed markets generate more conflict and with stronger markets recently, there have been fewer disputes. This is not to say that real estate litigation has halted completely, however, as we are still seeing ground lease rent resets and operating escalation disputes, which are regularly recurring types of litigation. Further, well-known difficulties in the retail sector have resulted in an increased number of disputes in that space.

CD: What are some of the most common causes of dispute? What global and regional trends have been impacting this space?

Simpson: In terms of scale and value, real estate disputes are often substantial. A delay in bringing a development to market can give rise to very substantial loss. Claims which risk sterilising

land or adding to development costs, overage or increased foundation costs, for example, are often very significant. On the landlord and tenant side, challenges within the retail market are starting to have an impact. We are seeing a rise in the number of CVAs, and a rise in landlords' challenges. If an economic downturn is on the horizon, we are also likely to see an increase in lease breaks, dilapidations disputes and potentially overvaluation claims against surveyors. Finally, we have seen an increased willingness to challenge some high value introduction and referral fee claims, especially those that are not properly documented. This could potentially impact the way many off-market deals are done. Supply chain issues, in particular relating to a shortage of construction materials, have been prevalent in recent years, with some developers being willing to challenge suppliers that look to break or renegotiate contracts when demand outstrips supply.

Ward: Disputes most commonly arise in distressed markets. The tough retail environment has caused an uptick in defaulted mortgages, workouts and foreclosures relating to retail properties. We are also seeing retailers fight with landlords over rent hikes and issues like the allocation of shared expenses. In New York, another trend we are seeing is increased litigation stemming from the glut of new developments for sale. An oversaturated market means developers are not meeting their projected returns and investors are looking for someone to blame, be it project managers and contractors for failing to keep costs in check or architects for making errors that require costly corrections. The softer market has also strained the relationship between developers and brokerage firms. In the second half of the year, several brokerage firms have sued developers alleging unfair practices and unpaid fees. Even after units are sold, developers are not out of the woods – we are seeing a growing number of construction defect cases resulting from construction issues in high-end condominiums.

Drummond-Brassington: The pressure on the high street is starting to play out in the market. Rent recovery is always a common area of disputes. We are also seeing a rise in the number of rent review instructions. For years, rent review has largely been the remit of rent review surveyors. However with the pressure to reduce overheads at all levels increasing, points are being taken on rent review bringing lawyers back into the arena. Development in London is booming – there are currently 13 projects underway in London's financial district alone – and all manner of site constraints are emerging, 'rights of light' continues to be hard fought and one of the top development risks in the City. The changes to the Telecommunications Act that were brought into force on 28 December 2017 are showing all the signs of being a highly contentious area as operators and landowners find their way with the new rules.

However, it is too early to tell what the impact will be.

CD: To what extent are tough economic conditions and increasing project complexity fuelling real estate disputes?

Drummond-Brassington: This depends on the matter in dispute and the importance to the party. In some cases, companies will not be looking to spend money and a cost-benefit analysis of a dispute may mean it is not worth it – essentially, you are just throwing good money after bad. On the other hand, a certain set of facts may mean that there is no option but to fight or defend a position, for example if a corporate's reputation is at stake. Sometimes issues arise that if looked at on a property-by-property basis would mean it is not worth it. However, when looked at on a portfolio basis, the case is worth the investment in resolving the dispute.

Ward: Overall, economic conditions have been improving in the US, contributing to the relative stability of the commercial real estate market. We have not seen economic conditions fuel real estate disputes the way we have in previous down cycles. Nor have we really seen increasing project

complexity spur additional disputes, as New York real estate projects have been highly complex for many years.

Simpson: In our experience, developers and landowners are as willing to litigate now as they were in 2009 and 2010, immediately following the crash. Many of these disputes are dealt with by expert determination or arbitration rather than in court, so they are confidential and not always known about. The amounts at stake are often very high, which justifies fighting hard. The need to maintain relationships with landowners and other developers often mitigates against this and can be important in bringing about settlement. Increasing project complexity is certainly fuelling disputes. The more complex a project and the more parties involved, the more likely it is that misunderstandings will arise and mistakes will be made. We often see mistake and rectification and contractual interpretation claims as a result. Additionally, development on complex sites – for example, mixed use high rise developments in tight city centre plots – raises multiple issues, all of which fuel disputes, such as rights to light, party wall, rights of way, boundary and funding disputes.

CD: Have any recent, high-profile real estate disputes caught your eye? What made them notable?

Ward: Earlier this year, the Second Department of the New York Appellate Division held that a commercial tenant's waiver of its right to bring a Yellowstone injunction was enforceable and not contrary to public policy. In New York, Yellowstone injunctions have long been used by commercial tenants to challenge or extend the time to cure lease defaults without risking lease forfeiture. Going forward, landlords will likely demand that tenants waive the right to seek Yellowstone injunctions, thereby gaining a substantial edge in disputes regarding alleged lease defaults. In another interesting decision, a federal judge in the Eastern

> **"In our experience, developers and landowners are as willing to litigate now as they were in 2009 and 2010, immediately following the crash."**
>
> *Malcolm Simpson, Walker Morris LLP*

District of New York awarded a group of graffiti artists a judgment of $6.75m against a real estate developer who destroyed the artists' work, which had been featured on the exterior walls of the developer's building known as '5Points', located in Queens, New York. The decision is instructive for property owners and artists who look to collaborate on future projects.

Simpson: In line with the prevalence of development contract disputes, three overage and development contract disputes have recently hit the legal headlines: *Gaia Ventures v Abbeygate Helical* (2018), *Sparks v Biden* (2017) and *Burnside v Promontoria* (2017). These cases show that many overage and contingent contractual terms are poorly drafted, failing to cater for unknown future events, for parties with changing and potentially conflicting interests and to cover all possible eventualities over the life of the agreement. We have also noticed a flurry of lease break cases and service of notice disputes, for example *Goldman Sachs International v Procession House Trustee Ltd* (2018), *Teoco UK v Aircom Jersey* (2018) and *Zayo Group International Ltd v Michael Ainger & Ors* (2017). We are watching closely as these cases may be among the first indications of market uncertainty and decline.

Drummond-Brassington: *S Franses Ltd v. The Cavendish Hotel (London) Ltd* is the case that everyone is watching at the moment. This concerns the opposition to renewal on redevelopment grounds and the landlord's intention to carry out works. The case has been leapfrogged to the Supreme Court and will be heard in Autumn 2018. It has the potential to change the way ground for cases can be made out and make it harder for tenants to challenge a landlord's position.

CD: What advice would you offer to parties on overcoming the challenges they are likely to face during a real estate dispute? What essential steps and considerations do they need to make?

Simpson: I once heard a developer describe his relationship with a competitor, and former JV partner, as being like 'squabbling cousins'. Both were willing to litigate – the case went to the Court of Appeal – but each viewed the dispute as being a discrete issue and took care not to let it get in the way of the overall relationship. In many real estate disputes the parties will have an ongoing commercial relationship – whether that is in the context of a continuing development JV agreement, a landowner and developer relationship, neighbours or a landlord and tenant relationship. Even where specific contracts have come to an end there are often future opportunities to work together, so parties often have regard to longer-term interests.

Drummond-Brassington: First and foremost, parties should try and remain objective. Understandably, emotion can play a part, even with corporate property holdings. We would urge companies to remain objective, try to take a step back and look at the dispute from a practical and reasonable standpoint. People tend to make rash decisions and rather than looking at the right one for the company in the long run, they opt to side with what feels good at that moment in time. You need to have a pragmatic approach to survive. Parties should try to identify both the best-case scenario and the worst-case scenario. By focusing on the risks at the beginning of a matter, it helps plan a route map. Usually, by route mapping and identifying the costs that could be incurred, parties know when they need to resolve an issue by.

"Resolving disputes through mediation and arbitration is normally far more efficient and cost-effective than lengthy trial litigation."

Robert J. Ward, Schulte Roth & Zabel LLP

CD: What strategies can disputing parties deploy to help manage the cost of dispute resolution?

Drummond-Brassington: Most cases can be resolved. However, if the parties adopt entrenched positions straight away, this becomes more difficult. Mediation is an effective solution, but both parties have to want to resolve the matter, otherwise it can be a wasted day. Certainly, obtaining legal advice is crucial, and is something we would always urge parties to take. However, sometimes parties are too quick to get lawyers to go on the record, which escalates the position and brings costs into the equation. If parties can discuss their issues before lawyers on the record, often the issues can be narrowed. Honesty can sometimes be forgotten about in stressful times. You need to be honest about the team involved. In some cases, we have experienced a 'blocker'. This is someone who might have a different appetite for resolution and may not necessarily be acting in a helpful manner to get the matter resolved. It is a tough decision to make but you need to be clear about the direction of your business and make sure everyone is on board and travelling in the same direction.

Ward: Of course, resolving disputes through mediation and arbitration is normally far more efficient and cost-effective than lengthy trial litigation. Another strategy for managing the cost of dispute resolution is to include a fee-shifting provision in operative contracts. This has proven effective in preventing would-be litigants from filing weak lawsuits.

Simpson: Parties should refer specifically to any dispute resolution clause in the contract or lease. It may contain mechanisms for resolution which are appropriate to the case and cost-effective. Many real estate disputes are technical in nature and may be better suited to expert determination by, say, a surveyor or quantity surveyor, than to litigation. I would generally advise against all-encompassing expert clauses – legal issues are generally best dealt with by the courts. I have often seen parties get into great difficulties because of arguments about the scope of an expert's jurisdiction. This can result in parallel proceedings in court and before an expert, which invariably means more, not less, cost. In the worst case, I have seen it lead to disaster for an unwitting party with an unexpectedly conflicting outcome, as was the case for Woodford in *Woodford Land Limited v Persimmon Homes Limited* (2011). Although there are traps for the unwary, expert determination can, in appropriate cases, lead to a quick and cost-effective outcome which, being confidential, can also spare blushes and help maintain relationships. Where litigation is required, there are always opportunities for parties to manage cost.

CD: In your opinion, how important is it for parties to ensure they have effective policies and strategies in place to manage and resolve potential sources of real estate-related conflict, before they become matters of dispute? How might they achieve this?

> **"Mediation is an effective solution, but both parties have to want to resolve the matter, otherwise it can be a wasted day."**
>
> *Danielle Drummond-Brassington, CMS Cameron McKenna Nabarro Olswang LLP*

Drummond-Brassington: It is hugely important for parties to have policies in place. Parties should make sure, wherever possible, that they take a sensible and forward-looking approach to all

disputes. The right advice may not always be what you would like to hear, but you need to trust the parties around you to have your best interests in mind to resolve the dispute as cost-efficiently and quickly as possible. Real estate litigation is different to other types of litigation. Often parties can be embroiled in a dispute while still tied together in an arrangement, for example a lease or development agreement. It cannot be all-out war; parties must keep their relationships in mind. There is no point litigating at the expense of the relationship if you have another 10 years locked in together.

Simpson: Active contract management is vital, as is managing longer-term relationships in a cooperative way. All too often, contracts are only considered after a dispute has arisen, which can be too late. Getting contracts right in the first place, and keeping staff up-to-date with changes in law and practice, is also paramount. In relation to overage provisions – formulas for calculating valuations, technical specifications and the like – worked examples within the contract can go a long way toward mitigating against future disputes. Suitably worded recitals can minimise the potential for interpretation, intention and construction disputes.

CD: Do you expect to see an increase in real estate disputes over the coming months and years? What trends do you predict will define this space?

Simpson: Given the value and complexity of real estate deals there will always be plenty of scope for disputes. I am seeing as many disputes now – and often as hard fought – as there were in the years immediately following Lehmans. Often, the issues are similar, even if the reasons for pursuing them are not. In difficult times parties often litigate because they have to; in better markets, parties can see value and opportunity and they have the cashflow to fund claims. I anticipate that development and contractual disputes will increase as clients continue to progress as many sites as possible against the backdrop of the UK's housing shortage. As market and economic circumstances change – not least with Brexit uncertainty on the horizon – I expect to see contractual terminations and renegotiations. Parties will look to extract maximum value from deals and to extricate themselves from marginal sites which no longer appear viable. Retail sector challenges, combined with a potential adjustment in the property market, are also likely to result in arrears and possession claims, professional negligence, including overvaluation, claims, lease break service of notices disputes and dilapidations, service charge and rent review disputes.

Ward: There is always a boom and bust aspect to real estate litigation. We may see an increase in the near future. Interest rates are going up, which could have a constraining effect on the commercial real estate market. Additionally, tax changes from the

recent tax laws may result in more litigation, caused by additional pressure resulting from lost deductions.

Drummond-Brassington: Disputes will always be there. As long as property investment remains attractive, there will always be a dispute needing to be resolved. We do not necessarily think there will be an increase in real estate disputes as a whole, but as alternative real estate asset classes, such as 'build to rent', become fashionable, there will be a shift in the type of disputes. We will all need to adapt to the different classes of real estate investments and the disputes that arise in those sectors. Real estate dispute teams will need to be well hedged to deal with all types of property investment. It is no longer just about the landlord and tenant. The other thing that is going to change the nature of disputes is technology. With the pressure for 'smart buildings', technology will be a feature of disputes if the 'smart buildings' fail to delivery. Also, the use of AI and blockchain mean we are going to have to evolve. CD