MILLS & REEVE

Familymatters

Spring 2010

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Editorial

Welcome to the spring edition of Mills & Reeve's *Family Matters*.

It has been a busy six months or so in family law, and once again we find ourselves somewhat in limbo on the big issues. This will be complicated further by family law issues becoming political in the run-up to an election.

Some of the major questions in financial cases are now relatively settled, with the concept of fairness in asset-allocation at the forefront, and a fairly defined list of circumstances that judges will accept as reasons to depart from an equal division in a big money case. However, the new Supreme Court has found itself assailed on all sides in family law matters: we had two judgments on tricky children matters at the end of 2009, and we await two on matrimonial finance. The first case, *Agbaje*, was heard last year and the judgment has now clarified in what circumstances those divorced abroad may bring a financial claim in the English courts. The second, *Radmacher v Granatino*, should help to determine the relevance of pre-nuptial agreements, and also the impact of different European cultures on our family law. This case is being argued before a panel of nine Supreme Court Justices at the end of March, the number of judges being reflective of the importance with which this case has been endowed. We will keep you updated as always on our website: www.divorce.co.uk.

In practical terms, we have seen a significant upsurge in the number of clients asking us to prepare pre-nuptial agreements. There has also been an increase in interest in alternative dispute resolution. Each of our offices has a number of senior lawyers experienced in resolving relationship breakdown through collaborative law. We also have a number of mediators, all of whom have just undergone updated training to cope with the increased demand for these services. More and more high net worth families are, thankfully, trying to settle their differences within the spirit of the current law but outside the confines of the court system, and we fully embrace this shift in emphasis. Although ADR is not appropriate in every case, we find that it is easier for couples to preserve or regain a co-operative relationship if they can reach a consensual solution, rather than one imposed by a judge or reached through the attrition of correspondence. Particularly where children are involved, this can only be a good thing.

Further exciting news: family law partner Nick Stone and our longstanding head of agriculture, William Barr, have produced a book entitled *Divorce and the Farm* to provide a cohesive overview of the law and practicalities in this very specialised area. Due to the dynastic nature of many farms and the challenging economic framework of modern agriculture, framing these divorce settlements requires flexibility and creative thinking. The is a valuable tool for professionals involved in advising farmers facing the unfortunate prospect of marital breakdown, as well as farmers themselves.

Our joint head of the family team, David Salter, has also just published his magnum opus *Pensions on Divorce*, which is already regarded as the definitive work on this area. David led the massive education process of both the legal profession and the judiciary when pension sharing came in and, with Philip Way, leads nationally in this highly technical area.

Finally, I should mention that Roger Bamber, our other Joint Head, has received the accolade of being appointed one of the legal profession's "Hot 100 Lawyers". *The Lawyer* magazine assembles a list each year of "the good, the great and the influential" within the profession, and Roger is one of only two family lawyers there, the other being a leading counsel.

I and my colleagues hope that you enjoy this issue of *Family Matters*. If there is anything we can do for you, do give me a call.

With best wishes

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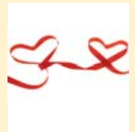

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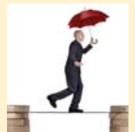

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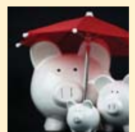

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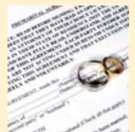

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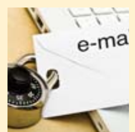

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Cultural barriers broken by a marriage of thousands

Marriage was far from a private affair for those 40,000 people across the world that recently took part in a mass wedding ceremony. Couples from countries including South Korea, Japan and America became man and wife following the blessing by the Rev Sun Myung Moon, the controversial founder of the Unification Church. The brides wore white or traditional dress and the grooms wore black suits with red ties and white scarfs around their necks. During the ceremony, Mr Moon sprinkled holy water and the couples exchanged rings, following which the newlyweds were sprinkled with white confetti. Many of those marrying had only met their partners on a couple of occasions before the ceremony and were brought together from different nations to further the pursuit of creating a multicultural religious world.

Grandchildren need their grandparents

Grandparents are closer than ever to their teenage grandchildren, playing a critical role in their everyday lives, a study by national charity Grandparents Plus, has revealed. The study demonstrates that grandparents are becoming friends, mentors and confidantes – as well as carers – to their teenage grandchildren. The study adds further fuel to the injustice that some grandparents feel when they are excluded from their grandchildren's lives upon relationship breakdown and divorce. Presently, grandparents must seek leave of the court to apply for a residence or contact order, and many feel this does not reflect the important relationship between grandparent and grandchild. The debate has received further publicity following an article published in *The Times* by a retired judge going through the painful experience of applying for contact with his grandchild following the death of his son. Any proceedings involving children can be a long and difficult journey, but for grandparents it can be particularly frustrating if courts fail to recognise other relationships that are important in a child's life.

Quick bites

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Good news for female couples

Changes to the Registration of Births and Deaths Act 1987 mean that female civil partners who use fertility treatment to conceive their children can now both include their names on the child's birth certificate. In addition, female couples not in civil partnerships but receiving fertility treatment may also be registered as parents in the same way as unmarried heterosexual couples. Prior to the change, only the birth mother could be named on the birth certificate. The changes to the regulations were approved by Registrar General James Hall earlier this year following Royal Assent for new parenthood provisions contained in the Human Fertilisation and Embryology Act 2008. The Act's provisions only apply to female couples who have fertility treatment on or after 6 April 2009.

Non disclosure at your peril

A businessman ordered to explain the disappearance of his £400 million fortune in ancillary relief proceedings has been given one last chance to provide a full explanation of the decline in his fortunes by a High Court judge. Mr Young has failed to comply with his duty to provide full and frank disclosure of his financial circumstances, and the court's indication that he will face prison if he continues to disregard court orders is a warning to those embarking on ancillary relief proceedings. Presently, if one party is not fulfilling his or her duty of disclosure, applications to compel disclosure can be costly. In recognition of this, however, there can be cost sanctions against the non-disclosing party as it is likely to be considered as litigation misconduct. The court can also make adverse inferences against any party refusing to disclose. The court has the power to make an order for specific disclosure, or to attend an "inspection appointment" or be cross-examined at court if they refuse to provide information material to the proceedings. A party who continues to flout court orders and fails to provide full and frank disclosure may face the ultimate sanction of a penal notice and be left to consider the consequences of his or her (non) action from prison!

All's fair? Maintenance after divorce

The well known case of Mr and Mrs McFarlane has returned to the court on the wife's application to increase her maintenance. The judge sought to clarify the questions raised by earlier decisions. However, guiding principles for future cases remain uncertain.

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The background

The parties were together for 18 years before separating in December 2000. They have three children, the youngest of whom is 12.

Mr McFarlane is an accountant at Deloitte. Mrs McFarlane was a solicitor when the parties married. She worked until the birth of their second child and she earned as much if not more than her husband. In 1991, they agreed that she should stop working to raise the children.

The parties agreed to divide their £3 million capital equally between them. They could not agree the level of Mrs McFarlane's maintenance.

At the time of the original hearing in 2002, Mr McFarlane earned £750,000 net annually. Mrs McFarlane claimed she needed £215,000 per year for herself and the children.

The judge awarded her £250,000 per year for the rest of her life, until she remarried or until further order. They had both contributed equally, albeit in different ways, and they should each have the same opportunity to save for retirement.

After various appeals, the House of Lords heard the case in 2006 and restored the original order. They directed that courts should consider the principles of needs, sharing and compensation when deciding the fair outcome.

In 2007 Mrs McFarlane applied for an increase in her maintenance.

The current facts

Mrs McFarlane now has £3.868 million of capital (property and investments) and £28,000 in a pension. Mr McFarlane has £3.655 million and £84,000 in pension, plus an unfunded annuity which will pay up to £66,000 gross at age 60.

Mrs McFarlane works four days per week at a Patent and Trade Mark Attorneys and earns £22,000 net per year. She hopes to qualify as a trade mark attorney, earn between £60,000 and £90,000 gross and retire at age 60.

Mr McFarlane is in the top 2 per cent of the highest paid partners at Deloitte. He earned £982,664 net in 2006-07 and £1,109,697 net in 2007-08. He expects to earn between £720,000 and £770,000 net in the foreseeable future and he wants to retire by age 55.

His new wife is also a partner at Deloitte. She intends to leave work next year to spend more time with their son, but she may retrain in due course.

The decision

Child maintenance was increased from £20,000 to £25,000 per child until they each reach 23 or complete university. Spousal maintenance was backdated to the wife's application (25 June 2007) and payable as follows:

- 40 per cent of earnings up to £750,000;
- 20 per cent of earnings between £750,000 and £1million; and
- 10 per cent of earnings over £1 million.

Spousal maintenance was limited to a fixed period which will end on 31 May 2015. However, Mrs McFarlane can apply to extend the term before that date, if appropriate.

The reasons

The decision that Mrs McFarlane should give up work meant that Mr McFarlane's income should be used to provide for her retirement as well as his own.

The judge assessed each party's needs and then identified the surplus in Mr McFarlane's income. He considered the principles of needs, sharing and compensation when dividing the surplus. He acknowledged their Lordship's comments that compensation was key in this case and needs could not be the sole justification for the order.

He acknowledged Mr McFarlane's new wife's income but, when considering surplus, it would be inappropriate to assess Mr McFarlane's needs as less than Mrs McFarlane's just because of his new family commitments.

The court found that Mrs McFarlane could downsize her home in due course, freeing up capital to put towards her retirement. As a point of principle, there should be a clean break on or before Mr McFarlane's intended retirement.

The implications

The "fair" outcome

Fairness remains the key objective in each case.

Assessing parties' needs to determine how any surplus should be divided is a useful starting point. However, exactly how the strands of needs, sharing and compensation will influence other cases remains uncertain.

The decision that Mrs McFarlane should not work was the key factor in this case, although the court does not clarify how much maintenance someone in her position should receive.

When arguing compensation, parties should not try to ascribe monetary value to a loss of career, or how much the other's earnings have been increased by non-financial contributions. Neither should they blindly adopt any percentage-based approaches used in other reported cases. However, there are no guiding positive principles here about what should be done to decide the fair outcome in future cases.

Given current economic uncertainties, the judge considered a percentage approach to be particularly sensible as it caters for caution, optimism, inaccuracy and annual variations.

Backdating

This is always a matter for a judge's discretion, but as an increase may be backdated to the date of application, solicitors should be minded to issue court applications sooner rather than later. Sadly, this adversarial approach runs counter to protocol, and recognised good practice.

Term orders

The court in this case appears more relaxed about the prospect of extending termed maintenance orders than in previous decisions. Perhaps this is an indication of less certainty for the payer about the end-point of financial obligations to a spouse.

Summary

There are practical points to take from the decision, but it does little to clarify the approach to be taken in cases where there is a significant surplus income but not enough capital for an immediate clean break.

Family law in England and Wales remains inherently discretionary and the actual outcome in any case will always depend on the individual judge on the day. Family lawyers advising clients have to consider each case on its own facts and do their best to predict what a judge will decide is the elusive "fair outcome".

Family Investment Companies – a way to protect family wealth?

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Trusts have always been the vehicle of choice for families that have wanted to ring-fence wealth for future generations. They enable assets to be passed on to the next generation whilst retaining control, and importantly they can prevent assets being lost if future generations are affected by divorce. Trusts also used to be very tax efficient but this has changed in recent years. Putting cash and most other assets into a trust above the available nil rate band (currently £325,000) will trigger an immediate tax charge at 20 per cent, and from next April the trust income tax rate will be 50 per cent. These tax charges have made trusts less attractive for wealthy clients.

What is a Family Investment Company?

A Family Investment Company (FIC), is a private investment company designed to mirror many of the features of a discretionary trust. As it is a company, it is very flexible. Share rights can be tailored to meet clients' specific needs, for example, enabling income to be paid only to one shareholder, or at different rates to different shareholders.

Control of the FIC rests with the board of directors and their powers are largely similar to trustees of a trust. The board will determine the investment policy of the FIC and will have control of when and if income is paid to shareholders. Shareholders' rights can be restricted to protect the control of the FIC and the constitution of the company generally.

To protect privacy, an FIC is likely to be formed as an unlimited company as this entitles the company to an exemption from filing accounts at Companies House.

Tax treatment of an FIC

An FIC is an investment company, so it will suffer two levels of tax as profits – made up of income and gains – are subject to corporation tax (generally at 28 per cent), and tax is also payable when those profits are extracted. From next April, the maximum impact of this double charge is an effective tax rate of 54 per cent. At first sight this suggests an FIC is not a tax efficient structure, but that is not the case where the intention is for income to be accumulated.

For example, if £100 was invested at an annual interest rate of 5 per cent in an FIC, at the end of five years, the FIC would have £137.48 after paying tax annually at 28 per cent. If the same investment was made in a trust suffering a 50 per cent annual tax charge, the trust would have just £124.89. The funds in the FIC will have grown 12.59 per cent more than in a trust. This extra growth more than compensates for any additional tax payable when the income is extracted.

But an FIC can be even more tax efficient: for example, dividends received from other UK companies and most offshore companies are not subject to corporation tax. Accordingly an FIC can easily work positively to invest income that rolls up tax free.

It is worth noting that capital gains are taxed in the same way as income within an FIC, so they will also suffer tax at 28 per cent. This does not compare well to the 18 per cent paid by a trust, but an FIC can claim indexation allowance which reduces the effective rate over time. It is also widely anticipated that the 18 per cent capital gains tax rate will be increased, possibly to 25 per cent or even 30 per cent. If that happens of course, an FIC will look even more attractive.

Estate planning

The payment of inheritance tax is something that most families would prefer to avoid. As a result it makes sense to pass wealth down the generations where at all possible. An FIC makes this easy, as investments are pooled and a share in the FIC is then gifted as appropriate. This avoids having either to choose which assets should be given to which beneficiary, or dividing ownership between a number of beneficiaries.

Another benefit worth noting is that when a shareholding in an FIC is valued, a discount can be applied to take account of the size of holding. The reduced value will of course mean that less inheritance tax is

payable if the shareholder dies than if they had held a direct interest in each of the assets owned by the FIC.

Asset protection

Protecting assets, particularly on divorce is a major concern for clients and it is perhaps in this area that FICs are particularly useful. The case of *Hashem v Shayif & Another* (2008) is a significant case dealing with corporate structures in family proceedings. A family owned company was central to the litigation and the family court was asked to make orders against the company to transfer company assets to the wife. Several different arguments were put forward but the judge refused to pierce the corporate veil – its separate legal personality – and instead made clear that a court can only look behind the corporate structure to the people controlling the company if there has been some impropriety linked to the company. The judge did not believe that legitimately taking advantage of a corporate structure involved any impropriety. Accordingly, no order was made against the company even though to do so appeared to be in the interests of justice.

It is important to note that in the case of *Hashem* the judge did emphasise that this was a properly formed and managed company (for example, appropriate board minutes were maintained). To ensure maximum protection is available, it is vital that an FIC is also properly established and operated. It is also possible to increase protection, for example, the company's Articles should restrict the identity of shareholders to prevent a family court ordering a transfer of shares.

An FIC can be better than a trust for asset protection, as an FIC formed by a party to a marriage during the marriage is still able to offer protection against divorce, whereas a trust established in that situation would be characterised as a nuptial trust and exposed to the courts' wide powers to make orders against it. This does not mean, however, that the value of the shares will not be seen as a resource but the key is that the assets are protected. In practice the courts allow time and flexibility on how any settlement is reached.

Summary

FICs enable families to pool investments, pass on wealth down the generations, retain control, keep taxes to a minimum and protect wealth. An FIC is therefore a very attractive alternative to a trust, particularly to a family worried about the wide discretion of the family courts to redistribute assets in the event of a divorce.

Paper weight – is there any point in a pre-nup?

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Are pre-nuptial agreements finally worth the paper they are written on? This is the question that, following the recent case of *Radmacher*, many people are struggling with, whether they are family lawyers or individuals who wish to enter into such an agreement to regulate the way the financial arrangements would be dealt with in the unfortunate event of a divorce.

The short answer to this question is yes, they are worth it. However, as with so many issues in the highly discretionary field of family law, there is a "but" …

The history

None of the many statutes that deal with family law and the division of assets on divorce addresses the question of whether pre-nuptial agreements are binding on divorce. Over the years, judges have struggled with what level of importance they should give to these arrangements. In the mid-1990s, considered opinion in the case law was that a pre-nuptial agreement would be of very limited significance in an English divorce. However, the weight to be given to a pre-nuptial agreement (subject to certain safeguards) developed over the following decade so that by 2003, a judge gave effect to part of a pre-nuptial agreement in the case of *K v K (Ancillary relief: Pre-nuptial Agreement)* by holding the wife to the capital provision that she had agreed to, albeit giving her some additional provision for maintenance.

The year 2007 saw the next major development when the *Crossley* case came before the courts. Mr & Mrs Crossley had both been married several times before and were each independently wealthy. They were married for a very short period of time and the court held that their pre-nuptial agreement was a "factor of magnetic importance" that meant that Mrs Crossley's claim for ancillary relief should not be allowed to get off the ground.

The trend has therefore been towards gradually giving pre-nuptial agreements greater influence when the courts come to split finances on divorce, where it is fair to do so.

Recent developments

The *Macleod* case in the Privy Council last year focused on a post-nuptial agreement – ie, an agreement reached during the course of the marriage rather than before it – and held that such an arrangement would be enforceable, provided it was not made as a result of duress, fraud or undue influence. The court further held that it could have recourse to certain statutory powers, if necessary, to amend or alter provisions under a post-nuptial agreement but only if the circumstances had changed since the agreement was made, or if insufficient provision was made in it for children. This decision somewhat eclipsed the previous judicial focus on pre-nuptial agreements, but their role has been revisited once again by the Court of Appeal in the case of *Radmacher v Granatino*.

The facts in *Radmacher*

Katrin Radmacher was a German national who came from a very wealthy family. While working in London she met Nicolas Granatino who was French and who also came from a wealthy family. They signed a pre-nuptial agreement, got married, and had two children. Although Mr Granatino had previously earned significant sums as a financier in London, in the later stages of the marriage he embarked on an academic life and so was earning significantly less.

The original judge, Mrs Justice Baron, decided that the amount that Mr Granatino should receive should be discounted because of the pre-nuptial agreement which provided, amongst other things, that neither party would have any interest in any property brought into the marriage by the other. However, she said that there were flaws in the pre-nuptial agreement that meant it would not be fair for the husband to be held to all of its terms.

Ms Radmacher appealed to the Court of Appeal, who agreed with her that not enough weight had been given to the pre-nuptial agreement by Mrs Justice Baron. The Court of Appeal said that the crucial factors in this case that meant the pre-nuptial agreement should be upheld were:

- the parties were French and German nationals and pre-nuptial agreements are standard practice and enforceable in both jurisdictions; and
- although Mr Granatino had not received any legal advice on the agreement before signing it, he was a professional man, used to operating in the financial world and therefore knew what he was entering into.

The Court of Appeal felt that these factors meant that the husband's award had not been sufficiently reduced to reflect the impact of the pre-nuptial agreement, and they revised the award to Mr Granatino so that he received nothing directly in his own capacity as a husband, but received funds in his capacity as father to the children. Therefore, for example, the housing fund (of £2.5 million) that he had been awarded in his own right by the first court, was clawed back by the Court of Appeal so that it would be held on trust for Mr Granatino's occupation whilst his parenting duties continued, but once the children have grown up, the funds will be returned to Ms Radmacher.

So where does this leave pre-nuptial agreements?

The Court of Appeal judges were at pains to make clear that:

- any clear and decisive change to the law in relation to pre-nuptial agreements would have to come from a change in legislation; and
- the unenforceability of pre-nuptial agreements in England was increasingly unrealistic and out of step with the rest of Europe.

It seemed to them particularly important to the Court of Appeal that the parties were European citizens and came from a jurisdiction in which pre-nuptial agreements are known to be binding. Indeed, the European dimension, and the scale of wealth in this case make it anything but run-of-the-mill; it remains to be seen what approach the courts might take to a pre-nuptial agreement between British citizens when the financially weaker party is the wife, rather than the husband.

The husband has appealed the Court of Appeal's judgment and the Supreme Court has agreed to hear arguments on the case in March 2010 to make a final decision on the impact of the pre-nuptial agreement in this case. It is clear that there is a growing feeling among the judiciary that they would like people to be able to regulate their own affairs better, to give greater certainty in the event of divorce. It is clear that at the moment, properly drafted pre-nuptial agreements may well provide a good level of protection for those who wish to reduce the risk of interference by the family courts on divorce. Pre-nuptial agreements are, therefore, certainly worth the paper they are written on – as long as they are done by specialist lawyers who know what they are doing!

Think before you hack

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We live in an age of easy access to online information with many people using internet banking and running businesses from home. When involved in or contemplating divorce proceedings, it is very tempting to access a spouse's or partner's computer to try to obtain information that you fear they may not voluntarily disclose.

However, you need to be aware that it is an offence under the Computer Misuse Act 1990 to access a programme or data held on any computer if you know your access is unauthorised. An offence can also be committed by remotely accessing a computer or by installing software to monitor key strokes or otherwise to gain access to information held on a computer without permission.

The recent case of *Imerman v Tchenguiz* reiterated that, if information held on a computer is protected by a password, that information will be subject to rights of privacy and confidence regardless of its content.

The issue of taking documents belonging to a spouse has also been considered in the recent case of *Marco Pierre White v Withers*. This related to paper documentation rather than electronic data, but where the wife was found to have interfered with husband's possession of his own documents the court said it was a clear case of unlawful removal of goods from where they were deposited or stored.

These cases present a salutary warning to people considering removing documentation or data technically belonging to another person. There is a balancing act between the need for a trial to proceed fairly with full and frank disclosure from both sides, and the criminal activities of obtaining unauthorised access to electronic data or programmes, and wrongfully retaining documents belonging to another.

The clear message is that you should speak to a solicitor before obtaining information through questionable channels. It is perfectly possible to preserve information by applying for an order from the court and that is the correct route to take, rather than trying to deal with potential criminal sanctions after the fact.

Schedule 1 – "top-up" child maintenance

Whilst the Child Support Agency (CSA) has jurisdiction relating to general maintenance for children, regardless of the marital status of their parents, the assessment made by the CSA will only take into account earnings of up to £2,000 net per week.

For unmarried parents their only recourse for child maintenance against a parent earning more than £104,000 net per annum is to apply for top-up maintenance under Schedule 1 of the Children Act 1989.

In the recent case *H v C* (2009) the mother had originally applied to the CSA for an assessment relating to the parties' two children in 1999. The father had refused to provide proper disclosure of his assets or co-operate with the CSA procedure. Consequently, the matter was listed for a tribunal hearing, when the mother achieved the maximum CSA assessment. This did not take place until 2007, some eight years after her initial application.

Although the mother had been awarded a top-up of £15,000 per child per year, she subsequently discovered the father had failed to disclose pension income of £400,000 per year. Inter alia, the mother sought, in this application, an increase in periodical payments to £57,000 per child per year while under 18 and significant back-dating.

The mother was awarded top-up periodical payments for each child at £45,000 per year, to be backdated for five years. The court stated any previous order for top-up was not expressed as final. As a result the court had the power to back-date the maintenance to 2003 as opposed to the date of this application, as the father was proposing.

The case highlights the problems experienced by mothers applying to the CSA when fathers choose not to participate in the process. It also shows the courts willingness to act appropriately in the circumstances, utilising the important powers contained in Schedule 1.

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March 2010