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**KEY POINTS**

- The COVID-19 pandemic is, first and foremost, a health crisis. At the same time, it has caused an economic crisis which will have enormous global repercussions.
- Instability, uncertainty and financial pressures are likely to combine to produce a raft of business disputes across many sectors and many areas of the law.
- Alternative means of dispute resolution will play an important role in handling the legal consequences of COVID-19. Now is the time for creative solutions.

# Business disputes in a pandemic: preparing for a peak and flattening the curve

In this Spotlight article, Rick Grove and Camilla Macpherson consider the types of business disputes most likely to arise from the COVID-19 pandemic, and the options for more efficient means of resolving them.

## AN ECONOMIC CATASTROPHE: PREPARING FOR A DISPUTES PEAK

The COVID-19 pandemic is not yet over, but it has already caused a more severe recession than the 2008-09 Global Financial Crisis. The economic catastrophe now underway may last longer than the virus itself.

Government measures to support businesses and individuals, such as rent moratoria, furlough schemes, guaranteed loans and other fiscal stimuli have helped many. Central banks have also taken aggressive actions, including large liquidity injections and credit market support. However, intervention carries its own risks. Support measures cannot last forever, and the consequences of unwinding them are hard to predict. Many government-backed loans will default. Many businesses will not re-open. Bail-outs can create the illusion of a stronger market than is really the case, by effectively protecting (and even encouraging) risk-taking behaviour. Trying to prevent one crisis may simply lead to another.

There is one certainty in these uncertain times: Where businesses struggle, disputes inevitably follow – some of them quickly, but many unfolding over a number of years. Some of the disputes that came out of the Global Financial Crisis are only now being finally resolved.

## WHAT TYPES OF DISPUTES ARE MOST LIKELY TO EMERGE?

### Consequences of volatility

Volatility in the equity and oil markets earlier in 2020 led to diminished liquidity, with

wide bid-offer spreads making it difficult to determine prices. Valuation discrepancies mean disputed margin calls. Additionally, big market moves cause substantial losses in transactions with asymmetrical risk-return ratios where a high probability of modest gain is achieved by taking a small risk of major loss. When major losses occur, the suffering party may seek redress by disputing the validity of the transaction.

### Commercial mortgage backed securities

Commercial mortgage-backed securities (CMBS) are bonds backed by mortgages on commercial properties rather than residential real estate backed bonds that were the source of many losses in the Global Financial Crisis. The ability to service CMBS depends on rent collection. This has diminished in many cases, sometimes due to government-initiated moratoria and sometimes because businesses simply cannot afford to pay their rent. It is unclear how well certain struggling sectors, such as hotels and retail, will recover as lockdowns are eased. Even some relatively unaffected businesses have signaled that they will allow staff to work from home indefinitely. We may be seeing a shift in working practices that far outlasts COVID-19 and leaves commercial space unoccupied. Consequently, multiple CMBS have already been downgraded or placed on credit watch, and there has been significant repricing of CMBS.

### Contractual interpretation

In difficult times, commercial contracts often no longer work as one party or the other intended. Many businesses will be reviewing

their contracts to understand to what extent they are still required to fulfil their contractual obligations.

Force majeure clauses – traditionally regarded as boilerplate and therefore not always given close attention – are coming under particular scrutiny. These clauses enable contracting parties to suspend, postpone or cancel performance of their obligations on the occurrence of events beyond their control. Much turns on the wording of the particular clause, and under English law at least such provisions are construed narrowly.

Material adverse change clauses may also be relevant. Illegality clauses – triggered where performance by one party has become illegal – could also come into play. Contracts often also contain clauses requiring parties to use their reasonable or best efforts to perform, or to act in good faith.

These concepts, the application and acceptance of which varies enormously across jurisdictions, tend under English law to turn closely on the wording of the contract at issue and the factual matrix. Difficult issues are likely to arise. What is reasonable in the middle of a pandemic? Has a particular piece of COVID legislation really made performance illegal, or simply more difficult? The scope for debate – and therefore disputes – is significant.

### Insurance

Businesses that have closed due to COVID are looking to make claims on their business interruption policies. Again, much turns on the policy wording. Has the business truly been interrupted? Are pandemics covered or excluded? Are the consequences of pandemics, ie government mandated lockdowns, to be treated differently?

### Insolvency

There have already been a number of high-profile bankruptcies, such as J. Crew, Neiman

# Spotlight

## Biog box

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Marcus and JC Penney in the US. Many other businesses, big and small, will not recover from the pandemic, and insolvencies are likely to rise towards the end of the year. As businesses fail, there will be a knock-on effect on bank balance sheets which may cause further problems. To date, this crisis has not seen the failure of a large, systemically important financial institution, but this may still come.

## Financial crime and fraud

Businesses in distress and individuals concerned about their livelihoods are vulnerable. Areas for focus include:

- Corruption in contract renegotiations.
- Wrongful diversion of funds intended for procurement and construction projects such as community medical facilities.
- Creation of false trades and phantom shipments in order to generate revenues or access credit lines.
- Individual involvement in bribery or money laundering. Employees can be hard to monitor when everyone is working from home.

Fraudsters have already taken advantage of the COVID crisis, for example by filing false claims for government relief and setting up fictitious businesses ostensibly to supply face masks and other equipment.

## Pre-existing challenges

The pandemic has hit at a time when the business community was already confronting major challenges.

At the end of 2020, the UK will leave the European Union, unwinding forty years of regulatory conformity. LIBOR is being phased out by the end of 2021. Before the pandemic, both Brexit and LIBOR transition topped the risk agenda for many businesses. Both continue on schedule, and it is highly likely that both will give rise to disputes.

## FLATTENING THE DISPUTES CURVE

The pandemic is going to produce disputes on a scale far above the usual flow anticipated by the courts.

The courts have had mixed success in managing their caseload through the

pandemic. In some jurisdictions, courts were closed for a time. In others, courts stayed open virtually, but faced technical challenges. In some cases, the transition to a virtual environment has been fairly smooth. As COVID disputes get underway, the question is whether court systems, many of which are already struggling with underfunding, are equipped to manage the flood of issues heading in their direction.

Of course, litigation in the courts is not the only means of resolving a dispute. There is often a place for negotiated solutions at a business level, for example contract renegotiations to prevent default by offering short-term relief.

Mediation, whereby a neutral third party assists the parties in coming to a negotiated settlement, is also likely to gain prominence. Mediation can be a very flexible, quick and cost-effective means of dispute resolution. The absence of hard and fast rules provides scope for creative approaches. One such creative approach was developed by a P.R.I.M.E. Finance disputes expert and a P.R.I.M.E. Finance markets expert to resolve bank creditor claims against an institution wrong-sided by market volatility earlier this year.

Arbitration also offers an alternative to court litigation. Arbitration has responded well to the challenges of the pandemic, with virtual hearings already taking place regularly. P.R.I.M.E. Finance has recently launched a review of its Arbitration Rules with a view to ensuring they are state of the art for users. Amongst other things, P.R.I.M.E. Finance will be considering how to ensure that arbitrations brought under its rules make best use of electronic and virtual technologies.

There are other possibilities for innovation in dispute resolution. Different jurisdictions are taking different approaches, and there will be much they can learn from each other.

France, for example, has seen the establishment of an initiative called the *Tiers Conciliateurs*. The *Tiers Conciliateurs* is a collaboration between judges, lawyers and the Ministry of Justice, under the aegis of the Paris Commercial Court, aimed

at establishing a confidential and rapid system whereby businesses can be helped by independent conciliators to resolve contentious commercial issues relating to the pandemic and identify solutions that will allow business relationships to be maintained.

In England, the Financial Conduct Authority has brought a test case in the Financial List (the first test case since the Financial List was established in 2015) seeking clarification on wording contained in a range of business interruption policies. A number of insurers are participating in the case. If this initiative works as the FCA intends, it may significantly reduce the number of individual business interruption claims that reach the English courts, although uncertainties no doubt will remain.

Finally, ISDA's Credit Derivatives Determinations Committee (established by ISDA in 2009 and now independently administered) also offers a possible model for efficient dispute resolution. The Determinations Committee was established during the Global Financial Crisis to offer speedy and binding resolution by the industry of issues relating to credit default swaps. It may be that now is the time to apply the principles and approach of the Determinations Committee to a wider range of disputes. ■

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## Further Reading:

- Potential legal implications of the regulatory response to COVID-19 (2020) 7 JIBFL 431.
- Loans in the time of COVID-19: how loan documentation has fared in this challenging environment (2020) 7 JIBFL 441.
- LexisPSL: Coronavirus (COVID-19) implications for dispute resolution – overview.