

A UK Business View Of COVID-19's Economic Fallout

By Alex Leitch and Harry Denlegh-Maxwell (May 13, 2020, 1:18 PM EDT)

While the toll of the novel coronavirus on human lives continues to rise at a staggering rate, the outbreak is also deeply affecting businesses around the world.

According to research released by the Centre for Economics and Business Research, the COVID-19 pandemic could cause world gross domestic product to fall by at least 4% this year, which would be twice as large as the decline in GDP in 2009 during the financial crisis, and would be the largest peacetime drop in GDP in one year since 1931 other than in years of war.

Meanwhile, the Office for Budget Responsibility estimates that U.K. public sector borrowing this year will increase by £218 billion, relative to its March budget forecast, to reach £273 billion, or around 14% of GDP. Jitters around Brexit uncertainty will also return later this year, which may further compound business uncertainty and any economic contraction.

But by almost any measure, the pandemic appears poised to eclipse anything the global markets have seen in terms of business disruption. Perhaps the most important indicator of the overall economic health of a business is its cash flow.

Results from the British Chambers of Commerce's fifth "**Coronavirus Business Impact Tracker**," released on April 29, indicates that 51% of firms have three months' cash in reserve or less. Five percent of these firms reported that they had already run out of cash in reserve. BCC Director General Adam Marshall noted on April 8 that the data in BCC's second Business Impact Tracker "shows that many businesses face a cliff-edge scenario, either at the end of this month or over the course of the next quarter."

So while the primary focus of any business will rightly be on ensuring the health and well-being of staff and their families, it is clear that businesses are facing an increasing number of challenges that need to be addressed and mitigated.

This article focuses on what this means for businesses and their ability to navigate any legal issues and prosecute or defend business-critical claims that will inevitably stem from the economic effects of the pandemic. It also identifies several themes that may emerge from the pandemic, in particular access to litigation funding, insurance disputes, class actions, and guidance from the court on the concepts of "frustration" and "force majeure."



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Commercial and Legal Landscape

It is often said that there is generally an inverse relationship between the global economy and litigation. During a boom, businesses may have less interest in resolving any differences through litigation — finding commercial solutions to disputes is often easier when businesses are enjoying growth, profitability and ready access to capital. When the economy turns, however, that narrative changes.

While there may be a lull in litigation activity as businesses focus on protecting employees, taking stock of the situation and managing cash flow, businesses and their counterparts now may be less interested in finding commercial solutions, or simply may not have the financial capacity to accommodate what (in normal trading conditions) would be commercially sensible settlements. Legal claims that they could once afford to pass over may now need to be pursued, as doing so could represent a business-critical need to recoup losses and/or mitigate expenditure.

So what does recent history tell us about the types of disputes that emerge as a result of an economic crisis? Looking back to the 2008 financial crisis, the vast majority of businesses could fairly have been described as "doves," while a minority were "hawks," with regard to their attitude to litigation or the threat of litigation.

In the current climate, the "doves" may look for ways to seek to mitigate any losses they have incurred or will incur, and make assessments as to: the robustness of any outstanding receivables; their contractual and/or common law rights to cancel or suspend payments to creditors; their right to contend that a payment or contract can no longer be lawfully made or performed; and their economic and legal ability to leverage amendments to any payment obligations and contractual terms generally.

Whereas the "hawks" — businesses that may be more cash rich and able (or willing) to adopt a more robust approach — may try to use the current climate as an excuse to extricate themselves from a bad deal, or simply to try to rewrite or leverage better contractual terms against financially weaker counterparties.

The spread of COVID-19 has already resulted in an increase in businesses experiencing financial distress as they try to mitigate the financial impacts of supply chain issues coupled with lower customer demand. The truly immediate impact on liquidity can be exacerbated if the situation results in working capital lines being blocked, financial covenants being breached, events of default occurring and/or the triggering of termination payments or other contingent liabilities for nonperformance. Businesses with already high debt levels are finding existing credit lines being withdrawn at a time when they are needing to pay suppliers.

Similarly, planned refinancing and distressed M&A activity is being delayed, with the result that businesses are finding it more challenging to execute and implement time-critical turnaround plans. So although businesses may have legitimate legal claims to pursue or defend, the above issues all meaningfully exacerbate the demands and strains on working capital.

Bridging the Liquidity Gap

The economic scale of the current pandemic presents huge challenges, and businesses across all industries are feeling the impact. Although now is the time for those businesses to consider how the spread of the virus may affect the conduct of their underlying business and what their options are to help address the economic turbulence ahead, they need to do so at a time when cash is scarce, and is

more urgently needed elsewhere to sustain the business. At this point in time, litigation expense can hit a business's bottom line, with no assurance that the spend will necessarily achieve any business-critical objective or outcome.

There may be some options available to help businesses offload or reduce their legal expenses. Inevitably, many third-party litigation funders sense an opportunity to help businesses fund litigation that may not otherwise be possible due to the impact on cash-flow.

Litigation funding was in its relative infancy in the aftermath of the 2008 financial crisis, so it is therefore difficult to predict accurately how, and to what extent, businesses may seek to utilize litigation funding in the current climate. However, litigation funding may be a particularly attractive option now because it enables businesses to pursue their claims while conserving cash to meet their immediate business needs, while also transferring the cost liabilities associated with litigation off-balance sheet, and avoiding (or at least drastically reducing) the downside risk. This is particularly the case if the use of funding would still enable a business to receive a financial benefit in the event of a successful outcome.

It is worth noting, though, that it is too early to predict what a litigation funder's appetite to provide funding will be in this climate. The leading funders tend to conduct careful and thorough due diligence before agreeing to fund a dispute. The standard to which these funders conduct this due diligence may even increase (particularly in respect of insolvency risk) to avoid new risks that they or, indeed, the wider market do not yet fully understand.

In this context, it may now be the time for the government to take formal steps to regulate the funding industry, to ensure best practice is uniformly adopted across the market. Additionally, there may be increased and evolutionary pressure on the litigation funding market to consider new and innovative ways to fund not simply the pursuit of claims, but also the defense of claims. Typically, as a funder makes its recovery from any damages awarded, it will only fund either a claimant or a defendant with a counterclaim.

Insurance Litigation

As COVID-19 has hit businesses indiscriminately, there will be some obvious and less obvious common themes and claims that emerge from the pandemic. Most immediately, the insurance industry is bracing itself for a significant number of high value claims, particularly in respect to losses claimed under business interruption and event cancellation policies.

The Financial Conduct Authority recently intervened to note the importance of ensuring that claims are assessed and settled quickly, and to remind smaller businesses that the Financial Ombudsman Service has jurisdiction to entertain coverage claims for up to £350,000. While a significant sum, it is easy to see that many claims against insurers will exceed this sum, and businesses already suffering impaired cash flow will have the burden of funding litigation to try to recover for losses they contend should have been made good promptly by insurers. In such circumstances, it is reasonable to ask what the government and the court system might be able to do to mitigate such hardships.

A relatively straightforward legislative approach that might immediately help policyholders would be to strengthen the protections conferred by the Enterprise Act 2016, which for the first time enabled businesses to claim damages against insurers for failing to honor damages claims within a "reasonable time."

While a healthy insurance market is critical to any economy, experience tells us that insurance companies have not to date seen the risk of such damages claims as a particularly compelling reason to respond to claims promptly. The time taken to process claims by policyholders is, and will continue to be, a critical component in the ongoing solvency of many businesses — many businesses simply cannot afford to wait several months or years to understand whether their COVID-19 claims are covered or not.

In the specific context of insurance, it is also worth noting that many businesses will have bought standard insurance policies, and that the question of whether the losses caused by the pandemic and/or by the government's lockdown will be the same for many businesses.

Noting that class actions were introduced in England and Wales for the first time in 2015, it is remarkable that some five years later we have not seen a single class action being certified. Given the commonalities inherent in suing insurers for coverage in respect of pandemic losses, is there any principled reason why, given the overarching importance of insurance at this particular moment in time, emergency legislation could not be enacted so as to enable the many policyholders affected by the pandemic to benefit from the ability to share costs and risk in the form of a class action or other collective proceedings?

While such legislation may be unlikely, the reality is that many viable claims against insurers will simply not be pursued, due to the additional pressure on working capital that litigation brings, resulting in redress (yet again) not being available to those who most need it.

Frustration and Force Majeure

There has been a significant volume of commentary on the concepts of "frustration" and "force majeure" in the wake of the pandemic. The degree of interruption to manufacturing and supply chains, trading systems and contractual obligations generally cannot be overestimated, and it is inevitable that these concepts will require a proper revisiting by the English courts.

This time last year, it was thought that Brexit would be the market-changing event which would require these concepts to be looked at again (as it did in the *Canary Wharf v. European Medicines Agency* case). At the time, no one would have expected that the legal challenges of Brexit were about to be superseded by challenges of an altogether different scale.

It seems very likely that the English courts will, in short order, need to consider and lay out some ground rules as to whether the issues businesses are experiencing now can be said to frustrate contracts or suspend performance under them. On this, and the other issues outlined in this article, early guidance from the court is going to be critical.

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