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PRESSURE POINTS: THE LIGHT AT THE END OF THE COVID-19 TUNNEL? THE LANDSCAPE FOR ARBITRATION AND DISPUTES IN A TIME OF UNCERTAINTY AND HOPE

Global
Legal Briefings

The approval and rollout of mass Covid 19 vaccinations across many parts of the world has prompted many to look ahead to a “post-Covid” world. For clients and practitioners of arbitration who have witnessed the almost overnight shift of arbitral practice into the virtual arena, that quest for a sense of when, and how, we may return to “normal” is just as powerful.

But are we really there yet? There remain many questions about the virus and our global response to it. While the direction of travel may appear to be a positive one, there are likely to be a number of bends and turns before “normality” will return. And, importantly, for an international practice area such as arbitration, the speed and trajectory of that journey will differ significantly across the world.

With that in mind, are we really ready to predict what will happen next in terms of disputes and arbitral practice?

DISPUTES: WHEN, WHAT AND HOW?

THE 2008 GLOBAL FINANCIAL CRISIS AS A MODEL FOR PANDEMIC DISPUTES?

The Covid-19 pandemic has led to an almost unprecedented disruption to economic activity on a global scale. Many are drawing on the experience of the 2008 Global Financial Crisis in their efforts to predict what may happen in this current crisis, particularly as to the types and number of disputes that may arise.

So what did the financial crisis look like in terms of disputes? Immediately after the events of 2007 and 2008 we saw an initial spate of corporate and securities-related disputes, many of which were focused on the allocation of blame and the resulting financial consequences of individuals' and entities' action or inaction. Governments began civil and criminal investigations into the events that led up to the crisis, also focused on allocating responsibility and managing the considerable fallout. The first wave of civil disputes was felt within the financial and mortgage sectors. As the crisis spread to other sectors, it resulted in a global recession and seismic financial shock to international markets, causing a far larger wave of civil litigation and insolvency-related disputes. The long tail of these later disputes is still being fought.

DO DISPUTES SO FAR SEEM TO FOLLOW THOSE TRENDS?

To date, there are some noteworthy differences in the first wave of disputes arising out of the Covid-19 pandemic. The financial crisis stemmed from particular actions of individuals and entities and was initially felt first in one jurisdiction. The Covid-19 pandemic is a natural phenomenon, and spread globally extremely quickly. There have certainly been efforts in some jurisdictions to allocate blame in the pandemic, notably in a series of lawsuits brought in the US against China. However, this has not been the picture in the vast majority of the disputes brought. A far wider number of industries and sectors have also been more immediately affected by the pandemic than was witnessed in the first stages of the financial crisis. The almost overnight contraction of global mobility and national restrictions have impacted aerospace, shipping, travel, leisure, hospitality, consumer products, energy and the insurance industry, to name but a few. Each of these industries have already seen a significant increase in disputes, many of which are focused on the allocation of financial risk, often without any requirement of responsibility or intent, and are aimed at preserving valuable and necessary cash resources. In some cases this has resulted in a significant exploration of boilerplate Force Majeure and Material Adverse Change clauses. The contraction of these industries has also resulted in a spate of M&A disputes where buyers have sought to avoid completing on deals struck before the crisis hit, particularly in the retail and hospitality sectors. Industries hit by the restrictions have also faced a number of consumer actions and employment claims.

Interestingly, and perhaps as a consequence of the scale of the initial impact, the way these disputes have been resolved has also differed from the financial crisis. At the start of the pandemic many businesses found themselves unable to meet their contractual obligations or found their counterparties were unable or unwilling to perform. There does appear to have been a significant effort made by a number of parties to adopt a more collaborative, rather than combative, relationship in light of the global nature of the pandemic. Some parties have sought to reach negotiated settlements and share risks and costs with a "we're all in this together" approach.

WHAT ABOUT FUTURE DISPUTES ARISING FROM THE PANDEMIC?

So if the first wave of disputes looked different, does that mean that the financial crisis is not a good model for predicting future disputes? Right now, it is hard to tell. The pandemic is not yet over, and the course it takes could significantly impact the shape of the disputes landscape. At the moment, many governments are borrowing large sums to maintain public support schemes and have changed insolvency regimes during the pandemic, making it difficult for creditors to pursue companies in difficulty. The longer the pandemic lasts and the global economy remains in stasis, the greater the underlying economic distress we expect to see in all markets, even if that distress is deferred by those public support systems. Fast-paced vaccination programmes in some jurisdictions may enable a swifter bounceback and economic recovery and may limit the number of more domestic disputes. However, the disparity in vaccination rates on a global scale is likely to mean that the pandemic will continues globally throughout 2021 and potentially into 2022, having a significantly impact on domestic and international trade. If so, the number of disputes that arose out of the financial crisis may pale by comparison to disputes generated by the pandemic.

While the scale may be in question, there will certainly be disputes. Just as there was in the financial crisis, there is also likely to be a long tail of those disputes. In terms of that tail, some parties may have been so intent on crisis management through the pandemic of that it will only be a release of that sense of crisis than enables them to consider their options and the allocation of risk and responsibility between its contracting parties. Some may have weathered the initial wave of the pandemic, but second, third and even fourth waves of infections and restrictions, potentially at different times in different jurisdictions, may push businesses "over the edge". For others a return towards "normality" may prompt a change in attitude and a move away from negotiation towards more adversarial options.

Some categories of disputes that arose during the height of the pandemic also look set to remain part of that longer tail. The disruption has caused losses that are not unique to an individual or business, but are common to many, which provides a fertile environment for class actions or group claims. Regulators throughout the world during the pandemic showed leniency, but are likely to resume investigations and aggressive enforcement action, giving rise to increased litigation and arbitration. Employee, insurance, securities and competition claims have already been commenced across the world and in numbers that suggest more may follow. As public support schemes and insolvency restrictions around the world come to an end, businesses will be expected to return to more normal operations, albeit potentially with increased costs and reduced turnover. Creditors will pursue unpaid debts and landlords will evict for non-payment. As a consequence, there is a significantly increased risk of restructurings and insolvency filings, all of which increase the risk of disputes.

Whether the release of restrictions in different jurisdictions will also prompt parties to consider any claims they may have against governments or states is also an open question. Whether or not a specific state's actions in response to Covid-19 could result in a breach of treaty protections, and whether an actionable claim arises for a specific investor as a consequence, will be heavily fact- and treaty- specific, but it seems likely that some claims will arise in future. Indeed, the first few treaty claims which are based on a Covid-19 background or fact pattern are starting to be made. A notice of dispute has reportedly been submitted by two French investors against Chile under the France-Chile BIT regarding the concession for the operation of Santiago's airport and the impact of the pandemic, while potential claims have also apparently been threatened against both Peru and Mexico. If the 2008 financial crisis can be used as a template, it may well be a 2-4 year lead time for the majority of these claims to materialise.

HAVE THOSE DISPUTES RESULTED IN MORE ARBITRATIONS?

Of particular interest to arbitration practitioners will be whether these different waves of disputes will be arbitrated, litigated, or pursued through other dispute mechanisms. Unlike the financial crisis, the pandemic has had a seismic impact on the entire system, forcing all forms of dispute resolution onto some form of virtual or hybrid platform. Initially, this resulted in understandable concern and pushback from clients and practitioners alike. In the early stages of the pandemic, when the long term implications were still unclear, it appeared that only the most critical of cases would push forward to a hearing. In those first weeks and months, many parties chose to postpone hearings and even to postpone commencing disputes while the pandemic uncertainty remained. While that initial impact on arbitration is hard to gauge, we can look at the impact on national courts systems as a comparison. Despite the efficient and effective shift to virtual hearings in the English courts, the number of new claims filed in the courts halved during March compared to the previous year.

Despite an initial short, sharp shock for the whole system of dispute resolution including arbitration, there has been a palpable sense of an increase in activity since then. In the English courts, case numbers stayed low until August, before rising to baseline levels in October and November. Meanwhile, arbitration recovery since the summer of 2020 appears to have been particularly strong. Anecdotally, many arbitration practitioners have indicated that their caseload has increased. Given many of these proceedings are confidential, it can be hard to tell initially whether this is a wider trend until institutions release their annual statistics. However, headline 2020 statistics from a number of arbitral institutions strongly suggest an upswing in arbitrations across the board. The International Chamber of Commerce (ICC) recorded a total of 946 new arbitration cases in 2020 (the highest number of cases registered since 2016). The London Court of International Arbitration (LCIA) reported an all-time high of 444 referrals in 2020 and the HKIAC has reported a similar picture, with a total of 318 filings in 2020, the highest since 2010. The SCC is also reporting a rise, with 213 new cases. Perhaps most interesting are the Singapore International Arbitration Centre (SIAC) statistics, which show it registered 1,005 cases for the first 10 months of 2020, more than double the annual caseload of over 400 in each of the last few years, many of these involving investments and US parties.

It is hard to extrapolate any real answers yet from these figures in terms of the Covid-19 disputes trajectory, but it certainly appears that many of the disputes from the first wave, at least, are being arbitrated, and that they may be being arbitrated more quickly than they were during the global financial crisis. Assuming we do follow the similar shape of disputes to that from the financial crisis (even if from a potentially higher initial wave), we should expect a further rise in arbitrations during the remaining pandemic, with a long tail of disputes over the following 3-5 years.

THE ARBITRATION WORLD: CHANGES IN PRACTICE AND PROCESS?

What will the process of arbitration look like for those disputes that are arbitrated that arise out of the pandemic? And are there any other trends in arbitration that might result from the pandemic?

A RETURN TO IN PERSON HEARINGS?

Many clients and practitioners are hoping for a return to a more "normal" way of working during the course of 2021 and 2022. However, in this first quarter of 2021, it is very hard to predict how quickly that will happen and for whom. The development of vaccines has been a win for the scientific community and for those of us who will benefit from them. As in all areas of life, the return to "normal" will be dependent on the availability and supply of vaccine doses, the speed and ease of distribution and the protection offered by those vaccines. While there are positive signs so far, data is still being gathered about the extent to which the vaccines will work to prevent infection, limit serious illness, or reduce the ability of the vaccinated person to transmit the virus. Hospital capacity and the prevalence of serious illness once those most at risk have been protected will be critical. We do not yet know how long the protection offered by a vaccine will last, how long immunity lasts for those who have had the virus, whether new variants will continue to emerge, and whether Long Covid is a sufficient concern to lead governments to vaccinate their whole populations and maintain curbs on life until they have done so.

The answers to each of these questions will have a significant impact on when, and how, we can return to normal. Each country will also face a very different trajectory to "normality" based on how these issues play out on the global stage. The speed with which international trade and travel opens up will require considerable negotiation and planning by each government, balancing the protection of the health of domestic populations against the recovery of domestic economies. Few can yet predict with any real certainty whether and when people will be able to travel freely across international borders and the extent to which will need to prove immunity or immunisation prior to doing so.

A standard international arbitration involves parties from across multiple jurisdictions. While so much uncertainty remains, it would seem overly optimistic at this stage to assume that many fully in person international hearings will happen during 2021. What we may see is an increasing number of “hybrid” hearings over the latter half of 2021 where those who are able to travel will do so, or those in the same jurisdiction meet in person, with those from other jurisdictions attending virtually. These hybrid hearings will require careful handling to ensure equal treatment and procedural fairness, particularly where some arbitrators are able to attend in person with one party and their legal counsel, while others are not.

Those planning hearings throughout 2021 and 2022 would be well advised to be flexible in their hearing planning, working on the assumption that virtual hearing arrangements of some form may be required. Awareness of Covid restrictions and vaccination schedules within the jurisdiction in which an in-person hearing is scheduled is likely to become an increasingly relevant part of hearing planning, with the picture potentially shifting month to month. For what looks to be the medium term at least, virtual hearing technology in some format looks likely to remain highly relevant.

While we are still mid-pandemic it is also difficult to predict whether the shift towards virtual or hybrid hearings will be permanent. Users of arbitration who have had a positive experience of virtual hearings may find the cost savings and environmental benefits extremely attractive even when in person hearings become feasible. Others who have yet to experience a virtual hearing or who have had a more negative experience may revert to “normal” with a sense of relief. Not all parties have access to the technology that is required to make a virtual hearing run smoothly, whether for lack of funds or simply because they are in a location with inadequate internet.

We may find a two-tier approach to hearings based on the sums in dispute, with lower value disputes erring towards the virtual or hybrid option. For those involved in truly “bet the company” cases, in-person hearings are likely to remain the preferred option, allowing both sides to see the whites of each other’s eyes.

CHANGES IN VALUATION AND DAMAGES METHODOLOGIES?

Immediately following the pandemic we saw M&A disputes arising as buyers explored whether they could avoid completing on planned transactions, or reduce the price. While that first set of M&A transactions which were due to close in the early months of the pandemic may have finished, many of those disputes remain active.

We are also seeing a real shift in approach in ongoing transactions that have been being negotiated during the pandemic, with buyers increasingly reliant on expanded warranties and indemnities, earn-out periods that continue for the life of the pandemic and wider material adverse change provisions to protect from further unforeseen Covid-19 related eventualities. Valuation methodologies in M&A transactions are also shifting away from “locked box” accounts, increasingly popular prior to the pandemic, towards completion accounts, giving more scope for adjustments, but also increased scope for disputes.

When assessing damages for breach of contract, experts are facing challenges in how to assess the impact of the breach and strip out the impact of Covid-19. Some companies have faced hugely challenging situations. Other businesses have found that the pandemic has provided significant opportunity for growth, some of which may be sustainable, some not.

Given the considerable uncertainty and volatility in the global markets, using historic data to draw from comparable companies and transactions to quantify damages is proving challenging, and many experts are using a discounted cash flow approach. It will be very interesting to see whether this trend continues and how experts continue to adapt to the situation as the shape of the pandemic changes and the situation begins to improve.

AN INCREASE IN THIRD PARTY FUNDING AND INNOVATIVE FEE ARRANGEMENTS?

In a time where holding onto cash within businesses is seen as critical, the pandemic would seem to be an obvious moment for clients who have been reluctant to consider alternative forms of funding to gravitate toward ways to fund their disputes without hitting their balance sheet. With more companies facing insolvency, funding options may provide a way for a nearly insolvent company to pursue a meritorious claim. These options could include using a third party funder to finance the legal costs of bringing a claim in return for a share of any damages on success, or approach outside legal counsel for a fee arrangement which involves reduced or no upfront costs, again, for either a share of damages or an uplift in fees in the event of success. The pandemic has also come at a time in which third party funding has become accessible across more jurisdictions, including Singapore and Hong Kong. Clients have been showing an interest in innovative funding arrangements from their lawyers for some time and this does appear to have become a focus of many starting new disputes in the last six months. Right now, however, this is purely anecdotal, with little in the way of industry-wide statistics to show whether speculation around growth has resulted in a real increase.

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