

COVID-19's Impact on Tech Startups

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By **Ryan Abbott**

The COVID-19 pandemic has caused unprecedented business interruption across nearly all industries, with tech startups facing some of the greatest challenges. Venture capital funding has quickly become more selective, which can hurt companies dependent on a steady infusion of capital. Some startups are seeing dramatic revenue reductions because existing customers are either unable or unwilling to pay on time. Revenue is falling short of pre-COVID-19 financial projections because prospective customers are tightening their belts. Supply chain disruptions have left a few startups unable to manufacture or sell their goods, and even though employees are largely working remotely, commercial landlords have taken firm positions with respect to rent. To top it off, insurers have been unreceptive to force majeure claims.

It has not all been bad. On the positive side, tech startups are

relatively well situated to adapt to remote working arrangements. Also, the interruption has directly benefited companies offering online services, cloud infrastructure and automation technologies. COVID-19 may increase demand for cutting-edge and disruptive services. In the meantime, a number of tech startups have pivoted to create offerings related to COVID-19, such as diagnostic and therapeutic tools and solutions.

However, tech startups are now facing the sorts of challenges that can lead to litigation, and litigation is rarely a desirable avenue, especially now. For example, a dispute over withdrawn financing or a withheld payment might take years to resolve—which means a favorable judgment may ultimately come too late for a startup that needs cash now. Litigation can take years in the best of times, and COVID-19 has effectively halted the wheels of justice.



(courtesy photo)

Dr. Ryan Abbott, JAMS Mediator and Arbitrator

Courts have scaled back their functions, so trials and hearings across the country have been continued or suspended. For startups seeking efficiency, spending money on litigation when the courts are closed is a questionable proposition.

Alternative dispute resolution (ADR) is an attractive option for startups. Whereas conventional litigation can be very time-consuming, an expedited arbitration should result in a final award within six months. And while courts have largely

shut down, arbitrations are being conducted online. Just as tech startups offering online services have experienced a surge in interest, so too has online dispute resolution.

ADR may even be able to prevent a conflict from progressing to litigation. When the potential for conflict arises—attempted renegotiation of deal terms, manufacturing failures, partnership disputes—neutral third parties can help to resolve these matters with pre-dispute mediations or structured negotiations. Litigation tends to create barriers to settling and forces parties to become entrenched in their positions, while early mediation can allow parties to save face and to adopt flexible and business-oriented solutions. A neutral may even be assigned to a particular project or partnership before a problem develops. Implementing a conflict management process can contain and deescalate friction before it derails critical initiatives. Even at a more contentious stage, ADR can help to stave off litigation through early case assessment or neutral evaluation of a dispute.

Consider a recent scenario involving a tech startup experiencing a cash flow crisis that

resulted from its venture capital (VC) partner declining to provide additional funding despite recently executing a second-round term sheet. The startup and VC partner went to mediation after their negotiations reached an impasse and litigation was threatened. Shortly thereafter, the VC partner provided less funding than initially agreed, but enough to allow the startup to continue operations for several more months. This helped the VC partner avoid negative publicity and protect its earlier investment in the startup, and it allowed the startup to seek alternate means of financing and to restructure in a way that reduced its burn rate.

The startup was able to further lessen its short-term financial obligations through a mediator-led structured negotiation with its primary contract manufacturer. In a creative resolution, the startup satisfied its outstanding liability to the manufacturer through a combination of its own services and a longer-term contract that deferred payments.

No court could have ordered such outcomes, and conventional negotiation, which is inherently competitive in nature, seldom prioritizes finding common ground. Amid the

political and economic turmoil arising from COVID-19, attitudes toward technology and the environment are changing. In uncertain times, long-term plans must be shaped by short-term exigencies. A favorable judgment a few years from now is worth nothing if the debtor cannot pay, and while capital is tied up in value-destructive litigation, technology and competition continue to advance. Disputes are a drain on a company's resources. Few can afford the distraction when events, attitudes and markets are shifting this rapidly.

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