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The Selling of Arbitration Awards – Are your clients aware of their options?

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Litigation funding (https://www.thejudgeglobal.com/litigation-funding/) is now well understood as an option for Claimants pursuing international arbitration disputes to remove the financial cost burden of paying legal fees and expenses. The majority of legal budgets we see at TheJudge typically range between $1m-$15m, with a few outliers exceeding the upper end of the spectrum. Coupled with the own side budget is the potential risk of arbitrators awarding costs to the successful party, which in some instances could double the financial exposure. It's no wonder therefore that international arbitrations are one of the most prominent areas of activity for professional funders.

However, while an increasing volume of arbitrations are being financially supported by professional investors, there is equally a large volume of disputes where the Claimant has self-funded or perhaps their law firm has heavily invested their own fees risk via a contingency fee (mitigating the need for an external funder). Some of these Claimants will have fully reserved for their

dispute, which might be proceeding exactly according to the original strategy. However, given the unpredictably of litigation and arbitration, many cases won't go according to plan. The budget might be overrunning due to actions of the Respondent, the case might be taking longer than expected due to interim skirmishes or procedural delays by arbitrators, including the time it takes to issue their award. In an investor-state claim, for example, even if a successful award is rendered in the Claimant's favour, an annulment process could be threatened or instigated by the Respondent, not necessarily because the State is confident it will prevail, but rather as a further action to frustrate, delay and strengthen its bargaining position for any future settlement negotiations.

So, what was perhaps forecast to be a 3 year process, with a projected $5m budget, could easily become a 6-year process, needing a $9m budget. All the while, the Claimant won't have seen a dollar back of its outlay let alone recompense for the original wrong-doer's act. The good news is that in today's climate that doesn't need to be the case.

The buying and selling of arbitration awards

Much like an investor willing to fund the legal fees and expenses to progress a claim, other investors also exist who have an investment appetite to purchase arbitration awards. Before progressing further it's important to highlight that when talking about the buying of awards, this doesn't necessarily mean the investor purchases the full financial entitlement to the award. In fact, most deals we see involve a partial purchase (or 'partial monetization') of the award. This means the investor advances the Claimant an agreed sum today in exchange for a pre-set share of any subsequent recovery once the award is enforced or resolved via settlement.

The motivations for a Claimant to want to monetize or partially monetize their award can vary enormously. For some it could simply be down to business survival and a pressing need for capital. The arbitration award might be the company's most valuable asset, yet it is not one likely to be recognized by traditional financial institutions. For others it might simply be spending fatigue (e.g. they simply want to see an exit to what may have been a half decade or more of paying legal fees). For larger enterprise companies, it might represent a neat corporate finance move (e.g. perhaps to restructure loans so that the underpinning collateral is solely limited to the arbitration award rather than secured against other more tangible assets of the business. Or perhaps the CFO and board have other reasons to monetize part of the arbitration assets (e.g. for

bolstering the balance sheet or to supplement income in turbulent times). The list of possible motivations could go on and on, but it's important to stress these arrangements have potential application regardless of the financial status of the Claimant.

There is no single formula as to how these arrangements are structured, as each case has its own unique features such as: the level of award; whether the award could be susceptible to future challenge; the Respondent in question; the level of advance the Claimant is seeking and the pricing they will entertain. Furthermore, some professional investors will argue they add value beyond just capital. For example, they may have a skill set and experience of enforcing similar claims or have other commercial interests which could help leverage an accelerated resolution for the Claimant.

Another important aspect when considering monetizing an award is that it doesn't necessarily have to be at the post-award stage. For example, some professional investors will consider a partial monetization before an award is rendered, if required. Clearly this is a higher risk to the investor since they not only have to worry about whether the claim will prevail on liability, they equally lack certainty as to the quantum of the award if a favorable decision is received. Sometimes these pre-award monetization arrangements will form part of a wider litigation funding agreement with the investor also funding some or all the legal budget on the Claimant's behalf. Whereas in other cases it might be a standalone arrangement perhaps with the Claimant self-funding fees or where the lawyers are on some form of contingency fee arrangement.

Some (non-exhaustive) examples of how monetization arrangements might be structured:

i) Claimant is self-funding fees and expenses, but nonetheless has a need to raise capital from their arbitration asset. A partial monetization payment is made by an investor pre-award in exchange for a share of the proceeds ultimately recovered. The Claimant is free to use the capital for whatever purpose they require.

ii) As above, but the monetization payment is only made at the point an award is received. In this scenario the parties might have already agreed the financial structure in advance of the award (i.e. on the expectation of a favourable award being received). If the case is successful, the pre-agreed terms are immediately executed within weeks of the award being received.

That payment might be an outright purchase or more likely a partial monetization. The investor and Claimant would then have an agreed earn-out split based on the proceeds ultimately recovered.

iii) A combination of i) + ii). For example, the investor advances payments in two tranches. Typically, it would be a smaller payment for the pre-award payment given the heightened risk to the investor, followed by a subsequent (and often larger) payment if and when a favourable award is received.

iv) Any of i) – iii) above but combined with a traditional litigation funding agreement. For example, the investor finances the legal fees and expenses (or portion thereof) from the outset, but also integrates some monetization structure into the deal.

Control following monetization

A common fear of litigation finance agreements is whether a funder will seek to exert too much control over the process. Most credible funders will ensure their agreements stay on the right side of the line to emphasize the Claimant retains full decision-making control. However, monetization arrangements can be a different animal, particularly where the monetization is taking place post-award. The funder is essentially buying a stake in the award and thereafter taking on the collection risk to enforce the award. As mentioned previously, some funders might have expertise relevant to the necessary enforcement campaign that the Claimant will need to embark upon. The level of control exerted is therefore a key point of negotiation.

As a rule, the larger the financial commitment (investment) the more control or input the funder would want to have into the enforcement process/strategy. However, there can be exceptions. If the Claimant is a very large corporate enterprise seeking to raise say a $1bn advance against a $6bn award, it's unlikely that for a variety of governance and other commercial reasons the Claimant would want a third-party exercising any material control. Deals like this would likely therefore see the external investor(s) take a passive role. Conversely, if the Claimant is essentially an SPV company with little or no other assets, it might be that the investor simply agrees to buy the company or a share of the company and thereby acquire the controlling interest in terms of the onward enforcement of the award.

How big is the market of investors willing to monetize awards?

The investor base for award monetization is diverse. On the one-hand there are the specialist litigation funding companies, whose primary investment mandate is to invest in legal disputes, whether that's financing legal fees/expenses or monetizing awards. Whereas on the other hand there are investors whose primary business would not see them labelled as a "litigation funding company" but who nonetheless have appetite for certain types of deals. That appetite might be exclusive to an industry sector (e.g. mining & gas), by a particular geography, or perhaps they are simply attracted by the commercial opportunity given its economics. For example, there are some highly capitalized investors who are particularly interested in deals that would require the advance of hundreds of millions (or higher), which would be well outside the capabilities of many of the mainstream litigation funders, who typically invest smaller sums.

No one size that fits all

Monetizing international arbitration awards is a growing industry. It's a highly specialist market, and so be warned there are opportunists who could waste valuable time, either through a lack of expertise; capital resources or credible connections/relationships.

For those Claimants who are either pursuing an arbitration claim or have an existing award, it doesn't take much time to have an informal discussion about possibilities to at least be in an informed position of potential options, even if the Claimant ultimately decides to retain full ownership of the award asset.

As is apparent from the comments in this article, there is no one-size fits all when it comes to monetization arrangements. While that can often be a frustrating thing to say, as it would be so much easier for lawyers to be able to advise their clients if the answer is simply X, the truth is that it's to the client's advantage. Determining an acceptable price point between seller and buyer is unquestionably an important feature of discussions, but there are other equally important factors to discuss to ensure the deal works for both parties.

The lawyers' opportunity

For lawyers, the trading of awards is one step further removed from their primary role. Indeed, some lawyers find having to deal with litigation funders as a necessary evil, let alone commercial discussions between the Claimant and an external investor over monetization arrangements. Even here there is no one typical approach.

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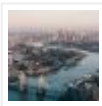

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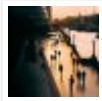

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It could be that the law firm's own financial interests are entwined with the Claimant, for example, where the law firm has a large portion of fees on a contingency. Having an external investor purchase a portion of the award not only provides the Claimant with immediate liquidity, it could also prove an exit opportunity for the law firm under their own alternative fee arrangement.

Some arbitration lawyers would prefer to take a hands-off approach to the process, and so the discussions are largely between client and investor, whereas others see a value-added role by being involved. Indeed, a sound knowledge of these potential arrangements could well be a useful additional tool when pitching for instructions generally. To take an active role in facilitating the financial remedy (and quickly), however achieved, will undoubtedly be a welcome, and probably refreshing, discussion for many clients. After all it is a discussion that could have an immediate and certain impact on their business or personnel interests in a process that otherwise lacks certainty and predictability.

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