



BonelliErede

with LOMBARDI



International Arbitration Focus Team

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Covid-19: impact on construction companies' arbitrations

Construction companies involved in international projects are being severely affected by Covid-19-related disruptions.

The forced shutdowns that have been imposed on these projects not only cause delays in execution, but also have serious financial implications. Payments may be shifted to the future or made conditional upon delivery. At the same time, these companies often need to make certain payments of their own – e.g., to employees and suppliers – that cannot be postponed or made subject to completion.

Legislative acts, contract provisions on force majeure events and insurance protection may, of course, provide partial solutions to these difficulties, but both the risk of facing and potential need to institute new litigation and arbitration cases are looming.

Managers of construction companies are finding themselves facing immensely difficult decisions between competing priorities for allocation of scarce liquidity. The question often boils down to: “**Whom do I pay first?**”

In these scenarios, pursuing an international arbitration case may not be a company's highest priority for immediate allocation of scarce resources, but it may be a *strategic* priority to achieve medium and long-term financial stability. Managers, in these circumstances, will need to rapidly find the financial resources to support these legal actions. And companies already in possession of a favourable arbitral award may need to fund actions to enforce the award in a foreign jurisdiction.

External financial resources, like any debt and classic corporate finance instrument, entail significant costs. And again, managers would have to select *what* to finance.

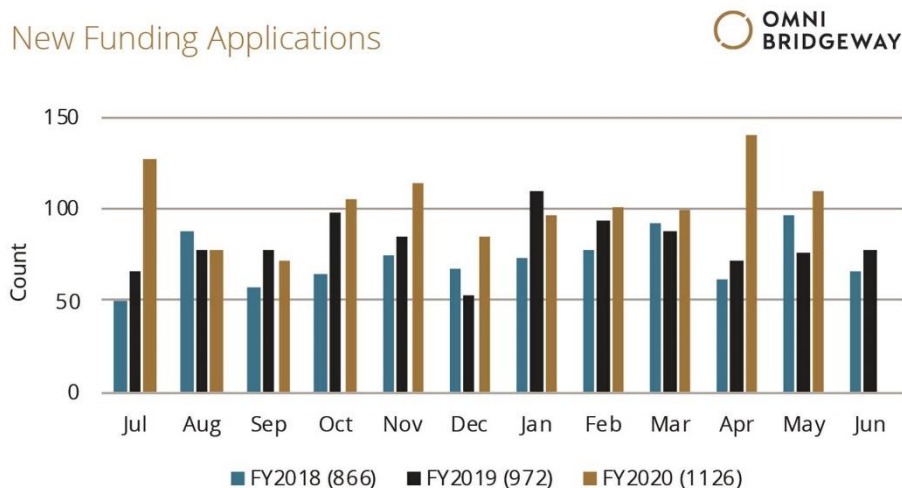
Dispute finance can provide a more prudent solution. Instead of a company allocating its existing financial resources to arbitration, litigation or award enforcement – thus denying financial support to other strategic business areas – managers may consider external funding sources from specialist litigation funders.

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External funding by a litigation funder is on a non-recourse basis – i.e., the funder gets paid only if the company wins (with a portion of the amount awarded to the company); otherwise the funder is not reimbursed, and the company does not incur any cost.

A company that seeks to pursue an arbitration would have the double benefit of not using its own financial resources *and* allocating the risk of losing to the external funder.

Companies involved in international projects are increasingly using dispute finance as a corporate finance, risk mitigation, and management tool, as summed up in the graphic below.



A couple of examples in the construction industry are instructive:

- 1) An Italian construction company was financed by a litigation funder to pursue arbitration against the Ministry of Works of an African country in a dispute relating to an infrastructure project. In 2018, the arbitral tribunal rendered an award of USD 43 million (including interest). The litigation funder financed the enforcement and collection of the award amounts, coordinating and financing enforcement actions in multiple jurisdictions and conducting settlement negotiations. The matter was ultimately settled for the principal sum, to the company's great advantage.
- 2) A Middle Eastern construction company was contracted to complete a mining project in an African country. The project was cancelled, and the company lost a substantial amount of sunk costs. Reluctant to invest more money in a post-project arbitration, the company's management agreed to work with a funder suggested by external counsel. The arbitration is now ongoing, and the company's legal and expert witness costs are being covered by the funder in return for a recovery of a multiple of those costs in the event of a favourable award and recovery of the sunk costs.

Litigation funding is becoming a highly significant corporate finance tool for construction companies: Funders have the necessary liquidity to finance high-value arbitrations and award enforcement actions and are looking for opportunities to do so.

An additional benefit of a case assessment by an experienced third-party funder is that **it provides an objective opinion of what a case is worth** and whether spending resources and management time is justifiable. And if a company has an award in hand that has not been honoured by the losing party, a funder can provide specialist experience and assessment of the chance of obtaining enforcement of the award in foreign jurisdictions. A funder with specialist enforcement experience can formulate and execute a strategy to realise unexpected value – or advise that enforcement is unlikely to succeed and perhaps arrange a sale of the potential award proceeds to an entity that makes such purchases.

The assessment process

Third-party funders conduct a detailed due diligence process to determine the cases they consider worthy of financing. The jurisdiction, merits and quantum phases of a case are assessed by the funder, usually with the assistance of the company's external counsel (i.e., the counsel that will be the advocates for the company in the arbitration). If the third-party funder decides that it wishes to accept the case for funding, the funder and the client will negotiate a **funding agreement** that governs all aspects of their relationship. **Each funding agreement is unique and tailored to the needs of the individual company.** As a general matter, the funder will pay some or all of the costs of the legal fees to pursue the claim and may potentially pay additional capital, when required (again, depending on the individual funding agreement between the parties).

Third-party funding is today regulated by many arbitral institutions (e.g., ICC, CAM, HKIAC, SIAC), and others – like ICSID – are considering such regulations.

The principal aspects to take into account when considering third-party funding are: the preparation of a set of documents to be submitted to the third-party funder, the negotiation of the funding agreement, the management of the case (which should remain with the company), and the likely disclosure to the arbitral tribunal of the existence of the third-party funding. Of critical importance is the establishment from the outset of a cooperative relationship between the company's external counsel conducting the arbitration and the funder's staff members who are participating in the oversight of counsel.

Conclusion

In times of major economic uncertainty, it is particularly important for construction companies to seek out trusted counsel with the expertise to

conduct cases effectively, but also to work with reliable third-party funders that have the capacity to finance their cases by covering their counsel's fees.

BonelliErede and Omni Bridgeway can assist construction companies by assessing the prospects of legal claims.

BonelliErede can further support companies in preparing the file to submit to a funder for evaluation. When prospects of the legal claim are good and the case meets the fund's investment criteria, Omni Bridgeway can finance the case in return for a share of the proceeds. This enables the company to focus on its main business – executing construction projects.



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The Focus Team is a constellation of skills in different practice areas with a focus on International Arbitration.

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