

What is the investment value of a dispute?

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Summary: The investing world is driven by time-value metrics, including internal rate of return (IRR), net present value (NPV) and return on invested capital (ROIC). When an investment becomes the subject of a complex dispute, it is more important than ever to maintain financial discipline in decision-making on dispute resolution. By looking at disputes through the lens of NPV, investors can exercise better risk management and improve outcomes for financial recovery and reputation.

The first lesson in a business school finance course is that of the *time value of money*, the principle that a dollar today is worth more than a dollar tomorrow. This concept underpins most risk-taking decisions in business and, importantly, the financial metrics by which companies assess performance.

While it is expected that executives will bring financial rigor to all corners of their world, Covid-19 is increasingly exposing a significant blind spot — how companies manage complex disputes. Since 2014, the global aggregate value of international arbitration claims has grown at an estimated 10-12% per annum to approximately \$2.4 trillion.

Covid-19 has only added to the burden of global disputes claims, based on fights for liquidity and other scarce resources across companies, sectors and countries. Reining in substantial legal costs and often larger opportunity costs requires a view of disputes not just as legal problems, but as business problems with consequences for the bottom line.

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As the world deals with the economic aftermath of Covid-19, it will be timely and essential to begin to treat disputes as business problems that deserve the same financial rigor and decision

optimization as any other risk on the balance sheet. The good news is that the most basic principles of financial risk management still apply to better management of disputes, starting with net present value (NPV).

The wild west of disputes meets valuation

Cross-border disputes often arise when a corporate foreign policy¹ goes wrong. For Barrick Gold and Antofagasta, corporate foreign policy went awry in Pakistan in 2011 when the Balochistan provincial government in Pakistan revoked licenses to develop and operate the Reko Diq copper and gold mine — the largest foreign direct investment (FDI) project in the country, with public estimates placing ore value at over \$200 billion.

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In this public example, having invested a few hundred million dollars to the point of losing its mining license (potentially worth billions), the joint venture partners faced the management decisions of whether to:

- Initiate an arbitration for \$11.4 billion at the World Bank's International Center for Settlement of Investment Disputes (ICSID)²
- Find a settlement with the Pakistani government, who had approximately \$16 billion in foreign currency reserves in 2011³
- Sell its mining rights at a discount to another investor, who might have more appetite for dealing with a difficult government, and/or,
- Cut losses and withdraw from the project completely.

Internal stakeholders to a company's decision for how to manage a dispute may have vastly different lenses for assessing the best course of action as well as career interests for doing so. Shareholders, however, should want decisions to be made with clear

assumptions that help estimate a risk-adjusted net present value. And board directors have strong corporate governance imperatives for seeking clear analysis to underpin the difficult judgement calls they need to make in complex disputes.

Eight elements of dispute risk analysis

When conducting an NPV analysis of a dispute, there are (broadly) five factors that feed into the model:

- (1) **Prospects of Headline Claim:** How much is your company owed, and how likely you are to win that amount in a court or tribunal? In the Pakistan example, the parties claimed over \$11 billion, though ICSID statistics would suggest that a 'normal' case would yield a fraction of that amount.⁴
- (2) **Time:** How much time will a legal process take? An ICSID tribunal normally takes around 3.75 years, plus annulment and enforcement proceedings which can add a few additional years to the process.
- (3) **Cost:** What are the legal, advisor and administrative costs to a legal process? A top law firm in international arbitration can charge as much as \$10 million per year. And unlike many domestic litigation systems, in international arbitration the losing party can often be ordered to pay a large fraction of the winning party's costs.
- (4) **Opportunity Cost:** How much would you earn were you to take a settlement today and re-invest the cash in your business? Barrick Gold, for example, has a return on invested capital (ROIC) of around 9% today.
- (5) **Enforcement:** Does the counterparty have assets that are accessible, and how much additional time and cost will it take to execute against those assets once you have won a judgement or award? Outside its own borders, Pakistan owned relatively few assets available to be attached in the event of a successful award for the mining investors.

Additionally, there are three factors outside the expected value of the recovery that may also have broader financial impact, including:

- (1) **Commercial Impact:** Are there other business opportunities that will be lost by way of pursuing the dispute, for example in the same market or within the same network?
- (2) **Management Time:** How much time and attention will be required by an executive team to oversee the dispute as a project, and how much more productive would it be if they were spending this time and attention on the core business?
- (3) **Reputation and Social License:** Does it disadvantage our organization in other ways if we are known to be in an external dispute, is it a non-issue, or does it confer any benefit that we are known to stand up for ourselves? Conversely, are there reputational concerns about being seen as a 'soft target' that will not stand up for its rights?

These eight elements will come from a variety of sources, including legal data and/ or management estimates, but the key is to start with clear and defensible assumptions that help set a baseline NPV and allow for further sensitivity analysis over time.

Knowledge of disputes valuation is power

In the Pakistan example, having won the ICSID arbitration and been awarded \$5.9 billion in 2019, Barrick Gold and Antofagasta are today continuing legal proceedings to enforce that award against assets owned by the Pakistani state and state-owned enterprises.

While they have identified hotel assets in New York and Paris, they have not found sufficient assets to cover the whole award, so will ultimately have to negotiate with the Pakistani government to resolve the matter. What the ultimate NPV or IRR (internal rate of return) will be on this case will depend now on (i) how fast the matter can be settled and (ii) what discount the investors will have to give.

If an investor or management team does not understand the costs and risks inherent in a complex cross-border legal process, they may be in for a rude awakening.

Conducting a baseline NPV analysis at the outset of a dispute creates a number of benefits for the investor with respect to decision-making and optimizing the use of resources:

- First, there is inherent value in setting realistic expectations. If an investor or management team does not understand the costs and risks inherent in a complex cross-border legal process, they may be in for a rude awakening.
- Second, understanding the limitations in a presumed path of legal recourse may help an investor and their advisors develop alternative legal and enforcement pathways that will yield a better recovery.
- Third, disputes can also be resolved through commercial negotiations, diplomatic settlement, mediation or a follow-on transaction. A Dispute NPV provides an essential benchmark for any of those negotiations. Moreover, a similar analysis from the defendant's viewpoint will usually indicate good reasons why the defendant should be prepared to pay a premium for settlement.

As the world faces a global pandemic of disputes,⁵ financial markets are increasingly pushing clients and legal firms to consider disputes more through a financial lens. The NPV of a dispute cross-pollinates a simple best practice of the investing world to bring better insight and control to complex risks in a volatile world.

Notes

¹ <https://bit.ly/3BJJ3Rc>

² <https://bit.ly/3BMenii>

³ <https://reut.rs/3DKuGgq>

⁴ The ICSID Caseload — Statistics (<https://bit.ly/3BEfkmk>)

⁵ <https://bit.ly/3DEiPju>

About the authors



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