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Suits Make Strong Case With Investors

LAW: Litigation funding firms say returns average 20 to 45 percent.

By ALFRED LEE *Staff Reporter*

When **Allison Chock** meets a client with a potential legal case, she brings years of experience as a trial attorney at some of the city's most storied firms to bear.

She analyzes the strengths and weaknesses of the case and hires outside experts to take a look if necessary. But she isn't deciding whether to bring a lawsuit – she's deciding whether to invest in it.

Chock is an investment manager at **Bentham IMF**, a player in the growing field of litigation finance, in which third-party investors pay the costs of a suit in exchange for a share of the winnings. When Bentham, a subsidiary of a publicly traded company in Australia, came to Los Angeles in September, it became the first large-scale litigation funder to have an office in the market, joining a growing number of smaller homegrown and national firms investing in cases.

The firms hire experts, often former attorneys, to examine large commercial cases such as patent claims or breach-of-contract disputes. If the case looks like a winner, they agree to cover all or some of the costs, often tallying millions of dollars, to fight the case in court. If the client settles the case or wins a judgment, the financier profits by taking a portion.

The practice is growing in popularity as the cost of litigation goes up, and as both law firms and corporate clients look to hedge risks and cut costs.

"The business of law is changing," Chock said. "Litigation becomes very expensive these days. I think people see it as a way to really bring access to justice to a larger group of people. And law firms see it as a way to take on more cases without putting as much hard capital at risk."

The returns can be huge. Firms that have invested in cases in Los Angeles told the Business Journal that annual returns across their portfolio are between 20 percent and 45 percent. Bentham's parent company has reported a gross return of 290 percent in all of its completed lawsuits.

But results aren't guaranteed. In recent months, several high-profile national cases using litigation financing were dismissed, resulting in big losses for investors. One financier, New York's BlackRobe Capital Partners, shut down in May after internal disagreements and a failure to raise capital.

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Judgment Call: Allison Chock at Bentham IMF.

Critics say the practice encourages meritless lawsuits and turns courthouses into investment vehicles. Practitioners counter that they perform due diligence on cases and give legal firepower to clients who lack the means to take on larger opponents.

"This is just a travesty for the practice of law," said **Lisa Rickard**, president of the **U.S. Chamber Institute for Legal Reform** in Washington. "Third-party financing has the potential to be one of the most dangerous lawsuit-expanding creations we've come across in a really long time."

Deal-making

Litigation financing has long been available for personal injury lawsuits, but it's only recently caught on for commercial cases in the United States.

Commercial case financiers can cover some or all of attorneys' fees and other costs of litigation, including expert witnesses and document discovery. They might contract to take a percentage of a lawsuit's winnings or take a predetermined multiple of their original investment. The share can go up if cases drag on longer. In patent cases, financiers have even been known to ask for a share of patent ownership.

In some cases, financiers also get attorneys to work at a discounted hourly rate and then award them a bonus if the outcome is successful.

The size of these investments can range wildly, from as low as several hundred thousand dollars up to as much as $10 million. The money is generally drawn from a pool of individual and institutional investors; larger players such as London's **Burford Capital**, which has invested in about a half-dozen L.A. cases, have investment pools exceeding $300 million. Financiers seek to recover between two and three times what they put in on each deal.

El Segundo's **Vinson Resolution Management**, which launched last year, charges $75,000 for an initial case evaluation. The six-employee company takes the basic facts of a potential lawsuit and produces a short video telling its story. It then shows the video, along with other information, to former judges; attorneys; and "surrogate" jurors, sortable by demographic and location, and has them fill out an online survey. This information is combined with in-house analysis to produce a score, similar to a credit score, for each case.

The process helps make the decision simpler for Vinson.

"It really almost comes down to a binary scientific response," Chief Financial Officer **David Kurs** said.

The results are forwarded to the company's investment committee, which decides whether to invest. Vinson invests between $2 million to $3 million in these cases and takes a percentage of winnings, usually no higher than 45 percent.

Not all proposals get funded.

Bill Tilley, president of **Amicus Capital Services** in Valencia, said he pulls the trigger on about one in 15 cases. His company funds commercial cases as large as $4 million, and has financed several in Los Angeles County. Tilley assumes 5 percent to 10 percent of cases will be losses, and said he realizes an annual return on investment of about 45 percent.

Instead of taking a percentage of winnings, financiers can also contract to take a multiple of their original investment. **Ken A. Linzer**, an attorney in Los Angeles who does transactional work for litigation financiers, said he worked on a financier's investment of about $1.5 million in a case. The financier's agreed take of winnings was 2.6 times the original investment, plus 6 percent of any money recovered over $100 million. Though the case was declared a mistrial because of a procedural issue and must be retried, he said jurors were about to award $147 million – which would have made the financier nearly $7 million.

Deals are confidential; none of the financiers agreed to name specific cases or law firms they worked with.

Mike Hennigan, principal in the L.A. office of law firm **McKool Smith**, said his firm has used litigation finance in several cases. The firm took each case on contingency and in some cases the financier bought a share of the risk.

"It enables the firm to take on very large cases that would otherwise be too much of a risk," he said. "Most firms with any sense are looking for ways to mitigate their risk, and we're interested in talking to finance sources when the risk is quite large, where the size of the likely expenditure of attorney resources is in the tens of millions."

While both litigants and law firms can bring financiers into a case, it is generally the firms that have the relationships.

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Stepping Up: Allison Chock at the downtown L.A. office of Bentham IMF.

Risks

Critics said this use – allowing firms to take bigger risks – is a problem.

"(Financiers) can take a bigger chance on a case that's maybe riskier because they're spreading their risk across a broader portfolio of cases," said the legal reform institute's Rickard. "It incentivizes lawsuits, particularly abusive ones. They don't need to hit every single one of those cases. One windfall can subsidize many lawsuits."

She said investors should be required to disclose their involvement in a case – there are no rules in place forcing them to – and that the system should be regulated to ensure they have no control over a case.

Financiers said they don't control cases and are passive investors. **Ernie Getto**, a Burford managing director based in Santa Barbara, said the company invests in good cases.

"Burford is a publicly held company with shareholders and it has no interest in investing in frivolous cases," he said.

Bentham IMF's Chock added her firm vets cases "even more carefully than a litigator."

In any case, the market appears poised for more growth, both in Los Angeles and nationally.

"The West Coast is an extremely active area for commercial litigation. We've got tech companies in both Northern and Southern California, biotech in San Diego and general business litigation has always been active in Los Angeles," she said. "IMF feels it's uniquely positioned for growth."