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# The gavel gamble: Litigation emerges as an asset class

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For years, the profits that have emerged from the opaque world of law have been beyond the reach of non-lawyers in Canada.

But that is changing quickly. A recent ruling in Ontario has helped swing open the door for litigation investment funds — which allow investors to bankroll lawsuits in the hopes of sharing in the potential proceeds — to establish a beachhead in Canada.



From left, John Fisher, Edward Truant and David Sedgwick have created a Toronto-based fund that invest in lawsuits. Tyler Anderson/National Post

At the more gilded end of the spectrum, three Toronto-based asset managers are setting up Balmoral Wood, a fund that aims to distribute money from sophisticated investors across a range of established litigation finance firms already operating around the globe. And at the retail end of the spectrum, an Australian-based litigation funder listed on the Australian Stock Exchange, IMF Bentham Ltd., has also set up shop in Canada.

Whether the funds are coming from moms and pops or high net-worth investors, the

concept is the same. Lawsuits are emerging as a distinct asset class, just like real estate, private equity, precious metals or stocks and bonds.

“We view this asset class similarly to private equity in the 1970s when outsized returns relative to risk were available,” says David Sedgwick, one of the three principals behind Balmoral Wood. “We are at a comparable stage in the evolution of the commercial litigation finance sector.”

This is a revolutionary shift. For years, it was only possible for a party to a case to fund a lawsuit in Canada. Third parties were banned from funding litigation according to something called the rule against “champerty and maintenance.”

Things started to shift with the onset of class action lawsuits. Judges accepted third-party funding to support access to justice. Canadian law requires that losers pay a winner’s legal fees. Third-party funding originally was seen as a means to insure unsuccessful class action plaintiffs from the burden of paying massive cost awards. In exchange for the protection, successful class action plaintiffs agreed to share a percentage of a settlement or judgment with the funder.

But a case last summer involving Valeant Pharmaceuticals International Inc. has taken this further. An Ontario judge recognized the access to justice is also at issue in single-plaintiff commercial cases. He allowed a British firm to provide up-front funding for a Swiss businessman’s contract dispute with Valeant. He capped the amount the funder can collect to 50 per cent of any recovery.

As asset classes go, tort and commercial litigation is an exotic beast. Litigation is binary, a bet that you either win or lose. There’s no dividend or interest for the funder to collect as a case winds its way through the courts. And assessing those bets can be more art than science. It seems an odd fit for the retail market, but Bentham shares (IMF/ASX) are there for all.

“We’ve got plenty of Mom and Dad shareholders turning up for our AGM,” says Tania Sulan, chief investment officer of Bentham’s newly opened Canadian operations.

“We’ve got a handful of cornerstone investing institutions who turn up. Then the rest are Nans and Pops who want to have a free cup of tea.”

Sydney-based Bentham, which operates in the United Kingdom, Europe, New Zealand, Hong Kong and Singapore, opened its Toronto office this year.

Other global funders are taking notice of the Canadian opportunity. “We think Canada is a very interesting market. We’ve met with many of the major firms and are in a position to consider cases that come out of Canada,” says Andrew Langhoff, a principal with Chicago-based Gerchen Keller Capital LLC.

Funders look for cases that are large enough to offer a decent cash split among the plaintiffs bringing the case, the lawyers arguing the case in court, and the funders. Sulan says that in Australia, that balance tends to result in plaintiffs recovering about 63 cents on the dollar from successful cases, with lawyers and funders splitting the rest.

Funders also take a thorough look at whether defendants have pockets deep enough to pay any settlement or judgment. “It’s a waste of everyone’s time, including a waste of judicial resources, if we’re funding a case and we get to the end and we can’t collect,” Sulan says.

Yet with novelty comes risk. Balmoral Wood aims to raise funds from a mix of high net worth individuals, family offices, pension funds and institutions. The firm will then spread those funds among five to seven established litigation financiers who might have a total of 100 cases under management.

“As a fund manager, you have to think about hitting singles and doubles,” says John Fisher, a principal of Balmoral. “You’ll significantly increase your risk profile if you’re only out to get home runs.”

Diversification is a strategy employed by Gerchen Keller. The firm was established in April 2013 by two lawyers who clerked for U.S. Supreme Court justices — pretty

much the gold standard for U.S. legal expertise — and an investment banker from Goldman Sachs. Gerchen Keller has committed \$700 million in 75 investments. Of those, 19 out of 20 have reached a successful conclusion.

“We look at litigation not just as something that gets funded, but as a corporate asset,” Langhoff says.

Still, case diversification is not a complete answer. Bentham has a stellar win-loss record. It has funded 180 cases since it was established in 2001. As of Dec. 31, 2015, the mid-point of its 2016 fiscal year, some 73 per cent of those cases have resulted in a settlement or a courtroom win.

Yet the dollar values can be fleeting. Bentham reported an after tax loss of A\$900,000 on global revenue of \$26.2 million for first-half 2016. Some of the loss was due to its expansion overseas into Canada and elsewhere. The company also took hits because it funded three cases that lost in court, though appeals are underway.

The stock has been fairly volatile, trading in a 52-week range of A\$1.94 to 92 Australian cents. The stock is up more than 40 per cent since hitting its 52-week low on Feb. 16. Bentham is in the midst of shifting its strategy to focus on more low dollar value cases and away from big disputes with claims over A\$50 million.

Meanwhile, the Canadian opportunity looms. The men behind Balmoral Wood have been meeting with potential investors to raise the funds they will deploy with global litigation fund managers. Litigation funding will change the legal business, and they want to be part of it.

“We’re currently speaking to local litigators about litigation finance and its applicability to Canadian cases,” says Edward Truant. “We view ourselves as an agent of change in the Canadian market.”

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