

Is there a case for litigation funding?



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Investing

One of the odd things about now is that the global economy is in many ways in a much worse state than it was in 2008.

The problem of private sector debt across the west hasn't gone away. The problem of skyrocketing public sector debt is still getting worse (note that even in "austerity Britain" the budget deficit is rising very fast). It is clear that China's banking system is in trouble. Chinese banks have hugely overextended themselves since 2008 (banks just can't help creating credit bubbles

when times look good). Now, growth momentum has disappeared. And, as ever, the market is wondering whether the assets they hold are worth quite what they should be.

The result? An implicit acknowledgement from Beijing that there is a problem in the form of an intervention to buy financial stocks and stop share price collapses.

If this sounds familiar it is because it is. Japan spent much of the 1990s indulging in what was known as PKO (price keeping operations). Not a good precedent. My guess is that as the China bear case becomes recognised in the west, asset prices in Asia will become even more volatile. And probably cheaper too. No need to rush in. At the same time, Europe's waiting game continues and there is an increasing recognition that forcing banks to recapitalise might mean they pull back on lending. If they don't want to or can't raise significant capital at the moment, they'll simply call in all

their loans instead. That happened in Japan too. Hello, deflationary recession. The result of this, of course, is that markets are all over the place. Take Germany's Dax. It has risen about 20 per cent in the past two and a half weeks. But, given the environment, it makes as much sense to bet on it falling 20 per cent from here as rising any further. None of this is nice for investors.

How about something completely different? Something like litigation funding? This is a relatively new but simple idea. Specialist funds provide funding for commercial litigation cases to cover the costs of a case in return for payment if the case is won. The return comes in the form of a multiple (2.5x is not unusual) of the funding commitment offered in the first place.

You can see why this would work: people who can't afford to take cases to court are financed to do so and funders get a superb return on their

money if the case is successful.

Until recently, such funding has been "held to be unlawful", says Jon Robins in a report on the matter for City law firm Fox Williams. But "it is now recognised that many claimants cannot afford to pursue valid claims without third-party funding; that it is better for such claimants to forfeit a percentage of their damages than to recover nothing at all; and that

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third-party funding has a part to play in promoting access to justice".

The key for funders, of course, is to make sure the cases they support are likely winners or, at least, ones in which opponents are likely to settle quickly.

And that is where the expertise comes in. Andrew Rimmington, a partner at

City law firm Mishcon de Reya, believes less than 10 per cent of cases will be accepted.

Investing in this area isn't straightforward. You can do it via Aim-listed companies Burford Capital and Juridica. But these both tend to focus on drawn-out US cases and come with both that risk and the share price risk inherent in them being listed smaller companies.

The other option, if you qualify as a sophisticated investor, is to buy into a fund from the likes of Therium Capital or Harbour Litigation Funding. The minimum investment will typically be £100,000 and access to the fund comes via independent financial advisers or other intermediaries such as the City of London Group Plc.

This is hardly risk-free – cases can be lost as well as won – but at least one funder is offering "capital protected" investments as well as "at risk" investments, so that an investor's original capital can be protected in return

for a cap on the upside. You can also argue it serves a social purpose as it provides access to justice. And it might make you a real return, and an utterly uncorrelated one at that.

The outcome of one case is not going to be correlated to that of another. And the outcome of a group of lawsuits (unless I am missing something) is unlikely to be correlated to shifts in the equity, bond, currency or commodity markets.

In tough times, companies are more likely to sue each other and more likely to look for external finance to do so. But that's a connection, not a correlation. Given that, at the moment, all risk assets (bar the odd currency) seem to move as one – often in the wrong direction – that is surely no bad thing.

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