

Business & Practice
June 2, 2023, 5:30 AM

Litigation Funders Say Capital Becomes Scarce as Recession Looms

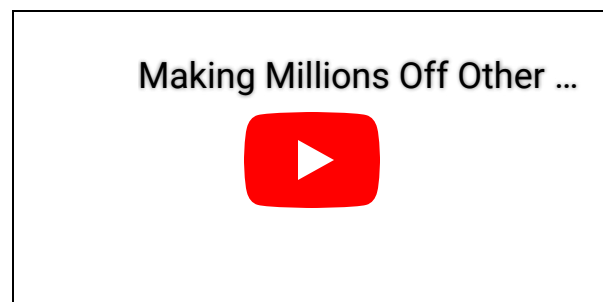
By Emily R. Siegel

- Investors are shying away from risky asset classes
- Litigation funders say it's a difficult environment

The desire of law firms and their clients for litigation finance is running into the tight financial markets, leaving too few dollars for a burgeoning demand.

Litigation funder Validity Capital is laying off half its staff after its backer TowerBrook Capital decided to cut investments in the litigation finance firm.

Lionfish, the litigation funding subsidiary of UK-based RBG Holdings, was put up for sale in April after the company took a 4 million euro hit following losses in two cases it invested in.



Video: Making Millions Off Others' Lawsuits: How Litigation Funding Works

"There's been a pullback from risk assets and litigation is definitely seen as a risk asset," said Charles Agee, chief executive officer of litigation finance consultanting firm Westfleet Advisors. "It's caused a little bit of a cooling effect on various fund managers who are trying to raise capital right now."

While law firms and their clients are flocking to outside investors as a way to save costs, avoid borrowing and offload risk, the funding pullback in a tough economy underscores the challenge of realizing litigation finance ambitions.

The situation is particularly challenging for new entrants into the litigation funding space, who didn't exist in prior liquidity-rich years when older rivals built reserves. Others won't be able to keep up because of unsuccessful investments, slow returns or a lack of a diverse portfolio.

"A lot of these companies just might have to wind up their operations," said Matt Harrison, co-chief information officer at litigation funder Omni Bridgeway. "They don't have the money available to them to invest in cases and in law firms."

Some investors may be hesitant to put new capital into third and fourth rounds of financing before seeing returns on their first investments, said David Perla, co-chief operating officer at Burford Capital.

"They like to say your first fund, you're selling mystery, your second fund is mystery—and a little bit of history—and your third and fourth funds are all history," Perla said. "So if you're on fund three or four and you're not doing well, you can't sell the mystery anymore."

'Cooling Effect'

Litigation finance, which involves investors supplying money for lawsuits and reaping a return if the case results in an award, has been in existence in the US for a little over a decade. It is estimated to have nearly \$14 billion assets under management, according to a 2022 Westfleet report.

Omni Bridgeway said earlier this month that funding requests for lawsuits increased about 30% this fiscal year compared with a year ago. Validity Finance said it saw the highest number of leads ever in the previous quarter.

But despite the demand, high inflation and tight credit has encouraged investors to keep their money on the sidelines. Many economists say a recession is coming.

"Investors across the board are just being very careful about their investments now in this economy," Harrison said. "It's natural that the big investors, whether they're investing in litigation finance or in hedge funds—they are slowing down."

Some litigation finance firms locate cases that seem like good investments and raise funds afterward, said Rebecca Berrebi, a litigation finance consultant and broker. There is no mandatory documentation that requires funders to disclose the amount of capital they've raised.

There's speculation about which firms are in harvest mode—managing old investments only—but there's no official way to obtain this information. Some funders said they've been approached by intermediaries for their competitors attempting to sell off old investments to obtain some liquidity.

"It's important to know your funder," Berrebi said. "There are funders out there who don't currently have capital to commit but are still looking at cases as though they do. It can be a big waste of time and energy."

To contact the reporter on this story: Emily R. Siegel at
esiegel@bloombergindustry.com

To contact the editors responsible for this story: Chris Opfer at
copfer@bloombergindustry.com; John Hughes at
jhughes@bloombergindustry.com

© 2023 Bloomberg Industry Group, Inc. All Rights Reserved