LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
MONDAY, NOVEMBER 28, 2022

PERSPECTIVE

The state of the legal finance industry in California post-Covid

It's notable that corporate legal teams are increasingly using commercial legal finance, as this reflects its continued normalization as a routine business tool and points to still more potential growth in the future.

By Jonathan Owen

The California legal market is ahead of the curve when it comes to innovation, so when faced with a post-pandemic economy, California lawyers will inevitably find ways to innovate. One such way is with the use of legal finance.

As companies grapple with rising costs and inflation, Californian companies must focus on preserving capital. Legal finance is one tool that can help manage the risk and cost of litigation on company books or advance capital that can be used for other business purposes.

Legal finance is the provision of third party capital that companies can use to offload the cost and risk of pursuing meritorious litigation, whether on a single-case basis or as part of a larger recovery effort. It enables companies to focus on growth, innovation, research and development and job creation – all key to business success in an uncertain economy. And for corporate legal departments as well as firms that are willing to work on a contingent basis, the duration risk of commercial disputes – that is, the time-is-money calculation that clients make when they spend tens of millions to pursue matters that may take years to get to trial or settlement – has significantly increased because of Covid, and that makes legal finance all the more attractive to them.

Given the importance of legal finance to the post-Covid environment in California, it is worthwhile exploring the state of the industry today. The following trends come to mind: We are seeing incremental increases in legal cases moving forward in addition to continued growth in demand and increased use by corporates.

'The California legal market is ahead of the curve when it comes to innovation, so when faced with a post-pandemic economy, California lawyers will inevitably find ways to innovate. One such way is with the use of legal finance.'

#1: Cases are moving forward again, slowly

A nascent but obviously welcome trend is the fact that commercial cases are moving forward again, albeit slowly and with a lot of catching up to do following the significant interruptions posed by Covid.

With the advent of Covid in early 2020, courts shut down in-person proceedings (and especially jury trials) for long periods, creating an enormous backlog of matters that was especially acute in already clogged courts, especially in the US. As courts returned to in-person proceedings, criminal trials took precedence over civil matters. Nonetheless, commercial cases are moving forward again – not full steam ahead as before Covid, but more so than at any time since the pandemic, and with the benefit of lessons learned from virtual proceedings that could prove a long-term benefit.

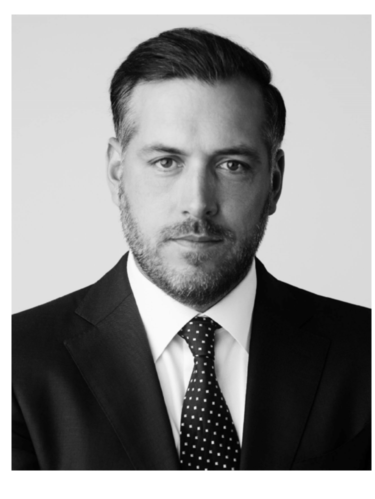
Anecdotally, there is reason to believe that commercial disputes are moving forward, slowly. For example, an executive at a leading expert witness firm whose business went largely silent during Covid because trials weren't happening recently reported that business is booming. And law firm leaders have been quoted expressing similar confidence.

#2: Continued growth

As noted above, Covid has augmented the pressures that make using legal finance capital such an efficient alternative both to using working capital to pursue claims and to waiting to access cash tied up in judgments and awards. In the post-Covid phase that we are in now, companies and the firms that represent them face a confluence of inflation, potential recession and the need to preserve and enhance working capital, both to invest in growth and compete for talent. Shifting cost and risk to an outside legal finance provider instead of using working capital to pay for lawyers out of pocket is a very sensible alternative.

These factors translate to the continued growth of legal finance, a trend that has been in place for some time but that is especially evident in the post-Covid phase that we are in now. Growth is reflected in a recent survey by Bloomberg in which nearly one third (30%) of lawyers report that

Jonathan Owen *is a vice president at Burford Capital with responsibility for originating new business with US law firms and companies, with a focus on California and the West Coast.*



they are more likely to seek litigation financing "if a downturn or recession occurs in the next year"; nearly one third (33%) are more likely to do so than one year ago, and nearly seven in ten (67%) are more likely to do so than five years ago. Bloomberg Law, "2022 Litigation Finance Survey." Law firms and companies are both determining ways to innovate their businesses, especially post-Covid. As I mentioned, key to the increased demand and growth is how corporates and law firms are beginning to realize that legal finance can be a partner in their business' innovation.

At Burford, we have also been thoughtful about how we can advance innovation in the legal industry through the use of economic levers. For example, in 2018 Burford Capital announced The Equity Project, our initiative to increase diversity in the law, in which we earmark legal finance capital to promote diversity by giving historically underrepresented lawyers an edge as they pursue leadership positions in significant commercial litigations and arbitrations. The Equity Project also augments companies' ESG and DEI initiatives by providing incentives for the firms that represent them to appoint historically underrepresented lawyers and to award them origination credit. Burford has already committed over $100 million of the $150 million previously earmarked to this initiative.

#3: Increased use of legal finance by corporate legal departments

Building on this trend, it's notable that corporate legal teams are increasingly using commercial legal finance, as this reflects its continued normalization as a routine business tool and points to still more potential growth in the future.

Research and data bear this out. According to the GC of a multinational logistics company, "Fifteen years ago, if someone asked about funding litigation it sounded radical, but now it is mainstream." Burford Capital, 2022 Affirmative Recovery Programs Report. At Burford, as recently as 2018, corporates accounted for only 20% of commitments, but as of Dec. 31, 2021, corporates account for more than half (56%) of commitments.

It's worth calling out why legal finance is so attractive to GCs, CFOs and other corporate leaders of often very large companies. The two most obvious reasons are that legal finance considerably reduces costs while simultaneously considerably increasing certainty around commercial litigation and arbitration. Cost management and certainty are always important – and elusive – in corporate legal departments, but especially now given the combination of short-term inflation and potential recession that businesses are facing. Because legal finance capital is nearly always non-recourse, companies can use it to shift the cost of winning a significant recovery – or an expensive loss – to a third party. As the litigation counsel of a multinational investment bank said, legal finance "make[s] economic sense because you can remove negative downside and make the upside more predictable." Ibid.

A significant legal finance growth area for corporates is monetization, as previously mentioned. The concept is simple: Rather than waiting for a matter to resolve to be paid their expected damages, companies can work with a legal finance partner to obtain an advance of a portion of the expected value of a claim or an unenforced judgment. Companies can use that capital for any corporate purpose, including investment in the business or even paying for other meritorious litigation that otherwise might not be pursued. They also gain certainty around cash flows and outcomes: If the matter wins, they can expect a substantial share of the remaining damages, and if it loses, they keep any monies advanced, locking in a minimum outcome. In both scenarios, the company maintains control of its litigation – and considerably more control over its finances.

What's ahead for legal finance in California

The legal finance industry – and every industry – will be grappling with the impact of Covid for years to come. Some of the effects have been heartbreaking, but some potentially transformative in ways that are still unfolding. Arguably, this post-Covid era is reinforcing the real value of what we do. Any business thrives insofar as it benefits clients where they are now, and at a time when certainty and cost management are valued more than ever, the growth of legal finance in the post-Covid era makes sense.

Law firms and clients have become more sophisticated and more commercially minded since the last recession, and they will likely be all the more so as clients grasp for predictability in the current climate. Andrew Maloney, "Is Big Law Ready for a Recession?", The American Lawyer, May 31, 2022.

As I continue to make the case for using legal finance, I will reiterate the benefit that legal finance providers provide as an innovative partner in business for law firms and corporates alike, vital to the Californian legal system.