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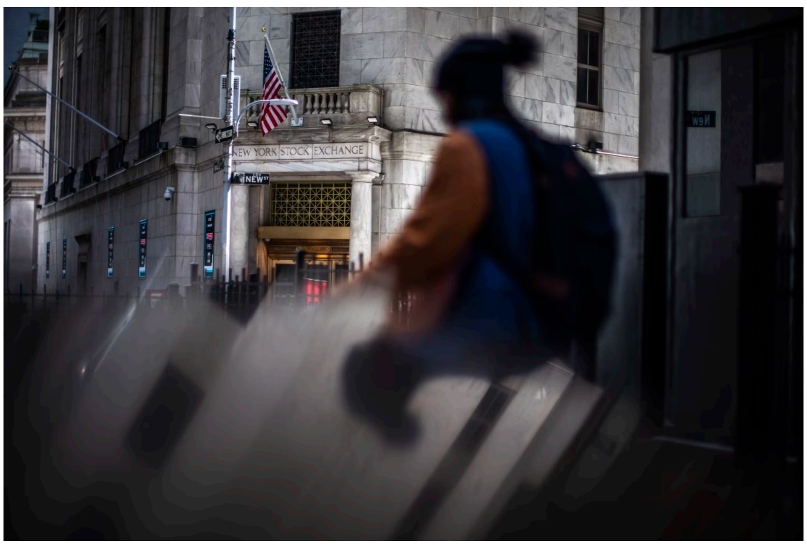
Why Arizona Law Firms Are a Hot Investment for Private Equity

Arizona program meant to make it easier to get legal services attracts professional investors

By Erin Mulvaney Follow

Updated March 20, 2024 4:38 pm ET



Wall Street investors are exploring Arizona's Alternative Business Structures to have an equity stake in law firms. PHOTO: EDUARDO MUNOZ ALVAREZ/ASSOCIATED PRESS

Arizona launched a program to expand access to legal services for people who can't afford or find lawyers. Three years later, the program is catching Wall Street's eye.

In most states, the owners of law firms need to be attorneys. But the Arizona Supreme Court lifted that barrier, and since 2021, nonlawyers can apply to open firms known as Alternative Business Structures to provide legal services in the state.

Hedge funds, private equity groups and other investors are exploring Arizona's unusual opportunity to have an equity stake in law firms.

"Every other business is allowed to take growth capital to pay their expenses," said Ted Farrell, who runs Litigation Funding Advisers, which consults in the legal finance market. “The question is, how much smart money wants to get in bed with lawyers?”

It turns out, plenty. As much as 40% of the legal businesses approved as Alternative Business Structures are backed by private equity or hedge funds, according to an estimate by a program committee member.

Charles Platt, chief executive of Cartiga, an investment firm that funds civil litigation, said he created an Arizona business to make the process of partnering with law firms more efficient. His firm works with lawyers around the country.

“We thought, ‘Is there some way to enhance and measure the value of what a lawyer delivers in what we think is an overly long process?’” Platt said. “Having nonlawyer ownership would advance the ability to get to the bottom of the question.”

A new model

Arizona’s nascent program is potentially the tip of the spear, testing what would be a paradigm shift in how to structure law firms. The program thrust the state into the center of debate both about how to expand access to legal services and about who profits off the legal ecosystem.

The idea behind Arizona’s program is to bring in capital to make it possible for legal businesses to open that otherwise wouldn’t be able to. Many states have been looking to unconventional solutions to address the dearth of lawyers available to help people with critical services such as evictions, divorces and immigration law. It is common for people to represent themselves in court.

Critics of nonlawyer ownership of law firms raise ethics concerns and fears that the businesses would prioritize profit over the interests of clients. Efforts failed in California and Florida to create similar plans. Only Utah and Washington, D.C., allow comparable structures.

The Arizona Supreme Court has approved 70 applications and there are at least 40 more applications in the queue. A special committee and court staff review the applications before sending them to the state supreme court for final approval.

So far, a handful of the new firms help with immigration, family law or social justice issues, which the program’s proponents hope will help people who can’t afford traditional legal fees.

The Arizona Supreme Court in Phoenix. PHOTO: ROSS D. FRANKLIN/ASSOCIATED PRESS

From taxes to the metaverse

Other new Arizona firms range from technology platforms that generate court documents for cheap to traditional business law outfits that help perform general legal work. Others provide services in niche areas, such as bounty hunting, while some handle tax services or estate planning. There is one that focuses, in part, on legal issues in the metaverse.

About one-third of the new firms specialize in personal injury claims and mass tort litigation, which is where investors have turned their attention, making Arizona's fledgling program a potential runway for litigation financiers.

"The most surprising thing—in our naiveté—were the numbers of either marketing companies or private equity from out of state that were interested in investing in law firms," said Lynda Shely, an Arizona attorney who sits on the committee that oversees the program.

Many of the new law firms market and recruit potential clients for some of the biggest mass litigation in the country, working with law firms outside the state through fee sharing or co-counsel arrangements.

Lenders turned stakeholders

Wall Street involvement in this area of law isn't new. In mass litigation, plaintiffs' firms bringing large-scale product liability claims don't receive a payoff until the end of a case, either requiring lawyers to put the money up themselves or borrow.

Financial firms lend money for personal injury and mass tort litigation, typically through high-interest loans. What is different in Arizona is that the investors can now have equity, and potentially have much higher margins.

“It allows an investor to get equity-like returns, rather than debt at a fixed interest rate,” Chris Spillman, who currently serves as the compliance lawyer for Scout Law Group, one of the firms that specializes in mass litigation. The firm is backed by Miami-based investment firm 777 Partners.

‘Dark money’ concerns

Nonlawyer ownership of law firms has been widely criticized in the legal community, and the American Bar Association in 2022, after fierce debate, passed a resolution that said fee sharing with nonlawyers is “inconsistent with the core values of the legal profession.”

Stephen Younger, a Nixon Peabody lawyer, and former president of the New York State Bar Association, said there is limited evidence it is expanding access to justice, as is intended. “Mostly rich people are getting serviced. All it does is move the capital out of the hands of lawyers to nonlawyers,” Younger said.

The U.S. Chamber of Commerce and other business groups have pushed for more transparency in who funds the Arizona businesses.

“Our concern is the way that it has the potential to invite dark money,” said Nathan Morris, senior vice president of legal reform advocacy at the U.S. Chamber Institute for Legal Reform.

Social justice startups

Some business owners say the program allows new firms built around social justice initiatives to be funded like a startup, getting infusions of cash at the onset of a project. Noella Sudbury founded Rasa Legal, a platform that operates in Utah and Arizona that allows people to expunge criminal records for a flat $250 fee. The process typically could be as high as $5,000.

Allowing investors to have an equity stake allowed Sudbury to have the capital to hire competitive software engineers to build a platform. Removing criminal records can change a person’s life, including getting jobs and housing, she said.

Even for mass litigation, supporters say the program allows access to private capital that enables large cases to be built that otherwise might have been too costly for law firms.

"What I'm seeing is that they've evened the playing field against large companies," said Andy Kvesic, managing partner of Radix Law, which offers services such as estate planning, real estate and family law. The new firms "now have the money to pursue expensive cases."

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Appeared in the March 21, 2024, print edition as 'Arizona Law Firms Attract Investors'.

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