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ANALYSIS

 **Arizona and Utah Opened the Door, But Firms Remain Skeptical of Alternative Business Structures**



Litigation funders are eager to make equity investments in law firms, but partner resistance and regulatory uncertainty present major obstacles.



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Law Firm Structure



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Reporter



What You Need to Know

- Despite the potential benefits of accepting outside investment, many law partnerships remain wary of giving up equity to nonlawyer investors.
- Arizona and Utah have loosened restrictions on nonlawyer ownership of law firms, prompting the ABA to reaffirm its opposition to such an ownership model.
- Litigation funders such as Burford Capital have been early nonlawyer investors in law firms.

Despite the opportunities for law firms to accelerate their growth with outside investment, the vast majority of firm leaders in the U.S. have been reluctant to experiment with new ownership models made available by rule changes in Arizona and Utah pertaining to nonlawyer ownership of law firms.

Concerns over the impact that nonlawyer stakeholders could have on client services is enough for many firm leaders to wait for test results from recently created U.S. regulatory regimes before shaking up their own firm's ownership model, according to consultants and former firm leaders interviewed for this report.

"Lawyers are more risk-averse than your average person, and some of that is due to the nature of the business of law," said Marcie Borgal Shunk, president and founder of consulting firm The Tilt Institute.

“They are delivering services based on precedent, so as a lawyer you are typically looking at what came before,” Shunk continued. “Then there’s the partnership model which is designed to create the most profit within a single year. That is not the mindset that drives innovation.”

In 2020 and 2021, the supreme courts of Utah and Arizona relaxed the American Bar Association rule prohibiting nonlawyers from sharing in the ownership of a law firm, with the former launching a “sandbox” running through 2027 that allows the creation of alternative legal businesses and the latter eliminating rules barring nonlawyers from partnering with lawyers. Since then, the two states have granted a total of 91 licenses for alternative legal business entities, according to The American Lawyer’s review of registered entities in those states.

In response to the rule changes, the ABA’s House of Delegates [voted in August to reaffirm the decades-old resolution](#) that discourages law firms from offering ownership or investment opportunities with nonlawyers.

Consultants such as Shunk said that the regulatory changes could prove to be a disruptive force for adherents of the traditional law firm structure if organizations such as the Big Four accounting firms and alternative legal service providers use the new regulatory regimes to integrate legal with nonlegal services or use technology to handle rudimentary contract work.

Partners Are Resistant

The unwillingness of partners to give up control over firm operations is one impediment to the expansion of private equity and capital markets funding in law firms, according to Allen Fagin, former chairman of Proskauer Rose who serves as a senior adviser to litigation funder Validity Finance.

Fagin said law firms will likely stick with other means of raising capital, such as drawing on their credit without ceding control over their operations.

“The primary reason is law firms are partnerships, and I don’t think they want to cede control over their operations or their destiny by looking for other forms of investment that will entail ownership or governance,” Fagin said.

Advocates of alternative business structures (ABS) for law firms point to the potential for investors to help finance growth initiatives and tech upgrades without having to draw from equity partners’ accounts. But Shunk said the immediate haircut partners would have to take from sharing their profits with investors, in exchange for possible growth years later, is a “difficult sell” for many firm partnerships.

“In the existing model, partners are generating wonderful compensation and they get high profits out of the business,” she said. “If you suggest to them we’re going to reduce your take-home 10% and years down the road you’re going to increase 50% ... that’s a difficult sell to partners.”

Widespread embrace of ABS will likely be precipitated by a major law firm that proves the concept is successful, Shunk predicted. “Ultimately, you have to have a large player demonstrate that it could be highly successful before you start to see firms take a step in that direction,” Shunk said.

Josh Kubicki, director of legal innovation and entrepreneurship at the University of Richmond, said nonlawyer influence over legal advice for clients is indeed a “red flag” for law firms. But Kubicki said he hopes that outside funders can add discipline to firms’ deployment of capital while allowing lawyers to maintain their independence.

“It comes down to measurement,” Kubicki said. “If I’m going to be giving you millions of dollars, I want to make sure you have the right resources to have a better chance to succeed. ... They should influence the business model but not the independent professional services of the lawyers. Law firms are not strong when it comes to performance metrics and resource allocation metrics.”

Funders Waiting on the Doorstep

Of all the business sectors most likely to share in the ownership of a law firm, it's no wonder why litigation finance has emerged as an eager candidate.

Financers have recognized that deploying millions of investor dollars into a contingency-fee case with the hope of reaping a cut of the award is, in microcosm, an alternative business model for law practices.

But those wanting to scale up that investment across an entire firm will have to wait for the regulatory regime across the U.S. to catch up with more permissive jurisdictions.

Validity Finance CEO Ralph Sutton said his company would buy in to a law firm's business, rules permitting. Outside sources of funding for a firm's operations would have the same intended effect as outside funding for a litigation claim, which is to level access to legal representation, Sutton said.

Publicly traded case funder Burford Capital said it was the first in the industry to take a share of a law firm, when in 2020 [it purchased a minority stake](#) in a U.K. litigation shop. Leaders at the companies said the deal allows Burford and PCB Litigation to consolidate the former's portfolio financing services with the latter's dispute resolution practice.

Jonathan Molot, Burford's co-founder and chief investment officer, called legal finance companies such as his "natural partners for law firms that embrace" the ABS that has emerged in Utah and Arizona.

"The immediate cash injection allows firms to make long-term investments without sacrificing post-tax partner capital," he said in a submitted article to [Law.com International](#). "For example, capital can be used to make key hires, invest in efficiency enhancing technology and facilitate growth into new sectors and jurisdictions."

Although his company is seeing an uptick in interest from investment banks asking it to put up the money for an equity deal with a firm, Burford co-chief operating officer David Perla said the company is taking a "conservative" approach in the U.S. because of the limited number of jurisdictions that allow entities to experiment with the ownership structure of law firms.

"We see the limits of states' acceptance of the interplay between Arizona ABS firms and a non-Arizona law firm," Perla said. "It's going to be a year or two before people get some comfort on what the limits are."

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