Q&A

UNCORRELATED AND UNPRECEDENTED

A BOLD OUTLOOK AS LITIGATION FINANCE FIRMS BRACE FOR A POTENTIAL DOWNTURN

Michael Nicolas is Co-Founder and Managing Director of Longford Capital. He is responsible for portfolio management, including underwriting, investment selection, and overseeing the efforts of independent attorneys and other professionals as part of due diligence. We spoke to him about how a potential downturn might affect the litigation finance sector.

WE'RE TALKING ABOUT THE ECONOMY IN THIS ISSUE, AND THERE'S A LOT OF SPECULATION ABOUT A DOWNTURN. WHAT IS YOUR OUTLOOK?

We founded Longford over a decade ago. What we've found is that this asset class is truly uncorrelated with the ups and downs of the market. The word *uncorrelated* is thrown around a lot in the investment space. But when we talk to our investors, when we look at our business, the two words *truly* and *uncorrelated* are what we always come back to.

If indeed we go into a recession — which there's a lot of chatter about — third-party litigation finance will continue to thrive. We've seen several economic cycles, including a global pandemic, when we experienced a significant uptick in demand.

DURING COVID, EVERYBODY HAD TO BE INNOVATIVE AND ADAPT IN THE SHORT TERM. BUT BACK IN THE GREAT RECESSION WE SAW THAT LEGAL SERVICES WERE NOT IMMUNE TO ECONOMIC FACTORS. CAN THIS SECTOR STAND THAT KIND OF TEST?

We don't see the world entering into a global financial crisis. But in downturns, we've seen increases in demand for corporate portfolios, which is where we work with claim owners on multiple lawsuits.

The other area where demand tends to increase is corporate monetizations. That's where we enable companies to monetize a portion of their contingent interest in future proceeds in a lawsuit, at moments when those claim owners may need to generate revenue in ways that they've never had to do before.

During the COVID crisis, we saw significant demand from companies of all sizes who were looking to generate revenue and looking to control their legal expenses. There was a significant tightening of legal budgets. I would expect to see this happening during a recession as well.

CORPORATIONS AND LAW FIRMS ARE VERY DIFFERENT TYPES OF CLIENTS FOR YOU. WHERE ARE YOU SEEING MORE ACTIVITY?

We continue to see more and more law firms embracing litigation finance. That ranges from the Am Law 50 law firms to smaller boutique litigation shops that are more nimble. We see expanding demand for capital, and a broadening of the relationships that we've built on the claim owner side.

There's also a growing group of corporations — companies of all sizes — that are looking to share risk, and also potentially add revenue by working with third-party litigation funders.

ON THE CORPORATE SIDE, IN DOWN ECONOMIES PEOPLE LOOK AT THE LEGAL DEPARTMENT AS A COST CENTER. THIS IS SOMETHING THAT CHANGES THE EQUATION SOMEWHAT. ARE YOU SEEING THAT?

Absolutely. There's a balance that a company must strike between pursuing an affirmative legal claim, which is an asset to the company, and the expense associated with pursuing that asset — what it takes to monetize that asset. For most companies, particularly in a recessionary period, while they may hold a valuable asset in the form of a legal claim, litigation is not their core business. Even monetizing a portion of that claim during a recessionary period offsets legal expenses and puts money to the bottom line.

LET'S TALK ABOUT THE LAW FIRM SIDE A LITTLE BIT MORE DEEPLY, BECAUSE YOU MENTIONED THE AM LAW 50 FIRMS EMBRACING THIS TO SOME EXTENT. THAT'S A FAIRLY RECENT DEVELOPMENT, RIGHT?

The prevalence of litigation finance continues to grow year over year. When we first entered this asset class, a lot of what we did was education on what litigation

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finance is, and why it's a better solution to the billable hour model.

Over the last several years in particular, the acceptance of commercial litigation finance has reached a point where firms of all sizes — whether they be the largest firms or the smallest — are not only aware of litigation finance, but they see that their competitors are utilizing it to their benefit. And so, we see a broader acceptance of the asset class.

The second piece of the puzzle is that firms of all sizes are looking at litigation finance as a way to meet the clients' demands to share risk. Clients are simply not interested in paying 100% of a firm's hourly rates.

IN THIS ECONOMIC CYCLE, THIRD-PARTY FUNDERS ARE A LOT MORE VISIBLE THAN THEY'VE BEEN PREVIOUSLY. WHAT DOES THAT MEAN FOR YOU?

In our view, the increased awareness of litigation finance helps level the playing field for litigants.

When a well-financed defendant and its counsel are aware that there is a reputable third-party litigation finance company on the other side of the table, we think there is an appreciation and understanding that a sophisticated party that is not one of the litigants has evaluated the case, has come to the conclusion that it is highly meritorious, and is willing to put independent capital behind the prosecution of those claims to hopefully reach a successful conclusion.

They understand that the tried-and-true defense strategy of outlast and outspend will not be effective. Hopefully, what this leads to is not only a balancing of the scales of justice, but also adding efficiency to the legal process.

WE ARE ENTERING AN ELECTION CYCLE. DO YOU SEE LITIGATION FINANCE BEING A POLITICAL ISSUE AS WE MOVE AHEAD?

We've been through both Democratic and Republican administrations during our time here at Longford, and what we've seen is that our business is unaffected by who's sitting in the Oval Office.

Much more important than whether we have a Republican or Democratic president is the continued growth and education process that we're deploying to make all constituents aware of the value of commercial litigation finance. That really isn't impacted at all by whoever is in the administration.

WHAT ELSE ARE YOU SEEING IN THE SPACE? WHAT'S NOTEWORTHY?

We are seeing a dedicated effort on the part of funds in the asset class that are now devoted entirely to the secondary market. We've always believed this is one of the key examples of growth. It's a sign of maturation of the asset class.

In addition, we have seen a significant increase in interest from large insurers to participate in our asset class. We have worked with some of the leading insurance carriers in the world to craft judgment preservation policies that protect positive trial judgments from the risk of reversal on appeal. Several large insurance carriers have begun to offer portfolio insurance wrappers, where the carriers will insure some or all of a litigation funder's portfolio of investments.

These are significant steps forward for our asset class, additional indications that litigation finance is here to stay.

THE MATURATION OF THE ASSET CLASS IS AN INTERESTING TOPIC. WHERE WOULD YOU SAY WE STAND RIGHT NOW ON THE SPECTRUM?

I'd say we're still in the early innings, to be honest with you. I'd say we're in the third or fourth inning of a nine-inning ball game when it comes to the overall potential of this asset class.

When we look at where and when Longford started — which was with single case investments back in 2011 — to where we are today, we have matured a lot. More competitors have come online. But there is still plenty of growth that remains, and that's exciting. I'm curious to see, as a veteran of the space, where we'll be a decade from now.