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OCCASIONAL PAPER

# An Early Assessment of the Civil Justice System After the Financial Crisis

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Something Wicked This Way Comes?

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The research described in this paper was conducted within the RAND Institute for Civil Justice, a research institute within RAND Law, Business, and Regulation (LBR). LBR is a research division of the RAND Corporation.

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Published 2012 by the RAND Corporation  
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## Summary

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The financial collapse of 2008 has had a lasting, disruptive effect on many aspects of the U.S. economy. Whenever unforeseen economic disruptions produce widespread losses, there will predictably be some civil justice system aftereffects as people seek compensation for those losses. The shock of the financial collapse arguably may have had a deep justice system impact: The subsequent erosion in state budgets has placed stress on court mechanisms at the same time that particular kinds of litigation, such as disputes over foreclosure, seem to have increased.

In 2009 and 2010, RAND researchers engaged in a series of investigations and conversations that focused on the impact of the financial crisis on various facets of the civil justice system. This paper provides a snapshot of several of these facets, from the initial years of the post-2008 “collapse era” to early 2011. We focus, in particular on (1) state judicial branch resourcing, (2) patterns of litigation, (3) securities litigation and enforcement, (4) trends in the legal services industry, and (5) legal aid and the provision of legal services. We formulated this list of topics based on aspects of justice system performance that we felt were particularly important, incorporating input from the RAND Institute for Civil Justice Board of Overseers and our RAND colleagues; we targeted areas with anecdotal evidence of an impact associated with the financial crisis and for which we were able to identify public sources of information to draw a picture of the short-run effects of the financial crisis. Beyond providing a summary overview, this paper also comments on the availability of descriptive data on the civil justice system and poses related policy questions that future studies might address.

The most fundamental insight we can offer, based on this yearlong research effort, is that it is still very early in the game to draw firm conclusions about what the ultimate effects of the financial crisis will be. Between 2008 and 2010, there were observable blips and inflection points in several elements of civil justice performance and resourcing, such as the volume of home foreclosure filings and the level of federal and state funding for legal aid services. These sorts of blips, and the potential for longer-run sequelae with public policy significance, deserve closer empirical scrutiny over time. Our chief observation at present is that limited and low-quality data across many dimensions of civil justice system performance will hamper any future empirical efforts. Consequently, we suggest a set of priorities for future civil justice data collection activities. Our second observation is that the financial crisis, although itself a transient event, may also be a marker for a more fundamental transition in the posture of government and in the broad availability of public-sector resources in the United States. If indeed that proves to be true, then narrow causal questions about the effects of the financial crisis on the civil justice system may eventually prove to be tangential and less important than the simple ability to trace the system’s performance and resourcing empirically over time. It is our hope

that this paper makes the case for undertaking the latter effort as a high priority for empirical legal research in the future.

## **State Court Funding**

Available summary data from the National Center for State Courts (NCSC) suggest that many state court systems experienced both stress and funding reductions in 2009 and 2010. Whether these developments can be attributed to the financial crisis, however, is less clear. Results from our examination of seven years of official appropriations budgeting data for each of several selected state court systems were surprising: They did not reflect the broad downturn in judicial branch funding that has been described by NCSC and anecdotally reported elsewhere. We discovered, in reading the annual reports published by the state court systems, that (1) those systems involve financial and accounting complexities that are difficult to parse from the reports themselves, and (2) in some instances, the official budget data are difficult to reconcile with the official narrative describing the same budgets. Given that anecdotes continue to accumulate that state courts are facing serious fiscal problems, we think that further investigation into the financing mechanisms of state courts—and better accounting data describing their actual resourcing levels—are high priorities for future research.

## **Patterns of Civil Litigation**

Descriptive data suggest recent increases in civil litigation volume in many trial courts, possibly associated with the financial collapse. In particular, federal bankruptcy and state foreclosure filings have surged. Moreover, according to NCSC data, the number of national civil claims in the state courts rose for the entire decade from 1999 to 2008, and similar trends were observed in California, Florida, Illinois, New York, Pennsylvania, and Texas. Unfortunately, the NCSC statistics on state court litigation include a data lag of two years, so, at present, it is impossible to determine whether the trend through 2008 has been sustained more recently. Further analyses of trends in state court funding might be complemented by additional administrative data describing court processes, caseloads, and resources. Overburdened, underfunded state courts may find it difficult to effectively administer justice when faced with ever-mounting demands. Future empirical research studies can and should investigate these concerns.

## **Securities Litigation**

The published summary data on securities litigation suggest that the financial crisis has had a mixed impact on justice system activity in the area of securities litigation. Five-year trends through 2009 show that some indicators of securities litigation activity rose in 2007 and 2008, corresponding to an increasing volume of cases related to the crisis. Per the Stanford Securities Class Action database, for example, new securities class action suits increased in volume during 2007 and 2008, but the new suits began to subside in 2009, and the downward trend reportedly continued in early 2010. Meanwhile, government enforcement activity, as reflected in U.S. Securities and Exchange Commission settlements, apparently did not tick upward as a

result of the financial crisis (at least as reflected in data from NERA, an independent consulting firm). Finally, insurance industry consulting firm Advisen's database and annual summary statistics tracking "securities litigation" show an upward trend in the overall volume of litigation since 2005—a period not limited to the crisis of 2007 and 2008. Taken together, these various data sources suggest that there may have been a securities litigation surge associated with the financial crisis but that this has manifested in complex and inconsistent ways across different snapshots of the justice system.

## **Legal Services Industry**

In the wake of the financial crisis, a variety of anecdotal and government sources suggest that legal services employment plunged, legal budgets dried up, and companies and law firms looked for new ways to economize on legal services. According to the U.S. Census Bureau, the legal services industry shed 50,000 jobs between 2007 and 2009, returning to 2003 employment levels. Whether the direct effects of the financial crisis will produce longer-lasting shifts in the legal services industry remains an open but compelling question. The financial crisis in 2008 may have accelerated longer-term trends toward alternative billing arrangements, legal process outsourcing, alternative firm ownership structures, and third-party litigation financing arrangements, but these changes began before the crisis. Going forward, it will be important to consider how these changes in the legal economy and services market affect the legal profession and the broader civil justice system. New developments in firm and in-house employment of lawyers, law firm business models, and the ownership of law firms may have significant consequences for the operation of business enterprises and for the justice system. Perhaps our most practical observation concerning these various topics is that basic data on legal services innovation are scarce. Consequently, there may be important opportunities for future civil justice research to address these data needs and to better document emerging business practices and related outcomes in the legal services sector.

## **Provision of Legal Aid Services**

Based on our review, the general U.S. outlook for legal aid services (i.e., subsidized legal counsel provided to low-income persons in connection with a range of civil matters) appears grim. At the same time that the demand for various forms of legal assistance appears to be on the rise, funding for those services has come under increasing pressure and legal aid programs have felt the squeeze on their operating budgets. Taken together, this increased demand for legal aid services and funding coupled with a diminished supply may reduce access to the justice system for low-income earners in ways that disproportionately affect the most vulnerable members of society. This aspect of the civil justice system could be a major focus area for future research.

## **Recommendations for Future Civil Justice Research**

Taken as a whole, our review on the financial collapse and the civil justice system suggests three potential angles for a future research agenda. First, there are several possibilities for new

major data collection. For example, better data are needed on court system budgets, securities litigation, and legal outsourcing and alternative fee arrangements. Second, the impact of the financial collapse invites a focus on the judiciary and the legal profession, as well as on outcomes and process measures pertaining to civil litigation itself. Finally, we believe that the top priority for new civil justice research involves a deeper examination of judicial branch resourcing and financing across the states. Better data on resourcing, and a better taxonomy for state court system financing mechanisms, could offer a much clearer picture of the operating “strain” on the civil justice system going forward. We also believe that such financing information could be combined with various judicial branch administrative performance measures to explore how court systems respond to austerity and the ultimate impact of austerity on litigation volume and outcomes.