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Patrick Moloney: Litigation actions an asset if outsourced

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The Australian Legal Review, a magazine devoted to legal affairs, is published today. In this edited extract of his interview with legal affairs editor Chris Merritt, LCM chief executive Patrick Moloney puts the economic case for litigation funding.

Chris Merritt: When people think about litigation funding they think about class actions. But I hear that is not the main game.

Moloney: Absolutely. If you look at LCM's portfolio of investments into litigation you will find the vast majority is into commercial disputes and arbitration, and while we certainly do operate in the class action space, it is by no means the largest part of our business. As a company we have a balance between our investments into various sectors. We manage our portfolio of investments such that we go into commercial insolvency arbitrations and into class actions. We don't like to have a concentration of risk in one sector.

Merritt: Tell me about the corporate side of things.

Moloney: Traditionally litigation finance was very much seen as a product that was used only by impecunious claimants or claimants who could not really afford to pursue their rights through the courts. We all know that litigation is exceptionally expensive. But what we are now seeing is a move towards corporates who can afford to run their own litigation but are deciding that they really want to look at outsourcing the cost of that to someone else's balance sheet.

So in very much the same way as they would use other corporate finance products, they are now looking to outsource that in the same ways they might lease photocopiers or a fleet of cars. They are looking at an external source of capital to run their litigation.

Merritt: I see. And using their own capital to run their business?

Moloney: If you think about it as an investment, they are probably much better at doing whatever their core business is than investing shareholders' funds in a piece of litigation.

Merritt: So by using outside capital, does this make it possible for companies to extract value from causes of action that were withering on the vine?

Moloney: Yes. We encourage corporates really to look at their pieces of litigation as assets. Now they are typically not of that mindset. Typically they see litigation more as a liability and something that creates drag on their profitability as opposed to an asset.

We encourage corporates to look at it as an asset and we provide a number of services including monetisation of these pieces of litigation before the courts might adjudicate them.

So we can make litigation far more efficient for a corporate.

Merritt: I imagine the other benefit is having an independent set of eyes have a look at a case?

Moloney: And not only just another independent set of eyes but someone whose sole business is looking at litigation and whether a case is going to be successful. And we also look at it with the - entirely dispassionate or forensic eyes.

The other advantage that corporates get from using an external capital source is the litigation spend inside a corporation is horribly inefficient. It has to be expensed, it cannot be capitalised against that intangible asset being the outcome of the litigation. So in any given year whatever a corporation is spending on its litigation is eroding its EBITDA, which is in turn eroding its profitability, which in turn if they are valued on a multiple of their price-earnings ratio is eroding their valuation.

So there are sound economic reasons why you would want to outsource that spend.

Merritt: Is this hitting home. Are general counsel getting this?

Moloney: Financial controllers of corporations do, because they are much more keenly focused on the financial aspects of litigation and what effect that might have on cash flow, on profitability.

We are undertaking modelling exercises with a number of very, very large listed corporations in the Australian market. But the driver for this is really coming from offshore.

We have an office in London that services the London market and Europe. We are getting a lot more traction in those markets. But certainly Australian corporations are now seeing the significant merits in this.

Merritt: Is it one-off funding? Would a company just take financing for one dispute or is it a broader thing?

Moloney: We are encouraging larger corporations to allow us to bundle together a larger amount of litigation, and by doing that we can reduce the risk for the funder in terms of providing a capital source, which is non-recourse.

And by doing that we can reduce the cost ... to make it a whole lot more palatable than a single-case investment for us. A single-case investment for a funder has a binary outcome. You win or you lose or you negotiate a profitable or an unprofitable outcome.

And that is one of the reasons why it's an expensive product. But if you can spread that risk across five, six, seven pieces of litigation, you can bring the costs down.

Merritt: For a lot of companies I imagine this would involve a complete flip in mindset because for a long time they would have associated litigation funding with class actions and with being on the wrong side of that dispute. Now it sounds like what is happening is litigation funders, yourself anyway, are going to be the best pals of business.

Moloney: We are very much encouraging corporations to think about this more as a sophisticated corporate finance tool. There are some compelling reasons why they should be using a non-recourse form of capital to fund litigation, which would otherwise erode their profitability. It just makes so much commercial and economic sense.

What we are seeing now is the transition to people using this by choice and that is really a tipping point that is going to exponentially open up such a large market for the litigation finance industry.