Funding Patent Assertion Litigation

By

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If you want to sue for patent infringement, but you do not have the resources to pay for patent litigation, you are in good company.[2] Expect to pay $3 million or more for serious patent infringement litigation. All but the largest companies have reason to consider alternatives to direct funding of patent assertion litigation.

We explore in this article a variety of alternatives to direct funding of patent assertion litigation. The company embarking on a patent litigation must consider some threshold questions. It must have respectable odds for winning the case, and therefore at a relevant stage must have its case evaluated by counsel with experience. It must have available to it, either in house or otherwise, personnel who can devote time to making strategic decisions during and concerning the course of the litigation. If the technology involved is its own, the company must also be ready to have its technical personnel devote substantial time to the litigation. If the technology involved is not its own, then the company must risk being called a “patent troll”, a term coined in 2001 by Peter Detkin, then assistant general counsel at Intel Corp, to describe a patent holder who seeks to enforce a patent without intending to practice the technology that is patented.[3]

It has been pointed out that because patents are exclusionary rights, big companies, producing many products, often sue for infringement of patents covering technology that they do not practice.[4] Peter Detkin, who is now with the patent aggregator Intellectual Ventures, co-founded by Microsoft alumni Nathan Myhrvold and Edward Jung, has changed his position and has now decided that the term “patent troll” should apply only to one who “must own no more than a few patents of questionable merit and is not in any business related to the patents.”[5] Regardless, the company suing to enforce patent rights cannot expect to be popular with the targets of its enforcement.

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[2] We assume here that the reader has an expectation of suing on a particular patent or a suite of patents. There is a different task altogether in evaluating a large portfolio of patents to identify specific patents as candidates for licensing or enforcement activities. A representative company in this space, one that manages a team of technical personnel to provide evaluations of portfolios to identify candidates for licensing or enforcement, is UTEK-EKMS, Inc. (www.ekms.com). Although there is some overlap in capabilities of companies like UTEK-EKMS and the patent assertion manager-brokers discussed below, their core competencies lie in distinct, albeit adjacent, areas.

[3] See excerpt from Brenda Sandburg, "Inventor's lawyer makes a pile from patents," The Recorder, July 30, 200, at www.wordspy.com/words/patenttroll.asp.

[4] See Alexander Poltorak, “On Patent Trolls and Other Patent Myths,” presentations at IPO Conference, March 2005 and at AIPLA Spring Meeting, May 11, 2005, and downloadable at www.patentclaim.com/Patent_Claim/Media_Coverage/160/.

[5] The quote is a paraphrase appearing in Brenda Sandburg, “A Modest Proposal,” The Recorder, May 9, 2005, reproduced at www.law.com/jsp/article.jsp?id=1115370308794, which in turn is cited on the web site of Intellectual Ventures at www.intven.com/RecentNews.

The potential sources of funds for patent assertion litigation come from a variety of places. One can buy patent enforcement insurance, but the structure of such insurance differs from more traditional kinds of insurance and such insurance is not available if you already have a target in your patent gun sight. One may be successful in having patent litigation counsel fund the litigation in whole or in part, but such deals are not easy to find and are tricky. One might strike a deal with a patent assertion manager-broker, but there are few of these with experience. One might seek to talk directly to a funding source that has its own capital resources, but most such funding sources are inexperienced in dealing with patent assertion litigation. Finally, regardless of the method used for financing patent assertion litigation, one must still address who makes the critical decisions about the litigation and how these decisions will be made.

We will discuss these topics in order: patent assertion insurance, contingent fee arrangements for patent assertion, third party funding arrangements (achieved through manager-brokers and directly), and considerations when using outside funding.

Patent Assertion Insurance

Patent assertion insurance differs from normal hazard insurance, because in the case of patent assertion insurance, the insurer typically has the right to recoup, from the insured, some or all of the insurance proceeds if the litigation is successful. In other words, a company pays a premium to insure against the risk that the company might incur expenses in bringing a suit for patent infringement. If this risk materializes, and the company needs to bring a suit for infringement, then, if the policy terms are met, the insurer will pay the company's legal fees incurred for bringing the infringement suit. If the company is successful, however, the policy in this context typically gives the insurer the right to recoup some or all of the insurance proceeds from the company.

The insurer's right to recoup its proceeds under various conditions makes patent assertion insurance different from typical hazard insurance. On the other hand, the policy typical requires that the insured did not know of the infringement at the time of purchase of the policy. This limitation is critical. It can be a basis for denying an insured's claim downstream. So if you, as a patent owner, are already targeting a particular infringer for patent infringement litigation, it is too late for patent assertion insurance.

Patent assertion insurance may make sense for a small or medium-sized company amassing a patent portfolio developed to cover ground-breaking products that threaten old-technology product offerings by big companies. In such a case there may be no known or even suspected infringement as yet, even though there is a good likelihood of infringement later on.

Patent assertion insurance of the type discussed above is offered by Intellectual Property Insurance Services Corporation, 9720 Bunsen Parkway, Louisville, KY 40299 (www.infringeins.com).[6]

Contingent Fee Arrangements for Patent Assertion

[6] As to patent insurance generally, see Richard S. Betterley, CMC, "INTELLECTUAL PROPERTY INSURANCE MARKET SURVEY 2005: A Small, but Important, Market," The Betterley Report, April, 2005, published by Betterley Risk Consultants, Inc. (www.betterley.com), excerpted at www.betterley.com/adobe/ipims_05_nt.pdf .

If you have found a lawyer willing to handle your patent assertion litigation on a contingency basis, you might be lucky, but you should also be worried. If you are a lawyer willing to handle your client's patent assertion litigation on a contingency basis, you might be lucky, but you should also be worried. Both scenarios—which are really the same scenario seen from different points of view—highlight the great risks and great rewards associated with patent assertion litigation performed on a contingency basis.

Consider that the law firm handling patent infringement litigation on a contingency basis is financing the three-or-more-million-dollar charges of such litigation. In fact, the $3 million figure is an estimate only for proceedings through trial. Where interpretation of patent claims is at issue, the reversal rate on appeal of patent cases is approximately 40%. The appeal statistics make the litigation more unpredictable and point to further delay in judicial resolution of the underlying dispute. Moreover, of the $3 million, expert witness fees and other out-of-pocket costs may consume $1 million. With charges at this level, the scope of work in contingent fee patent litigation goes beyond typical contingent fee personal injury litigation and more nearly approximates the scope of work in class action tort cases. The client needs to know whether the law firm has the staying power to handle a case of this magnitude—let alone the expertise necessary to mount a patent infringement case in the first instance. Even the law firm that has experience in patent litigation may become dispirited if in the course of the litigation the going gets rough and the odds seem longer than they were at the outset. Will the client still have vigorous representation? The law firm considering taking a patent infringement case on a contingency basis must ask the same questions. The financial risk for the firm undertaking patent assertion litigation on a contingency basis is that it will have made a multimillion dollar effort and expended a million dollars in out-of-pocket costs and receive no compensation.

Although, for ethical reasons, the client in contingent fee litigation must remain liable for the out-of-pocket costs of litigation, it is another question altogether whether the law firm will require payment of such costs up front (at the beginning of the litigation as an advance) or at all. Many clients seeking contingent fee arrangements, including for patent assertion litigation, do not want to advance or to cover costs and are often unable to do so.[7]

As a foundational matter, no law firm a client would want to hire would take on a patent assertion contingency litigation, unless the two key prerequisites for contingency litigation are satisfied: a good case for liabilities and a good case for damages. There must be a good case to establish that the targeted defendants are liable for patent infringement. A case that is weak is not likely to excite interest for contingent fee litigation. There must also be a good case to establish substantial damages for infringement. How substantial?—substantial enough to justify incurring $3 million of risk for a loss. This means considerably more than $3 million of potential damages. Fifteen million dollars would seem to be a floor. Twenty-five or more million dollars would be much better to obtain interest of a firm on a contingent fee arrangement.

The agreement for contingent-fee-based patent assertion litigation should not be hastily assembled, and must address the specific risks associated with such litigation. First, of course, one must address how to share the recovery in the event of success.

[7] See discussion below on questions of champerty and maintenance.

Although in a personal injury case a law firm might find one-third of the recovery would be normal and reasonable compensation, the greater risks associated with patent litigation usually lead the law firm to seek a greater percentage, forty or more percent, if the case proceeds through trial.

In fact, the sharing arrangement may be considerably more complex. The case might be settled with royalty payments, or other payments that come in stages. It often makes sense to share the settlement proceeds in layers. It is normal in any event for the law firm in contingency litigation to obtain recovery of its out-of-pocket costs "off the top". So costs may be subtracted from the proceeds before sharing the balance. As an example, for structuring the sharing of the balance, the parties might decide that, of the balance, the first $10 million will be shared evenly, and any of the balance above $10 million, regardless when received, will be shared with the law firm getting one-third and the client getting two-thirds. Variations on this theme are endless. Maybe there will be administrative charges associated with monitoring or handling royalties that can be assessed by the law firm if the payments are received over multiple years. Maybe there will be multiple defendants and different arrangements depending on which defendant contributes to the recovery.

Sharing the recovery, however, is only one of many terms to address. The agreement should not be entered into without addressing expectations of the parties for the litigation. What is a reasonable settlement? A law firm might expect much more money than the client expects as a payment to settle a case—or vice versa. If the settlement offer is $5 million, and the law firm's invested fees and costs to date are worth $2.5 million, would the client accept the settlement? Would the law firm accept the settlement? The parties need to discuss these questions in advance. Consideration should be given to placing these matters in the agreement to the extent that they can be worked out. Alternatively, one may hedge the question while still confronting them generally by memorializing target recoveries that would be expected by the parties to be satisfactory for settlement purposes.

Typically, a patent suit may be filed in any of a number of jurisdictions. Some jurisdictions, such as in Delaware, in northern California, and in parts of Texas, are favored as a result of factors including the experience of the judges, the speed to trial, and the existence of specific local rules for patent cases. Similarly, there will almost certainly be the need for testimony by experts in damages and in the relevant technology. Moreover, one side or another will likely want to call the inventor or inventors to testify. The client and the law firm should discuss these matters in advance as well, with a view to aligning the expectations of both the law firm and the client.

While this discussion has focused on pure contingency arrangements, similar considerations apply to hybrid contingency arrangements. A hybrid contingency arrangement includes both a contingency component and a regular fee component. For example, the firm and the client might agree that the firm provide a fifty percent discount from its normal rates, but get paid all of the firm's out-of-pocket costs, and then obtain twenty-five percent of the proceeds from a successful outcome of the litigation. Of course the amount and nature of the discount can be subject to negotiation, as well as the share of the proceeds on contingency.[8] The presence of the contingency payment means that the law firm and the client need to go through the same exercises as discussed above in the case of a pure contingency arrangement.

Third Party Funding Arrangements

Because contingent-fee-based patent assertion litigation arrangements are few and far between, third party funding arrangements can make a difference to a company seeking to assert one or more patents against a targeted infringer.

Third party funding can come from a number of sources, which we categorize as follows: patent aggregators, patent assertion manager-brokers, patent assertion broker-manger-investors, and novice patent litigation investors. These categories have some overlap with one another, but we will consider them each in turn.

The patent aggregators are in the business of building up portfolios of patents, which they may seek to license at least voluntarily (that is, without litigation) as a group. A company having a patent to assert may find that its patent has joined forces with other patents in the portfolio of the patent aggregator, which then may seek to license groups of patents in the portfolio. Representative patent aggregators include GE Licensing and Trading, One Independence Way, 4th Floor, Princeton, NJ 08540, a unit of General Electric; Intellectual Ventures, Bellevue Washington (www.intven.com), and Acacia Technologies Group, Newport Beach, California (www.acaciatechnologies.com).[9] Except for Acacia Technologies, the activities of these companies are not well publicized. If Acacia Technologies is unsuccessful in voluntarily licensing technology in its portfolio, it has not hesitated to bring suit. It may be possible to structure a deal with a patent aggregator in which the patent owner obtains a share in any recovery by way of licensing or litigation. Because the patent owner has only a passive role in exploiting the patent property in this context, however, the share of recovery available to the patent owner may be less than in other contexts. On the other hand, placing the patent property with a patent aggregator may be useful if the property itself is not a good candidate by itself for patent assertion litigation

The patent assertion manager-brokers typically operate in a different way, by considering a company's patents to be asserted on an individual basis and specifically with potential litigation in mind. Representative patent assertion manager-brokers include PhoneTel Patent Services, Incorporated, Ft. Worth, Texas (www.phonetel.com); General Patent Corporation International, Suffern, New York (www.patentclaim.com); and ThinkFire Services USA, Ltd., Clinton, NJ (www.thinkfire.com). These companies often have relationships with a number of patent attorneys and patent litigation attorneys to assist them in evaluating cases and in providing representation if voluntary licensing is unsuccessful or would be futile. They also have identified sources of funding patent assertion litigation. As brokers, these companies may structure litigation with their

[8] It is also possible to structure the non-contingency portion with a cap, but a law firm contemplating the acceptance of a cap should first understand the scope of open-ended work for which it might be signing up once the cap has been exceeded.

[9] Particularly as to Acacia Technologies, see Stephen M. Cherry, "The Patent Profiteers," IEEE Spectrum Online, 25 June 2004, at www.spectrum.ieee.org/WEBONLY/publicfeature/jun04/0604aca.html.

attorneys and litigation funding sources so that they (along with their attorneys and funding sources) receive a portion of the proceeds if there is a successful outcome.

Another category exists where the patent assertion manager-broker also has internal sources of funding. In this category—perhaps uniquely so for now—is Altitude Capital Partners, L.P., of New York, New York (www.altitudecp.com). This company can fund from its internal resources a patent assertion litigation that it likes, and, like the patent assertion manager-brokers, has a number of patent attorneys and patent litigation attorneys to assist them in evaluating cases and in providing representation if voluntary licensing is unsuccessful or would be futile.

Novice patent litigation investors are the last category. Most seasoned investors are still novice investors when it comes to investing in patent assertion litigation. However a seasoned investor may become interested in investing in patent assertion litigation. In the case of novice investors, someone still has to structure the arrangement among the parties. That task must fall at least in part on the patent litigation firm, because, just as in the case of contingency litigation, it is litigation counsel who will be able to identify the issues on which the parties need to have some consensus.

Ethical Considerations and Funding Structures

It will be apparent that investing in litigation raises ethical considerations when the investor is someone other than the attorney or firm doing the litigation. In particular, "maintenance" is rendering assistance or encouragement to a party in litigation by one who has neither an interest in the litigation nor any other legally justifiable reason to do so. "Champerty" is a kind of maintenance, in which one obtains a share in the outcome of the litigation in exchange for rendering assistance. It is critical to structure the funding of patent assertion litigation so as to comply with ethical standards.

If the arrangements between all the parties are purely contractual, there is a reasonable chance that they could run afoul of these ethical requirements. A more sophisticated way of structuring the arrangements is to transfer the patents to an LLC or limited partnership or similar entity and provide an interest in the entity to each of the participants in the arrangement—for example, to the original patent owners, to the funding source, and to the law firm. Then the LLC is the client bringing the legal action, and all the participants have a direct interest in the client.

In structuring the arrangements with third party funding, one must still address all of the matters discussed above in the context of contingency litigation: the manner in which proceeds will be shared, how the litigation will be conducted, and what criteria should be applied in accepting settlement. If these matters are addressed carefully, then the arrangements can be optimized for success.

Conclusion

A patent owner seeking to fund patent assertion litigation has greater needs than the ordinary patent owner. Both patent owners want savvy patent litigation talent, but the patent owner seeking funding needs a counselor who understands risk and who can structure a funding arrangement that works in the complex world of patent litigation. Such a funding arrangement must create an alignment of interests in the outcome of the litigation, must reflect the expectations of all the parties, and must provide an equitable and ethical distribution of the proceeds. A funding arrangement that achieves these goals gives the patent owner a real opportunity in patent litigation and a chance to participate in any resulting success.