DAVID VS. GOLIATH PATENT CASES: A SEARCH FOR THE MOST PRACTICAL MECHANISM OF THIRD PARTY LITIGATION FINANCING FOR SMALL PLAINTIFFS

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I. INTRODUCTION

"Nearly every man who develops an idea works it up to the point where it looks impossible, and then he gets discouraged. That's not the place to become discouraged"

-Thomas A. Edison

Small private entities and individuals comprise a very small percentage of plaintiffs in high-tech patent litigation. The American legal system has given them the tool, in the form of patents, to protect these breakthroughs from infringement. Despite having this tool, inventors often lack the means to wield it for the purpose for which it was designed. The low percentage of small entities and individuals who file high-tech patent lawsuits may well be explained by the fact that the cost of intellectual property litigation is prohibitive to these entrepreneurs being able to assert their legal rights against what is, oftentimes, a much larger allegedly infringing entity, which possesses far greater means to defend against any potential legal attacks.

There are multiple third party litigation funding alternatives for these patentees; some that have been utilized for years, and others that are newly emerging. This article briefly explores each of these methods in search of the most practical approach for these uniquely situated plaintiffs, and concludes that some newly emerging methods of third party litigation finance are the best-suited to help level the proverbial playing field for these David versus Goliath plaintiffs.

II. Background

Individuals and small private entities have long been a formidable presence in bringing about the innovations that drive technological developments and economic progress.[1] Yet, the cost of pursuing litigation to enforce the patents that protect the creative genius of these innovators has gone well out of their reach.[2] It has been noted that these costs are a likely catalyst in causing such a large number of patent lawsuits to be settled, in relativity to the small number that are adjudicated based on their merits.[3] In fact, most patent cases are settled quickly, within about twelve to fifteen months after the complaint is filed.[4] Moreover, the allegedly infringing adversaries frequently have greater financial means than the patent-holder.[5]

One study demonstrates the effects of this imbalance of wealth on the outcome of patent lawsuits filed by individuals, finding that "…individual plaintiffs had only half as good a chance

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[1] One commentator noted that:

> [A]n examination of more than 1,300 inventors listed in the May 27, 1997 Official Gazette of the USPTO showed a full 50 percent of domestic patentees came from entities with one thousand employees or less, or from the nonprofit sector. While large corporations are obviously an important piece of the innovation community, they also have more options than the smaller entities and are probably less dependent on the patent system in the first place.

Scott Erickson, *Patent Law and New Product Development: Does Priority Claim Basis Make A Difference?*, 36 AM. BUS. L.J., 327 at 336-37 (citations omitted).

[2] According to a 2009 economic survey commissioned by the American Intellectual Property Law Association (AIPLA), in patent infringement cases where the amount in dispute is less than $1 million, the total litigation costs can outweigh the amount at stake. In those there the amount at stake is between $1 million and $25 million, total litigation costs average in excess of $3 million. In cases where the amount in dispute exceeds $25 million, average total litigation costs are roughly doubled. William R. Towns, *U.S. Contingency Fees: A Level Playing Field?*, WORLD INTELL. PROP. MAG. (February, 2010), *available at* http://www.wipo.int/wipo_magazine/en/2010/01/article_0002.html (last visited Dec. 19, 2010).

[3] Jay P. Kesan & Gwendolyn G. Ball, *How Are Patent Cases Resolved? An Empirical Examination of the Adjudication and Settlement of Patent Disputes*, 84 WASH. U. L. REV. 237, 264 (2006) (noting that, according to the authors' data, approximately 80% of patent cases settle, which is "…cause for significant concern that the high transaction costs associated with patent litigation create incentives for parties to settle and inhibit the ability of the courts to rule on the validity and infringement of patent rights."); *Id.* at 311 (summarizing that patent litigation costs are a driving force of this finding, "[R]ulings on the merits by the courts concerning patent validity, patent infringement, and remedies for infringement, i.e., injunctive relief or damages, are rare, expensive, and not pursued to completion by most litigants.").

[4] *Id.* at 311. *See also* Jean O. Lanjouw & Mark Schankerman, *Protecting Intellectual Property Rights: Are Small Firms Handicapped?*, 47 J.L. & ECON. 45, 56 tbl.2 (2004) (reporting about ninety-five percent of lawsuits initiated by independent inventors between 1978-1999 were settled).

[5] Paul M. Janicke & LiLan Ren, *Who Wins Patent Infringement Cases?*, AILPA Q.J., Winter 2006, at 42.

as corporations to win patent infringement suits,"[6] and concluding that, "The wealth disparity very likely helps accused infringers to prevail by putting more effort into the case than the patent owners on average do."[7] In fact, the study found that the largest accused infringers in the data set (firms with over $1 billion in revenue) had by far the lowest chance of losing the case.[8]

Another survey found that small entities, dismayed by potentially overwhelming legal costs, are less likely to litigate to protect their patents, despite their belief that their patents are infringed upon at a higher frequency than those held by large corporations.[9] This data lends credence to the assertion that a rational would-be infringer may decide to infringe after taking the financial weakness of a small business or individual patentee into account, knowing that the risk of enforcement is relatively low[10], and that if such patentees do decide to litigate, their relative lack of financial strength strongly correlates with the outcome of the case.[11]

An oft-cited case that underscores the plight of these individual inventors is that of Robert Kearns, inventor of the intermittent windshield wiper used in vehicles.[12] Ford Motor Company refused Kearns' offer to license his technology, and proceeded to infringe on his patent.[13] After years of Ford allegedly stalling the litigation, Kearns had racked up $10 million in legal expenses before obtaining his second favorable judgment.[14]

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[6] *Id.* at 21 (according to the data compiled and examined, individual patentees won 12% of patent cases studied, in contrast to the overall patentee win rate of 24.4%).
[7] *Id.* at 42.
[8] *Id.* at 17.
[9] Jeff A. Ronspies, *Does David Need a New Sling? Small Entities Face a Costly Barrier To Patent Prosecution*, 4 J. MARSHALL REV. INTELL. PROP. L. 184, 197 (2004) (citing Josh Lerner, *The Patent System and Competition*, at 4, *available at* http://www.ftc.gov/opp/intellect/lernerjosh.pdf (last visited Dec. 28, 2010)); also noting that in a survey of 376 companies in 1990, legal costs were a factor in deciding whether to litigate for twice as many small entities as large companies. *Id.*
[10] Stuart J.H. Graham & Ted Sichelman, *Why Do Start-Ups Patent?*, 23 BERKELEY TECH. L.J. 1063, 1086 (2008).
[11] Janicke & Ren, *supra* note 4, at 14 (noting the "…finding that financial strength is significant when considered alone and also when considered in a regression with the other factors" in predicting the outcome of a patent lawsuit).
[12] Ronspies, *supra* note 8, at 196.
[13] *Id.* (citing John Seabrook, *The Flash of Genius*, NEW YORKER, Jan. 11, 1993, at 38).
[14] *Id.* (citing *The Week In Review, No Shortage of Saviors*, WASH. TIMES, June 14, 1992, at A14).

As a possible result of such disparities, individuals and small private entities brought only five and twelve percent of high-tech patent lawsuits, respectively, between January 1, 2000 and March 21, 2008.[15] Faced with such a daunting landscape, some observers have expressed fear that individuals and small entities are being discouraged from giving birth to new ideas and seeking patent protection for those ideas.[16] Two schools of thought regarding solutions might be borne out of the realities faced by these plaintiffs. First, perhaps the existing litigation system ought to be reformed and overhauled. Or, second, methods allowing resolution within the existing systematic framework of litigation ought to be explored, and new ones developed.

The first path, which might include the implementation of non-litigation-based alternatives for solving patent disputes such as compulsory arbitration or some form of patent defense union[17], or hybrid methods such as a mutual insurance association that would first mandate arbitration for members[18], is beyond the scope of analysis here. Instead, we will focus on the second path. In light of the fact that small plaintiffs usually lack the funds to mount a patent prosecution on their own, the current legal landscape dictates that they must turn to third party litigation finance.[19] But which form? This article seeks to examine the available

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[15] Colleen V. Chien, *Of Trolls, Davids, Goliaths, and Kings: Narratives and Evidence in the Litigation of High-Tech Patents*, 87 N.C. L. REV. 1571 at 1600 (citing data derived from the Stanford Intellectual Property Litigation Clearinghouse, http://www.law.stanford.edu/program/centers/iplc/ (last visited Jan. 28, 2011)). The data examined tracked suits involving hardware, software, and financial patents filed between Jan. 1, 2000 and Mar. 21, 2008. *Id.* at 1593. Small private entities are those with less than $10 million in annual revenue. *Id.* app. A at 1614.

[16] *See* Ronspies, *supra* note 8, at 203, 211 ("Litigation costs…act as a disincentive for small entities to patent their innovations…[and] the ability of the small-entity inventor to obtain and enforce patent rights is becoming an increasingly difficult financial burden to bear. The extreme cost of protecting a patent through litigation may result in fewer patents filed by small entities and thus less innovation.").

[17] Such solutions have been suggested for application in the European Union. *See* WILLIAM KINGSTON, ENFORCING SMALL FIRMS' PATENT RIGHTS (2000).

[18] *See* Mark C. Vallone, Note, *System and Method of Funding SMEs Commencing Patent Infringement Disputes*, 56 SYRACUSE L. REV. 181, 189-97 (2005). *But see* J. Rodrigo Fuentes, *Patent Insurance: Towards a More Affordable, Mandatory Scheme?*, 10 COLUM. SCI. & TECH. L. REV. 267 (2009) (calling for statistical studies similar to those conducted in Europe to analyze the viability of implementing a *mandatory* patent insurance scheme in the United States).

[19] The term "third party litigation finance," for purposes of this article, indicates a lawsuit that is financed by funds from a source other than the direct parties to the litigation. While the concept has sparked some controversy, its access-to-justice benefits are also increasingly recognized by commentators. *See, e.g.,* Susan Lorde Martin, *The*

alternatives and determine which among them is the most practical to help level the proverbial playing field for small private entities and individuals seeking to assert their legal rights in enforcing high-tech patents they hold against larger entities; so-called "David versus Goliath" cases.

For these individuals, unlike some plaintiffs, such as those in personal injury or products liability cases, methods of having the litigation financed by a third party are more limited, given the particularly complex and expensive nature of patent litigation. Among the funding arrangements that are available are contingency fee arrangements, loans, patent insurance, and, more recently, non-recourse funding and transfers of interest.[20] As will be examined, some of these solutions may have more utility for plaintiffs in other types of cases, or even for somewhat larger entities suing over a patent, but are simply are not practical for their individual or small entity counterparts.[21]

III. OUR STORY BEGINS…

Forgive us, if you will, for engaging a cliché little law school hypothetical for illustrative purposes. Our story begins with Ida Inventor, who had an innovative idea and designed a high-tech device that she hopes will revolutionize the daily lives of people near and far. She spent much of her savings to hire a competent patent attorney, who patented her idea, giving it protection from being imitated by a would-be competitor. As she sat down to breakfast one morning, she turned the television to the cable business news station. To her shock and horror,

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Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed, 10 FORDHAM J. CORP. & FIN. L. 55, 56-57 (2004) ("…litigation financing firms can provide a worthwhile service to level the playing field in lawsuits when defendants have much greater resources available than plaintiffs…"); Lauren J. Grous, *Causes of Action for Sale: The New Trend of Legal Gambling*, 61 U. MIAMI L. REV. 203, 205 (2006) ("Litigation financing companies can tip the scales in what would otherwise be a David versus Goliath-type situation – with the necessary cash, plaintiffs need not become victims of a sophisticated defendant with significant resources.").

[20] Michael L. Lovitz, Connolly Bove Lodge & Hutz LLP, American Law Institute - American Bar Association Continuing Legal Education Presentation: Strategies for Funding IP Litigation: Insurance and Other Avenues (October 19-20, 2006).

[21] *See infra* Section IV.

the leading story proclaimed that Conglomo-Enterprises (a large fictional company) is introducing a product, which happens to use her patented idea as a key component. Ida is but one humble inventor who now wishes to assert her legal rights against Conglomo-Enterprises for patent infringement. What are her options with respect to financing such a legal battle? In the pages that follow, we will follow Ida's journey in search of the most practical option for her and others like her.

IV. THIRD PARTY LITIGATION FINANCE SOLUTIONS

A. Contingency Fee Arrangements

Ida has heard of contingency fee arrangements. In fact, as a layperson, it was one of the first ideas that sprang to her mind. Like most of us, she has seen her share of television commercials, ranging from humorous and corny to downright somber, urging injured individuals to contact a particular law office to explore their legal options for obtaining redress against an alleged wrongdoer. The commercials promise that the attorney will not be paid unless the outcome of the client's case is successful; indeed, this is the very nature of contingency fee arrangements.[22] However, Ida seems to only recall hearing about such arrangements when someone has been physically injured.[23] She wondered: are such arrangements available for patent litigation?

As a matter of fact, contingency fee arrangements are available in intellectual property cases. The practice, while not as widely known and publicized as that for personal injury and

[22] Maya Steinitz, *Whose Claim Is This Anyway? Third Party Litigation Funding*, 95 MINN. L. REV. (forthcoming 2011) (draft at 26, on file with author).
[23] William E. Jackson, *Contingency Fee Representation in Intellectual Property Cases*, 1 U. BALT. INTELL. PROP. L.J. 207 (1993) (noting that contingent fee representation is well established in the practice areas of personal injury and products liability).

products liability cases, has been in use for decades by some practitioners.[24] Indeed, some very high-profile patent cases have been made possible by lawyers willing to work under a contingency fee arrangement.[25]

However, the supply of lawyers willing to take such cases on a contingency fee basis is small, due to a number of complicating factors, which are quickly pointed out by even those willing to work under these arrangements.[26] Chief among them is the very nature of a patent lawsuit; it is likely to be complex, drawn-out, and expensive to fight.[27] Other difficulties include the burdensome task of evaluating damages[28], as well as the fact that there is little incentive for patent lawyers to work based on contingency fees, since there is much work to be done that is paid on an hourly basis.[29] Despite the potential for windfall financial rewards for such practitioners[30], such risks result in very few attorneys who are willing to represent patent litigation clients on a contingency fee basis.[31] Given these risks and complexities, while an individual plaintiff with a personal injury claim wouldn't have any difficulty finding a lawyer willing to work on a contingency fee basis, one with a meritorious patent claim "may find that the best law firms for his or her case would prefer to charge by the hour."[32]

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[24] P.L. Skip Singleton, Jr., *Justice For All: Innovative Techniques for Intellectual Property Litigation*, 37 IDEA 605, 610 (1997) (noting that attorney Alfred Engelberg began litigating patent cases in 1985 on a contingency fee basis).

[25] The struggle of independent inventor Robert Kearns against Ford Motor Co. and others he accused of stealing his idea for intermittent windshield wipers was brought to the big screen in the 2008 movie "Flash of Genius." FLASH OF GENIUS (Intermittent Productions 2008); Kearns v. Ford Motor Co., 32 F.3d 1541 (Fed. Cir. 1994). Kearns was represented on a contingency fee basis by Arnold, White & Durkee, P.C. *Id.*

[26] Singleton, *supra* note 23, at 608.

[27] *Id.*

[28] *See* Jack L. Slobodin & Seyfarth Shaw, *Examining Damages Experts in Patent Litigation*, *in* PATENT LITIGATION 2003, at 667, 669 (PLI Pats., Copyrights, Trademarks, & Literary Prop. Course, Handbook Series No. 766, 2003) *available at* WL, 766 PLI/Pat 667.

[29] Singleton, *supra* note 23, at 608.

[30] *Id.* at 610 (even by 1997, attorney Alfred Engelberg had received more than $100 million in contingency fees, when the same litigation taken on an hourly basis would have yielded a mere $15 million).

[31] *Id.* at 608.

[32] Jonathan T. Molot, *Litigation Finance: A Market Solution to a Procedural Problem*, 99 GEO. L.J. 65, 74 (2010).

Additionally, if one is able to find a lawyer willing to litigate a patent claim on a contingency fee basis, the upfront and ongoing costs that many assess, borne by the patentee, in order to retain the lawyer's services have been estimated to be in the range of $20,000[33], which is likely a significant sum to a small business or individual. Contingency fee practitioners must be able to evaluate the damages at stake from the outset in order to determine whether to take on a particular case which, as previously noted, is a complex proposition in patent cases.[34] In order to do so, some require both an infringement opinion and a validity opinion from a first attorney, which can cost close to $10,000, payable by the patentee.[35] If the lawyer agrees to represent the inventor under a contingency fee arrangement after this analysis, additional costs payable directly by the inventor, estimated to at least match those of the infringement and validity opinions by a first attorney, include expenses for depositions, travel, and evidentiary exhibits.[36]

Thus, the lack of lawyers willing to take patent litigation cases on a contingency fee basis, coupled with significant upfront and ancillary costs payable directly by the inventor, results in a relatively impractical option for financing patent litigation brought by the small entity or individual patentee.

B. Loans and Non-Recourse Funding

Ida also wonders what sort of options may be available if she (or her law firm) needs to borrow money in the form of a loan in order to finance the litigation. If she is unable to find a lawyer to take her case on a contingency basis, Ida will need funds to pay the lawyer's hourly rate, or her lawyer may opt to borrow funds to cover these fees while the litigation proceeds. If a

[33] Ronspies, *supra* note 8, at 198 (citing John P. Costello, Patent Enforcement with Teeth, INVENTORS DIG., May 1, 1999).
[34] Slobodin & Shaw, s*upra* note 27.
[35] Ronspies, *supra* note 8, at 198 (citing John P. Costello, Patent Enforcement with Teeth, INVENTORS DIG., May 1, 1999) (noting that the average cost of an infringement opinion is $5,000, and the average cost of a validity opinion is $3,750).
[36] *Id.* (estimating ancillary costs to be approximately $10,000).

lawyer does take Ida's case on a contingency fee basis, the law firm will likely need to borrow money to cover the high costs of the litigation.[37] As it turns out, there are two subcategories of lenders that may consider loaning money to Ida or her lawyer: traditional lenders, and another group known as cash advance or "non-recourse" funding companies.

1. Traditional Lenders

One of the obstacles an individual or small business would face in trying to secure a loan in present times from a traditional lender is the sluggish economic climate that continues to persist. The results of a recent Federal Reserve senior loan officer survey painted a picture of hesitation and tightened standards in certain sectors of the lending arena.[38] Certainly, the availability of funds depends upon the type of loan being sought, as well who is seeking the loan.[39] For instance, an individual such as Ida may consider taking out a home equity loan, a cash advance on a credit card, or a personal loan[40] (or some combination of methods), and a business like her lawyer's firm (the size of which can obviously vary) would probably seek a business loan. Overall, however, the survey revealed that more than two-thirds of loan officers responded that, on average, their current standards and terms are more stringent than they have been historically.[41]

In addition to the challenges presented by the current economic climate, traditional lenders are generally ill-equipped to finance litigation if the borrower is seeking a specialized loan product with repayment tied to a potential recovery. After taking an application, a bank

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[37] Paul Bond, Comment, *Making Champerty Work: An Invitation to State Action*, 150 U. PA. L. REV. 1297, 1330 (2002) (noting that "…many small plaintiffs' firms finance their operations through bank loans.").
[38] Sudeep Reddy, *Banks Keep Lending Standards Tight*, THE WALL STREET JOURNAL, May 4, 2010, http://online.wsj.com/article/SB10001424052748704342604575222363579664310.html (last visited Jan. 7, 2010).
[39] *Id.*
[40] Any of which would have to be repaid regardless of the outcome of the litigation. Further, gaining access to the hundreds of thousands or even millions of dollars required to finance such litigation via a home equity loan or credit card is an extremely unlikely proposition for most individuals, particularly with the weak housing market wiping out homeowners' equity.
[41] Reddy, *supra* note 37.

must evaluate the request to loan funds, which is routine enough in cases of individuals taking out a home equity loan or credit card, where methods such as credit reports and home appraisals provide the bank with a means to determine the likelihood of the loan being repaid. But evaluating a request for a loan to an individual or a law firm with only the potential litigation recovery as collateral is anything but routine, since valuing a claim is much more complex and uncertain than valuing, say, a tangible asset.[42] Typically, such valuation is the domain of experienced trial lawyers and insurance claims adjusters, rather than loan officers.[43] Further, in the case of a law firm, if it operates primarily on contingency fees, it does not have accounts receivable like other firms that operate on an hourly or flat fee basis.[44] Finally, there are usually no installment payments to be made on such loans, no set maturity date, and it is often difficult to enforce a security interest in anticipated recoveries.[45] In order to be compensated for such risks and uncertainties, the appropriate interest rate on a subject loan may likely violate usury laws.[46] While it was noted in 2004 that some banks had started a new line of business by extending lines of credit to contingency lawyers[47], they frequently employ cumbersome application,

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[42] Douglas R. Richmond, *Other People's Money: The Ethics of Litigation Funding*, 56 MERCER L. REV. 649, 651 (2005) (noting that "...the lender may have no means of valuing…varied cases.").
[43] *Id.* at 650-51.
[44] *Id.* at 651 (citing Mike France, *The Litigation Machine*, BUS. WK. ONLINE, Jan. 29, 2001, http://businessweek.com/2001/01 05/b3717001.htm.).
[45] *Id.* at 651.
[46] Lovitz, *supra* note 17. S*ee generally* Richmond, *supra* note 41, at 665 (discussing usury).
[47] Although the practice areas of the firms to whom these lines of credit are extended are not noted,

> Sunwest Bank of Tustin in Orange County, California has targeted law firms that take cases on a contingency basis because lawyers in southern California are well known for winning huge awards from juries. Not only do these lawyers repay their lines of credit, but they put the proceeds of these cases in the bank, and they refer clients to the bank. In addition, banks can charge contingency-fee lawyers higher rates because the business is riskier, banks can require personal guarantees or lawyers' personal residences as collateral, and the banks may require the lawyers to provide a monthly list of cases and expenses. Other banks in Oregon, Tennessee, and Louisiana also view these lawyers as a unique opportunity to make money in the financing business because there is little competition.

Martin, *supra* note 18, at 72-73 (citation omitted).

documentation, reporting, and oversight requirements.[48] Despite the opportunism of a few traditional lenders, many or all of which may have subsequently ceased lending in this arena after the advent of the current recession, most are simply unwilling to lend money to fund litigation in light of the associated risks.[49]

Therefore, using a traditional lender to fund litigation is rarely, if ever, a practical option for these plaintiffs or their attorneys.

2. Cash Advance / Non-Recourse Funding Companies

Somewhat recently emerging is a specialized group of companies that seeks to fill the market gap that traditional lenders leave. These companies have discovered that by structuring their products as non-recourse funding, they are able to reap the potential rewards for taking a high risk without running afoul of government regulations. For instance, the funding arrangements charge a fixed interest rate versus a percentage of the plaintiff's potential recovery, thus freeing them from laws prohibiting maintenance and champerty.[50] And, by making repayment contingent upon a recovery, the interest rate assessed can be high enough to compensate for the risk that the lawsuit may result in a judgment for the defendant or a recovery that is smaller than the sum borrowed, without violating usury laws.[51]

Depending on the lender, this funding may be made available either directly to plaintiffs, or the law firm that is representing them.[52] In the case of the latter, it may allow a plaintiff

[48] Richmond, *supra* note 41, at 651.
[49] *Id.*
[50] Molot, *supra* note 32, at 94. "'Maintenance' is officious intermeddling in a suit which in no way belongs to the intermeddler by…assisting either party to the action, with money or otherwise, to prosecute or defend it…'Champerty' is a type of maintenance in which the intermeddler makes a bargain with one of the parties to the action to be compensated out of the proceeds of the action." 14 AM. JUR. 2D *Champerty, Maintenance, and Barratry* § 1 (2010).
[51] Molot, *supra* note 32, at 94.
[52] *Id.* at 98. However, lending directly to law firms is likely to take a form other than non-recourse, using firm assets such as future fees and real property, as collateral. Steven Garber, *Alternative Litigation Financing in the United States: Issues, Knowns, and Unknowns*, RAND Institute for Civil Justice Law, Finance, and Capital Markets

access to a risk-averse firm with a strong reputation in patent law that ordinarily represents clients on an hourly fee basis, since such funding would allow the firm to take on a potentially lucrative patent case on a contingency fee basis.[53] In fact, some non-recourse funding companies require a plaintiff's attorney to be working on a contingency fee basis as a prerequisite for funding approval, thereby excluding any plaintiffs who may intend to borrow money upfront to fund their attorney's hourly billing.[54] These lenders are common in the personal injury arena, but a survey of the websites of members of the American Legal Funding Association (an industry trade group[55]), as well as those of a few other selected lenders in the industry, revealed that a fair number also fund in commercial claims cases, with several even specifically noting that they are willing to lend money for patent or intellectual property litigation.[56]

Program at 13 (2010), *available at* http://www.rand.org/content/dam/rand/pubs/occasional_papers/2010/RAND_OP306.pdf (last visited Jan. 17, 2011).

[53] Molot, *supra* note 32, at 100. Such a scenario is outlined:

> [T]he law firm might take the case on a contingent fee basis, the financier might lend money to the law firm in amounts that would cover its hourly fees (or an agreed upon amount that might be discounted from its regular hourly fees), and the law firm would repay the loan plus interest out of its contingent fee. Under this…scenario, the law firm would be guaranteed its hourly fee, for if the case results in a lower recovery, the terms of the non-recourse loan would not entitle the lender to recover any more than the law firm collected in the case. But if the contingent fee ended up exceeding the hourly billings by an amount large enough to cover accrued interest and leave extra profit for the law firm, the law firm would reap those benefits.

Id.

[54] "You must be represented by an attorney on a contingency fee basis." Chestnut Hill Funding, http://www.chestnuthillfunding.com/site/692107/page/2306637#Q2 (last visited Jan. 20, 2011).

[55] ALFA's stated purpose is:

> To establish and maintain the highest ethical standards and fair business practices within the legal funding industry; To represent ALFA's members and their interests to regulators, legislators, the media and the public; To develop awareness of the industry and to ensure that information about the industry is accurately disseminated; and To establish a legal and regulatory framework in individual states, that meet the needs and concerns of all parties interested in legal funding.

http://www.americanlegalfin.com/FactsAboutALFA.asp (last visited Jan. 20, 2011). Yet, defined criteria for membership were not able to be located.

[56] *See infra* Appendix A. The websites did not specifically indicate whether the funding associated with these claims is non-recourse, or if it involves claim transfer (*see* discussion *infra*), but the companies surveyed are not those that seem to typically specialize in commercial claims via claim transfer. *See* Garber, *supra* note 52, at 15 (listing companies that have been noted to specialize in funding commercial claims via claim transfer).

The primary drawback to these arrangements, for any potential borrower, is the interest rate that is assessed. These rates are sometimes well in advance of 100%, which would certainly run afoul of usury laws if they applied to these arrangements.[57] In a well-known Ohio case, albeit one involving a personal injury victim, the interest rates on two cash advances taken by the plaintiff were calculated to be 180% and 280%, respectively.[58] The shady practices in this particular corner of the litigation funding industry that have occurred in the past have led some commentators to examine such funding as a type of sub-prime lending,[59] which can encourage plaintiffs to settle early for lower amounts.[60] Although the interest rates charged to law firms for such funding may be lower than those charged to plaintiffs[61], these methods have, of late, given way to emerging methods of funding, such as transfers of interest, which may be better suited to commercial cases such as patent disputes.

Thus, despite increased availability of funds from cash advance/non-recourse companies vis-à-vis traditional lenders, small entities or individuals looking to fund patent infringement suits would be best-advised to examine their other options before committing to such an arrangement.[62] The chances are good that more attractive alternatives are available that will bolster their bargaining power, as well as that of their lawyers.[63]

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[57] *See, e.g.,* Rancman v. Interim Settlement Funding Corp., No. 20523, 2001 WL 1339487, at *1 (Ohio Ct. App. Oct. 31, 2001) (noting the lower magistrate's holding that the loans violated the usury interest law).
[58] *Id.* at *1. But, "[I]t is hard to know whether the percentages cited in Rancman…exemplify those in the industry in general." Susan Lorde Martin, *Financing Litigation On-Line: Usury and Other Obstacles*, 1 DEPAUL BUS. & COMM. L.J. 85, 98 (2002).
[59] *See* Martin, *supra* note 20.
[60] Molot, *supra* note 32, at 101.
[61] Such interest rates can "still be quite high--25% per year or greater, depending upon the risk involved." *Id.* at 98 (citing JURIDICA INVESTMENTS LIMITED, PROSPECTUS 30, *available at* http://www.juridicainvestments.com/en/investor-relations/~/media/Files/J/Juridica/pdfs/Admission_Documentation.pdf) (last visited Jan 17, 2011).
[62] Even some funding companies in this industry have encouraged plaintiffs "to explore all other means available to them before considering" a non-recourse loan. Bridge Funds, http://www.bridge-funds.com/ethics.hrm (last visited Jan. 20, 2011).
[63] Molot, *supra* note 32, at 101.

C. *Offensive Patent Insurance*

Ida has pondered other things in her life that could lead to litigation. For instance, she could be in a car accident, or a guest in her home could fall down the stairs. But she pays for insurance to offset the risk of financial liability in scenarios such as these. Could she have purchased insurance for her patent that would have offset the risk of expensive litigation in the case of infringement?

Patent insurance is available to reimburse patentees for litigation expenses, up to a policy-specific limit, incurred while defending their patent against infringement. This allows a policyholder to spread the litigation risk to a third party. However, some familiar problems, similar to those already discussed that plague other methods of funding litigation for these plaintiffs, also beleaguer offensive patent insurance. To begin with, there are few firms operating in the patent insurance field[64], which minimizes the competitive forces that benefit consumers, such as lower prices and increased choices that may be more tailored to each particular consumer's needs. This is likely due to the risks involved, some of which can be quantified through a complex underwriting process[65], and others that cannot.[66]

Another drawback is that the policy must be bought before any infringement is known to have occurred.[67] Effectively, if infringement predating the policy is discovered during the claims approval process, or even subsequent to approval, the approval will be denied or revoked, and the insured must reimburse any litigation expenses paid by the insurer in the case of the latter.[68]

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[64] Fuentes, *supra* note 19, at 271.
[65] Such as the litigiousness of the insured, and the industry in which they operate. *Id.* at 288.
[66] Such as changing laws. *Id.* An example is the increased difficulty of obtaining an injunction in the wake of *eBay v. MercExchange*, which led to higher litigation expenses and, by extension, increased risk for insurers. *Id.* (citing eBay v. MercExchange, 547 U.S. 388 (2007)).
[67] Ronspies, *supra* note 8, at 209.
[68] Fuentes, *supra* note 19, at 278-79.

A patentee like Ida would not be eligible, given that the infringement has occurred and she did not have a policy in place prior to it.

Perhaps one of the highest barriers that would prevent these patentees from availing themselves of coverage is the expense associated with such policies. These costs take the form of upfront costs prior to coverage, premium costs required to maintain the policy, and other costs associated with the policy. First, in terms of upfront costs, like some contingency fee lawyers, certain patent insurance companies have been noted to require upfront fees to be paid by the patentee in order to examine the patent to determine whether it is eligible to be covered under their policy, which may preclude many small entities and individuals from being financially able to even apply for coverage.[69] Second, the average premiums for an offensive patent infringement litigation insurance policy may also be out of reach for this group of patentees, quoted by one insurer at roughly $14,500 annually for a single patent with a $2 million policy limit and "average risk."[70] This would result in premium costs of close to $300,000 over the life of the patent.[71] Last, but not least, there are the additional costs that are associated with the coverage. Before submitting a claim under the policy, the insured must first obtain an infringement opinion from an attorney[72], the cost of which can range from $10,000 to $100,000, depending on a number of factors, including complexity and the insured's industry.[73] A cost of

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[69] Lisa A. Small, *Offensive and Defensive Insurance Coverage for Patent Infringement Litigation: Who Will Pay?*, 16 CARDOZO ARTS & ENT. L.J. 707, 743 (noting that Lloyd's of London employs lawyers and accountants to pre-screen patents and select those for coverage that are "legally valid and valuable" for coverage. This examination requires a fee of $25,000 to be paid by the entity seeking review and subsequent coverage if approved.).

[70] Intellectual Property Insurance Services Corporation (hereafter "IPISC"), http://www.patentinsurance.com/products/insurance-policies/abatement/ (last visited Jan. 20, 2011).

[71] Based on an average annual premium cost of $14,500 multiplied by the twenty-year lifespan of a patent.

[72] Fuentes, *supra* note 19, at 287 (citing IPISC, Intellectual Property Infringement Abatement Insurance Policy Specimen 9-10 (2000)).

[73] Fuentes, *supra* note 19, at 287 (citing Edwin H. Taylor & Glenn E. Von Tersch, *A Proposal to Shore Up the Foundations of Patent Law that the Underwater Line Eroded*, 20 Hastings Comm. & Ent. L.J. 721, 740 (1998)).

$30,000 is a reasonable estimate for the average infringement opinion.[74] If a monetary settlement results from the litigation, the insured is typically required to share the award with the insurer at 1.25 times the amount the insurer has covered in litigation expenses.[75]

Moreover, an insured seeking to submit a claim will face an arduous task, fraught with additional expenses, that is best accomplished by a lawyer.[76] Finally, if a claim is approved and litigation proceeds, the insurance carrier will have a good deal of involvement in and control over the litigation.[77] This includes requiring the insurer's approval of the insured's chosen litigation counsel, the proposed litigation budget, and additional approval for any possible appeals.[78]

Therefore, given the expenses and aforementioned barriers associated with offensive patent insurance, it is unlikely to be a reasonable consideration for most small entity and individual patentees.

D. Transfers of Interest

Ida is running out of ideas; there seem to be many drawbacks to all of those that she has explored so far. She ponders for a moment whether she has access to anything else of value that

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[74] From a large New York law firm. Fuentes, *supra* note 19, at 287 (citing Interview with Henry Lebowitz, Partner, Fried, Frank, Harris, Shriver & Jacobsen LLP in New York, N.Y. (Apr. 11, 2008)).

[75] Small, *supra* note 72, at 279 (policy underwritten by Lloyd's of London).

[76] Vallone, *supra* note 19, at 188. An overview of the process is as follows:

> To make out a claim, the policyholder must, among other things, submit a detailed outline of the proposed litigation, copies of warning letters sent to suspected infringers, a report showing efforts made to license the patent, a letter prepared by patent counsel identifying the patent claims alleged to be infringed and rendering an opinion as to the patent's validity and infringement, including a description of prior art discovered subsequent to the issuance of the patent . . . . The policy claim also must describe the article considered to constitute infringement, a description of the patent holder's product falling within the scope of the patent, a description of the evidence to be introduced to prove infringement, a budget projection for litigation expenses, a credit report on the infringing parties, and a copy of the complete prosecution file . . . . [I]f there are multiple, independent infringers, the insurance carrier must insist that wholly separate claims be supplied for each infringer.

Id. at 188-89 (citation omitted). *See also* Fuentes, *supra* note 19, at 281.

[77] Fuentes, *supra* note 19, at 281 (citing IPISC, Intellectual Property Infringement Abatement Insurance Policy Specimen at 6, 10 (2000)).

[78] *Id.*

she can leverage in order to fund the legal defense of her patent. Then, she realized that she has two things. First, she owns the patent that she is seeking to defend. Second, she expects proceeds from the litigation that she is going to bring against Conglomo-Enterprises for infringing on her patent. Is there any way that she can leverage either of these?

In short, yes. Companies exist that seek to purchase the rights to patents in order to leverage their financial strength to extract licensing fees from other companies wishing to utilize the patent.[79] And, some investment funds and banks have somewhat recently begun directly investing in lawsuits by purchasing the rights to a portion of the potential recovery, particularly in commercial litigation, such as patent disputes.[80] Part of the force driving this development, in addition to the growing permissibility of the practice in international jurisdictions, has been the global recession.[81] The resulting demand has come from both sides of the table, with investors clamoring for financiers to seek new asset classes of investments "not cyclically correlated with bonds and equities," and cash-strapped businesses looking to offload litigation risk.[82]

1. In Intellectual Property Rights

One arrangement of funding litigation via transfer of interest requires a plaintiff like Ida to sell or license the rights to her patent to a third party, sometimes referred to as a non-practicing entity (NPE).[83] In exchange, the inventor receives a share of revenue generated or an agreed-upon cash sum.[84] The NPE would then proceed in prosecuting the patent.

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[79] Lovitz, *supra* note 21, at 6.
[80] Molot, *supra* note 32, at 96.
[81] Steinitz, *supra* note 25 (draft at 11-16, on file with author).
[82] *Id.* at 16.
[83] FTC, To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy, ch. 2, at 31 (2003), available at http://www.ftc.gov/os/2003/10/innovationrpt.pdf (last visited Jan. 28, 2011). NPEs have come under intense scrutiny from many commentators, who frequently refer to them as "patent trolls." *See generally* Gerard N. Magliocca, *Blackberries and Barnyards: Patent Trolls and the Perils of* Innovation, 82 NOTRE DAME L. REV. 1809 (2007); Daniel J. McFeely, Comment, *An Argument for Restricting the Patent Rights of Those Who Misuse the U.S. Patent System to Earn Money Through Litigation*, 40 ARIZ. ST. L.J. 289 (2008). *But see* James F. McDonough III, *The Myth of the Patent Troll: An Alternative View of the Function of Patent Dealers in an Idea Economy*, 56

The major concern for a patentee considering this method of funding litigation is that which is common among all of the methods: how much is this going to cost? In this instance, the "cost" is not in terms of an interest rate or out of pocket expenses, but whether the patentee is receiving a fair value for the patent from the NPE. As previously discussed, one of the complexities of patent litigation is the difficulty encountered in valuing a particular patent. Accordingly, though a NPE may not be able to accurately estimate the true value of a patent down to the dollar, it will almost certainly have more resources at its disposal in order to attempt the feat, unlike an individual inventor or small entity. This may result in the NPE attempting to exploit the situation by purchasing the rights to the patent at a much-reduced price and then subsequently licensing them for an exorbitant fee, versus drafting an agreement that fairly compensates both the inventor, as well as the NPE for taking on the litigation expenses.[85]

But, assuming a fair purchase price or licensing fee is agreed upon with the NPE, the patentee enjoys several benefits. First, the involvement of a NPE may increase the amount received by the inventor for their patent, since a NPE has the resources to assert a credible litigation threat to the infringing entity, thereby enhancing the bargaining position of the patent-holder and likely bringing a larger sum.[86] Echoing this benefit, one testimonial by an independent inventor referred to a NPE as his "saviour," noting that many patents had referenced his, but since he had no resources to litigate, it would have been infringed upon had it not been

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EMORY L.J. 189 (2006) (arguing that "patent trolls" benefit society by bringing "liquidity, market clearing, and increased efficiency to the patent markets - the same benefits securities dealers supply capital markets."); Sannu K. Shrestha, Note, *Trolls or Marketmakers? An Empirical Analysis of Nonpracticing Entities*, 110 COLUM. L. REV. 114 (2010) (using empirical data from the U.S. Patent and Trademark Office and the Stanford Intellectual Property Litigation Clearinghouse to test the arguments for and against NPEs).

[84] "The client can receive a percentage of our net recoveries from licensing and enforcement, and in some cases an up-front cash payment." Acacia Technologies, LLC, http://acaciatechnologies.com/clientagreement.htm (last visited Jan. 28, 2011).

[85] Shrestha, *supra* note 84, at 129 (citing McFeely, *supra* note 84, at 294) (discussing a $500 million patent infringement suit by TechSearch, a NPE, against Intel over a patent it acquired for a mere $50,000 at a bankruptcy sale).

[86] Molot, *supra* note 32, at 97; Shrestha, *supra* note 84, at 127.

for the NPE he worked with.[87] Second, in offloading the litigation risk, the inventor can resume a focus on creating new innovation.[88]

2. In Litigation Proceeds

Another method of funding litigation via transfer of interest involves a plaintiff selling all, or a portion of, his or her rights to the proceeds of the litigation to an investment firm or fund.[89] Indeed, a plaintiff retaining some slice of interest in the case seems preferable to investment companies or funds, since it would ensure the plaintiff's cooperation in the case (e.g., giving testimony), decrease possible jury bias against seeing a portion of the recovery go to investors rather than the harmed plaintiff, and prevent a possible challenge by the defendant to the investor's standing to sue.[90] While this may at first seem analogous to the contingency fee, whereby a party other than the plaintiff acquires a right to a portion of the recovery, there are some important distinctions:

> One, the funder is not providing a service for a fee but rather is investing in an asset. Second, the funder–client relationship is unlike the very unique, and uniquely-regulated, attorney-client relationship. In fact, one of the characteristics of third party funding is that the client is often also represented by an attorney who can help negotiate the funding agreement. Third, litigation funding benefits corporate America as much as it does the Plaintiffs Bar and its clientele. Litigation funders are likely to develop ongoing relationships with both sides of this great divide. Fourth, and perhaps most crucial, funders are likely to engage in secondary trading of the litigation stakes they purchase, attorneys are not.[91]

Again, a primary consideration for plaintiffs pondering this arrangement is how much it will cost; the percentage of the recovery that the investor commands in exchange for funding.[92]

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[87] Jason Kirby, *Patent Troll or Producer?*, FIN. POST, Jan. 14, 2006, *available at* http://www.financialpost.com/story.html?id=1509d361-0144-4432-b6dc-2c14026c98d6 (last visited Jan. 28, 2011) (quoting independent inventor Paul Ware's assessment of NPE Acacia Technologies, LLC).
[88] Shrestha, *supra* note 84, at 127.
[89] Lovitz, *supra* note 21, at 6.
[90] *Id.*
[91] Steinitz, *supra* note 25 (draft at 28, on file with author).
[92] <CITIATION>

But, by assigning the rights to a portion of the proceeds and receiving an advance cash-out, albeit at a reduced rate, the correlated benefit is that the plaintiff effectively removes some of the uncertainty of the litigation.[93] In doing so, the infusion of cash would allow an individual patentee plaintiff greater options in choosing counsel, since he or she could afford to retain a patent lawyer on an hourly basis versus being confined to the task of locating one of the few who are willing to work on a contingency fee basis.[94] It may also allow them to continue to grow their business even as the litigation proceeds by funding the research and development of other products[95], or cover other expenses.

In sum, individual inventor and small entity patent plaintiffs should enter into a claim transfer arrangement with caution to ensure that they receive a fair bargain. Like all forms of third party litigation finance, the primary concern is the cost to the plaintiff. However, claim transfer mechanisms present the most practical solutions for such patentees to finance the complex, high-stakes litigation that will protect their intellectual property, both in terms of increasing availability, as well as being uniquely tailored to suit the difficult set of circumstances faced by these inventors. [96]

V. CONCLUSION

Plaintiffs in any case face a myriad of challenges and barriers. The high costs of litigation are not a new phenomenon by any means. Nor is the concern that these costs may stifle the ability of small plaintiffs to assert their legal rights against larger defendants. However,

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[93] Lovitz, *supra* note 21, at 6.
[94] "[L]itigation finance of this sort is especially attractive for small, start-up companies with large intellectual property claims against established companies. The small start-up may need cash to fund the lawsuit, as the best patent lawyers are often at law firms that charge by the hour rather than working for a contingent fee." Molot, *supra* note 32, at 97 (citation omitted).
[95] *Id.*
[96] Molot, *supra* note 32, at 101 ("Hedge-fund investment in commercial claims, particularly intellectual property claims, probably offers the most promising market solution to risk imbalances between small, one-time plaintiffs and large, repeat-player defendants.").

these costs and the consequential disparity in access to the justice system are magnified when looked at through the lens of the small private entity or individual inventor seeking to protect their patent from a larger adversary, owing to the particularly complex nature of intellectual property claims.

For that same reason, just as these considerations are not specific to small private entities or individual inventors, but are particularly cumbersome to them, so are the unique challenges faced by these plaintiffs when they must pursue alternative methods of funding their litigation, since very few of them are able to bear such high costs by drawing only from their own financial resources. While many avenues of third party litigation finance, some of which have been in use for many years, may be open to their counterparts who have been injured in an accident or by an allegedly faulty product, far fewer are actually feasible for use by the small inventor-plaintiff.

Thankfully for these patentees, recent developments in the industry, such as the advent of transfers of interest, are more tailored to suit the unique nature of their claims. The increased availability of this method, which will be made possible by reforming outdated legislation, remains to be developed. While there are still important considerations for these "David" plaintiffs before they choose to avail themselves of such arrangements, on the whole, they provide the best alternative yet among third party litigation funding alternatives to help level the playing field when taking on a "Goliath" infringer.

APPENDIX A

SURVEY OF NON-RECOURSE LENDERS (JANUARY, 2011)

Members of the American Legal Finance Association (ALFA)[97]				
Company Name	**Website (Homepage)**	**Website Specifying Eligible Case Types**	**Commercial Litigation specifically noted as being eligible for funding?**	**Patent or Intellectual Property Cases specifically noted as being eligible for funding?**
Bridge Funds	www.bridge-funds.com	http://www.bridge-funds.com/eligibility.htm	Y	Y
Cambridge Management Group, LLC	www.cmgcash.com	http://www.cmgcash.com/plaintiff_resources.html	Y	Y
Case Funding*	www.casefunding.com	http://www.casefunding.com/about/commerciallitigation/	Y	Y
Global Financial Credit, LLC	www.glofin.com	http://www.glofin.com/qualify.aspx	N	N/A
LawCash	www.lawcash.net	http://www.lawcash.net/html/case-types.html#other	Y	Y
LawMax Legal Finance	www.fundmycase.com/en/index.php4	http://www.fundmycase.com/en/eligibility.php4	Y	Y
Oasis Legal Finance, LLC	www.oasislegal.com	http://www.oasislegal.com/case_types/plaintiff/	N	N/A
Plaintiff Investment Funding, LLC*	www.legalfundingnow.com	http://www.legalfundingnow.com/faqs.html#10	N	N/A
Plaintiff Support Services	www.plaintiffsupport.com	http://www.plaintiffsupport.com/plaintiff/cases.html	N	N/A
Preferred Capital Funding	www.preferredcapitalfunding.com	http://www.preferredcapitalfunding.com/clients.html	N	N/A

97 http://www.americanlegalfin.com/alfa1/LinkClick.aspx?fileticket=Lm8x6cRYF6c%3d&tabid=71&mid=553 (last visited Jan. 16, 2011). The websites for Lawsuit Cash Advance and Lancaster Financial Corp., two other member companies listed, were unable to be located.

PS Finance	www.psfinance.com	http://www.psfinance.com/lawsuit-financing-help	N	N/A
The Law Funder	www.lawfunder.com	http://www.lawfunder.com/	Y	N
Whitehaven	www.whitehavenplantifffunding.com	http://www.whitehavenplantifffunding.com/faq.asp#casetypes	Y	N
USClaims	www.usclaims.com	www.usclaims.com	N	N/A

*"Associate Members"

Selected Other (Non-ALFA Member) Lenders				
Company Name	**Website (Homepage)**	**Website Specifying Eligible Case Types**	**Commercial Litigation specifically noted as being eligible for funding?**	**Patent or Intellectual Property Cases specifically noted as being eligible for funding?**
Allied Legal Funding	www.alliedlegalfunding.com	http://www.alliedlegalfunding.com/casetypes/commercial.html	Y	Y
American Legal Funding	www.americanlegalfunding.com	http://www.americanlegalfunding.com/content.asp?page_id=4	Y	N
Barrister Capital Group, LLC	www.barristercapitalgroup.com	http://www.barristercapitalgroup.com/types_of_case_we_fund.html	Y	N
Case Advance	www.caseadvance.com	http://www.caseadvance.com/faq#faq_2	N	N/A
Chestnut Hill Funding	www.chestnuthillfunding.com	http://www.chestnuthillfunding.com/site/692107/page/2041837	Y	Y
Fair Rate Funding	www.fairratefunding.com	http://www.fairratefunding.com/pre-settlement-loans.html	Y	Y
Golden Pear Funding	www.goldenpearfunding.com	http://www.goldenpearfunding.com/Plaintiffs_FAQ.html	N	N/A
Interim Funding,	www.interimfunding	www.interimfundin	N	N/A

Inc.	inc.com	ginc.com		
Law Capital Enterprises, LLC	www.lawcapital.com	http://www.lawcapital.com/cases.php	N	N/A
Litigation Capital Investors	www.cash-now-for-accident-cases.com	http://www.cash-now-for-accident-cases.com/typesofcases.php	N	N/A
Magnolia Legal Funding	www.magnoliafunding.com	www.magnoliafunding.com	N	N/A
Plaintiff Funding Service	www.plaintifffunding.com	http://www.plaintifffunding.com/personal.html	N	N/A
SMP Advance Funding, LLC	www.smpadvance.com	http://www.smpadvance.com/pre-settlement-loan/	N	N/A