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The Pros and Cons of Third-Party Funding of Patent Litigation

Article by Andrew Riddles

A patent is only as valuable as the patent owner's willingness, and ability, to enforce it. But patent litigation is expensive?--and risky. The average patent lawsuit in the United States costs about $3 million in attorney fees alone. Additional litigation expenses, including electronic discovery, expert witnesses and court reporters, can tack on $1 million or more. One patent litigator describes the risk this way: "There are more ways to lose a patent case than any other area. ... Patent cases are harder to predict." Historically, companies and law firms have addressed these cost and risk concerns by pursuing patent litigation through various alternative fee arrangements. Within the last few years, a new solution, "third-party funding," has gained popularity. What is third-party funding? What are its pros and cons? And who might be a candidate for it?

Candidates for third-party funding include those who are unable or unwilling to fund the litigation on their own. Individual inventors, small companies and universities are obvious candidates, as they rarely have the money to self-finance patent litigation. But larger companies with deeper pockets might be candidates as well. Management may not want the impact of litigation expenses on the company's financial statements and may view the investment in patent litigation as being particularly risky.

Before examining third-party funding, it is worthwhile considering what makes patent litigation so risky. As with any type of litigation, if the case is tried by a jury, factors such as which side has more articulate witnesses and the particular personalities of the trial attorneys can influence the outcome of the case, sometimes in seeming contravention of the facts. One reason patent litigation is uniquely risky is that if the defendant in the case can find an obscure piece of prior art previously unknown to the inventor and the patent examiner, a court can find the patent invalid after the patent owner has invested years in litigation.

As mentioned above, companies and law firms have historically entered into various alternative fee arrangements to pursue patent infringement litigation. These fee arrangements vary widely and include, among others, straight contingent fees, mixed hourly-contingent fees, flat fees and not-to-exceed fees with a success component. Possible arrangements have been practically limitless and depend on many variables, including the nature and magnitude of the case, the company's goals (e.g., injunction, monetary damages, business deal), and the company's and law firm's respective tolerances for risk.

Third-party funding is an alternative risk-management tool. Third-party funding is provided by a professional investment entity that, in return for funding the litigation, will demand a success fee or contingency fee to be paid out of the "proceeds" of the claim. In the event of a successful outcome, this fee will be taken from the company's damage award. It is therefore crucial to have sufficient margin between the level of funding required and the expected level of damages. Should the claim be unsuccessful, however, the funder will simply lose its investment without recourse.

Funded patent litigations generally have certain key features, which limit the availability of funding to a relatively small pool of cases. The following criteria provide a good general guide:

- Strong patent position
- Clear evidence of infringement
- Substantial monetary claim
- Judgment-worthy defendant

There are generally two different types of third-party funding sources. The first type of third-party funding entity will fund all of the expenses of patent assertion, including attorney fees. The other type will pay litigation expenses when there is a law firm willing to take the case on a contingency basis. Often, although a law firm may be willing to take a case on a contingency basis, it is unwilling or unable to pay the substantial litigation expenses required to prosecute the case through to conclusion.

The main disadvantage of third-party funding sources is the cost of such funding. The entities that will fund 100 percent of a patent litigation generally share revenue on a "net" basis. By the time all costs and fees are deducted, however, there may not be much net revenue left for the company. Even financing for only the litigation expenses is usually very expensive money.

Most entities providing litigation financing will require that they get repaid first, before the company shares in any of the money recovered. They will usually expect a five to 10 times return on the money they invest (to compensate for the risk), and it's not unusual for their return to increase dramatically if the case takes longer than a predetermined amount of time to resolve. Setting a predetermined time to resolution, however, is often unrealistic given the unforeseeable delays of civil litigation.

Nonetheless, with costs often in the millions of dollars, companies and other patent owners frequently require some amount of financing to support a patent litigation. For companies confronting the cost of major litigation, under the right circumstances, third-party funding sources may offer a practical solution.

Even organizations that have the financial resources to launch patent litigation may find it economically advantageous to finance the campaign with third-party funding. When a company is spending only its own money, at some point it may be disinclined to take on more risk and to invest more money as litigation fees and expenses accumulate. Third-party funding gives companies more "staying power," making it more likely that they can see litigation through to conclusion and obtain a larger damage award.

A well-crafted third-party funding arrangement creates an alignment of interests in the outcome of the litigation, reflects the expectations of all of the parties, and provides 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 to realize the benefit of any resulting success.

Restrictive Covenants Under New York Law

Article by M. Alexander Bowie II

Because nothing lasts forever, savvy businesspeople know that effective restrictions on the post-employment competitive conduct of important employees are vital for businesses. Employers should always consider including restrictive covenants in the employment agreements of key employees that restrict the employees' ability to compete with the employer following the end of their employment. New York law on such restrictive covenants is complex and nuanced and has important implications that can be counterintuitive. Beyond crucial considerations in structuring and drafting employment agreements and strategies to deal with the abrupt departure of critical employees, legal criteria in this area can also be important for other activities, such as the documenting and handling of critical confidential business information and even mundane matters such as the documenting and reimbursement of marketing expenses.

New York law disfavors restrictive covenants, although not to the degree they are disfavored in certain other jurisdictions, most notably California. E.g., *Reed, Roberts Assocs., Inc. v. Strauman*, 353 N.E.2d 590, 593 (N.Y. 1976); *Aon Risk Services v. Cusack*, 958 N.Y.S.2d 114 (App. Div.2013). To enforce such agreements, New York law requires that employers show a "legitimate interest" warranting protection, such as the protection of misappropriated trade secrets or preventing competition by a former employee whose services are unique or extraordinary. E.g., *1 Model Mgmt., LLC v. Kavoussi*, 918 N.Y.S.2d 431, 432 (App. Div. 2011). Even then, the restriction must pass a "reasonableness" analysis, limiting the restriction to the minimum necessary to protect the employer's legitimate interest, which in effect often severely limits the duration and geographic reach of the restriction. E.g., *BDO Seidman v. Hirshberg*, 712 N.E.2d 1220 (N.Y. 1999).

Employers, however, are not without options under New York law to impose meaningful restrictions on important employees competing with them after the employees' departure. The most effective is to defer some significant amount of an employee's compensation out into the future, with the proviso that the employee's receipt of the deferred compensation is contingent upon the employee not competing with the employer. New York courts uphold such arrangements under the "employee choice" doctrine, reasoning that the former employee faces the "choice" between receiving the deferred compensation or competing with the former employer. *Morris v. Schroder Capital Mgmt. Int'l*, 859 N.E.2d 503, 506 (N.Y. 2006). The employer need only show that it would have continued to employ the employee had the employee not chosen to leave. *Lucente v. IBM*, 310 F.3d 243, 254 (2d Cir. 2002); *Post v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 397 N.E.2d 358, 360 (N.Y. 1979). New York courts do not subject such agreements to the "reasonableness" requirement, thus enabling their duration and geographic scope to exceed that which would be permitted under that analysis. While employers cannot use this approach to obtain a court order enjoining their former employees from competing with them, in practice such arrangements can provide a strong disincentive to the former employees who might consider engaging in such competition.

Day Pitney LLP New York trial partner Alex Bowie along with two of his colleagues in Day Pitney's New York City office, counsel Michael Weiss and associate Chelsea Mullarney, recently authored a chapter explaining New York law on restrictive covenants in the newly published treatise *New York Business Litigation*, published by New York Law Journal Books, a unit of American Legal Media Publishing. Alex's thorough discussion of New York law in this area is a comprehensive and accessible resource for employers navigating this complex area of New York law.

Flooded Vaults in New York Financial District Benefit from Day Pitney Crisis Management in the Wake of Superstorm Sandy?

Article by Chelsea E. Mullarney and Frank E. Lawatsch, Jr.

In the wake of Superstorm Sandy in October 2012, a team of Day Pitney attorneys led by Frank Lawatsch, a partner in the New York office, has been instrumental in providing crisis management services to the largest securities custodian in the world. The client's vault in New York was severely affected by Superstorm Sandy. Documents in the vault were subject to water exposure. A Day Pitney legal team, across numerous departments and in offices in New York, New Jersey and Connecticut, collaborated to advise the client regarding the damage.

For the duration of the project, Day Pitney has been providing unique services, including:?

- Providing advice on hiring and retaining contractors, including negotiating, drafting and finalizing agreements.
- Addressing security and regulatory concerns, including interfacing with state and federal regulators.
- Dealing with environmental concerns, including aiding in the development of a Health and Safety Plan (HASP) and participating in site visits.
- Securing endorsements to the client's existing insurance policies and obtaining new policies to cover the recovery processes.

Prior to Superstorm Sandy, Frank Lawatsch had the unique background of providing crisis management services to clients in New Orleans following Hurricane Katrina and to a large international bank after September 11, 2001. As a result, the firm had the specific ability to provide similar services to its client following Superstorm Sandy. The client's damaged property was worth several billions of dollars and required a specialized recovery process to halt the water damage. Day Pitney attorneys assisted the client in securing contractors with patented services to freeze-dry the damaged property and sterilize it to ensure it was safe for further use.?

With the effectiveness of the recovery process being extremely time-sensitive, Day Pitney attorneys worked around the clock to ensure that the proper contractors were in place to stabilize the client's property and commence recovery operations, all under heavy security requirements. As soon as the recovery process began, Day Pitney attorneys were instrumental in negotiating and finalizing the agreements with the recovery specialists. Even when faced with a looming deadline requiring movement of the damaged property, the Day Pitney legal team helped the client negotiate insurance that would cover both the movement of the property and the actual recovery process.

Throughout the recovery process, Day Pitney has been tasked with overseeing the legal aspects of many of the contractors, coordinating update meetings and providing a line of communication to the underwriters of the client's insurance policies. In addition to the help on the ground, Day Pitney has provided the client with advice regarding the destruction of property that could not be salvaged, obligations under certain regulatory statutes, and requirements with respect to HASP plans and hiring guidelines.

This project has allowed Day Pitney attorneys to showcase their ability to work across practice groups and offices in an extremely time-sensitive manner. Day Pitney has been successful under pressure not only in aiding the client in building a recovery team, but also in providing sound legal advice and project oversight. Mindful of the costs of such a project, Day Pitney was able to deliver these services in a cost-effective manner.