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Intellectual Property Alert: Third-Party Funding Of Patent Litigation

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Michael J. Garvin

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As recently as five years ago, third-party funding of litigation the United States was an anomaly. Since then, the industry has grown dramatically, with hundreds of millions of dollars being invested in funds that provide funding for the litigation of business disputes, including breach of contract, antitrust and, notably, intellectual property litigation.

In short, litigation funding involves a third-party funder making an investment to defray at least part of the cost of a plaintiff's litigation cost. Ordinarily, funding is on a non-recourse basis, i.e, the funder receives nothing back if the case is not successful. Litigation funding can be for a single case, or for a portfolio of a company's (or law firm's) cases. Although nothing prevents the funding of defense cases, by far the highest percentage of litigation funding is on behalf of plaintiffs. This is because funding for plaintiffs' cases is ordinarily in return for a share of the settlement or verdict. Arriving at an appropriate funding arrangement for defense cases is much more challenging.

As in venture capital, companies providing litigation funding engage in significant due diligence when considering whether to provide funding for a case or a portfolio of cases. Funders routinely hire their own counsel to evaluate the merits of the litigation and financial analysts to estimate the potential recoveries.

Due in part to its non-recourse nature, litigation funding bears another significant similarity to the venture capital industry: Because of the risk inherent in any single investment, funders look to fund cases that, if successful, will result in a recovery of a multiple of their investments. Suppose, for example that a funder invests \$1 million into a single case, which usually is the smallest sum an investor would invest. Since, as described above, the funder and the client agree to share the proceeds of the litigation, a funder at the \$1 million level is unlikely to invest in a case that has the potential to result in at least \$10 million in damages if successful.

There are no readily available statistics on the breakdown of cases in which third-party litigation funding has been provided, but all major litigation funding firms promote patent and other intellectual property cases among the kinds of cases they fund, no doubt because patent cases often involve very high damages. Indeed, Vorys lawyers who focus on patent infringement litigation are frequently approached by litigation funding firms.

Seeking and obtaining litigation funding can create litigation risks for plaintiffs if not addressed appropriately. For instance, although almost all courts that have dealt with defendants' efforts to discover the communications between plaintiffs and funders have held them to be protected by the work product immunity, care must be taken to preserve that immunity, such as by ensuring the plaintiff and funder enter into appropriate nondisclosure agreements. Moreover, some states, such as Ohio, have statutes requiring counsel for parties receiving litigation funding to make various disclosures. For lawyers whose clients are seeking litigation funding, there are also ethical obligations that must be considered.

Litigation funding is not optimal for every patent infringement lawsuit, if for no other reason the funders require the patent owner to pay a hefty share of any recovery. But for patent owners with meritorious cases who cannot afford to fund the entire cost of litigation, or are unwilling to do so, third-party funding is a viable option worthy of serious consideration.