

ALTERNATE ROUTE

Infrastructure investing is more than a detour

BY JOHN RUBINO



The Case for Litigation Financing

Court is now in session for a new approach to investing in intellectual property

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Capital markets place a high value on intellectual property (IP)—and rightly so. To better appreciate the value the market assigns to intellectual property, one need look no further than the often high market capitalization of a company relative to its book value. It could be logically estimated that this difference is largely attributable to the value of a company's intellectual property. The market understands that companies can use their patents, trademarks, trade secrets, copyrights, and service marks to earn excess returns. Intellectual property gives companies the ability to limit the potential for competitors to enter a market, to create better products, and/or to garner efficiencies that provide flexibility in the marketplace.

The value associated with these intangible assets is often the crux of numerous contested matters, including infringement and unfair trade practices. Defending intellectual property through litigation is risky and, at times, prohibitively expensive. Factors that influence the costs include (among others) the amount of damages at stake, litigation complexity, fee arrangements, and aggressiveness. According to a 2003 report by the American Intellectual Property Law Association, the average cost of a patent case with damages of more than US\$25 million at stake was approximately US\$3.9 million. This amount decreased to approximately US\$2 million when damages sought were between US\$1 million and US\$25 million.

While there are certainly examples where the costs far exceed these amounts, the potential rewards can be quite large.

Law firms have implicitly invested in such opportunities for years via contingent fee arrangements. Because many law firms lack the appetite for risk associated with this type of investment of time and resources, more risk-oriented investors—such as venture capitalists, private equity funds, alternative investment practices, and high-net-worth individuals—may find an opportunity in a new approach. Litigation financing, which pays traditional hourly professional fees in return for a share of the ultimate damage award, can efficiently and appropriately allocate the risk and reward among all parties. Hypothetically, arrangements can also be made for funding the defense of IP litigations, whose return is predicated on an inverse formula.

Unlike a more traditional approach to investing in intellectual property, such as owning equity in a company with significant IP assets, dedicated funds could be raised to finance IP litigation in a limited partnership structure with a general partner responsible for finding, managing, and monitoring investments. Clearly, the funds would need to follow traditional portfolio investment practices and diversify among many different litigation investments so that large damage awards or settlements could offset investments for which the entire amount expended is lost. General partners with knowledge and experience in IP litigation could create added value through intelligent investment decisions, such as narrowing the selection process to the disputes that offer the best set of facts and circumstances to the party for whom the investors intend to fund the litigation.

One of the most recent and compelling examples of IP litigation financing/investing is one that created anxiety for many of us addicted to being in constant touch with our e-mail. We refer, of course, to the *NTP v. RIM* (Blackberry) patent infringement case in which RIM agreed to pay NTP US\$612.5 million in a settlement. According to the *Wall Street Journal*, the law firm representing NTP, Wiley Rein & Fielding LLP, bore the risk of a contingent fee arrangement and in return received roughly a third of the settlement. Though there are many other contributing factors in this case, it epitomizes the very large payoffs that can result from patent litigation.

The growing field of IP litigation offers the potential for significant returns commensurate with the risk. In a world that is changing rapidly as a result technological advances, companies must protect their intellectual assets. Under the current system, litigation is an important component of such protection. Investors need to consider how the recent rash of IP litigations will shape the overall market—including the possibility of new investment vehicles—in the future. ▀

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