

COPYRIGHT INFRINGEMENT MARKETS

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Should copyright infringement claims be treated as marketable assets? Copyright law has long emphasized the free and independent alienability of its exclusive rights. Yet, the right to sue for infringement—that copyright law simultaneously grants authors in order to render its exclusive rights operational—has never been thought of as independently assignable, or indeed as the target of investments by third parties. As a result, discussions of copyright law and policy rarely ever consider the possibility of an acquisition or investment market emerging for actionable copyright claims, and the advantages that such a market might hold for copyright’s goals, objectives and functioning. This Essay analyzes the opportunities and challenges presented by an independent market for copyright claims, and argues that copyright law, policy, and practice would stand to benefit from the regulated involvement of third parties in acquiring, financing, bringing, and defending infringement claims.

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INTRODUCTION

The phenomenon of third parties acquiring, financing, or investing in private litigation has begun to see a sharp increase in the last few years.¹ Large commercial disputes, previously thought to be immune to any third party involvement, are today the principal targets for such involvement. In the process, rather robust claim markets have begun to emerge in various substantive areas.² Despite this general trend though, the copyright system remains resistant to the role of third parties in acquiring and bringing infringement claims. The perceived one-sidedness of the system, which favors large commercial enterprises at the cost of individual user-defendants, and the general tendency among defendants to avoid litigating the question of fair use are together thought to render copyright litigation something of an evil that ought to be avoided unless absolutely necessary.³ Allowing third parties to bring claims independently is, in this climate, seen as anathema. Copyright law thus contains stringent rules of standing that courts all too readily invoke and extend, in order to keep third parties out of the system.⁴

This tendency to view copyright litigation as an active hindrance that needs to be curbed has only been exacerbated by the recent public outcry against “copyright trolls”, which are seen as entities that seek to profit from litigation by monetizing it.⁵ While the disquiet originated in the palpably problematic context of entities that merely sought to take advantage of

¹ See, e.g., Maya Steinitz, *Whose Claim is this Anyway? Third Party Litigation Funding*, 95 MINN. L. REV. 1268, 1275-86 (2011); Jason Lyon, Comment, *Revolution in Progress: Third-Party Funding of American Litigation*, 58 UCLA L. REV. 571, 577 (2010); Jonathan T. Molot, *Litigation Finance: A Market Solution to a Procedural Problem*, 99 GEO. L.J. 65, 90 (2010).

² See Steinitz, *supra* note __, at 1277.

³ For an analysis of how this affects the behavior of litigants, see Jennifer E. Rothman, *The Questionable Use of Custom in Intellectual Property*, 93 VA. L. REV. 1899, 1909-24 (2007) (describing practices that participants—primarily potential defendants—adopt in order to avoid costly copyright litigation).

⁴ The rigidity originates in the Ninth Circuit’s decision in *Silvers v. Sony Pictures, Inc.*, 402 F.3d 881 (9th Cir. 2005). See also 3 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT §12.02 (2012).

⁵ See, e.g., *Copyright Trolls*, EFF.ORG, <https://www.eff.org/issues/copyright-trolls> (last visited May 28, 2012); Parker Higgins, *Trouble in Trolltown: Judges Increasingly Catch On to Copyright Trolls’ Unfair Tactics*, EFF.ORG, Apr. 14, 2012, <https://www.eff.org/deeplinks/2012/04/trouble-trolltown>; *Who Are Copyright Trolls?*, FIGHT COPYRIGHT TROLLS, <http://fightcopyrighttrolls.com/about/> (last visited May 29, 2012); Mike Masnick, *Rapidshare Countersues Perfect 10 For Being A ‘Copyright Troll’ Who Only ‘Shakes Down’ Others*, TECHDIRT, June 14, 2010, <http://www.techdirt.com/articles/20100614/0105019802.shtml>.

copyright's statutory damages regime,⁶ it has since extended to just about any effort to profit from copyright litigation, regardless of the legitimacy or otherwise of the underlying claim itself. Copyright litigation is thus seen as deserving of avoidance, and third parties' involvement therein is in turn viewed as doubly problematic and actively frowned upon.

In this Essay, I argue that this approach is at once both myopic and counter-productive. Courts, scholars, and policy-makers have for far too long believed that meaningful reform in the copyright system needs to occur through copyright doctrine, be it at the legislative level or through judicial interpretation.⁷ In the process, they have ignored the possibility that market forces, if regulated and channeled appropriately, could do just as well and in certain respects perhaps even better than traditional law reform efforts. This is precisely what a regulated market for actionable copyright claims promises to do for copyright law. And contrary to popular belief, the increased involvement of third parties in the copyright system will inure to the benefit of both plaintiffs and defendants in copyright infringement actions.

Copyright litigation today exhibits obvious malaises that litigation funding is well placed to correct. Litigating a copyright claim is no longer an affordable prospect for a vast majority of authors and creators. As of 2011, the average cost of litigating a copyright infringement case through trial, for either plaintiff or defendant—and excluding judgment and awards—was estimated to range from \$384,000 to a staggering \$2 million.⁸ To individual, small business, or non-commercial creators, all of who are intended beneficiaries of copyright, copyright litigation remains an unaffordable proposition. On the defendant side, users and copiers of creative works are for identical reasons, all too reluctant to defend themselves in court when threatened with an infringement lawsuit, and go to extreme lengths to avoid the risk of being sued, even when their actions are fully defensible under copyright's fair use doctrine.⁹ Needless licenses, clearances, and permissions—which are expensive, but cost less than litigation—are today the norm among users and copiers, even when wholly unnecessary as a legal matter, and motivated entirely by the impulse to avoid costly litigation.

The costs of copyright litigation thus have a distortionary effect on copyright law and policy. On the one hand, these costs hinder the system's

⁶ See generally Shyamkrishna Balganesh, *The Uneasy Case Against Copyright Trolls*, 86 S. CAL. L. REV. (forthcoming May 2013).

⁷ See, e.g., Jessica Litman, *Real Copyright Reform*, 96 IOWA L. REV. 1, 53-55 (2010) (noting that reform will have to come through the legislative process even though Congress is unlikely to undertake such reform efforts in the near future).

⁸ AMER. INTELLECTUAL PROP. L. ASSOC'N, REPORT OF THE ECONOMIC SURVEY 2011, at 35 (2012).

⁹ See PATRICIA AUFDERHEIDE & PETER JASZI, RECLAIMING FAIR USE (2011); James Gibson, *Risk Aversion and Rights Accretion in Intellectual Property Law*, 116 YALE L.J. 882, 887-906 (2007).

purported ability to function as an incentive for creativity.¹⁰ If creators and authors recognize that enforcing their copyright claims in court is an unworkable prospect (i.e., for cost reasons), copyright law's ability to induce creative expression begins to automatically diminish. Simultaneously, the costs also render copyright law's safety valves—such as the fair use doctrine, and other limitations and exceptions to exclusive rights—meaningless, with defendants rarely ever invoking them (given their dependence on a judicial determination), but instead actively undermining them through their litigation-avoidance strategies.¹¹

Allowing third parties to enter copyright litigation, and acquire, fund, or insure infringement claims—in a regulated manner—presents copyright law with a plausible a solution. Their entry is likely to lower the cost of litigation for participants in the system, even if not in the abstract, in the process allowing both creators and users to focus more directly on their production and use of creative expression. In addition, their entry will also produce a host of indirect benefits for the copyright system, as seen and predicted in other substantive areas where their participation is permitted. Indeed, third party funding (and acquisition) of litigation claims has begun to gain prominence in jurisdictions around the world, principally because practice is believed to benefit litigants' access to justice via courts—an expensive proposition—without at the same time overwhelming the court system.¹²

In this Essay, I show how copyright law, practice, and theory would all stand to benefit from allowing third parties to fund infringement claims and defenses through diverse mechanisms and devices. Part I sets out the emerging practice of allowing third parties to acquire, fund, or invest in private legal claims and shows how the practice is altogether absent in copyright litigation. Part II makes the theoretical case for more third party involvement in copyright litigation. It analyzes how the copyright system embodies certain features that make it a viable target for claim markets, and shows how copyright law, practice, and policy are likely to benefit through the greater involvement of third party funding in copyright litigation. Part III then examines the possible mechanics of a market for copyright claims, and the forms in which third parties can be involved. It then details the obstacles that exist under current law and policy to the emergence of such a market, and changes that will need to be made to induce the greater participation of third parties in copyright litigation.

I. THIRD PARTY LITIGATION FUNDING AND ITS ABSENCE IN COPYRIGHT LITIGATION

¹⁰ For an overview of copyright's dominant incentives rationale see Shyamkrishna Balganesh, *Foreseeability and Copyright Incentives*, 122 HARV. L. REV. 1569, 1570 (2009).

¹¹ See Gibson, *supra* note __, at 888-906.

The practice of third parties involving themselves in private litigation—also known as litigation funding—has seen a sharp increase in the law few years.¹³ The industry is still in its early stages in the U.S., but is predicted to grow rapidly in the next few years as courts, state legislatures, and local bar associations begin to relax the several restrictions that surround the practice.¹⁴

Litigation funding, broadly speaking, refers to the practice of “providing money to a party to pursue a potential or filed lawsuit.”¹⁵ Put simply, “it is the provision of funds by companies who have no other connection with the litigation” other than in its outcome.¹⁶ Such funding can be on either the plaintiff or defendant side. In the former, it allows claims to be brought in court by providing in the necessary capital, and in the latter, it enables defendants to defend against claims without having to settle earlier than necessary for lack of funds, or owing to the uncertainty of litigation.¹⁷ Recent estimates put the U.S. market for litigation funding at about \$1 billion, and most predict that it is likely to grow rapidly in the next few years.¹⁸

As a practice through, litigation funding is hardly new to the U.S. Since at least the 1990s, lawyers and law firms provided clients, who needed to bring expensive lawsuits with loans, often at extremely high interest rates.¹⁹ Their focus was on individual plaintiffs bringing personal injury claims. Whereas these early practices were on a small scale, and largely ad hoc, the last few years have seen the entry of large investment firms into the practice.²⁰ In addition to having significantly larger amounts of capital, these new entrants choose to invest in large commercial litigation (rather than personal injury

¹³ See, e.g., Binyamin Appelbaum, *Investors Put Money on Lawsuits to Get Payouts*, N.Y. TIMES, Nov. 14, 2010, <http://www.nytimes.com/2010/11/15/business/15lawsuit.html?pagewanted=print> (describing this trend); Steinitz, *supra* note __, at 1275.

¹⁴ RAND Institute for Civil Justice, *supra* note __, at 2; Appelbaum, *supra* note __.

¹⁵ Nat’l Ass’n of Mutual Insurance Providers, *Third Party Litigation Funding: Tipping the Scales of Justice for Profit*, NAMIC Issue Analysis Paper, May 2011, http://www.namic.org/pdf/publicpolicy/1106_thirdPartyLitigation.pdf, at 1.

¹⁶ Steinitz, *supra* note __, at 1276.

¹⁷ *Id.*

¹⁸ U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, *SELLING LAWSUITS, BUYING TROUBLE: THIRD PARTY LITIGATION FUNDING IN THE UNITED STATES 1* (2009), available at <http://www.instituteforlegalreform.com/sites/default/files/thirdpartylitigationfinancing.pdf> (“Third-party litigation financing is a growing phenomenon in the United States.”); Appelbaum, *supra* note __ (“Total investments in lawsuits at any given time now exceed \$1 billion, several industry participants estimated.”).

¹⁹ N.Y.C. Bar, Formal Op. 2011-02: Third-Party Litigation Financing, June 2011, <http://www.nycbar.org/ethics/ethics-opinions-local/2011-opinions/1159-formal-opinion-2011-02> (“Third party litigation financing first emerged as an industry in the United States in the early 1990s, when a handful of small lenders began providing cash advances to plaintiffs involved in contingency fee litigation.”); Susan Lorde Martin, *The Litigation Financing Industry: The Wild West of Finance Should be Tamed Not Outlawed*, 10 FORDHAM J. CORP. & FIN. L. 55, 55 (2004).

²⁰ See Steinitz, *supra* note __, at 1277.

claims), involving corporate entities—either as plaintiff or defendant. The “the number and types of lawsuits financed” and indeed the “financing provided” have grown dramatically,²¹ causing some scholars to refer to this as the “second-wave” of litigation funding in the U.S.²²

The impetus for this growth is often attributed to two reasons: international competitive pressures, and the rising cost of litigation. Other common law jurisdictions—mostly notably the U.K. and Australia—have come to actively encourage the practice, and put in place a host of regulations to allow claim markets to develop and grow there. In Australia, the practice was formally approved in 2006 by the High Court.²³ U.K. courts soon followed suit, and in 2011 the U.K. adopted a Code of Conduct for Litigation Funders, to govern and regulate the practice.²⁴ The exponential rise of civil litigation costs is well-known in the U.S.²⁵ A recent estimate puts the cost of bringing a civil claim in federal court at \$15,000 and cost of defending a claim to \$20,000 with both rising to well over \$100,000 depending on subject matter.²⁶

Broadly speaking, third party litigation funding works in three possible ways: (i) through claim acquisition, (ii) through investment in the litigation, and (iii) as “after the event” insurance.²⁷ In a claim acquisition, the third party purchases the actionable claim directly from the plaintiff either in whole or in part.²⁸ In a wide variety of subject areas, a complete acquisition confers standing to sue on the acquirer, allowing it to dictate the litigation and settlement strategy unilaterally.²⁹ In a litigation investment, the third party funds (i.e., invests in) a litigation by fronting capital to the plaintiff for litigation and related expenses, in return for a percentage of any eventual recovery through judgment or settlement.³⁰ Here, the plaintiff remains in the picture and litigates in its own name, but the parties usually enter into complex

²¹ N.Y.C. Bar, *supra* note __.

²² Steinitz, *supra* note __, at 1277. *See also* Holly E. Loiseau, Eric C. Lyttle, and Brianna N. Benfield, *Third-Party Financing of Commercial Litigation*, ABA IN-HOUSE LITIGATOR, Vol. 24, No. 4, 2009, at 1; *id.*

²³ *Campbells Cash and Carry Pty. Ltd. v Fostif Pty. Ltd.*, (2006) 229 CLR 386 (Austl.).

²⁴ *See* ASSOC’N OF LITIGATION FUNDERS OF ENGLAND AND WALES, CODE OF CONDUCT FOR LITIGATION FUNDERS (2011), available at <http://www.calunius.com/media/2540/alf%20code%20of%20practice.pdf>.

²⁵ *See generally* Emery G. Lee & Thomas E. Willging, *Defining the Problem of Cost in Federal Civil Litigation*, 60 DUKE L.J. 765 (2010).

²⁶ *Id.* at 770 (quoting a study conducted by the authors for the Federal Judicial Center).

²⁷ For a fuller elaboration of these alternatives as they apply to copyright law, see *infra* Part III.

²⁸ RAND Institute for Civil Justice, *supra* note __, at 11.

²⁹ *See* *Sprint Communications Co., L.P. v. APCC Services, Inc.*, 128 S.Ct. 2531 (2008) (holding that assignees of legal claims have standing under federal law to commence actions).

³⁰ N.Y.C. Bar, *supra* note __ (“If the claim appears meritorious, the financing company will advance amounts to cover attorneys fees and the other costs of the litigation...[and these] advances typically are made to the claimant or its outside litigation counsel, in return for a percentage of any eventual recovery.”).

arrangements to determine who controls the litigation.³¹ The third form of funding operates on the defendant's side, and involves a third party purchasing a defendant's litigation risk after a claim has been commenced. In effect this operates as a form of insurance, after an event has occurred, but where the magnitude of risk remains uncertain—hence its description as a form of “after the event insurance”.³² This form of funding is less common in the U.S. than the other two, especially since U.S. law doesn't allow fee-shifting by prevailing defendants, along the lines of U.K. law.³³ Each of these forms of third party funding carries over rather well to the unique circumstances of copyright litigation, which is discussed in greater detail later.

All three forms of funding facilitate the creation of “claim markets,” as the term is used here. While technically, it is only in a claim acquisition that the third party takes a formal ownership stake in the claim, the litigation investment and insurance too involve transferring the risk of litigation—either in part or in full—to the third party. While the third party may not obtain a formal ownership stake, it nonetheless alienates the risk that litigating the claim entails through a market mechanism.

Despite all of these trends, copyright litigation has remained by and large immune to third party involvement. Copyright litigation costs well over three times the already-high average cost of litigation.³⁴ And yet, market-based solutions to the problem of copyright's litigation costs have been somewhat rare. Unlike in the patent context, where non-performing entities (NPEs) are known to acquire patents pre-emptively and then sue for infringement,³⁵ copyright trades rarely ever occur in active anticipation of future litigation.³⁶ Contingency-fee based arrangements in copyright litigation too are very rare.³⁷ So too are collective enforcement mechanisms, where individual rights-holders

³¹ Maya Steinitz, *The Litigation Finance Contract*, 54 WM. & MARY L. REV. (forthcoming 2012) (manuscript at 38-40).

³² Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367, 380 (2009).

³³ See Philip S. Figa, *The “American Rule” Has Outlived its Usefulness: Adopt the “English Rule”*, NAT'L L.J., Oct. 20, 1986, at 13.

³⁴ See AIPLA, *supra* note 11.

³⁵ See generally Michael Risch, *Patent Troll Myths*, 42 SETON HALL L. REV. 457 (2012).

³⁶ It is sometimes mistakenly believed that patent infringement claims can be transferred and assigned independent of the patent itself. See RAND Institute for Civil Justice, *supra* note __, at 12 (“Patent claims are transferable under federal law.”). This is incorrect. Patent infringement claims, such as those for past infringement can be transferred only when accompanied by a transfer/assignment of the patent itself. See *Crown Die & Tool Co. v. Nye Tool & Mach. Works*, 261 U.S. 24, 43 (1923); 8 DONALD S. CHISUM, CHISUM ON PATENTS §21.03[g][i] (2011) (“The damage claim cannot be transferred as such apart from the patent.”); Roger D. Blair & Thomas F. Cotter, *The Elusive Logic of Standing Doctrine in Intellectual Property Law*, 74 TUL. L. REV. 1323, 1344 (2000) (noting how such a transfer “must be accompanied by an assignment of the underlying patent”). The rules of patent law are in this respect, strikingly similar, to those of copyright law. See *infra* Part IV.A.

³⁷ Copyright Office, Remedies for Small Copyright Claims: Notice of Inquiry, 76 FED. REG. 66,758, 66759 (2011).

band together to collectively monitor and enforce their rights, thereby cross-subsidizing their litigation costs.³⁸

II. THE BENEFITS OF A MARKET FOR COPYRIGHT CLAIMS

Having seen how litigation funding operates, and its failure—thus far—to influence copyright litigation, this Part moves to examining what the copyright system stands to gain through such funding, which effectively would result in the creation of a market for copyright claims. It bears re-emphasizing that the reference to a “market for claims” here includes not just situations where the claim is acquired in its entirety, but also those where third parties assume a portion of the risk associated with enforcing the claim by investing in, or funding it directly.

The discussion first looks at certain structural realities of the copyright entitlement and litigation, to highlight the need for such third party litigation funding (II.A.), and then proceeds to show how the entry of third party funders can provide copyright litigation with a host of direct and indirect benefits on both the plaintiff and defendant sides (II.B.).

A. *Why the Copyright System is Ripe for Litigation Funding*

While copyright litigation is no doubt very similar to traditional commercial litigation as a structural matter, it nonetheless embodies certain characteristics that make it well-suited to the practice of litigation funding. Two in particular deserve elaboration here: (i) the copyright entitlement’s fundamental dependence on litigation; and (ii) the exorbitant costs of copyright litigation (in comparison to other areas) and their distortionary effects on copyright law and policy. In some ways the two features are clearly at odds with each other, and copyright reform efforts have thus far done little to try and align them.

Copyright law’s basic entitlement structure anticipates and operates in the shadow of private litigation. As an analytical matter, copyright grants its holder a set of exclusive rights in relation to the protected subject matter, i.e., the original expression.³⁹ These rights revolve around the act of copying, which is central to copyright law. All the same, since copyright’s subject matter is intangible and therefore exhibits the characteristics of resource non-rivalry and non-excludability, the significance of the exclusive rights machinery operates in large part through the correlative duty that it imposes on

³⁸ See C. Scott Hemphill & Jeannie Suk, *The Law, Culture, and Economics of Fashion*, 61 STAN. L. REV. 1147, 1193 (2011) (advocating such a mechanism for the fashion industry).

³⁹ 17 U.S.C. §106 (2010).

others.⁴⁰ Copyright thus revolves around the “duty not to copy original expression” that it imposes on all but the original owner in society.⁴¹

In other words, ownership over a tangible object endows its owner with a set of exclusive rights to use the object. Yet, since the object is both rival and excludable in nature, these rights *enable* the owner to use the object in different ways without interference from others in society (i.e., non-owners). Moving to copyright though, since the object is intangible expression, the owner (the copyright holder) needs no actual enablement to use the object.⁴² As a physical matter, the object is perfectly capable of multiple, simultaneous use (and copying) by individuals with little problem. Copyright injects an artificial scarcity into this environment through its grant of exclusive rights. But given the non-rival nature of the object being protected, these exclusive rights *disable* non-owners (i.e., potential copiers) from interfering with the copyright holder’s exclusive rights in the work.⁴³ Copyright’s entitlement framework is therefore rooted in the disabling duties that it imposes on non-owners in society. And since copyright is in the end a private law system, for this disablement it relies heavily on the owner’s power, ability, and threat to invoke the state’s coercive machinery to ensure its realization. The copyright entitlement then, to put it simply, revolves analytically around the possibility of litigation.

As a functional matter, the copyright entitlement is formally determined for the first time only ever during litigation. Since it is premised on automatic protection once a work is created and fixed in a tangible medium of expression, litigation performs an important validation function for the existence and scope of the entitlement. Unlike the patent entitlement, which involves a formal prosecution process that results in the patentee obtaining a *prima facie* entitlement accompanied by a strong presumption of validity, copyright law contains no analogous review process.⁴⁴ Litigation thus performs more than just a remedial function in copyright law—i.e., merely correcting a harm—but instead also an important constitutive function for the entitlement.

⁴⁰ See Shyamkrishna Balganesh, *The Obligatory Structure of Copyright Law: Unbundling the Wrong of Copying*, 125 HARV. L. REV. 1664, 1669 (2012).

⁴¹ *Id.* at 1667-74. See also Jeremy Waldron, *From Authors to Copiers: Individual Rights and Social Values in Intellectual Property*, 68 CHI.-KENT L. REV. 841, 844 (1993).

⁴² See T. Cyprian Williams, *Property, Things in Action, and Copyright*, 11 L. QUART. REV. 223, 232 (1895) (making a similar point about the centrality of forbearance to copyright law).

⁴³ Balganesh, *Obligatory Structure*, *supra* note __, at 1670; *id.* at 226.

⁴⁴ For a recent account of this difference see: David Fagundes & Jonathan S. Masur, *Costly Intellectual Property*, 65 VAND. L. REV. 677, 679 (2012) (“Patents vest only after an applicant successfully navigates a cumbersome examination process administered by the federal Patent and Trademark Office (“PTO”) [while C]opyrights, by contrast, arise costlessly and often unintentionally, as soon as an author fixes a work of authorship in a tangible medium of expression.”). This isn’t to suggest that the patent entitlement isn’t subject to the vagaries of the litigation process as well, rendering it probabilistic. See Mark A. Lemley & Carl Shapiro, *Probabilistic Patents*, 19 J. ECON. PERPS. 75 (2005).

There remains additionally, an important respect in which copyright is also different from the entitlement underlying other private causes of action such as those involved in tort claims. While such private claims too are determined only during litigation (i.e., by a court), the abstract entitlements underlying them are almost never treated as alienable prior to their maturation into specific actions. Thus, it is uncommon to speak of trading (or transferring away) one's 'right not to be negligently injured,' prior to a negligent act actually transpiring.⁴⁵ Copyright on the other hand is treated as a tradable entitlement, in its unmaturing form, making it analytically very different.

Indeed, the copyright entitlement's tradability in its unmaturing form and its fundamental dependency on litigation caused some early scholars of the common law to argue that copyright was nothing more than a "chose in action", i.e., an actionable claim.⁴⁶ Since expression could never be "possessed" as an object, copyright was thought to be a "claim" that could "only be enforced by going to law".⁴⁷ Since all forms of property in the common law were either choses in action or possession, and copyright was clearly intended to be a tradable asset, this view insisted that it had to be understood as a chose in action. Copyright law as a structural matter thus fundamentally anticipates and depends on the possibility of litigation. Unlike other substantive areas where litigation can be seen as performing a vindicatory, remedial, or punitive function, litigation is of constitutive analytical significance to copyright law.

This analytical reality however faces an obvious functional problem. In spite of the centrality of litigation to copyright's entitlement structure, copyright litigation remains unaffordable to a large number of litigants. The average cost of litigating a copyright case through trial ranges from \$384,000 to over \$2 million, for both plaintiffs and defendants.⁴⁸ These costs have risen dramatically over the last decade, which has in turn seen a corresponding reduction in the number of copyright claims that are actually litigated in court. In the year 2005, a total of 5,796 new copyright cases were filed.⁴⁹ This figure has seen a steady decline since, and by 2011 this figure shrunk to 2,297—an astounding 60% drop.⁵⁰ The Copyright Office attributes most of this to the rise

⁴⁵ See Robert Cooter, *Towards a Market for Unmatured Tort Claims*, 75 VA. L. REV. 383, 383 (1989) (defining the entitlement prior to injury as an "unmatured tort claim"). See also Alan Schwartz, *Commentary on "Towards a Market in Unmatured Tort Claims": A Long Way Yet to Go*, 75 VA. L. REV. 423 (1989) (describing the problems inherent in allowing such claims to be traded).

⁴⁶ See Williams, *supra* note __, at 223.

⁴⁷ *Id.* at 226.

⁴⁸ AMER. INTELLECTUAL PROP. L. ASSOC'N, *supra* note 11, at 35.

⁴⁹ ADMIN. OFF. OF THE U.S. COURTS, 2006 JUDICIAL BUSINESS OF THE UNITED STATES COURTS: ANNUAL REPORT OF THE DIRECTOR JAMES C. DUFF 167 (2006) (detailing filing statistics from 2002 through 2006).

⁵⁰ ADMIN. OFF. OF THE U.S. COURTS, JUDICIAL BUSINESS OF THE UNITED STATES COURTS: 2011 ANNUAL REPORT OF THE DIRECTOR 130 (2011) (detailing filing statistics from 2007 through 2011).

in litigation costs, and in 2011 began exploring the possibility of low-cost “small claims” courts to decide copyright infringement cases.⁵¹ It thus observed:

If a copyright owner hires a lawyer, the expenses can add up quickly. Contingency fee arrangements are relatively rare in copyright lawsuits; thus most copyright owners will have to pay an hourly fee for representation. Lawyers charge hundreds of dollars per hour, which could reach a total of tens or hundreds of thousands of dollars when a case does not immediately settle and instead requires discovery, motion practice, and trial.⁵²

What makes copyright litigation rather expensive though is the necessarily fact-intensive nature of the dispute. In bringing a claim, a plaintiff must show actual copying by the defendant, which entails proof of access and similarity between the works. If the works aren’t identical, the plaintiff also needs to establish that the works are “substantially similar”, which is a subjective question of fact.⁵³ Courts treat both these issues as questions of fact, and are justifiably reluctant to decide them on motions for summary judgment.⁵⁴ The same is largely true for the defendant as well. While fair use is itself a question of law, the burden of establishing the facts that determine fair use, most notably the “effect” of the defendant’s use on the market for the plaintiff’s work,⁵⁵ falls to the defendant.⁵⁶ Discovery thus forms a large part of the litigation expenses.⁵⁷

Litigation costs influence parties’ behavior.⁵⁸ In addition to influencing parties’ litigiousness, i.e., their willingness to bring a claim in court, litigation costs also affect parties’ primary behavior, when the substantive regime in question is premised on inducing behavior of a specific kind. Tort law is a prime example, where the costs of litigation play a major role in a regime’s ability to deter negligent behavior. One scholar thus notes that “costly litigation implies that the tort system fails to compel actors to exercise socially

⁵¹ Copyright Office, Remedies for Small Copyright Claims: Notice of Inquiry, 76 FED. REG. 66,758 (2011).

⁵² *Id.* at 66,759-60.

⁵³ *Cf.* Shyamkrishna Balganes, *The Normativity of Copying in Copyright Law*, 62 DUKE L.J. 203 (2012) (extolling the subjectivity of substantial similarity for pluralist reasons).

⁵⁴ *See, e.g.,* Sid & Marty Krofft Television Prods., Inc. v. McDonald’s Corp., 562 F.2d 1157 (9th Cir. 1977).

⁵⁵ 17 U.S.C. §107(4) (2010).

⁵⁶ *See, e.g.,* Campbell v. Acuff-Rose Music Inc., 501 U.S. 569 (1994); 3 NIMMER, *supra* note __, at §12.10[3] (2012).

⁵⁷ *See* Sharon Cullars, *Trends in IP Litigation Costs*, LEGAL FIN. J., Nov. 24, 2011, <http://legalfinancejournal.com/trends-in-ip-litigation-costs/> (“One of the major factors contributing to the high litigation costs is collecting discovery.”);

⁵⁸ RAND INSTITUTE FOR CIVIL JUSTICE, *supra* note __, at 4.

optimal precaution” and thus fails in its deterrent function.⁵⁹ When individuals know that the costs of litigation make it unlikely that suits will be brought, the law’s ability to deter behavior begins to diminish in large measure. If litigation costs can influence a regime’s ability to *deter* behavior, they must in equal measure be able to influence a regime’s ability to *incentivize* behavior as well. And if copyright’s primary purpose lies in providing creators with an incentive to create—as courts and policy-makers routinely reiterate⁶⁰—then, rising litigation costs will in a similar vein impede the system’s realization of its core objective. The decline in litigation rates might thus suggest not just that parties are unwilling to litigate their claims, but rather a decline in the very utilization of the copyright system, especially given the centrality of litigation to its functioning as noted previously.

It is of course hard to assess the exact causes for the drop in copyright litigation rates, without disaggregating the empirical evidence further. Yet, the anecdotal evidence underlying accompanying the Copyright Office’s recent study seems to suggest that copyright’s litigation costs are doing more than just deterring lawsuits. In its submission, the American Society of Media Photographers (ASMP) for instance, described how these costs, and the lack of a cost-effective mechanism of redressal were “mak[ing] the investment necessary to become and remain a professional photographer a staggering and constant burden,⁶¹” in effect then deterring the very creative enterprise, rather than just the commencement of lawsuits.

Copyright’s high litigation costs also discourage defendants from contesting palpably frivolous, and overbroad infringement claims by copyright owners. When offered a settlement that is much lower than what they would have had to spend defending the claim—even if they know for sure that they are likely to succeed on the merits—rational defendants have good reason to prefer settling to litigating.⁶² This only encourages copyright owners to make overbroad claims. Some courts then unthinkingly treat these settlements as evidence of vibrant “licensing markets” to constrain the scope of the fair use

⁵⁹ Keith N. Hylton, *Litigation Costs and the Economic Theory of Tort Law*, 46 U. MIAMI L. REV. 111, 113 (1991).

⁶⁰ *Sony Corp. of Amer. v. Universal City Studios, Inc.*, 464 U.S. 417, 477 (1984) (“Copyright is based on the belief that by granting authors the exclusive rights to reproduce their works, they are given an incentive to create.”); WILLIAM M. LANDES & RICHARD A. POSNER, *THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW* 38-39 (2003); William M. Landes & Richard A. Posner, *An Economic Analysis of Copyright Law*, 18 J. LEGAL STUD. 325, 327 (1989); Justin Hughes, *Fair Use Across Time*, 50 UCLA L. REV. 775, 797 (2003); Joseph P. Liu, *Copyright and Time: A Proposal*, 101 MICH. L. REV. 409, 428 (2002).

⁶¹ See Victor S. Perlman, General Counsel and Managing Director, American Society of Media Photographers, Second Submission of Comments, Oct. 16, 2012, available at http://www.copyright.gov/docs/smallclaims/comments/noi_10112012/asmp.comments.2.10.16.12.pdf.

⁶² See Gideon Parchomovsky & Alex Stein, *The Relational Contingency of Rights*, 98 VA. L. REV. ___ (forthcoming 2012) (manuscript at 3).

defense doctrinally.⁶³ In effect then, defendants' failure to litigate fair use effectively whittles away its scope and significance. The fair use doctrine is however more than just a "defense" in copyright law. As copyright's primary safety valve, it safeguards a host of important First Amendment and free speech interests, and functions as an incentive for downstream creativity as well.⁶⁴ The functional evisceration of fair use thus has real downsides for social welfare and threatens to undermine the very legitimacy of the copyright system.

In short then, copyright's exorbitant litigation costs affect both plaintiffs and defendants, distort the system's core objectives and safety valves, and seem to show no sign of declining. Yet, few solutions seem to focus directly on the problem. They instead focus on reforming copyright doctrine, the law-making process or the adjudicative process. "Litigation" and the litigation-process as such are blamed for these costs and treated as a part of the problem rather than the solution. Litigation funding allows copyright law to directly address the problem of spiraling litigation costs without undermining its very dependence on litigation.

B. Third Party Funding in Copyright Law

Having seen why copyright litigation remains structurally well-suited to third party funding, this Section moves to identifying the concrete advantages that copyright law, practice, and policy are likely to see by allowing third parties to acquire and invest in infringement claims.

1. Reducing Incentive Dissipation

Copyright's *raison d'être* is thought to lie in its ability to induce the production of creative expression.⁶⁵ Despite the lack of empirical confirmation for this theory, it continues to inform copyright law-making, judicial interpretation of copyright doctrine, and scholarly writing on the subject.⁶⁶ By promising creators a set of temporally limited exclusive rights in any original work of expression that they produce, copyright law is thought to incentivize

⁶³ See James Gibson, *Accidental Rights*, 116 YALE L.J. POCKET PART 348 (2007); Gibson, *Risk Aversion*, *supra* note __, at 907.

⁶⁴ See Harry N. Rosenfield, *The Constitutional Dimension of "Fair Use" in Copyright Law*, 50 NOTRE DAME L. REV. 790 (1974). See also COMP. & COMM. INDUS. ASS'N, FAIR USE IN THE U.S. ECONOMY: ECONOMIC CONTRIBUTION OF INDUSTRIES RELYING ON FAIR USE (2010) (detailing the extensive economic contributions made by "industries whose output is driven increasingly by activities made possible by fair use").

⁶⁵ See, e.g., Justin Hughes, *Fair Use Across Time*, 50 UCLA L. REV. 775, 797 (2003); Stewart E. Sterk, *Rhetoric and Reality in Copyright Law*, 94 MICH. L. REV. 1197, 1198–1204 (1996).

⁶⁶ Diane Leenheer Zimmerman, *Copyrights as Incentives: Did We Just Imagine That?*, 12 THEORETICAL INQ. IN THE L. 29, 32-34 (2011).

the creation of such expression.⁶⁷ In other words, by promising creators recourse to the state's mechanism for disabling others from making unauthorized copies of an original work of authorship, copyright law is thought to motivate the production of such work. Now if recourse to the state's enforcement mechanism to prevent unauthorized copying is unaffordable (as noted earlier), and rational creators know this upfront, this fact will certainly interfere with copyright's ability to act as an inducement.

Assume that that cost of making a work—to Anne, an author—is \$2,000 and that she also knows that by selling copies of the work in the market, she can earn \$5,000, making a net profit of \$3,000. Copyright law is thought to signal to the creator that by disabling others from copying the work (once created), it will allow her to exploit the full market potential, i.e., \$5,000, for copies of the work; and in the process induce her to produce the work. Now assume that a competitor appropriates (i.e., copies) Anne's work, as a result of which the market for the original shrinks to sales of \$1,000, below her initial investment, i.e., her costs of creation. At this point, for Anne to be incentivized to seek these lost profits in an infringement action, she will need to be assured of a net gain at the end, taking into account the costs of both creation and litigation.⁶⁸ In our scenario, this means that for Anne to recover \$4,000 (the lost profits), the cost of litigation must be well below \$3,000, to make it economically viable. If this is unlikely, and she knows this in advance (i.e., prior to creation), her rational economic incentive to create the work will altogether disappear, since she will recognize simultaneously that (i) substitutive copying is likely to impact her profits, (ii) the costs of commencing an action against the copier to recoup these profits are very high, and (iii) as a result, they each individually and in conjunction make the creative activity altogether unprofitable.

The costs of copyright litigation thus influence not just the decision whether to litigate, but in scenarios where copying is both easy and very likely, they are also likely to affect the decision whether to create the work to begin with. The same holds true in varying degrees even when the unauthorized copying doesn't cause the creator's profits to fall below the break-even point. Table 1 is illustrative, which shows that even when creators expect large returns on their creative work and the extent of infringement increases, the

⁶⁷ *Id.* at 31 (noting how the incentive theory “conceives of the creative individual as a rational profit-maximizer whose willingness to invest effort, time, and resources in creative enterprises is directly correlated to the expected extent of the returns that will be forthcoming”); William M. Landes & Richard A. Posner, *Indefinitely Renewable Copyright*, 70 U. CHI. L. REV. 471, 474 (2003).

⁶⁸ If she spends \$2,000 in creating the work, and \$3,000 in litigating for lost profits owing to copyright infringement, she ends up recovering \$4,000 in lost profit compensation, and \$1,000 in terms of independent sales, barely allowing her to break even. Even at this point, a rational creator who can predict these costs upfront—which is hardly unlikely today—is unlikely to want to create in the first place.

costs of litigating the infringement claim begin to rise exponentially too, in effect lowering the incentive to create quite dramatically. The economic decision to create is thus impacted by high litigation costs, a factor that is especially true for individual and one-off creators. The inefficiency of litigation effectively dilutes and dissipates the economic incentive that the copyright system purports to grant authors.

Table 1: Incentive Reduction Owing to Litigation Costs

Cost of Creation	Expected Sales	Expected Benefit (Pre-litigation)	Lost Profits (Owing to copying)	Expected Litigation Costs	Expected Benefit (Post-Litigation)	Reduction in Incentive
2,000	4,000	2,000	2,000	5,000	-3,000	250%
2,000	6,000	4,000	3,000	5,000	-1,000	125%
2,000	10,000	8,000	5,000	5,000	3,000	62.5%
2,000	20,000	18,000	10,000	7,000	11,000	50%
2,000	30,000	28,000	15,000	10,000	18,000	35.7%
2,000	100,000	98,000	50,000	20,000	78,000	20.4%

It might be thought that copyright's allowance for plaintiffs to elect for statutory damages and recover reasonable attorney's fees alleviates this problem.⁶⁹ In reality though, these mechanisms still require copyright owners to make significant out of pocket payments to sustain the litigation, in the hope of obtaining these remedies, which in addition, are "not guaranteed".⁷⁰ It is precisely because of copyright's rising litigation costs and their effect on creators that the Copyright Office has recently begun considering the possibility of alternative "small claims" dispute resolution mechanisms where the litigation costs are likely to be significantly lower.⁷¹

Litigation funding, while not directly lowering the costs of copyright litigation in the abstract, nonetheless can ensure that effect of these costs is felt most directly on someone other than the creator. In the process, it reduces the extent to which these costs influence the incentive to create, the institution's primary purpose. When a creator's work is purportedly infringed by a copier, litigation funding would now allow third parties to either acquire the infringement claim from the creator and pursue the claim directly, or instead enable them to fund the claim by fronting capital to the creator, who will still bring the action in his/her own name.⁷² In such an arrangement, the creator is

⁶⁹ See 17 U.S.C. §504 & §505 (2010).

⁷⁰ See Copyright Office, *supra* note 54, at 66,760.

⁷¹ *Id.* at 66,758.

⁷² Part IV details further how copyright law's rules on exclusive licensing make this a distinctively feasible possibility.

able to obtain upfront payment for its claim (either directly or indirectly), which while likely to be less than the total expected value of the claim, is nonetheless sure to be higher than what the creator might have gotten on her own. This is so for two possible reasons. One, the litigation funder is likely to have lower litigation costs, making the lawsuit potentially lucrative, with some of those benefits passing on to the creator. Two, the litigation funder—unlike the creator—will be able to value the lawsuit based not just on the creator's lost profits, but on the availability of statutory damages, since this now becomes a realistic possibility.

The litigation funder has obvious incentives to enter into such arrangements. Remember that a litigation funder is usually an entity with expertise in litigation. The ability to accurately value a claim and assess the probability of a favorable outcome, the ready access to large stores of capital, and the expertise to run the process efficiently are characteristic features of such funders. The funder is thus well positioned to take advantage of copyright law's allowance for statutory damages, since the out of pocket expenses needed to run the litigation are hardly a deterrent. Going back to our earlier hypothetical involving Anne the creator, reveals how this might work.

To Anne, the costs of litigating the claim for lost profits of \$4,000 might be \$3,000, making it economically impractical to pursue. But to a litigation funder, XYZ, Inc, these costs might be significantly lower—say \$1,000. If XYZ now approaches Anne and offers to pay her \$2,000 for the claim (which is worth \$4,000), Anne still makes a net gain of \$1,000 in the overall scheme of things, effectively preserving her incentive to create. XYZ too can expect a gain from the litigation (of \$1,000) as well, even if lost profits were the sole basis for valuing the claim. In reality though, even if XYZ's costs of litigation are the same as what they were for Anne, XYZ might value the claim much higher—say at \$20,000—under copyright's statutory damages regime.⁷³ Since XYZ has the liquidity for the large out of pocket expenses, which are still likely to be far lower than this recovery, especially if attorney's fees are also awarded, the lawsuit now becomes a potentially lucrative investment opportunity. Very importantly though, this might even have an effect on Anne's arrangement with XYZ. If Anne knows that XYZ values the litigation not just on the basis of lost profits but instead based on the possible recovery of statutory damages, Anne is likely to negotiate for a much higher upfront payment for the claim. XYZ might thus choose to pay Anne \$6,000 if it knows that statutory damages are very likely, based on its assessment of the

⁷³ Copyright's statutory damages regime contained in 17 U.S.C. §504 allows a plaintiff to elect to receive statutory damages in lieu of actual damages, without having to establish a reason for the election. Once the election is made, and an infringement is found, a court is obligated to award the plaintiff no less than \$750 and no more than \$30,000 per work infringed. 17 U.S.C. §504(c)(1) (2010). In the event that the infringement is found to be willful, these damages can go to as high as \$150,000 per work infringed. 17 U.S.C. §504(c)(2) (2010).

claim. Anne thus stands to earn a net profit of \$5,000 from the overall scheme now. If creators such as Anne know that litigation funders exist to assist them with their infringement claims, their presence not only preserves their original incentive to create, but introduces the distinct possibility of *enlarging* it, by making the availability of statutory damages seem realistic.

In effect then, litigation funding is likely do two things simultaneously for copyright's incentive structure. First, it will likely prevent the complete dissipation of the incentive to create, by ensuring that creators don't have to feel compelled to litigate the claim themselves in order to recover lost profits. They could rely on third parties to enforce the claim, and thereby obtain a significant *portion* of these lost profits. Second, it will form a bridge between the creator and the Copyright Act's provision for statutory damages. By introducing a new set of participants into the system for whom the availability of large statutory damages after expensive litigation is both an independent incentive and of little hardship, it raises the market value of creators' actionable infringement claims and allows them to internalize a significant portion of this surplus. In the process, it allows for the possibility that copyright litigation might, counter-intuitively, now actively enhance creators' incentives to produce.

2. Lowering Agency Costs

A second benefit of litigation funding in copyright remains the possibility that it will lower agency costs between clients and lawyers in monitoring and enforcing infringement. Agency costs originate in a principal-agent problem, where an agent tasked with protecting a principal's interest has insufficient incentives to do so, which produces a net welfare loss.⁷⁴ It arises owing to the "the impossibility of complete contracting when one party (the agent) has discretionary and unobservable decision-making authority that affects the wealth of another party (the principal)."⁷⁵ It originates in situations where the principal has no way of monitoring the implementation of an arrangement with the agent, as a result of which the principal has little basis to know whether the agent's own conduct, or external factors produced a certain, less than perfectly desirable outcome.⁷⁶

⁷⁴ For a general overview of the principal-agent problem, see: HAL R. VARIAN, *INTERMEDIATE MICROECONOMICS: A MODERN APPROACH* 667-88 (6th ed. 2003); Kenneth J. Arrow, *The Economics of Agency*, in *PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS* 37-51 (John W. Pratt & Richard J. Zeckhauser eds., 1985).

⁷⁵ Robert H. Sitkoff, *An Agency Costs Theory of Trust Law*, 89 *CORNELL L. REV.* 621, 636 (2004).

⁷⁶ See Sanford J. Grossman & Oliver D. Hart, *An Analysis of the Principal-Agent Problem*, 51 *ECONOMETRICA* 7, 7 (1983); Stephen A. Ross, *The Economic Theory of Agency: The Principal's Problem*, 63 *AM. ECON. REV.* 134 (1973).

While agency costs are endemic to the attorney-client relationship in all substantive areas, they remain exacerbated in copyright law for a variety of inter-related reasons. As a direct consequence of its idiosyncratic subject matter (i.e., expression) that is protected automatically upon creation and fixation, copyright law operates primarily through standards rather than rules. As is well known, standards, which tend to be imprecise and open-ended, lack the certainty of rules and entail higher costs in their application.⁷⁷ Actors, who seek to be guided by the law, are the principal bearers of these costs, which usually manifest themselves either in the time and effort needed to understand the law and precedents, in obtaining professional legal advice, and in needing a comprehensive process of adjudication for courts to fill the content of these standards circumstantially *ex post*.⁷⁸ Copyright's unending standards thus exacerbate the information asymmetry between non-specialist creator/copier and his or her lawyer, which is the basis of the principal-agent problem.⁷⁹ And perhaps most importantly, this is so *for both plaintiffs and defendants*.

Take the plaintiff's side first. In situations where a defendant's copying isn't literal or verbatim, a plaintiff is obligated to establish that the defendant's work is "substantially similar" to the plaintiff's protected work, to establish a *prima facie* case of infringement.⁸⁰ As is obvious from its very title, substantial similarity is hardly a straightforward question, and is by most accounts, copyright law's most complex mechanism.⁸¹ Determining whether it is met in an individual case is a probabilistic assessment that entails examining a host of precedents and expert reports, and predicting a jury's intuitive response to the comparison. On the defendant's side, "fair use" is at once copyright law's primary defense, but also its most uncertain doctrine.⁸² Note that all of the principal-agent problems that we previously discussed, apply with equal force to defendants in copyright cases as well. Determining whether a use is non-infringing under the fair use doctrine in similar fashion requires resort to expert legal advice, in order to predict what a court is likely to do. Once again, the information asymmetry between principal and agent comes to be exacerbated. Indeed, for copyright defendants, empirical data too seems to suggest that avoiding any reliance on expert advice—and thereby minimizing both

⁷⁷ For an early account of the rules versus standards debate, see Ronald M. Dworkin, *The Model of Rules*, 35 U. CHI. L. REV. 14 (1967). The leading economic analysis of the distinction is by Louis Kaplow. See Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992).

⁷⁸ Kaplow, *supra* note __, at 569.

⁷⁹ See David Fagundes, *Crystals in the Public Domain*, 50 B.C. L. REV. 139, 151 (2009).

⁸⁰ *Id.* at 157-60.

⁸¹ For a fuller discussion of substantial similarity in copyright law, see Shyamkrishna Balganesh, *The Normativity of Copying in Copyright Law*, 62 DUKE L.J. 203 (2012) (detailing the complexity of substantial similarity and its working, and finding a rationale for such complexity).

⁸² *Dellar v. Samuel Goldwyn, Inc.*, 104 F.2d 661, 662 (2d Cir. 1939) (describing the fair use doctrine as copyright's "most troublesome" doctrine today).

litigation and agency costs—seems to be a preferred option, even when it is overall welfare-minimizing and inefficient (i.e., when the defendant does indeed have a valid claim of fair use).⁸³

To see how these costs impact copyright plaintiffs and defendants, consider the following hypothetical. Assume that Anne, our creator from the previous hypothetical, identifies the infringement that is causing her to lose profits, chooses to litigate the claim, and to this end retains the law firm ABC LLP for the same. Seeing her unwillingness to pay the firm's exorbitant "per-hour" charges, the firm offers to litigate the matter on a contingency fee basis. It agrees to take 30% of any settlement or judgment, instead of its hourly rate of \$200 per hour. Early on in the litigation, the defendant agrees to settle the matter instead of proceeding to trial, and offers to settle the claim for \$3,900. ABC has invested no more than two billable hours of time into the matter in all.

Let's leave aside for now any question of Anne's ex ante incentives to create and how the litigation costs might impact that.⁸⁴ In this scenario, ABC makes \$1,300 from the settlement, and having spent two billable hours (worth \$400 in all), its net gain is \$900. Anne takes \$2,600 from the settlement. On the face of things, this outcome seems fine for all parties involved: Anne breaks even, the firm makes a net gain, and neither plaintiff nor defendant wastes large expenses in protracted copyright litigation. Assume however that an extra hour's worth of research (say, into the jurisprudence of substantial similarity, to allege that the defendant's copying might have allowed the court to decide the matter on summary judgment) would have forced the defendant to raise its settlement offer by another \$600 to \$4,500. Assuming that ABC knows this to be likely, in deciding whether to spend the extra time doing this research, ABC has *no incentive* to do so. For even though it will raise the award by \$400 for Anne (making her payout \$3,000), the extra effort produces no net gain for the law firm, ABC. The extra hour is worth \$200 to them, which is also exactly what they will likely make from the increased settlement. The agent's (i.e., ABC's) failure to make this extra effort now causes the principal (Anne) a loss of \$400, which is a welfare loss. Anne has no way of knowing this, since her ability to monitor ABC's actions is very limited. This welfare loss is entirely a result of the principal-agent problem.

Even if Anne had chosen to be billed on an hourly basis, the problem would have manifested itself, but in a different form. In the initial settlement offer, Anne would have made \$3,500, and the firm \$400. Here however, ABC would have had every reason to continue negotiating with the defendant for every minor increment in the settlement. Thus if it takes ABC an additional five hours to raise the settlement by an added \$750, it might choose to do so to

⁸³ See Gibson, *supra* note __, at 887; Fagundes, *supra* note __, at 153.

⁸⁴ For a discussion of this see *supra* Part II.B.1 above.

make an additional \$1000, and raise Anne's settlement to \$4,650. Again Anne would have no way of knowing this, or monitoring ABC's incremental actions. All the same, Anne is paying \$1000 for the added \$750, producing an analogous welfare loss of \$250, caused once again by the principal-agent problem.

The welfare loss that these situations produce together with the costs it would take for a principal to effectively monitor the agent's actions to ensure compliance, constitute the "agency costs" produced.⁸⁵ The principal-agent problem, and the accompanying agency costs/welfare losses that it produces are the result of a misalignment of parties' interests, which produces contradictory incentives. An obvious solution is thus one that aligns parties' interests, or at least minimizes the possibility that they point in opposite directions.⁸⁶ In the copyright context, the extensive information asymmetry between lawyer and client exacerbates this. This is where the involvement of third parties will help.

Litigation funding arrangements allow for control—complete or substantial—over the copyright litigation process to be vested in the entity/individual actually bearing its full costs. In the process, it effectively eliminates the moral hazard that legal representation entails. Litigation funders are usually entities with significant legal expertise of their own, which would allow them to avoid relying entirely on outside representation to value, litigate, and settle the copyright claims that they acquire.⁸⁷ The process of claim acquisition thus allows such funders to obtain the claim from plaintiffs and litigate it on their own. This in turn situates ownership and control over the process in a single entity. Even when the funding is short of an outright acquisition—for instance, partial funding, or an investment—it still ordinarily relegates a good deal of control over the process to the third party funder, specifically in order to allow it to ensure that the funding is used effectively, and to avoid the moral hazard previously identified.⁸⁸

In short, the principal-agent problem is pervasive in copyright litigation and produces a host of social welfare losses, which a market for infringement claims would serve to minimize quite significantly.

3. Lowering the Costs of Defendant Risk-Aversion

⁸⁵ See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976).

⁸⁶ Sitkoff, *supra* note __, at 637-38 (summarizing some of these solutions in other areas).

⁸⁷ See Lyon, *supra* note __, at 593, 602, 608 (detailing the expertise of litigation funders).

⁸⁸ See, e.g., Steinitz, *Litigation Finance Contract*, *supra* note __, at 54 (analyzing a control mechanism in place for a complex litigation financing arrangement involving an investment rather than an outright acquisition).

Defendant risk aversion remains a major problem in copyright law. In addition to generating a host of socially inefficient practices, it also routinely distorts interpretations of the fair use doctrine.⁸⁹ Solutions to the problem have almost always focused on changes to copyright doctrine or institutions in order to introduce more bright-line rules into the system, in the belief that this would introduce greater certainty for litigants threatened with lawsuits.⁹⁰ The fair use doctrine, the device around which much of this risk aversion is seen, is thus thought to be in need of serious reform. And yet, there seems little reason to believe that courts or Congress will do anything at all to amend the current version of the doctrine.⁹¹ Here again, litigation funding can ameliorate the situation—at least partially.

Litigation funding is ordinarily thought to operate exclusively on the plaintiff's side. This need not be the case. In several common law jurisdictions, a market has begun to emerge for what is known as “after the event” (or ATE) insurance.⁹² In these situations, a third party insurer enters the picture and offers to insure a party—i.e., the defendant—*after* litigation has been commenced.⁹³ The premium for these policies is usually based on the unique nature of the claim and the possibility of a successful defense. The insurer in these policies, very importantly, doesn't offer to insure against the actual outcome or verdict, but rather against the expenses that the defendant needs to incur to defend the claim in court.⁹⁴ This includes attorney's fees, litigation costs, the costs of discovery, and the like. Indeed, in jurisdictions where the market for such policies is fairly robust on both the plaintiff and defendant sides, courts today allow claims for fee-shifting (i.e., to recover any attorney's fees) to include the premiums that a party has paid for any after the event insurance.⁹⁵

We could envision an expansion of this model where the defendant insures not just the expenses of litigation, but also the underlying

⁸⁹ Gibson, *supra* note __, at 881-906.

⁹⁰ See, e.g., Michael W. Carroll, *Fixing Fair Use*, 85 N.C. L. REV. 1087, 1143 (2007) (offering a regulatory solution to the uncertainty of fair use and analyzing other similar solutions); Gideon Parchomovsky & Kevin A. Goldman, *Fair Use Harbors*, 93 VA. L. REV. 1483 (2007) (advocating the use of bright-line harbors in fair use law to add certainty).

⁹¹ Litman, *supra* note __, at 41 (articulating a series of reforms but noting how they are very unlikely to be enacted into law).

⁹² For a recent overview of this phenomenon, see *Fee Shifting and After the Event Insurance: A Twist to a Thirteenth Century Approach to Shifting Attorneys' Fees to Solve a Twenty-First Century Problem*, 59 DRAKE L. REV. 1199, 1202-04 (2011).

⁹³ *Id.* at 1203.

⁹⁴ See, e.g., *After the Event Insurance*, THE JUDGE, <http://www.thejudge.co.uk/index.php/after-the-event-insurance#tab1> (last visited June 18, 2012) (“ATE Insurance (sometimes known as ‘Litigation Insurance’) provides an indemnity for legal costs in the event that the litigation or arbitration is lost...[and] typically covers the potential liability for the other side's costs (adverse costs), as well as some or all of the client's own legal fees.”)

⁹⁵ See, e.g., U.K. CIV. P. R. 44.3A & 44.3B (2012).

award/settlement as well. In this scenario, the defendant would purchase insurance from a third party that covers the expenses of litigation and a likely settlement/award figure, which is based not on what the plaintiff seeks in its claim or settlement offer, but rather on what the third party insurer objectively values the suit at, based on its own independent assessment of its ability to defend the claim, or force the plaintiff to a lower settlement. In recent work, Jonathan Molot has made the tentative case for such a modification of the insurance model, into what he calls the “market for litigation risk”.⁹⁶ He notes however that for this model to work, among other things, insurers would need to develop a way of valuing the litigation risk being acquired, which is highly problematic given how individualized it is likely to be.⁹⁷ The heterogeneity of the risk is thought to impede insurers’ ability to pool it together.⁹⁸ Molot however assumes the third party insurer’s portfolio of litigation risks to be sufficiently diversified—either in actuality or as a goal. In other words, the problems of individualized risk are enhanced by the diverse areas that the insurer is looking at. If the insurer were to instead focus on one specialized area, and rely on the valuations and assessments of its lawyers (rather than actuaries) as Molot suggests,⁹⁹ a large part of this problem is likely to disappear. Indeed, this is how a fair use insurance market might begin to emerge in copyright litigation.

While uncertain to the lay individual, the fair use doctrine is hardly completely unpredictable. With the vast amount of fair use jurisprudence that has developed over the years, coupled with the fact that it is a question for the court and not the jury, lawyers are today in a position to make a decent enough probabilistic assessment of whether a fair use defense remains viable or not in any particular case. In an extensive new empirical study, Matthew Sag reviews all fair use decisions handed down by federal courts to see if the doctrine is indeed predictably applied, and whether some coherence can be seen in cases decided using the doctrine.¹⁰⁰ Sag concludes that contrary to common perception, fair use decisions are indeed predictable along multiple dimensions. He goes on to note that in practice, the doctrine is hardly as incoherent as is believed to be.¹⁰¹ Over time and context, we today have a vast amount of fair use jurisprudence that actuaries—working with lawyers, as Molot suggests—should be able to synthesize into probabilistic assessments of the defense succeeding in any particular case.

⁹⁶ Molot, *Market for Litigation Risk*, *supra* note ___, at 375.

⁹⁷ *Id.* at 380-85.

⁹⁸ *Id.* at 381.

⁹⁹ *Id.* at 384.

¹⁰⁰ Matthew Sag, *Predicting Fair Use*, 73 OHIO ST. L.J. 1 (2012).

¹⁰¹ *Id.* at 85 (noting how the study “offers considerable evidence against the oft-repeated assertion that fair use adjudication is blighted by unpredictability and doctrinal incoherence”).

Third party litigation funders might thus, with the right set of procedural changes, begin to offer a tailored insurance product to defendants in copyright infringement claims—known as fair use insurance. The insurer would thus assess the likelihood of a defendant successfully raising the fair use defense in a copyright claim and offer to acquire the litigation risk from the defendant in return for a premium. If the premium is tied directly to the likely payout that the insurer will have to make, it may well be lower than a settlement offer made by the plaintiff, especially when the fair use defense is very strong. Copyright law already contains a provision allowing for attorney fee shifting, which applies to defendants just as much as it does to plaintiffs.¹⁰² If courts began interpreting it purposively, and followed the approach of U.K. courts in allowing litigation insurance premiums to be recovered as well,¹⁰³ we might well expect to see defendants transferring their litigation risk to an insurer, who then takes over the defense from the litigant (as a subrogation) instead of defendants caving in and settling for the amount demanded by the plaintiff. The insurer might hope that its entry and expertise will force the plaintiff to offer a low settlement, or indeed withdraw the claim altogether where it is without merit. Consider the following hypothetical.

ABC Studios commences an action against Joe for using a 10 second clip of its new blockbuster movie in a documentary film that Joe makes for his college project. ABC sends him a cease and desist letter (which he ignores), and then threaten him with damages of \$150,000 for willful infringement. ABC also offers to settle the matter if he admits liability and pays \$12,000 for a license. Joe knows that his use is very likely (if not certainly) a fair use of the work, but recognizes that even if he were to litigate the claim, it would cost him \$20,000 (in attorney's fees) to do so. Even though current law allows courts to award successful defendants their "reasonable" attorney's fees,¹⁰⁴ to Joe the risk of this award not covering his fees and the need for immediate liquidity cover the out-of-pocket expenses that this entails, makes him more willing to accede to ABC's demands and settle. This in many ways represents precisely what happens today. If litigation funding were to develop here, we might expect an entity, let's call it LF Inc., a litigation funder, to provide copyright defendants with an insurance product once the claim is filed. LF, Inc., would be an entity with significant expertise in copyright matters, with the capital to take on the risks that Joe is averse to. To make it viable for Joe, LF would have to offer Joe a premium lower than the projected settlement

¹⁰² See 17 U.S.C. §505 (2010) (allowing courts to award reasonable attorney's fees to the prevailing party); *Fogerty v. Fantasy, Inc.*, 510 U.S. 517, 527 (1994) (concluding that §505 applies to defendants and observing that "defendants who seek to advance a variety of meritorious copyright defenses should be encouraged to litigate them to the same extent that plaintiffs are encouraged to litigate meritorious claims of infringement").

¹⁰³ U.K. Civ. P. R. 44.3A & 44.3B (2012).

¹⁰⁴ 17 U.S.C. §505 (2010).

offer from ABC. Say, LF offers Joe insurance for \$6,000. LF knows fully well—from its assessment of past fair use cases—that ABC’s claim is (a) without merit, (b) as a result likely to also result in an award of attorney’s fees, and (c) that it has the ability and expertise to deal with the matter at a cost much lower than it would take for Joe to do so. In acquiring the defense claim from Joe, LF also hopes that ABC will come to recognize that the bargaining asymmetry which previously existed has now been eliminated, making it more willing to withdraw its claim altogether, or at worst to settle for a significantly lower amount (~\$1,000)—rendering its own investment profitable.

As an insurer with the ability to spread its risk across a wide range of parties, LF is likely to be far less risk averse than Joe, an individual litigant. LF also has the resources and expertise at its disposal, to lower its risk. This in turn allows it to fund defendants with otherwise high-risk claims. While such funding certainly doesn’t eliminate defendant risk-aversion in its entirety and in some ways is parasitic on it, it has the direct effect of reducing the socially wasteful costs associated with such risk aversion—both to the defendant, and the copyright system as a whole. In the aggregate, the funder’s risk-taking neutralizes some of the effects of the defendant’s risk aversion.

A more direct solution to the problem might seem to lie in reducing defendants’ overall litigation costs, thereby curtailing their risk aversion and its negative effects at its source. As a practical matter though, this is highly unlikely. First, extremely high litigation costs are hardly unique to copyright litigation. Most forms of commercial litigation face the same problem, and given that copyright disputes are indeed litigated in general (rather than specialized) federal courts, copyright litigants must endure the realities of the overall system. What makes it problematic for copyright however, is how heavily dependent the entitlement and its functioning are on such litigation. Thus, any lowering of costs will need to happen system-wide. Second, plaintiff-side lawyers—and the legal profession more generally—have little to gain from such a reduction. Both these factors render it highly unlikely that lowering litigation costs remains at all a viable solution. The entry of defendant funders however ensures that the *full impact* of these costs isn’t felt solely by defendants, which in turn distorts copyright doctrine.

To be sure, the entry of defense funders will certainly not eliminate the socially wasteful effects of defendant risk aversion altogether. In the hypothetical above, Joe still is forced to buy insurance (and transfer the defense to LF) when he shouldn’t have to do so at all as a matter of law, owing to the fair use doctrine. All that LF’s entry is able to achieve is a *reduction*, albeit a significant one, in the wasted expense. At the same time though, as more and more defense funders begin to enter copyright litigation, and the market becomes more robust, we are likely to see a huge reduction in the number of frivolous lawsuits being brought, i.e., lawsuits where a defendant

has a complete defense, and the plaintiff is merely seeking to take advantage of a defendant's risk aversion. Just as funding on the claim (i.e., plaintiff's) side forms a bridge between the creator and the regime of statutory damages, funding on the defense side is likely to form an analogous bridge between a defendant with a strong defense and copyright's fee-shifting provision, if sufficiently strengthened.

4. Valuing and Sorting Claims

In addition to performing an allocative function, markets in numerous contexts also perform the important purpose of enabling a price-based "commensuration" of anything transacted in.¹⁰⁵ Commensuration refers to the process of comparing "different entities according to a common metric."¹⁰⁶ A market for copyright claims would thus, in addition to allowing the claim to vest in an entity best positioned to enforce it, also result in a process wherein those very entities come to value the claim based on its probability of succeeding. With their purchase of or investment in the claim becoming public, this would have the effect of sending a signal to the parties involved, and indeed the court, on the strength of the claim in question.

This is especially likely to be true in situations where the third party's involvement is an outright acquisition of the claim, i.e., a claim transfer.¹⁰⁷ At the time of commencement of the action, or during discovery thereafter, a third party's acquisition of the claim and the price of such acquisition are likely to become public. This will in turn send an important signal – both to the other side, and potentially to courts as well. To the other side, it will signal the possibility that the claim is with *some* merit, evidenced in the third party's willingness to assume some of the risk that it entails. Meritless or frivolous claims are unlikely to attract such investment or acquisition. To a court, in similar vein, the third party's involvement might signal the absence of a frivolous or meritless claim. Yet, as a functional matter, what is likely to be more important to the system than what an actual acquisition or investment signals, is likely to be what the *absence* of such an acquisition of investment signals in a robust market.

In due course, when infringement claims of a certain kind are routinely financed by third parties, a litigant's inability to secure such third party involvement might communicate a signal that the claim has a low probability

¹⁰⁵ See DANIEL MARKOVITS, MARKET SOLIDARITY 22 (unpublished manuscript) (on file with author).

¹⁰⁶ Wendy Nelson Espeland & Mitchell L. Stevens, *Commensuration as a Social Process*, 24 ANN. REV. SOC. 313, 313 (1998).

¹⁰⁷ Every plaintiff in a copyright infringement suit bears the burden of establishing its ownership of a valid copyright. See 4 NIMMER, *supra* note __, at §13.01[A]. In situations where a third party acquires the claim from a creator-plaintiff, it too would have to present evidence of this ownership, for which the details of its acquisition will have to be entered into the court record.

of success, or indeed that it is meritless. This is in turn likely to make a defendant more willing to contest the claim, rather than settling early. In addition, this considered non-involvement by third parties is also likely to deter plaintiffs themselves from bringing such claims. In other words, a third party's refusal to fund or acquire an infringement claim for reasons having to do with the strength of the claim might in reality work to deter the very entry of such claims into the litigation system.¹⁰⁸

The idea of third parties being involved in the funding and acquisition of legal claims has met with a good deal of objection from those who believe that it is likely to raise the overall volume of litigation in courts, and encourage lawsuits to be brought where previously none might have.¹⁰⁹ Some have even suggested that it is likely to result in more frivolous lawsuits being brought.¹¹⁰ Yet it is indeed more likely that just the opposite will occur. When a potential plaintiff receives information from a third party to the effect that the claim is very weak and unworthy of outside investment, the plaintiff is highly likely to abandon it altogether. Litigation, it is often forgotten, involves large emotional, dignitary, and reputational costs, besides the obvious first order costs of its own.¹¹¹ Max Schanzenbach and David Dana point this out, in advocating for the greater involvement of third parties in tort litigation. They thus note that “the flip side to communicating the high value of strong, low-risk claims, is that it will also communicate the low value of nuisance claims [and a]ssuming a distaste for litigation among most people, a strong *ex ante* signal of claim value may act as a deterrent to low-value claims.¹¹²” When the probability of success is objectively calibrated—using third parties—even an otherwise risk-taking or over-optimistic plaintiff is likely to exhibit a reduced willingness to bring and continue the claim in court.

In short then, the entry of third parties into copyright litigation is likely to introduce a valuable sorting mechanism into the system. Key beneficiaries of this sorting are likely to be potential defendants, courts, and on occasion plaintiffs themselves.

III. STRUCTURING A MARKET FOR COPYRIGHT CLAIMS

¹⁰⁸ See Max Schanzenbach & David Dana, *How Would Third Party Financing Change the Face of American Tort Litigation? The Role of Agency Costs in the Attorney-Client Relationship*, (Searle Ctr. on Law, Regulation, & Econ. Growth Pub. Policy Roundtable on Third Party Financing of Litigation, Sep. 24-25, 2009), available at http://www.law.northwestern.edu/searlecenter/papers/Schanzenbach_Agency%20Costs.pdf.

¹⁰⁹ See U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, *supra* note ___, at 5-6.

¹¹⁰ *Id.*

¹¹¹ Schanzenbach & Dana, *supra* note ___, at 12.

¹¹² *Id.* at 13.

Having seen how the involvement of third parties in copyright litigation—through a market for actionable copyright claims—might serve to benefit both plaintiffs and defendants, and in the process reduce the various social costs traditionally associated with protracted litigation, this Part moves to describing how such a market might take shape and some of the necessary doctrinal changes that will need to be put in place to encourage and regulate the development of this market.

Section III.A describes five possible market arrangements wherein third parties play a role in copyright litigation, III.B then looks at some of the current doctrinal hurdles that serve as impediments to such arrangements.

A. Possible Forms of Third-Party Involvement in Copyright Litigation

As noted earlier, the “market for copyright claims” need not always involve an outright purchase of the actionable claim by a third party.¹¹³ All that it entails, as used here, is the process by which a third party acquires some degree of control over the copyright litigation by funding a primary litigating party, and through which the third party hopes to obtain a net benefit when the litigation ends. Arrangements short of outright sales are thus equally effective market mechanisms.

1. Assignments of the Right to Sue for Infringement

The most obvious market mechanism involving actionable copyright claims is likely to be instances where the third party acquires the claim as an asset from the plaintiff in return for valuable consideration.¹¹⁴ It is important to understand that in this arrangement, the third party obtains no interest whatsoever in the actual copyrighted work itself, i.e., it obtains no interest in the exclusive rights obtained by the original copyright holder under the copyright system. The third party merely obtains the unenumerated right to commence an action for copyright infringement either generally, or against defendants specified in the arrangement. The assignment can be prospective, i.e., for yet-to-occur infringements, or retroactive, i.e., for already accrued instances of infringement.¹¹⁵

In ordinary assignments of actionable claims, the original litigant drops out of the picture altogether and the assignee thereafter commences (or

¹¹³ See text accompanying notes ___-___.

¹¹⁴ See generally Walter Wheeler Cook, *The Alienability of Choses in Action*, 29 HARV. L. REV. 816 (1916); Percy H. Winfield, *Assignment of Choses of Action in Relation to Maintenance and Champerty*, 35 L.Q. REV. 143 (1919).

¹¹⁵ For a useful overview of copyright law’s treatment of retroactive transfers, see James K. Rothstein, Note, *Unilateral Settlements and Retroactive Transfers: A Problem of Copyright Ownership*, 157 U. PA. L. REV. 881 (2009).

continues) the litigation in its own name against the defendant.¹¹⁶ For this to work, it is thus essential that the law allow a third party assignee to bring the action in its own name without imposing onerous standing requirements on the third party, which render the acquisition meaningless. Courts today are divided on whether copyright law allows third parties to bring infringement actions when they acquire the bare right to sue—a factor that is likely to inhibit the early development of this arrangement.¹¹⁷

Assignments provide obvious advantages over most other forms of arrangements, for third parties. They give the third party complete control and autonomy over the litigation and settlement processes, since the original plaintiff drops out of the picture. They also allow the third party to itself alienate (or re-assign) the claim to another third party should it need to, without any restrictions at all. Assignments are also the most beneficial arrangement from an information-sharing perspective. With the court and the public easily obtaining information about the third party's direct involvement in the claim, the sorting and classification advantages discussed earlier are much more likely to be realized.¹¹⁸

2. Non-Recourse Financing of Infringement Lawsuits

Instead of acquiring the lawsuit as an actionable claim from the original plaintiff, third parties might instead choose to invest in the copyright infringement lawsuit through a financing arrangement. In other forms of litigation, such financing is normally done through a non-recourse loan, under which the plaintiff accepts no personal liability for repayment, and satisfaction of the debt (i.e., the loan) is to occur exclusively through the proceeds from the litigation—either the judgment award or the settlement.¹¹⁹ Unlike in an assignment, the original plaintiff continues to remain a part of the litigation since the lawsuit continues in its name. The third-party funder would nonetheless come to exert a good degree of control over the litigation process and strategy through a contractual arrangement with the plaintiff.

Arrangements of this kind leave the third party funder with less control and autonomy over the lawsuit than in an assignment, and are likely to be seen

¹¹⁶ The law treats the assignee as the “real party in interest”. See Charles E. Clark & Robert M. Hutchins, *The Real Party in Interest*, 34 YALE L.J. 259, 262 (1924).

¹¹⁷ Compare *Silvers v. Sony Pic. Ent., Inc.*, 402 F.3d 881 (9th Cir. 2005) (finding such assignments to be impermissible), with *Prather v. Neva Paperbacks*, 410 F.2d 698 (5th Cir. 1969) (permitting such an assignment).

¹¹⁸ See *supra* Section II.xx.

¹¹⁹ Non-recourse funding more generally is defined as involving “[a] loan secured by the revenue of the project the loan intends to fund, and nothing else...[i.e., it] does not allow the bank or other lending institution access to the borrower's other assets in the event of default.” FARLEX FINANCIAL DICTIONARY xx (2012).

in situations where the plaintiff (and its team) have significant expertise in copyright litigation, which the third party funder trusts and is willing to rely on. In addition to needing an independent contractual arrangement on the question of control, these arrangements also serve the information disclosure function to a far lesser degree, since the role of the third party is never made public—and is only ever learnt of during discovery.¹²⁰ As a result, the possibility of any *ex ante* sorting and signaling is diminished quite significantly (or indeed eliminated). Lastly, these arrangements also leave the third party with fewer exit options. Whereas in an assignment, the third party can readily alienate the claim to another party, or choose to terminate the litigation, in such financing arrangements, the third party has little ability to stop the lawsuit, and would need to find another investor to acquire the loan made to the plaintiff.

Non-recourse financing of this kind is likely to be seen in copyright infringement lawsuits between two large commercial competitors, and less so in individual lawsuits where an assignment is likely to be preferred by both the original plaintiff and the third party.¹²¹

3. Tailored Exclusive Licenses

A third way that third parties might choose to be involved in the infringement action is unique to copyright (and patent) law. It seeks to work around the ambiguity surrounding the permissibility of open assignments to sue, by using the law's standing requirements. The copyright statute treats an "exclusive license" as a transfer of copyright ownership for the purposes of the statute,¹²² and additionally allows copyright's bundle of exclusive rights to be disaggregated and broken down into idiosyncratic and narrow sub-rights in whatever way parties choose.¹²³ Thus, not only can the exclusive right to distribute the work be licensed independent of other rights, but that right itself can be broken down further (e.g., the exclusive right to distribute the work in Santa Clara County, San Jose City, California) and licensed or assigned independently.¹²⁴ The reason this matters is because the law then confers on the legal or beneficial owner of "an exclusive right" the power to commence an action for infringement of that right.¹²⁵ What this means then is that in order to effect a *de facto* assignment of the right to sue for copyright infringement to a

¹²⁰ In the copyright context, the Righthaven episode remains a prime example. See Balganesch, *Uneasy Case*, *supra* note __, at __.

¹²¹ See, e.g., *Lotus Dev. Corp. v. Borland Int'l Inc.*, 49 F. 3d 807 (1st Cir. 1995).

¹²² 17 U.S.C. §101 (2005) (definition of "transfer of copyright ownership").

¹²³ *Id.* at §201(d)(2).

¹²⁴ *Id.* at §201(d)(1).

¹²⁵ *Id.* at §501(b).

third party, the original copyright holder has to grant the third party an exclusive license that is artificially tailored to the market/context in which the infringement is occurring. This confers standing on the third party to bring the action in its own name, and the artificial tailoring of the license ensures that the original copyright owner (i.e., the licensor) has no reason to worry about the third party exploiting the work or doing anything other than bringing the infringement action. This is best illustrated through an example.

Assume that Jonathan is a first-time novelist based in New York City who self-publishes his book *The Seasons* in hardback on October 1, 2010 and begins marketing it shortly thereafter. He retains all the rights to his work. On January 1, 2011 Jonathan learns that a publisher located in Cambridge, MA has begun making paperback copies of his book and distributing them without his permission. Jonathan wants to bring an action against the publisher, and is approached by TF Inc., a litigation funder, on June 1, 2011. Instead of an assignment of the bare right to sue—which is of questionable validity—Jonathan grants TF an “exclusive license to reproduce *The Seasons* in paperback book form in Cambridge, MA, from January 1 to June 1, 2011”. This arrangement confers on TF the power to commence the lawsuit for copyright infringement on its own, since it is the legal owner of the right in question, even though the right has been chopped up along the dimensions of time (i.e., 6 months), geography (i.e., Cambridge, MA) and form (i.e., paperback). Even though TF obtains an exclusive license, the retroactive and limited nature of the grant render it highly unlikely (if not improbable) that TF will actually exploit the work by reproducing it. The effect of the exclusive license is thus that it operates exactly like an assignment, and is of unquestionable validity.

The obvious downside to using tailored exclusive licenses instead of actual assignments of the actionable claim is that it requires identifying specific defendants by region or market, before the license is executed—i.e., the tailoring. An assignment of the bare right to sue on the other hand doesn't require such identification and can transfer the power to bring infringement suits against whole classes of defendants, which an exclusive license cannot. The exclusive license route is thus likely to be used only till such time as courts (and perhaps Congress) come to accept the legality of assignments of the right to sue for copyright infringement.¹²⁶

4. Assignments of the Copyright in its Entirety

The most obvious way for a third party to be involved in a copyright infringement action is of course by acquiring the copyright in the infringed work in its entirety. Once properly executed, the third party becomes the new

¹²⁶ See *infra* Section III.B.2.

owner of the copyrighted work, with the power to commence an infringement action.¹²⁷ Much like the assignment of the actionable claim, the original owner exits the picture altogether, giving the third party complete control over the process. However, unlike in the assignment of just the claim, the original owner retains no rights whatsoever to continue exploiting or using the work, since the third party becomes the owner for *all* purposes. Consequently, assignments of the work their entirety merely in order to allow a third party to bring suit are likely to be somewhat rare, and occur in situations where either the original copyright holder obtains a large enough payout from the third party that renders it willing to avoid dealing in the work altogether, or the third party is willing to acquire the copyright seeing its potential to commence lawsuits against future defendants as well.

Third parties that acquire the copyright with the sole objective of litigating infringement claims or licensing its use to others, resemble non-performing entities or “patent trolls” in the area of patent law.¹²⁸ The probabilistic and prospect-like nature of the patent right encourages this model in relation to patents.¹²⁹ Copyright’s entitlement on the other hand, being tied to the specific expression in question, allows for such prospecting to a much lesser extent, which is likely to result in this approach to third party involvement being somewhat rare.¹³⁰

5. Fair Use Insurance

The previous mechanisms all described ways by which third parties may come to be involved in copyright infringement litigation on the plaintiff’s side. Yet, as discussed earlier, third party litigation funding can come to benefit defendants as well.¹³¹ The principal way in which this is likely to come about is through a mechanism best described as fair use insurance—where the third party underwrites the defendant’s likelihood of succeeding in its defense of fair use when an infringement claim is brought.

Situations could thus arise where a defendant being sued for copyright infringement raises a colorable defense of fair use. If a sufficiently robust fee shifting regime were put in place, the beginnings of which are already

¹²⁷ 17 U.S.C. §204 (2005).

¹²⁸ See 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, 1577-82 (2009).

¹²⁹ Mark A. Lemley & Carl Shapiro, *Probabilistic Patents*, 19 J. ECON. PERSP. 75 (2005). The original idea for this conception of the patent goes back to Ed Kitch’s seminal work. See Edmund W. Kitch, *The Nature and Function of the Patent System*, 20 J.L. & ECON. 265 (1977).

¹³⁰ For the argument that copyright law does not embody a similar architecture see Shyamkrishna Balganesh, *Foreseeability and Copyright Incentives*, 122 HARV. L. REV. 1569, 1621-24 (2009).

¹³¹ See Molot, *supra* note __, at 374; *supra* text accompanying notes __-__.

contained in current law,¹³² third parties are likely to be willing to underwrite the defense by pricing the risk associated with its success (and factoring in their own expertise in litigating the claim) and then potentially bringing the defense themselves. If the premium offered by the third party for such underwriting is significantly lower than the settlement offer from the plaintiff (which is in turn likely to be lower than the amount demanded at trial), defendants—especially those whose existence depends on their continued reliance on the fair use doctrine—are likely to obtain such insurance. In due course, we are also likely to see variations in the coverage offered by third parties, correlating to the amount of control they assume over the litigation and settlement processes. Here, we might thus see a variety of arrangements materializing, which track some of the options just discussed on the plaintiff’s side. The third party may simply fund the defendant’s case, or instead might choose to take the lead in defending the claim and deciding on litigation strategy. What distinguishes these policies from traditional liability insurance is the fact that they are obtained by defendants *after* the litigation (or the threat of litigation) actually materializes, and not necessarily in advance.

B. Obstacles

Having a market for copyright claims take shape will however require more than just an attitudinal shift among participants in the copyright system, requiring them to see litigation as a necessary and integral part of the system and its functioning. It will additionally require overcoming a host of legal obstacles that in turn have their source in the common law, in the statutory language of the Copyright Act, and in judicial interpretations of the same. This Section explores the primary legal obstacles that a market for copyright claims is likely to face and suggests possible remedial fixes. This Section discusses two somewhat independent sets of obstacles: (i) those originating in the common law, and (ii) those internal to copyright law.

1. Common Law Obstacles

The first set of obstacles is likely to originate in a set of principles and doctrines that have long been known to the common law since time immemorial. On the face of things, it may seem as though copyright is immune from these principles given its statutory origins. Yet, courts routinely invoke the interpretive principle of “common law conformity” while interpreting the Copyright Act, which mandates that the statute be interpreted in line with

¹³² 17 U.S.C. §505 (2005) (allowing “reasonable attorney’s fees” to be awarded to the prevailing party); *Fogerty v. Fantasy, Inc.*, 501 U.S. 517 (1994) (holding the successful defendants were entitled to invoke §505 as well).

existing common law ideas and doctrine whenever possible. Should courts come to extend this idea in relation to transactions relating to copyright claims, these obstacles are likely to become real.

a. The Non-assignability of Claims

The alienability of actionable claims in the common law has for long remained a controversial topic.¹³³ Early in the development of the law, courts invalidated all attempts to transfer such claims, worrying that it would result in courts being overburdened with contentious lawsuits, brought by disruptive third parties, i.e., strangers.¹³⁴ Over time, the common law came to relax the stringency with which the prohibition was applied and enforced.¹³⁵ Purely personal claims were still placed under the restriction, whereas non-personal ones came to be understood as alienable.¹³⁶ Since non-personal claims survived the death of the original plaintiff, while personal ones were terminated (under the maxim *actio personalis moritur cum persona*), alienability came to be tied to the survivability of the claim.¹³⁷ And paradigmatic of non-personal claims were indeed property claims, such as those relating to trespass and conversion.¹³⁸ Two reasons seem to suggest that the historic common law rule of non-assignability is unlikely to be invoked in relation to copyright claims.

The first reason is conceptual. Given its exclusive rights framework, copyright law is often thought of in terms of a property interest rather than as a purely personal claim. Copyright claims are thus paradigmatic of the kinds of claims that the common law itself came to allow assignments of in due course. Thus, even under the old rule, copyright claims are unlikely to be seen as non-assignable.

The second reason originates in the Supreme Court's more recent approach to the common law rule, especially as it applies to federal statutory claims. The Supreme Court's decision in *Sprint Communications Co. v. APCC Services* considered whether the common law's general approach to non-assignability ought to be extended to more recent statutory regimes created by Congress—and concluded against applying the rule.¹³⁹ In *Sprint*, the Court was

¹³³ For early work documenting the history of this development see: Walter Wheeler Cook, *The Alienability of Choses in Action*, 29 HARV. L. REV. 816 (1916); William S. Holdsworth, *The History of the Treatment of Chose in Action By the Common Law*, 33 HARV. L. REV. 997 (1920).

¹³⁴ 2 BLACKSTONE, *supra* note __, at *442. See, e.g., *Lampet's Case*, 77 Eng. Rep. 994, 997 (K.B. 1612) (forbidding the assignment of a “thing in action” to a stranger); Holdsworth, *supra* note __, at 1006-9.

¹³⁵ J. AMES, LECTURES ON LEGAL HISTORY 214 (1913). Commercial considerations are believed to have been responsible for these changes.

¹³⁶ See Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61, 74-75 (2011); W.W. Allen, *Assignability of Claim in Tort for Damage to Personal Property*, 57 A.L.R. 2d 603 (1958).

¹³⁷ Sebok, *supra* note __, at 75.

¹³⁸ 3 JOHN N. POMEROY, A TREATISE ON EQUITY JURISPRUDENCE § 1275 (1905); *id.* at 76.

¹³⁹ 554 U.S. 269 (2008).

presented with the question of whether the assignee of a bare right to commence a legal claim for money, based on a provision of the Communications Act of 1934, had standing to commence the action.¹⁴⁰ The original entitlement to sue was entirely statutory in origin, and a practice had emerged wherein third party enforces accumulated the claims of multiple parties and then through an assignment commenced actions for recovery (against the original defendants) in their own name.¹⁴¹ Despite the statutory nature of the right to sue, a majority the Court considered the applicability of the common law, but concluded that the common law itself had evolved and come to permit the assignability of claims as a default position—even when done so exclusively to bring suit. The majority thus found that the assignee had standing to sue.¹⁴² *Sprint* can thus be seen as confirming two ideas at once: (i) that the common law’s default position is no longer one of non-assignability, and (ii) that this new default (i.e., of assignability) extends to federal statutes.

b. Champerty and Maintenance

In addition to its rules on non-assignability, the common law developed specialized doctrines through which they policed (and continue to regulate) a third party’s involvement in bringing an actionable claim to court. The doctrines of “maintenance”, “champerty”, and “barratry,” serve this purpose.¹⁴³ These rules do not apply to outright transfers. Maintenance entails assisting a plaintiff in either bringing or defending a lawsuit when the person so providing the assistance “has no bona fide interest in the case”.¹⁴⁴ Champerty is a form of maintenance, performed for consideration.¹⁴⁵ Barratry is “adjudicative cheer-leading” wherein one person encourages an action to be brought.¹⁴⁶

State common law courts routinely use these doctrines to regulate lawsuits brought by third parties.¹⁴⁷ They usually scrutinize the individual claim brought in court, to see if it is affected by the third party’s involvement. They either focus on the type of action being brought, or on the relationship between the original claimant and the investor.¹⁴⁸ Some states for instance, forbid the investor from “intermeddling” in the litigation,¹⁴⁹ others forbid third

¹⁴⁰ *Id.* at 271.

¹⁴¹ *Id.*

¹⁴² *Id.* at 289.

¹⁴³ *Id.* at 94; Steinitz, *supra* note __, at 1289.

¹⁴⁴ BLACK’S LAW DICTIONARY 1039 (9th ed. 2009).

¹⁴⁵ *Id.* at 262.

¹⁴⁶ CHARLES W. WOLFRAM, MODERN LEGAL ETHICS § 8.13, at 490 (1986).

¹⁴⁷ For an excellent discussion of the connection between assignments and maintenance, see: Sebok, *supra* note __, at 94-97.

¹⁴⁸ *Id.* at 108-9.

¹⁴⁹ *Id.* at 109-12.

parties from getting involved in cases involving specific subject matter,¹⁵⁰ and yet others regulate it contextually, examining the plaintiff's real motivations for commencing the action.¹⁵¹

On the face of things, it may appear as though these doctrines are unlikely to apply to copyright claims, given that they originate in state common law, while copyright disputes are always questions of federal statutory law. Yet, the fact of the matter is that even while copyright infringement lawsuits are a question of federal law, agreements that govern the conditions under which the lawsuit may be brought are matters of contract law that must of necessity be governed by state law. Federal courts have in the past used state common law during infringement disputes, and applied the doctrines of champerty and maintenance to contractual arrangements. For example, in *Refac International, Inc. v. Lotus Development Corp.*,¹⁵² a third party had acquired a 5% stake in a patent “[t]o facilitate suit in [the third party’s] name as plaintiff and to avoid the need for having [the original owner] named or brought into the suit as a co-plaintiff.”¹⁵³ The court found this arrangement to be champertous under New York state law, and invalidated the arrangement during an infringement lawsuit.¹⁵⁴

The doctrines of champerty and maintenance remain an obstacle for third party involvement not just in copyright claims, but also other forms of litigation. Despite their having been in existence for centuries now, courts and scholars have struggled to find a coherent reason for their existence. Their principal motivation appears to be the idea that litigation is something of an evil that needs to be avoided.¹⁵⁵ As courts have come to recognize the absurdity of this idea, so too have they come to relax the stringency with which the doctrines of champerty and maintenance are applied.¹⁵⁶ It is thus quite conceivable that in the near future, a large number of states will come to abandon the doctrines altogether, or at least limit their application to cases of truly frivolous litigation.

2. Copyright Law Obstacles

¹⁵⁰ *Id.*

¹⁵¹ *Id.* at 113-20.

¹⁵² 131 F.R.D. 56 (S.D.N.Y. 1990).

¹⁵³ *Id.* at 58.

¹⁵⁴ *Id.* See also *American Optical Co. v. Curtiss*, 56 F.R.D. 26 (S.D.N.Y. 1971); *Jackson v. Rogers & Wells*, 258 Cal. Rptr. 454, 461-62 (1989).

¹⁵⁵ Stephen B. Presser, *How Did We Get Here? What Litigation Was, What It is Now, What It Might Be* 7, Common Good (June 27, 2005), <http://commongood.org/assets/attachments/142.pdf>.

¹⁵⁶ See Steinitz, *supra* note __, at 1289-90 (noting how New York courts in particular have adopted a pragmatic approach to the rule); *Bluebird Partners, L.P. v. First Fidelity Bank, N.A.*, 709 N.Y.S. 2d 865 (2000).

Even if the common law's traditional rules against assignability, and its doctrines of maintenance and champerty were rendered inapplicable to copyright infringement claims, copyright law's internal doctrines present a host of additional (and direct) obstacles to the realization of a market for copyright claims. Three in particular stand out: (i) copyright law's rule against the assignment of the right to sue—affirmed by the Ninth Circuit, (ii) copyright's requirement of formalities for statutory damages, and (iii) the reluctance with which courts award defendants costs and attorney's fees in unsuccessful infringement actions.

a. The Non-Assignability of Infringement Claims

Quite independent of the common law's rules on assignment, some courts have interpreted the Copyright Act as precluding assignments of the “bare” right to sue, independent of assignments involving the underlying copyright itself. The Ninth Circuit's en banc decision in *Silvers v. Sony Pictures Entertainment, Inc.* crystallized this position.¹⁵⁷ *Silvers* involved a plaintiff who had produced a copyrighted work under the work-for-hire doctrine, under which ownership of all rights vested with her employer.¹⁵⁸ On learning that the defendant was possibly infringing the work in question and realizing that her employer (i.e., the copyright owner) was unwilling to commence the action, she approached her employer and obtained an assignment of “all right, title and interest in and to claims and causes of action against” the named defendant and other possible infringers of the work in question.¹⁵⁹

Hearing the matter en banc, the Ninth Circuit found the assignment to be invalid. The court offered four reasons for its conclusion. First, it noted that the copyright statute vested the right to commence an infringement action only with the “legal or beneficial owner” of the work, which it had in turn circumscribed through a narrowly tailored definition.¹⁶⁰ Second, it looked to the legislative history of the Act to conclude that Congress had intended the list of assignable rights to be exhaustive, and enumerated in the Act itself.¹⁶¹ Congress's failure to list the right to sue, in other words, implied its non-assignability. Third, it looked to patent law, copyright's cousin, to find that in patent law too, courts had historically disallowed similar assignments of the

¹⁵⁷ *Silvers v. Sony Pic. Ent., Inc.*, 402 F.3d 881 (9th Cir. 2005).

¹⁵⁸ *Id.* at 883.

¹⁵⁹ *Id.*

¹⁶⁰ *Id.* at 885-86.

¹⁶¹ *Id.* at 886-87.

mere right to sue.¹⁶² Fourth and lastly, it looked to precedent from other circuits that had similarly disapproved of such transfers.¹⁶³

The court's overall reasoning in reaching its conclusion remains deeply problematic. In creating a set of enumerated rights and treating them as independently assignable, Congress was doing little more than attempting to simulate the basic structure of a property right. It was in the process saying very little about the enforceability of those enumerated rights, for which it needed to create an independent provision in the Copyright Act. Merely because the Act specifies the mechanisms by which copyright's exclusive rights may be transferred or assigned need not imply that it forbade other forms of assignments. The simple point is that assignments of claims (even copyright claims) are technically not actual transfers of copyright, and therefore outside the scope of the statute to begin with. The Supreme Court's opinion in *Sprint*, discussed earlier, makes this fairly clear.¹⁶⁴ In *Sprint*, the Court rightly relied on the common law's allowance for the assignability of claims—even when done so exclusively to bring suit—to find that the assignee had standing to sue.¹⁶⁵ The mere fact that the statute in question—the Communications Act in that instance—was silent on the point, presented the Court with no problem on this issue. In light of this, the Ninth Circuit's belief that a statutory scheme somehow had to be self-contained in *all respects* seems rather myopic.

The Court's other reasons remain equally flawed. Copyright and patent law derive from fundamentally different theoretical and structural rationales, which ought to have cautioned against the ready use of comparisons between the two. Indeed, even the Supreme Court has cautioned against over-reliance on the analogy between the two regimes.¹⁶⁶ In choosing precedent to follow from other circuits, the Ninth Circuit could have easily chosen a more permissive precedent to follow instead of the one that it finally did. The Court was in the end likely motivated by the same policy concerns that have historically informed the common law's rules against the assignment of claims, even though it masked these concerns in its formalist rhetoric.¹⁶⁷

Other circuits seem to adopt a different position. The Fifth Circuit, for instance, has adopted the position that assignments of copyright claims are perfectly valid, present no problems under public policy and indeed that such assignments comply with the the "real party in interest" rule.¹⁶⁸ While this

¹⁶² *Id.* at 887-88.

¹⁶³ *Id.* at 888-90.

¹⁶⁴ 554 U.S. 269 (2008).

¹⁶⁵ *Id.* at 289.

¹⁶⁶ *See, e.g.,* *Eldred v. Ashcroft*, 537 U.S. 186, 216 (2003); *Kewanee Oil Co. v. Biocron Corp.*, 416 U.S. 470, 484 (1974).

¹⁶⁷ *Id.* at 893-94.

¹⁶⁸ *Prather v. Neva Paperbacks, Inc.*, 410 F.2d 698, 700 (1969).

position was framed under the 1909 Act, there seems little reason to believe that the 1976 Act changed it in any way or form. The Second Circuit's position on the other hand remains somewhat unclear. While the majority in *Silvers* thought that the Second Circuit disallowed assignments of the bare right to sue,¹⁶⁹ the dissent in that case parsed the Second Circuit's opinions on the matter to come to the exact opposite conclusion and find that the Second Circuit in fact permitted just such an assignment and found it to confer standing on an assignee plaintiff.¹⁷⁰ In short, the law seems fairly unclear on the permissibility of such assignments under copyright law, which in itself forms a major obstacle.

Facilitating a market for copyright claims will of necessity require adopting a clear rule that permits assignments of the right to sue. Given the Supreme Court's position in *Sprint* and the flawed reasoning of the Ninth Circuit in *Silvers*, there seems little reason to believe that this will be hard to realize. Indeed, no circuit court has revisited the issue since the Supreme Court's decision in *Sprint*, which seems to implicitly override the interpretive logic of *Silvers* and its progeny. Were the issue to surface again, the logic and holding of *Sprint* is likely to force courts to validate such assignments, barring a misplaced argument that copyright law merits differential treatment.

b. Formalities for Statutory Damages and Attorney's Fees

Central to facilitating the involvement of third parties in copyright litigation is a robust damages regime—and copyright's provision for statutory damages can ideally perform that role. As noted earlier, the entry of third parties can form a bridge between plaintiffs who would have otherwise been unable to access statutory damages, and such damages.¹⁷¹ Additionally, a rule allowing courts to award a successful plaintiff its attorney's fees (a version of the English rule on fee-shifting) provides third parties with a further incentive to fund copyright plaintiffs. Yet, under current law, the availability of both statutory damages and attorney's fees depends entirely on actions undertaken by the copyright owner well in advance of the litigation, or indeed the third party's entry into the picture. §412 of the Copyright Act renders the availability of these remedies (for a published work) contingent on the copyright owner having registered the work within three months from the first publication of the work, when the infringement commences *before* such publication and registration.¹⁷² In effect, the copyright owner needs to register the work prior to the commencement of the infringement, for statutory

¹⁶⁹ 402 F.3d at 889-90.

¹⁷⁰ *Id.* at 909-11.

¹⁷¹ See text accompanying notes ___-___.

¹⁷² 17 U.S.C. §412 (2005).

damages and attorney's fees to remain available.¹⁷³ The legislative history accompanying this provision indicates that it was introduced in order to "induce" adherence to copyright's formalities, once they were rendered optional.¹⁷⁴ The idea was to prevent recourse to copyright's special remedies in situations where the infringement had occurred prior to registration; and the three month duration was intended to operate as "grace period".¹⁷⁵

§412 is likely to reduce—rather drastically—a third party's willingness to be involved in copyright litigation, since a large majority of copyright owners are unlikely to register their works prior to first publication or even shortly thereafter. This provision is also in contrast to §411, which mandates that the work be registered prior to the commencement of the infringement *action*, but not necessarily before the infringement itself began.¹⁷⁶

In an ideal world, the stringency of §412 would be relaxed, and it would come to operate along the lines of §411—requiring registration prior to commencing the lawsuit and not earlier. Alternatively, the "grace period" might be extended, especially given the periodic term extensions that copyright law has seen over the years,¹⁷⁷ which seem to rely on the assumption that creative works hold value for longer and longer periods of time. Yet, legislative modification of §412 is highly unlikely, especially given the extensive misuse of copyright's statutory damages in recent times.¹⁷⁸ The net effect of the provision and the possibility of third party funding is therefore likely to translate into authors (i.e., creators) who worry about high litigation costs and about being unable to litigate an infringement suit on their own, choosing to register their works voluntarily merely in order to preserve the option of enticing third party funders to acquire their claims in due course. In the short term then, §412 will serve to deter the entry of third parties into copyright litigation, in the medium term however it is likely to induce a greater number of creators to register their works hoping to entice third parties. As the involvement of third parties grows, and copyright owners are able to anticipate the kinds of claims that the market best responds to, §412 is likely to produce an equilibrium where works most suited to third party funding come to be registered.

¹⁷³ 2 NIMMER, *supra* note __, at §7.16[C][a].

¹⁷⁴ H.R. Rep. 94-1476, 1976 U.S.S.C.A.N. 5659, 5774.

¹⁷⁵ *Id.*

¹⁷⁶ 17 U.S.C. §411 (2005).

¹⁷⁷ See generally *Eldred v. Ashcroft*, 537 U.S. 186, 195-97 (2003) (describing Congress's practice of extending copyright's term retroactively).

¹⁷⁸ See Pamela Samuelson & Tara Wheatland, *Statutory Damages in Copyright Law: A Remedy in Need of Reform*, 51 WM. & MARY L. REV. 439, 441-43 (2009) (documenting some of the arbitrariness with which courts use the provision).

c. Defendants and Cost-Shifting

As discussed earlier, third party funding can come to benefit defendants in copyright infringement lawsuits as well—by moving the risk of litigation away from them through a mechanism of insurance. For this to work however, third parties need a somewhat strong incentive to acquire such risk. In the ordinary scheme of things, American law doesn't allow courts to award a successful party (plaintiff or defendant) the costs of the litigation, but instead requires each side to bear its own costs.¹⁷⁹ The copyright statute is however an exception to this. §505 of the Act gives the court “discretion” to award the recovery of “full costs” to a party and “reasonable attorney’s fees” to a successful party in an infringement lawsuit.¹⁸⁰ On the face of things, §505 draws no distinction between a plaintiff and defendant, as far as the court’s exercise of its discretion goes.¹⁸¹ Yet, as a historical matter, several courts tended to make such awards to plaintiffs rather than defendants and even adopted rules to this effect, which came to be known as the “dual approach”.¹⁸²

In *Fogerty v. Fantasy*, the Supreme Court clarified that successful defendants were to be treated no differently from successful plaintiffs as far as awards of attorney’s fees goes.¹⁸³ Since it based its conclusions on the structure and basis for the provision as a whole (i.e., §505), there is no reason to believe that its logic doesn’t extend beyond attorney’s fees, to a court’s award of “full costs” under the same provision. Central to the Court’s conclusion was the recognition that defendants too needed to be given an incentive to defend themselves.¹⁸⁴ It thus explicitly noted that “defendants who seek to advance a variety of meritorious copyright defenses should be encouraged to litigate them to the same extent that plaintiffs are encouraged to litigate meritorious claims of infringement.¹⁸⁵” Encouraging defendants to *contest* the claim through litigation, rather than settling, was thus central to the Court—something that third party funding will stimulate.

Despite the Court’s holding in *Fogerty* however, as a practical matter defendants rarely ever succeed in being awarded costs and attorney’s fees,

¹⁷⁹ See *Alyeska Pipeline Co. v. Wilderness Soc’y*, 421 U.S. 240, 247 (1975) (“In the United States, the prevailing litigant is ordinarily not entitled to collect a reasonable attorneys’ fee from the lose.”)

¹⁸⁰ 17 U.S.C. §505 (2005).

¹⁸¹ *Id.* It provides:

In any civil action under this title, the court in its discretion may allow the recovery of full costs by or against any party other than the United States or an officer thereof. Except as otherwise provided by this title, the court may also award a reasonable attorney’s fee to the prevailing party as part of the costs.

¹⁸² See 4 NIMMER, *supra* note __, at §14.10[D][2][a].

¹⁸³ 510 U.S. 517, 523 (1994).

¹⁸⁴ *Id.* at 527.

¹⁸⁵ *Id.*

even when they are successful.¹⁸⁶ The reason for this originates in the Court's own reasoning. In order to preserve lower courts' discretion on when to make such awards, the Court identified the use of factors such as "frivolousness, motivation, objective unreasonableness" and the ideals of "compensation and deterrence".¹⁸⁷ As a result of this observation, courts in most jurisdictions remain unwilling to award defendants attorney's fees unless convinced of the plaintiff's blameworthiness or culpability in bringing the suit to begin with.¹⁸⁸ As long as a plaintiff has a reasonable copyright claim, such culpability is in turn extremely hard to establish—and is usually associated with "bad faith motivation", "hard-ball tactics", or "objective unreasonableness".¹⁸⁹ The net effect is thus that both *Fogerty* and §505's limited move away from the traditional American rule have meant very little to defendants in practice. This is in turn likely to put a major dampener on the role that third party funding can play for defendants.

Overcoming this obstacle is entirely up to courts—and requires treating the fair use defense as something that the plaintiff ought to factor into its decision whether to bring the infringement suit to begin with. Some courts already take this position and remain willing to find fault with the plaintiffs when the defendant has a valid fair use defense.¹⁹⁰ They thus treat a plaintiff's insistence on pursuing a claim when the defendant has a valid fair use defense, as objectively unreasonable and potentially frivolous.¹⁹¹ To be sure, not all courts take this position, and indeed some view a defendant's risk-taking (by copying) as necessitating that it bear its own costs and expenses.¹⁹² A welcome change would thus be a uniform rule that treats a defendant's colorable fair use defense—when ascertainable in advance—as a basis for invoking §505 and requiring the plaintiff to bear the defendant's litigation costs. In some ways, this approach derives support from the very structure of the copyright owner's (i.e., the plaintiff's) basic entitlement, under which the set of exclusive rights is "subject to" the fair use defense (among other exceptions), to begin with.¹⁹³ Some scholars have used this language to suggest that the plaintiff ought to bear the burden of establishing that the defendant's use isn't a fair use to begin

¹⁸⁶ See 4 NIMMER, *supra* note __, at §14.10[D][2][b] ("[M]ost courts deny fees to prevailing defendants when the plaintiffs' claims were not motivated by bad faith.").

¹⁸⁷ 510 U.S. 517 at 534 n.19.

¹⁸⁸ 4 NIMMER, *supra* note __, at §14.10[D][2][b].

¹⁸⁹ *Id.*

¹⁹⁰ See, e.g., *Mattel, Inc. v. Walking Mountain Prods.*, Copyright L. Rep. (CCH), P28,824 (C.D. Cal. 2004), at 3-9.

¹⁹¹ *Id.*

¹⁹² See, e.g., *Blanch v. Koons*, 485 F. Supp. 2d 516, 518 (S.D.N.Y. 2007).

¹⁹³ 17 U.S.C. §106 (2005).

with.¹⁹⁴ At the very least though, the plaintiff ought to bear the risk of incurring the other side's litigation costs, even if not the actual burden of establishing the absence of fair use.¹⁹⁵

CONCLUSION

The copyright system is today in a state of deep crisis. In its current form, it seems to be imposing enormous costs on society, with its limited benefits flowing to a small minority of creators and users. And yet, attempts to reform the system remain largely unwilling to think creatively to bring about fundamental change. In specific, the possibility that solutions to some of the system's problems can come from the market, rather than from doctrinal reform, remains largely unexplored. In this Essay, I have argued that facilitating a regulated market for copyright infringement claims, where third parties can acquire or invest in, infringement or fair use claims in court, might make the system more egalitarian, less inefficient, and likely to thereby serve its goals of inducing creativity. Accepting this, of course, requires recognizing that litigation isn't an unavoidable reality of the copyright system, but rather a central analytical and functional part of how it works, something that scholars and courts have thus far resisted.

Once litigation is seen as part of the solution rather than as part of the problem, harnessing the resources and expertise of third parties can come to bring to it, can become a powerful source of reform for the system. To be sure, claim markets aren't likely to solve all of copyright's problems, many of which will indeed require doctrinal changes. At the very least though, it will recognize such markets to form a legitimate part of the conversation about copyright reform.

¹⁹⁴ See Ned Snow, *Proving Fair Use: Burden of Proof as Burden of Speech*, 31 CARDOZO L. REV. 1781, 1788 (2010).

¹⁹⁵ I bracket for the now the question of how a more robust "copyright misuse" doctrine might play into this analysis. The copyright misuse doctrine is today treated as an equitable defense that allows defendants to avoid infringement claims by showing that the plaintiff's behavior misuses the copyright privilege—either by enforcing it inequitably, in an anti-competitive manner, or to the detriment of copyright's safeguards. See Brett Frischmann & Dan Moylan, *Evolving Common Law Doctrine of Copyright Misuse: A Unified Theory and Its Application to Software*, 15 BERKELEY TECH. L.J. 865 (2005); Katherine Judge, Note, *Rethinking Copyright Misuse*, 57 STAN. L. REV. 901 (2004). The doctrine is yet to fully allow defendants to counter-claim for damages. While courts certainly shouldn't make a §505 recovery contingent on a showing of misuse, an independent misuse claim that allows defendants to sue for actual damages could conceivably support the working of §505, and perhaps even replace it in the long run.