

Vonage Fate Highlights Need For Strong IP Portfolio

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Friday, Jun 01, 2007 --- While most companies would think twice before launching a patent infringement action against the likes of IBM, with its massive intellectual property portfolio, when it came time for Verizon Communications to weigh the pros and cons of suing Vonage Holdings Corp., the decision was a no-brainer.

Intellectual property lawyer Nolan Goldberg of Proskauer Rose LLP said the small Internet broadband telephone provider, which recently warned that its ongoing patent battle with Verizon could force it into bankruptcy, was an easy target due to its small patent portfolio.

The likelihood of facing a counterclaim is nil for those suing competitors unarmed with a strong patent portfolio, and this factor weighs heavily in a company's ultimate decision to go to court, Goldberg said.

While Verizon may have sued Vonage regardless of the size of its intellectual property holdings, the outcome may have been markedly different had Vonage been able to take cover behind some patents of its own, he said.

Rather than facing the threat of a permanent court-ordered injunction, Vonage would have been looking at a monetary settlement, even the possibility of a mutually advantageous cross-licensing deal.

"Money is one thing, but an injunction can put a company out of business, and I would view that as a more serious outcome," Goldberg said.

Verizon sued Vonage in June 2006, alleging the company infringed five of its patents covering Internet phone technology. On March 22, a jury in the U.S. District Court for the Eastern District of Virginia found Vonage had infringed three of the patents, and awarded Verizon \$58 million in damages.

On April 6, a district court judge issued a partial injunction allowing Vonage to continue to service its existing 2 million customers, but banning it from signing up new customers.

The company filed an emergency motion in the U.S. Court of Appeals for the Federal Circuit in Washington, D.C. the same day, winning a temporary stay pending an appeal of the injunction. On April 24, the stay was made permanent.

Vonage, which is also facing several patent infringement suits brought by

other telecommunications companies, has said it will continue to vigorously defend itself against all the claims, but has acknowledged that it might not win.

“Whether or not we ultimately prevail, litigation could be time consuming and costly, and injure our reputation,” Vonage said, adding that the company could be forced into signing royalty or license agreements under unacceptable terms.

The company has been running at a loss since its inception, reporting a total deficit of more than \$720 million. It lost \$117 million in the last quarter of 2006, half of which went toward a \$66 million bond to secure a damages judgment in its dispute with Verizon.

In its annual filing with the U.S. Securities and Exchange Commission on April 17, Vonage said its “damaging and disruptive” legal tussle with Verizon posed a threat to its continued viability.

Announcing on May 11 that it was ready to deploy new technology to get around two of the three patents at issue in its dispute with Verizon, Vonage told the SEC that the ongoing litigation could still result in the loss of substantial numbers of customers and highly valued employees, cause its stock price to plummet, and ultimately leading to the company’s liquidation.

The company also cautioned that, given the rapid technological changes in the digital telecommunications industry and the continued development of new services, it could very well be subject to further patent lawsuits in the future, suits that it could not foresee.

Merchant & Gould IP attorney Tony Zeuli agreed that Vonage's slim patent portfolio might have been a factor in Verizon's decision to launch a lawsuit, but said that this was not the sole factor.

“If you suspect that a competitor is infringing on your IP and doing you some financial or business harm, in the background is the thought that if you launch a strike, something is going to come back at you,” he said. “But I've never had an experience where we've looked at a potential defendant and said, 'Let's go after them just because they have a small patent portfolio.’”

That notwithstanding, there is certainly a growing trend of beefing up one’s intellectual property assets to preempt litigation, according to Zeuli.

Andrew Thomases of Dechert LLP said many companies are now buying patents off distressed and bankrupt businesses to build a defensive patent portfolio.

Some companies are even hiring in-house counsel to track down potential patents for acquisition, which could serve as a lesson for Vonage and similarly situated companies.

The company acknowledged that its small patent portfolio made it vulnerable to attack from Verizon when, just a month after it was sued, it announced that it had bought three patents from Digital Packet Licensing Inc., saying the acquisition placed the company “in control of pending litigation.”

In what could have been seen as a belated move to arm itself with defensive weapons in its patent battles, the company said at the time that the acquisition was part of its strategic plan to “grow, create and acquire other significant intellectual property portfolios.”

“Vonage knew it had a deficiency in that area. They realized this was a missing part of their strategy,” said Goldberg, adding it was not uncommon for a young technology company to initially neglect its IP portfolio. “Patents are a nice thing to have, but a luxury for a lean, hungry company,” he said.