Statement for the Record
International Legal Finance Association

House Judiciary Subcommittee on Courts, Intellectual Property, and the Internet

"The U.S. Intellectual Property System and the Impact of Litigation Financed by Third-Party Investors and Foreign Entities"
June 12, 2024

The International Legal Finance Association ("ILFA") respectfully submits this written statement for the record to the U.S. House Judiciary Subcommittee on the Courts, Intellectual Property, and the Internet. Founded in 2020, ILFA is a non-profit trade association representing the largest and most well-known commercial legal finance providers in the world and promotes the highest standards of operation and service for the industry.

BACKGROUND

In general, commercial legal financiers provide non-recourse capital to businesses and law firms engaged in high-value business-related disputes, such as breach of contract, antitrust, and international arbitration. These are passive, outside investments, meaning that funders do not control the matters in which they invest, including questions of strategy and settlement, and the client maintains full control over the conduct of the case, including ultimate decision-making.

The U.S. Chamber of Commerce, a longtime critic of the industry, fears the impact of legal finance because it threatens the ability of large corporate defendants and their insurers to impede justice through scorched-earth litigation tactics against smaller business entities seeking to enforce their legal claims. They have worked for decades to undermine the legal finance industry, calling for automatic forced disclosure of funding and funding agreements in all civil litigation. Policymakers have largely rejected their attacks because they recognize how financing levels the playing field for smaller or startup businesses and supports the rule of law.

Most recently, the Chamber has pivoted to a deeply cynical attack against legal finance, claiming it "threatens national security." We believe national security is a very serious matter. They are engaging in fearmongering by spreading careless and baseless accusations with respect to the litigation funding industry, without any evidence or facts. This is an effort to obtain a long-sought, yet rejected, policy agenda of forced disclosure of funding and funding agreements. Their actions subvert national security interests by diverting resources from the real and critically important security challenges facing the country today. As one legal expert recently said, "[t]here are easier ways to conduct corporate espionage . . . through other means for which we have seen actual examples."[1]

We understand that the Subcommittee is concerned that foreign adversaries of the U.S., such as China and others, could be manipulating the U.S. legal system through the funding of patent

[1] Andrew Strickler, "A 'Boogeyman' National Security Threat in Litigation Funding," Law360, July 21, 2023, *available at* https://www.law360.com/articles/1701865.

litigation in an effort to weaken the U.S. economy or compromise U.S. national security. We have seen no evidence of this in our businesses.

Investors in legal finance providers have no control over investment decisions and investors cannot direct investments in specific cases or portfolios. Nor do investors have the ability to control or influence the provisions of funding agreements, gain access to sensitive case information, or control or influence litigation decisions, including settlement.

With respect to confidential discovery material, under the Federal Rules of Civil Procedure, parties routinely protect such information from unwarranted disclosure through the issuance of a protective order.[2] Additionally, courts have significant experience in protecting sensitive and confidential information. While it would be a very serious concern if certain trade secrets or other proprietary information were to be obtained by a foreign adversary, it likewise would be very concerning for such information to be obtained by an adversary in litigation. We all have confidence in the system to safeguard information as to the latter. ILFA submits that U.S. courts are capable of safeguarding against the former as well. Moreover—and importantly, the attorneys representing parties in litigation, as officers of the court and members of the bar, are subject to ethical rules and the court's rulings, and can be expected to protect confidentiality consistent with the law.

PATENT LITIGATION AND THIRD-PARTY FUNDING

It has been posited that patent litigation financed by third-party investors could cause harm in the following ways: (1) third-party investors could use their role as funders or investors to access proprietary or confidential information for improper purposes and (2) third-party investors could use their role as funders or investors to file burdensome and distracting litigation. Neither of these concerns has any merit.

Allegations of Access to Proprietary or Confidential Information

With respect to patent litigation, all such matters employ Protective Orders to guard against improper access to proprietary or confidential information. These Protective Orders are negotiated and agreed to by *both* parties to a litigation and are entered into the court record by the presiding judge after review and approval. While the terms of the Protective Orders vary from case to case depending on the preferences of the parties to the litigation, most limit access to an adversary's proprietary or confidential information to outside litigation counsel of record for the parties in the case and certain third-party expert witnesses in the case (but only after approval by the party whose confidential information is to be shared with that expert). The parties themselves, including in-house counsel, do not have access to this information. Investors and/or litigation funders certainly do not have access to this information. Indeed, outside of the funded party's own confidential information, the only evidence to which ligation funders have access is public information that is available through the public court filing systems. Neither funders nor their investors have any access to the adverse party's confidential information.

[2] Federal Rule of Civil Procedure 26(c) allows protection from "annoyance, embarrassment, oppression, or undue burden or expense" through a court issued order that specifies the terms and conditions for the discovery process.

Allegations of Burdensome and Distracting Litigation

With respect to allegations that funders might invest in litigation that is unmeritorious and designed to harass the U.S. tech industry, for example, all patent litigation is governed by the Federal Rules of Civil Procedure. Rule 11 requires that any attorney submitting any pleading (such as filing a complaint and thereby initiating a lawsuit) "certifies that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances" that such pleading or filing:

> (1) it is not being presented for any improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation;
>
> (2) the claims, defenses, and other legal contentions are warranted by existing law or by a nonfrivolous argument for extending, modifying, or reversing existing law or for establishing new law;
>
> (3) the factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery; and
>
> (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on belief or a lack of information.[3]

U.S. counsel take this and all other rules of practice and procedure very seriously, particularly given the prospect of court-imposed sanctions for the violation of Rule 11. The few cases filed without Rule 11 compliance are quickly disposed of. There is no evidence to suggest litigation funding is driving baseless patent litigation.

In fact, a 2024 report indicates that the volume of patent infringement lawsuits initiated in U.S. District Courts decreased significantly since 2013. The number of patent litigation cases filed in U.S. District Court trended from 6,497 cases filed in FY 2013, to 3,639 cases filed in FY 2022.[4]

As discussed above, the nature of legal finance—where the funder's only source of repayment of its investment is from a damages award or settlement—would suggest that litigation funding leads to fewer weak or unmeritorious lawsuits. As with any matter, funders considering patent matters undertake a robust underwriting process, engaging in extensive analysis of the validity of the patents as well the strength of any infringement claims. Indeed, diligence takes months and capital is provided only after the merits of the case are confirmed by one or more law firms with significant experience in patent litigation.

---

[3] Fed. R. Civ. P. 11.

[4] https://info.marcumllp.com/hubfs/pdf/2024-Marcum-Patent-Litigation-Study.pdf?hsLang=en [info.marcumllp.com]

Litigation funders make investment decisions on behalf of their investors according to a pre-approved scope of investment strategy. The majority of litigations that are financed (including patent litigations) are funded by the top legal finance providers in the world, all of whom are well-known in the financial and legal fields.[5] Nearly all are US, UK or Australian public companies or investment funds registered and regulated by the applicable US, UK or Australian laws. The investors in these funds are passive, limited partner investors and are overwhelmingly institutional investors such as pension funds and university endowments. None of these funders is a front for or doing the bidding of China or any other nation hostile to the U.S., and none of the special interests attacking the industry has ever come forward with any evidence to support such a charge.

As noted, as passive limited partners, investors in legal finance firms play no role in selecting the investments to be made or in managing the investments after close. Neither the funder nor the investors in a fund (limited partners or otherwise) receive any information. Limited partners simply play no role in any investment decisions.

A strong patent system has been and continues to be critical to this country's success in generating wealth and improving the health and welfare of the American people. When an unauthorized user is unwilling to voluntarily take a license to a patent, that patent's owner is left with the choice of either enforcing its patent rights (or transferring the property right to someone else to enforce) or allowing unauthorized use. Certainly, patents are a property right necessary to stop China and other hostile foreign entities from exploiting U.S. innovation. Many patent owners simply do not have the resources to enforce their patents without funding or financing options.

FORCED DISCLOSURE PROPOSALS

While ILFA does not oppose disclosure requirements in all instances, we believe that any such requirements should be appropriately tailored and consistent with the Federal Rules of Civil Procedure and applicable law. The U.S. Chamber of Commerce and others have urged policymakers to impose overbroad disclosure requirements on litigation funding, including funding agreements and the identities of all passive investors in funds. These proposals would not protect the American economy or American innovation. Instead, by disincentivizing legitimate access to financing for meritorious matters, they would hamper innovation and throttle the ability of US innovators to protect against unlawful misappropriation, including by China.[6]

---

[5] See, e.g. https://chambers.com/legal-rankings/litigation-funding-usa-nationwide-58:2816:12788:1

[6] Despite highly politicized efforts to mandate forced automatic disclosure in various forms, careful examination of the topic has yielded a consensus view among neutral organizations – including the Judicial Conference's Advisory Committee on Civil Rules of the Committee on Rules of Practice and Procedure ("Civil Rules Advisory Committee") and others – that existing disclosure mechanisms are adequate for the vast majority of federal cases. Over the past several years, ILFA and its members have robustly participated in public policy debates related to the commercial legal finance industry. Such efforts include deliberations by the Civil Rules Advisory Committee, the Advisory Committee on Appellate Rules, the Committee the Association of the Bar of the City of New York ("NYCBA"), the Uniform Law Commission ("ULC"), and the U.S. Government Accountability Office ("GAO"). Moreover, federal courts across the country have issued dozens of opinions analyzing disclosure of financing under Rule 26(b)(1), which have yielded an ever-growing body of precedent holding that disclosure is unwarranted absent special circumstances. Where disclosure is deemed appropriate, courts have exercised their inherent authority to

There is no need for a discriminatory rule specific to the legal finance industry, and no basis for only claimants to have to disclose their confidential financial arrangements to an opposing party in litigation. That type of disclosure would be highly prejudicial and create an unlevel playing field. Automatic forced disclosure would allow opposing parties to weaponize financing to their advantage, which disadvantages a much larger group of businesses and individuals that would choose to use commercial legal finance.

Moreover, forced disclosure of limited partners in funds that provide litigation funding would stifle if not extinguish investment in this area, which is, of course, the ultimate goal of the industry's critics. In fact, where parties have been able persuade courts to order such disclosure, they have used the information to intimidate investors.

CONCLUSION

Though the discussion of the hearing is ostensibly to discuss national security, the practical impact of litigation funding disclosure requirements would be to stifle the business of litigation funding. We encourage the Subcommittee to think carefully about such impact and the risk that such limitation could pose its own threat to both national security and innovation.

We are passionate about the importance of the U.S. patent system to the United States' ability to compete in the world and the empowerment that a strong patent system gives to the next generation of U.S. inventors and innovators to protecting against unauthorized use by China and others like it.

ILFA thanks the Subcommittee for its consideration of the Association's views and for accepting this statement for the hearing record.

implement orders that narrowly limit disclosure in a manner that promotes judicial economy, follows Rule 26's requirements of relevance and proportionality, and respects attorney-client privilege and work-product protection.