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Some Third-Party Litigation Funders Pose a Threat to US Security

Former House Armed Services Committee chairman Howard McKeon analyzes the risk foreign-based litigation investment entities pose to national security by asserting litigation against innovative companies in US courts.

Intellectual property is now a bedrock for national and economic security. Every strategically important industry, whether it is defense, high-tech, energy, or health care, relies on a vast network of interrelated technologies and patent property rights.

Stories about espionage and IP theft are flashy, and rightfully draw attention and concern from lawmakers. But, what if in addition to stealing US IP, foreign adversaries could also accomplish many of the same goals by using well-established, and legal, channels? This is exactly the current situation, as litigation investment entities and third-party litigation funders leverage US courts and patents without oversight or transparency.

Third-party litigation funding and, more broadly, litigation investment entities, have become prominent fixtures in the US legal landscape. These funders—including hedge funds, private equity funds, and even sovereign wealth funds—either pay for plaintiffs' litigation costs with an agreement that they will receive a large portion of any eventual payment, or own shell companies that exist only to profit through litigation.

Recent estimates put the US litigation funding market size at \$13.5 billion with an additional \$3.2 billion in new investments last year alone. Litigation investments disproportionately affect IP. Last year more than 20% of all new litigation financing capital commitments were directed toward patent litigation, following nearly 30% the prior year.

Even more troubling than the growth of an industry that monetizes IP litigation and the courts is that the vast majority of investments go undetected. A few courts have introduced funding transparency requirements, but by and large, investment entities are able to direct lawsuits from behind the curtain, without ever revealing themselves.

A November 2022 report from the US Chamber of Commerce Institute for Legal Reform captured the danger of this arrangement, pointing to the "clear path for foreign adversaries to undermine U.S. national economic and security interests through the infiltration of the American litigation system."

More specifically, by controlling litigation from overseas, foreign entities could damage the reputation of and drain resources from US competitors, while getting access to sensitive information during legal proceedings. The ILR report highlights TPLF in patent litigation as indicative of the litigation investment model's risks, in general.

Lawmakers are only just beginning to prioritize addressing the threat that litigation investment entities pose. A group of state attorneys general raised concerns in a letter to the Department of Justice "that TPLF is being used to harm our States and threaten our country's economic and national security," and "through strategic lending, foreign adversaries could threaten our economic and national security by weaponizing the U.S. judicial system."

Sen. John Kennedy (R-LA) echoed this sentiment in a letter to Attorney General Merrick Garland and Chief Justice John Roberts where he stated, "Merely by financing litigation in the United States against influential individuals, corporations, or highly sensitive sectors, a foreign actor can advance its strategic interests in the shadows since few disclosure requirements exist in jurisdictions across our country."

If groups in the US recognize the vulnerability in our IP and legal systems, our adversaries certainly do as well. And foreign competitors, like China, have sent strong signals in recent weeks that they are ramping their focus on intellectual property.

The Chinese National People's Congress elevated the China National Intellectual Property Administration to a top-level agency as part of a plan to accelerate "the building of a powerful intellectual priority nation." As China and others make greater investments in promoting and protecting their intellectual property, the US must do the same, or suffer the consequences.

We need to assess the true scope of the problem if we are going to protect ourselves from ill-intentioned investment entities. Addressing this massive blind spot in our legal system will prevent litigation funders from manipulating US innovators and our IP system.

A few courts proactively implementing transparency requirements for plaintiffs to disclose TPLF and ownership information is positive. But to be effective, transparency must be mandated across jurisdictions.

Whether it is through congressional action or amending the Federal Rules of Civil Procedure, defendants, judges, juries, and lawmakers, need to know who is using our courts and IP, and for what purpose.

The longer we wait to put a spotlight on litigation investment entities, the larger the threat grows, and the farther away we are from finding solutions. Greater transparency measures in our courts are a necessary first step to meet head-on the new dangers litigation investment entities pose to our security.

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