The Honorable Bob Goodlatte

Testimony Before the House Judiciary Committee, Subcommittee on Courts, Intellectual Property, and the Internet – Hearing on *"The U.S. Intellectual Property System and the Impact of Litigation Financed by Third-Party Investors and Foreign Entities"*

June 12, 2024

Chairman Issa, Ranking Member Johnson, and Members of the Subcommittee:

In the United States, our justice system is built on a strong foundation of equal justice under the law. Our courts are the venue through which citizens can settle disputes before judges and juries based on the merits of opposing arguments. This Committee is charged with ensuring that our courts function the way they should, and I am grateful to have the opportunity to discuss the emerging and growing danger of third-party litigation funding in U.S. civil litigation.

Third-party litigation funding ("TPLF") is the practice of hedge funds and other entities, such as sovereign wealth funds, investing in litigation. Typically, third-party litigation investment entities pay plaintiffs or their counsel to acquire a contingent interest in any proceeds the litigation generates. If the plaintiff wins or settles the lawsuit, the investor is guaranteed a cut of the award.

Litigation investment is a growing industry. Bloomberg reported that last year that there was more than $15.2 billion in U.S. litigation funding assets under management.

Under current practice, such investments in litigation matters are normally not disclosed. Neither the court nor the defendant knows that a TPLF entity has bought an interest in a case. The funder lurks in the shadows, totally concealed.

A leading academic discussed on 60 Minutes how TPLF is clandestinely reshaping every aspect of the litigation process, determining "which cases get brought, how long are they pursued, when are they settled. But all of this is happening without transparency. So we have one of the three branches of government, the judiciary, that's really being quietly transformed."

Third-party funders in cases both related to and outside of intellectual property lawsuits have an incentive to maximize their returns. At times, this may come into conflict with the interests of plaintiffs and prevent plaintiffs and defendants from reaching fair settlements. Third-party funders often claim not to be involved in legal strategy, but we have seen reporting in publications like *The Wall Street Journal* investigating conflicts between funders and plaintiffs, and painting a picture of an industry where the investors influence case strategy to serve their own objectives, not the plaintiffs'.

What's worse, there is substantial reason to believe that the lack of disclosure requirements is now giving America's adversaries a window to invest in litigation targeting critical industries and productive companies that are creating jobs, growing our economy, and keeping the United States on the cutting edge of innovation.

As I will discuss further, it is important in all litigation matters that the use of TPLF be disclosed to the court and all parties. But pulling back the curtain on this normally secretive activity is particularly critical in patent infringement cases.

Patents and the protections that they afford legitimate, creative inventors are critical to our economy. The proper use of intellectual property protections encourages innovation, rewarding those who invest time and resources in developing new technologies of benefit to all.

By law, patents are supposed to be granted only when a concept is useful, novel, and non-obvious. More than 600,000 applications for new patents are filed with the U.S. Patent and Trademark Office every year. Most are granted. However, because of that enormous volume and due to the limited resources available to review all those applications, the quality of the patents that are granted varies greatly. Many simply do not concern concepts that are truly distinctive—that is, novel and non-obvious.

The continuing output of numerous low-quality patents creates opportunities for exploitation through entities that are funded and controlled by investors seeking to profit not from finding novel, beneficial applications of a patented concept. Rather, these investors seek pecuniary gain from conjuring up claims alleging that legitimate businesses have engaged in patent infringement. As a result, there is a large secondary market for broad, low-quality patents. Hedge funds and other litigation funders create shell companies (whose connection to the investors is carefully hidden), all to acquire such patents and then assert infringement claims based thereon.

These shell companies are commonly referred to as "non-practicing entities" or "NPEs." They are also sometimes referred to as "patent trolls."

NPEs threaten and assert infringement claims against businesses of all types and sizes. The actions of many of these NPEs clearly constitute predatory behavior. And in many instances, those activities are being arranged and orchestrated by third-party investors who make every effort to stay hidden.

Unfortunately, these troublesome acts are not subsiding. According to the former acting Director of the U.S Patent and Trademark Office, third-party funding is now involved in 30% of the country's patent infringement lawsuits. This data strongly indicates deep flaws in our litigation

system, including in the patent context. It is also only a baseline estimate, as the lack of consistent disclosure means that the true number could be far greater.

The first—and most important—step to address these patent litigation problems is to shine a very bright light on those who fund these lawsuits.

NPEs often masquerade as start-up entities or small inventor operations, and it can be difficult to determine the source of their funding unless the court takes a determined approach to identify the real parties.

At present, our federal courts have established no uniform guidance regarding whether TPLF arrangements should be disclosed. Federal Rule of Civil Procedure 7.1 requires corporate disclosure statements, while Federal Rule of Appellate Procedure 26.1 requires nongovernmental parties to file a corporate disclosure statement. Neither is broad enough to mandate disclosure of the existence of TPLF arrangements or documents.

Fortunately, with increasing frequency, some courts (through local rules) or individual judges (through standing orders) are requiring more transparency. Most notably, Chief Judge Colm Connolly of the U.S. District Court for the District of Delaware has issued a standing order applicable to all cases on his docket that requires the disclosure of any third-party funding entities and the terms of any third-party funding agreements. The standing order requires parties to identify funders, to state whether funder approval is necessary for litigation or settlement decisions, and to provide a "brief description of the nature of the financial interest of the Third-Party Funder(s)."

As to identity, Judge Connolly has an additional standing order under Federal Rule of Civil Procedure 7.1 that requires all "nongovernmental joint ventures, limited liability corporations, partnerships or limited liability partnerships" to include in corporate disclosure statements "the name of every owner, member and partner of the party, proceeding up the chain of ownership until the name of every individual and corporation with a direct or indirect interest in the party has been identified."

The standing order also notes that other parties may be entitled to obtain additional discovery/disclosure if the litigation funder has a sufficient interest in the case, upon a showing that the funder has authority to make material litigation decisions or settlement decisions. Judge Connolly's initiative in this area has revealed that the real parties in interest in some patent actions pending before the court were not who they seemed to be based on the complaints and other filings.

In *Nimitz Tech. LLC v. CNET Media, Inc.*, Judge Connolly ascertained that several cases before him appeared to be interconnected despite having different plaintiffs. Chief Judge Connolly then held a hearing with the individuals named as owners of each of the plaintiff entities named in the complaints, only to realize that those individuals had little to do with the litigation. Instead, Judge Connolly found that the litigation was actually being driven by its funders and that, in some cases, those funders had actual conflicts with the nominal plaintiffs. Judge Connolly eventually indicated that he would refer the plaintiffs' attorneys to the relevant disciplinary authorities. Nimitz filed a petition for a writ of mandamus with the Federal Circuit asking for reversal of Judge Connolly's order and to "terminate [the court's] judicial inquisition of the Petitioner." The Federal Circuit denied Nimitz's petition to vacate the order and stated that "a direct challenge to [Chief Judge Connolly's] standing orders at this juncture would be premature."

Similarly, in *In re Creekview IP LLC* and *In re Waverly Licensing LLC*, the Federal Circuit, citing reasons similar to those cited in *Nimitz*, denied two petitions for a writ of mandamus. Judge Connolly had ordered the plaintiffs to appear in person to address his concerns that they had not complied with the standing disclosure orders. The plaintiffs voluntarily dismissed the cases after the order was issued. However, the district court continued its investigation rather than close the cases. The plaintiffs then filed mandamus petitions arguing that the district court had no authority to continue its inquiry following the dismissals. The Federal Circuit found the petition to be premature because neither party had yet "been found to violate those orders, and [they] will have alternative adequate means to raise such challenges if, and when, such violations are found to occur." The Federal Circuit also noted that "there is no absolute prohibition on a district court's addressing collateral issues following a dismissal. Rather, '[i]t is well established that a federal court may consider collateral issues after an action is no longer pending.'"

Due to the prevalence of patent-related litigation in numerous federal courts and the involvement of third-party funding therein, the type of transparency promoted by Chief Judge Connolly's standing orders is desperately needed across the board.

Perhaps the most important reason for requiring transparency in litigation funding is the national security concerns that it presents, including in patent infringement cases.

In December 2022, 14 state Attorneys General sent a joint letter to Attorney General Merrick Garland, requesting information about what the Justice Department has done, or is currently doing, to ensure our justice system is protected from TPLF-driven foreign interference. Their letter raised a number of valid concerns, including that foreign countries like China and Russia "could use TPLF to fuel targeted lawsuits designed to weaken U.S. national defense companies in the business of protecting our national security interests," and that "costly litigation aimed at

sabotaging major energy sectors that are vital to our economy poses a direct threat to our economic security interests and global independence."

Because of Chief Judge Connolly's third-party funding disclosure requirements in the District Court of Delaware, we also recently learned that a Chinese firm, PurpleVine IP, is bankrolling four patent infringement lawsuits in U.S. courts that are targeting technology companies.

Just a few months ago, in March of this year, another report uncovered that Russian oligarchs have evaded American sanctions, in part, by instead investing in lawsuits in our courts. These billionaires have spent millions of dollars that we know of on litigation even though they are supposed to be prohibited from doing business in the U.S. It's shameful.

A recent patent infringement case against Intel underscores concerns about secret foreign investment in U.S. litigation. Intel is the nation's only designer and manufacturer of high-end microprocessors. Because the company's operations are of obvious importance to the country, the federal government recently granted Intel several billion dollars to expand its production of computer chips. The substantial investment that the country made in Intel is at risk due to the opacity of third-party funding.

Intel was sued for patent infringement by VLSI Technology, a company that last produced semiconductors in the 1990s and currently has no apparent chip production or even any connection to the old VLSI. Nevertheless, VLSI obtained billions of dollars of damages against Intel for patent infringement. And even though the Patent and Trademark Office in another matter later determined VLSI's patents to be invalid, Intel may still be on the hook for billions of dollars of damages, not including the substantial litigation costs it has had to incur. This is money that the company could have applied to research and development on a product that this body has determined is of national importance.

What is the connection between this case and the issue of third-party litigation funding? VLSI's parent company is Fortress Investment Group, a hedge fund that invests in litigation and is largely owned by interests in Abu Dhabi. VLSI has indicated that its investors include sovereign wealth funds. VLSI has resisted disclosing its funders in its litigation with Intel – it dismissed a Delaware case with prejudice, rather than disclose its funders, even though it had been litigating the case for years. VLSI continues to litigate against Intel on other patents in other judicial districts that do not require the disclosure of third-party funding. We don't yet know what foreign interests are benefiting from this litigation. But some clearly are, and that should give this Committee, and all of us, pause.

Without universal disclosure requirements for third-party litigation funding, we have no hope of knowing the full picture of who is funding litigation in the U.S., and which industries or

companies are most at risk of finding themselves on the receiving end of an abusive lawsuit. This must end.

The good news is that there are steps we can take to fix this problem before it metastasizes any further. Here are some suggestions:

- Requiring disclosure of third-party litigation funding in civil cases – including federal class actions and multi-district litigation proceedings – where the third-party funder has a right to receive any payment that is contingent in any respect on the outcome of the civil action by settlement, judgment, or otherwise.
- Requiring funders to disclose all litigation funding from foreign entities and a foreign government and that government's role in the litigation to other parties, the court, and the U.S. government.
- And, of course, Speaker Johnson and Senators Kennedy and Manchin have also introduced the Protecting Our Courts from Foreign Manipulation Act to end overseas meddling in American litigation.

These steps should all be on the table as we consider how to address this pernicious threat.

I commend the Committee for holding this hearing. When I was Chair, I saw what impact third-party litigation funding was having and could have on our justice system, and I introduced legislation to address the issue. There is only more urgency now. A federal litigation investment disclosure bill should be enacted to ensure transparency in all civil litigation.

Thank you for extending an invitation to testify on this issue.