The Sedona Conference Journal

Volume 26, Number 2 Forthcoming 2025

The Venture Capital Model Applied to Litigation Funding: Misaligned Incentives and the Harm to Innovation

Michael J. Summersgill, Todd Zubler, Makenzi Herbst, and Nicolette Willis

November 2025

Recommended Citation:

Michael J. Summersgill et al, *The Venture Capital Model Applied to Litigation Funding: Misaligned Incentives and the Harm to Innovation*, 26 SEDONA CONF. J. 793 (forthcoming 2025).

For this and additional publications see:
https://thesedonaconference.org/publications

THE VENTURE CAPITAL MODEL APPLIED TO LITIGATION FUNDING: MISALIGNED INCENTIVES AND THE HARM TO INNOVATION

By Michael J. Summersgill, Todd Zubler, Makenzi Herbst, and Nicolette Willis

Michael Summersgill is a Partner at law firm WilmerHale based in Boston. He is a first-chair trial lawyer who focuses on high-stakes technology litigation including patent, trade secret, and general commercial litigation.

Todd Zubler is a Partner at law firm WilmerHale based in Washington, DC. He is a civil litigator with more than 20 years of experience managing complex litigation, with a particular emphasis on intellectual property and appellate litigation.

Makenzi Herbst is a Senior Associate at law firm WilmerHale based in Boston. She focuses her practice on complex litigation matters.

Nicolette Willis is a Senior Associate at law firm WilmerHale based in Boston. She focuses her practice on intellectual property litigation matters.

This publication may be cited as follows:

Michael J. Summersgill et al, *The Venture Capital Model Applied to Litigation Funding: Misaligned Incentives and the Harm to Innovation*, 26 SEDONA CONF. J. 793 (2025).

I. INTRODUCTION

The rise of investor-backed patent litigation in the United States is imposing a significant cost on innovation. The venture capital model of funding—where 50% to 70% of investments are expected to fail but the few "hits" account for the bulk of the VC profits—has been an engine supporting the development of early-stage companies and American innovation. When applied to patent litigation funding, however, it is having the opposite effect. It creates misaligned financial incentives resulting in litigation funders who are motivated to bring a high number of lawsuits—many of questionable merit—based on the chance that a small number may succeed and result in large damages awards. Meritless claims stifle existing innovators' ability to grow—exactly the opposite of the patent system's intended purpose. Establishing third-party funder disclosure rules and enforcing fees and sanctions against those who bring meritless cases will help to correct the misaligned incentives in the patent litigation landscape, restoring the appropriate jurisprudential balance that incentivizes meritorious claims while deterring claims that are merely "lottery tickets" in pursuit of a big payday.

II. THE RISE OF LITIGATION FUNDING IN PATENT CASES

Litigation finance has grown into a $15 billion industry, driven in part by private investors like venture capital and hedge funds that see it as a new asset class and an investment opportunity.[1] With the financial backing of private investment

1. Emily R. Seigel, *Four Questions to Keep Litigation Funders Up at Night in 2025*, BLOOMBERG LAW (Dec. 27, 2024, 5:00 PM), https://news.bloomberglaw.com/business-and-practice/four-questions-to-keep-litigation-funders-up-at-night-in-2025; Paloma Castro, *Litigation financing as an opportunity in the*

funds, substantial amounts of capital have transformed the litigation finance sector from small, individualized investments into mature funds dedicated to investing in larger portfolios of active lawsuits.

Patent litigation funding has been a key driver of the litigation finance industry's growth. In fact, patent litigation saw cases with funding deals increase 61 percent between 2020 and 2022.[2] Approximately 20 percent of commercial litigation funding overall in the United States is directed specifically to patent litigation.[3] Within the patent litigation ecosystem, estimates suggest that 30 percent of patent cases are backed by litigation funders; a dramatic increase from almost none in the early 2000s.[4] The secondary patent market, where entities buy up patents from other companies to assert against defendants in the hopes of a big payout, has boomed.[5] And the high upside of patent cases is attracting venture capital, hedge funds, and general investor funds to the patent-litigation market.[6]

---

investment market, DEMINOR LITIGATION FUNDING (Jan. 15, 2024), https://www.deminor.com/en/news-insights/litigation-financing-as-an-opportunity-in-the-investment-market/.

2. Kelcee Griffis, *Litigation Finance Gains Traction in Patent Infringement Cases*, BLOOMBERG LAW (Oct. 20, 2022, 4:46 AM), https://www.bloomberglaw.com/bloomberglawnews/ip-law/XESRGQI8000000?bna_news_filter=ip-law.

3. *The Westfleet Insider: 2023 Litigation Finance Market Report*, WESTFLEET ADVISORS, at 6, https://www.westfleetadvisors.com/wp-content/uploads/2024/03/WestfleetInsider2023-Litigation-Finance-Market-Report.pdf.

4. *At least 25% of the last 3 years NPE litigation caused by Litigation Investment Entities*, UNIFIED PATENTS (Feb. 21, 2023), https://www.unifiedpatents.com/insights/2023/1/4/2022-patent-dispute-report.

5. *See* Unified Patents, *supra* note 4.

6. Ellen Milligan & Katharine Gemmell, *Hedge Funds Turn Lawsuit Bets into $39 Billion Industry*, FL TORT REFORM, (Nov. 16, 2021), https://www.fltortreform.com/news/hedge-funds-turn-lawsuit-bets-into-a-39-billion-industry/; Michael Perich, *Profile of Litigation Funders*, BLOOMBERG

The current dynamics of litigation-funded patent cases may be attributed to the high-risk, high-reward nature of such lawsuits. Litigation funding is high risk to a funder because litigation outcomes are never certain, and the financial investment is non-recourse (the funder cannot recover the investment from a patentee if a lawsuit fails). Litigation funders demand high percentages of any recovery to counterbalance losses sustained in other non-winning cases, which, in turn, pushes plaintiffs to seek even higher (and sometimes astronomical) damages awards.[7] Damages claims in the hundreds of millions, if not billions, of dollars are now routine.

Adding to this dynamic is the fact that litigation funders can often initiate litigation anonymously—without anyone knowing their role and without the defendant, judge, or jury ever knowing that a significant part of any damages award will go to the litigation funder rather than the patentee. Litigation-funded patent cases are often brought by small non-practicing entity (NPE) plaintiffs that are effectively fronts or shell companies either owned or controlled by litigation funders.[8] Under this system, the litigation funders can control the case anonymously from behind the scenes while also controlling the distribution of any proceeds from the litigation.

LAW (Jan. 3, 2024), https://pro.bloomberglaw.com/insights/business-of-law/litigation-funding/#traditional.

7. *Forum: Challenges of navigating and negotiating litigation funding*, THOMSON REUTERS (Jul. 1, 2024), https://www.thomsonreuters.com/en-us/posts/legal/forum-negotiating-litigation-funding/; *Uniloc, Inc. v. Microsoft Corp.*, 632 F.3d 1292 (Fed. Cir. 2007) (awarding a $388 million verdict, then the 5th largest in history).

8. Brief for Unified Patents, L.L.C. as Amicus Curiae Supporting Appellant Dish Network, L.L.C., 101 F.4th 1366 (Fed. Cir. 2024) (Nos. 1:13-cv-02066-RGA, 1:13-cv-02067-RGA) at 3.

III. INVESTOR FUNDED PATENT LITIGATION LACKS TRANSPARENCY AND PROMOTES A "LOTTO TICKET" LITIGATION MODEL

Like the venture capital model or even a lottery ticket, patent litigation funders often need only one big win to generate an outsized return on investment.[9] These funders face little to no consequences for filing meritless suits because they operate anonymously behind the scenes. Instead, that risk is placed solely on the plaintiff NPEs—typically shell companies with no assets or capital with which to pay any fees or sanctions.[10] There is little to deter funders from bringing lawsuit after lawsuit in the hopes of one big damages award.[11] Patent litigation funding and its lack of transparency thus incentivize a "lotto ticket" venture-capital-style litigation model that causes several problems.

First, investment-backed lawsuits create the wrong incentives and lead to meritless lawsuits.[12] The venture capital

---

9. William Lee & Mark A. Lemley, *The Broken Balance: How "Built-In Apportionment" and the Failure to Apply Daubert Have Distorted Patent Infringement Damages*, 37 HARV. J.L. & TECH. 1 (2024); Mark A. Lemley & A. Douglas Melamed, *Missing the Forest for the Trolls*, 113 COLUM. L. REV. 2217, 2217 (2013).

10. For example, an ongoing Florida defamation case involves Leigh Rothschild suing an attorney over statements she made that were quoted in an article, including: "And with Leigh Rothschild, we never get the money because the shells go bankrupt." Rothschild is linked to patent licensing companies involved in patent infringement litigation. In Defendant's answer, she provides two examples where Rothschild entities were hit with attorneys' fees orders and could not pay. *See* Compl. ¶ 29-33, *Rothschild and Analytical Technologies, LLC, v. Starbucks Corp. and Rachael Lamkin*, No. 1:24-cv-24669-DPG (S.D. Fla, Jan. 28, 2025); *see also* Lauren Berg, *Baker Botts Atty Says Inventor's Defamation Claims Are False*, LAW360 (Jan. 28, 2025, 7:53 PM), https://www.law360.com/articles/2290117?scroll=1&related=1.

11. *See* Brief for Unified Patents as Amicus Curiae, *supra* note 8, at 3-4.

12. Korok Ray & Adam Olson, *Third-Party Funding of Patent Litigation: Problems and Solutions*, UTAH L. REV. 915, 915, 925 (2025) (noting that the use

investment model, where firms invest in early-stage companies with high-growth potential, emphasizes a diverse portfolio, aiming for a high potential return in just a few investments while accepting the risk of failure in many.[13] The idea is to make, say, ten investments across a diversified range of early-stage companies, where only one or two is needed to succeed for the investors to make a profit. That makes sense in the context of investment in early-stage companies. But applied to patent litigation, that same formula creates distorted incentives—it means that a significant percentage of funded litigations are "not good investments," or cases with little merit that should not have

---

of the champerty—i.e., the financial support of another party's litigation in exchange for a share of the outcome—"by patent trolls distorts the marketplace and causes frivolous litigation" and explaining that "third-party funding can dramatically distort the market, because it creates an assembly line of litigation and encourages the increase in patent trolls."); U.S. Gov't Accountability Off., *Intellectual Property: Information on Third-Party Funding of Patent Litigation*, GAO-25-107214 (Dec. 5, 2024), https://www.gao.gov/products/gao-25-107214 (explaining that "[t]he high risks and costs of patent litigation have made it an attractive investment opportunity for third-party funders, who provide capital to support litigation in exchange for a share of the potential proceeds" and elaborating that "patents associated with many of these third-party funded cases have weak infringement claims, and. . .the companies must incur legal defense costs even though they say these patents are likely to be invalidated"); Mark Behrens, *Third-Party Litigation Funding: A Call for Disclosure And Other Reforms To Address The Stealthy Financial Product That Is Transforming The Civil Justice System*, 34 CORNELL J.L. & PUB. POL'Y 1, 14 (2025) (explaining that "[i]n addition to fueling unsupported claims, TPLF [Third Party Litigation Funding] fuels questionable claims" in the context of mass tort litigation).

13. Bob Zider, *How Venture Capital Works*, HARVARD BUSINESS REVIEW, (November-December 1998), https://hbr.org/1998/11/how-venture-capital-works; Bill Clark, *Navigating Risk and Reward in Venture Capital Investments*, MICROVENTURES BLOG (Aug. 18, 2023), https://microventures.com/navigating-risk-and-reward-in-venture-capital-investments.

been brought. It encourages funder investment across a portfolio of litigations and thus the filing of multiple lawsuits—many of which lack merit—with the hope that one results in a large damages award (i.e., return on investment).[14]

The series of litigations filed by Fortress-backed VLSI against Intel Corporation is a good example of the harm that such funding can create.[15] Over the course of eight years, VLSI filed eight cases asserting 23 different patents against Intel in five different jurisdictions. As of the publishing of this article, 22 of the 23 patents have been dropped by VLSI and/or been found unpatentable or not infringed in IPR or district court proceedings. Yet, VLSI's serial lawsuits against Intel have nevertheless been a significant disruption for over eight years, and the cost of Intel defending itself has necessarily diverted resources from further investment in research and development. To put it in concrete terms, some estimates suggest that every $250,000 can fund an additional engineer. Forced to divert tens of millions of dollars to defend against VLSI's serial lawsuits, Intel was able to hire and retain far fewer engineers engaged in the research and development of new and innovative technologies. There are many similar examples of cases diverting resources from investment in future innovation.[16]

---

14. Behrens, *supra* note 1 at 10-11 (2025) ("Funders. . .are able to finance such risk taking because, 'unlike individual claimants, funding companies are able to spread the cost of litigation over a broad portfolio of cases and among numerous investors. . ..'").

15. WilmerHale represents Intel in connection with litigation brought by VLSI Technology LLC.

16. *AVM Technologies, LLC v. Intel Corporation*, No. 1:15-cv-33 (D. Del.) (AVM, a NPE, asserted a $2 billion patent infringement suit against Intel in which Intel ultimately prevailed with a jury finding no infringement on all eight asserted claims); *Akamai Technologies, Inc. v. Mediapointe, Inc.*, No. 2:22-cv-6233 (C.D. Cal.) (Mediapointe, a NPE, asserted patent infringement claims against Akamai in W.D. Tex, dismissed the claims without prejudice, and

Second, while it is true that investors and shareholders typically enjoy limited liability under corporate law, the structure of patent litigation financing—where the use of shell NPEs can enable funders to escape the standard penalties for filing meritless cases—warrants an exception. In traditional corporate settings, investors do not directly control litigation strategy or stand to gain a disproportionate share of litigation proceeds. In contrast, litigation funders in patent cases often act as the de facto plaintiffs, controlling litigation decisions and receiving a large portion of any recovery while remaining shielded from liability because they are not an official litigant before the court. Sanctions, such as awards of attorney fees, are imposed only rarely against patentees, and since the patentee plaintiff is often an NPE, with few assets or capital to pay sanctions or fee awards, there is often no one from whom a defendant can even potentially recover the costs of a meritless suit. These potential costs of litigation imposed on a defendant therefore never enter into the funder's and patentee's calculations, creating no meaningful deterrent against the filing of weak lawsuits that nevertheless impose significant costs on defendants to litigate.

Third, adding to the difficulties posed by investment-backed litigation is a lack of transparency that makes it difficult for companies to effectively defend themselves because there is no readily available information about the entity funding the litigation. A fundamental tenet of our legal system is that a defendant should know who their accuser is, yet that often is not the case in financed patent cases.[17] The funder is often completely

---

then lost on summary judgment in C.D. Cal. after Akamai filed a declaratory judgment action there).

17. FED. R. CIV. P. 10(a) (requiring the title of a complaint to name all parties); FED. R. CIV. P. 17 (requiring civil actions to be prosecuted in the name of the real party in interest).

undisclosed and unknown, hidden behind complex corporate holdings and agreements.[18] Accordingly, not only are courts unable to hold funders accountable for bringing meritless claims, but funders face few constraints with respect to how they drive the litigation. Unlike commercial cases—where the plaintiff is typically a business whose motivations and resources are more transparent—third-party funded patent cases often feature NPE plaintiffs with no operational history, no products, and no reputational constraints. When the funder—the real party controlling the litigation—is undisclosed and its incentives remain hidden, it is difficult for defendants to assess the credibility of the plaintiff or the likelihood of settlement and develop a responsive litigation strategy.

While there are some discovery tools that may enable obtaining information related to litigation funding, these tools exist on a court-by-court basis, and do not have the broad effect of enabling transparency into third-party funders.[19] Knowing who controls the litigation on the plaintiff's side allows the defendant to assess their credibility and strength of claims and to determine strategies for litigation and/or potential settlement.[20] Well-

18. *At least 25% of the last 3 years NPE litigation caused by Litigation Investment Entities (LIES)*, UNIFIEDPATENTS (Feb. 21, 2023), https://www.unifiedpatents.com/insights/2023/2/21/litigation-investment-entities-the-investors-behind-the-curtain.

19. Robert E. Colletti & Nisha Gera, *Disclosure of Third-Party Funding Documents in Patent Litigation: A Shift Toward Greater Transparency in Patent Ownership and Litigation Financing*, 29 IP LITIGATOR 1, 1 (May/June 2023) ("There is a lack of uniform federal guidance on the discovery of TPLF arrangements. Neither Federal Rule of Civil Procedure 7.1—which provides for corporate disclosure statements—nor Federal Rule of Appellate Procedure 26.1—which requires nongovernmental parties to file a Corporate Disclosure statement—is broad enough to mandate the disclosure of TPLF documents.").

20. *Id*. at 1 ("Documents concerning TPLF arrangements can contain relevant information about a plaintiff's case. For example, discovery regarding

resourced funders who hide anonymously behind under-resourced plaintiffs to avoid being the named plaintiff in a lawsuit make this impossible.[21] Consider that, if a case is being decided by a jury, the defendant would want to know the financial resources of the third-party funder in order to effectively defend against any narrative put forth by the plaintiff that they are a small entity or individual owner protecting their IP on their own.[22] Or consider again the Intel–VLSI litigation: Intel was able to assert its license defense only after discovering that Fortress Investment Group—VLSI's third-party litigation funder—also controlled Finjan, a company with which Intel had a preexisting license agreement. Intel successfully established that because Fortress controlled both VLSI and Finjan, the license should extend to certain of VLSI's claims against Intel. Without disclosure of Fortress's role behind VLSI, Intel would have no way of even discovering this defense.[23]

---

funding arrangements is relevant to standing, if the third-party funder controls settlement or participates in material litigation decisions.")

21. *See Justinian Capital SPC v. WestLB AG*, 28 N.Y.3d 160, 167-68 (N.Y. App. Div. 2016) ("the impetus for the assignment of the notes to Justinian was DPAG's desire to sue WestLB for causing the notes' decline in value and not be named as the plaintiff in the lawsuit. . . . Justinian's sole purpose in acquiring the notes was to bring this action and hence, its acquisition was champertous.").

22. *Id*. at 4 ("in certain cases, if the case is being decided by the jury, the jury ought to know the financial resources and third-party funding of the plaintiff to avoid any bias owing to the plaintiff being an individual inventor or a small entity").

23. *Intel Scores Legal Victory: Jury Confirms Fortress Investment Group's Control Over VLSI, Sparking Potential $3 Billion Patent Reimbursement*, PublicLawLibrary.org (May 31, 2025), https://publiclawlibrary.org/intel-scores-legal-victory-jury-confirms-fortress-investment-groups-control-over-vlsi-sparking-potential-3-billion-patent-reimbursement/.

Fourth, litigation funding by cloaked foreign states and sovereign wealth funds presents a potential national security risk. Foreign governments can use litigation funding to secretly target U.S. industries that are critical to national security and defense and to gain a tactical advantage by forcing U.S. companies to spend vital time and money defending against meritless cases and compromising confidential information held by U.S. companies.[24] Foreign governments can also use such litigations, particularly the discovery process, to gain sensitive information about American corporations. Evidence already exists that Russia and China engage in litigation funding in the United States.[25]

In fact, the U.S. Chamber of Commerce has raised concerns about the role of foreign sovereign wealth funds in funding patent litigation against American companies, including where Chinese and Russian backed entities finance lawsuits in U.S.

---

24. Michael B. Mukasey, *Patent Litigation Is a Matter of National Security*, WALL ST. J. (Sept. 11, 2022, 4:35 PM), https://www.wsj.com/articles/patent-litigation-is-a-matter-of-national-security-chips-and-science-act-intellectual-property-theft-lawsuit-technology-scammers-manufacturing-11662912581?mod=article_inline ("The U.S. patent system should work for American innovators, not foreign investors."); *The U.S. Intellectual Property System and the Impact of Litigation Financed by Third-Party Investors and Foreign Entities*, STATEMENT OF THE U.S. CHAMBER OF COMMERCE INSTITUTE FOR LEGAL REFORM BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES THE SUBCOMMITTEE ON COURTS, INTELLECTUAL PROPERTY, AND THE INTERNET, (June 12, 2024), https://docs.house.gov/meetings/JU/JU03/20240612/117421/HHRG-118-JU03-20240612-SD011.pdf.

25. Emily R. Seigel & John Holland, *Putin's Billionaires Dodge Sanctions by Financing Lawsuits (1)*, BLOOMBERG LAW (March 28, 2024, 4:00 AM), Emily R. Seigel, *China Firm Funds US Suits Amid Push to Disclose Foreign Ties (2)*, BLOOMBERG LAW (Nov. 6, 2023, 5:00 AM), https://news.bloomberglaw.com/litigation-finance/putins-billionaires-sidestep-sanctions-by-financing-lawsuits; https://news.bloomberglaw.com/business-and-practice/china-firm-funds-us-lawsuits-amid-push-to-disclose-foreign-ties.

courts.[26] In one case, Purplevine IP, a Chinese firm, funded patent suits against Samsung and received confidential Samsung information as a result.[27] Consider again the VLSI-Intel litigation: VLSI is backed by Fortress Investment Group, which is owned by Mubadala Capital, a sovereign wealth fund of Abu Dhabi. Before it became publicly known in 2025 that Fortress controlled VLSI, VLSI sought to keep its funders secret. Indeed, in a 2022 case against Intel in the District of Delaware, Judge Connolly ordered VLSI to identify its investors. But rather than comply, VLSI voluntarily dismissed the case—despite seeking $4 billion in damages—presumably to avoid revealing foreign involvement.[28]

Finally, litigation funding may undermine fairness and trust in the judicial system. Absent upfront disclosure of a funder's identity, defendants and judges have no way of knowing if the funder exists. This lack of transparency can lead to serious

---

26. U.S. Chamber of Commerce, *Letter to the House of Representatives Supporting the Protecting Our Courts from Foreign Manipulation Act of 2025* (Sept. 29, 2025), https://www.uschamber.com/security/letter-to-the-house-of-representatives-supporting-the-protecting-our-courts-from-foreign-manipulation-act-of-2025 ("This secrecy surrounding TPLF creates opportunities for foreign entities to weaponize the U.S. legal system, whether by targeting critical industries, accessing sensitive information through discovery, or driving up litigation costs to harm American businesses.").

27. *Chinese Company Funds US Lawsuits Raising Potential National Security Concerns*, DIGITAL WATCH OBSERVATORY (Nov. 7, 2023), https://dig.watch/updates/chinese-company-funds-us-lawsuits-raising-potential-national-security-concerns; *Judge Slams Claimant in Samsung Patent Suit*, ICLG (May 29, 2024), https://iclg.com/news/20745-judge-slams-claimant-in-samsung-patent-suit.

28. Scott Graham, *VLSI Drops Claim Amid Transparency Demands*, LAW.COM (Dec. 28, 2022, 3:12 PM), https://www.law.com/delbizcourt/2022/12/28/theyve-had-enough-of-judge-connolly-vlsi-drops-claim-amid-transparency-demands/.

consequences. For example, in the District of Delaware, Judge Connolly uncovered that several NPE plaintiffs were shell entities with no real connection to the asserted patents. His investigation revealed that the real parties in interest were hidden funders and monetization firms like IP Edge and Mavexar, which had orchestrated the litigation behind the scenes. In response, Judge Connolly issued orders requiring disclosure of litigation funding arrangements and ownership structures.[29] Allowing such cases to proceed without such disclosure—i.e., allowing funders to hide behind shell companies created for the purpose of asserting patent litigation—encourages the filing of questionable lawsuits and risks, eroding trust in the judicial system.

Further, in cases where the funder's identity is later revealed, a host of problems may arise that call into question whether the case has been equitably adjudicated. First, a late-in-the-game disclosure may reveal material information related to the case that, in fairness, should have come to light at the outset of the litigation, such as the plaintiff's motivations and resources. Second, disclosure of a litigation funder's identity midway through a case may present conflict-of-interest issues[30] for the presiding judge that require recusal, for example if the judge has a financial interest in the litigation funder.[31] Not only does this

29. Colletti & Gera, *supra* note 17 at 2.

30. Judge Connolly in the District of Delaware has advocated for requiring upfront disclosure of funders on the grounds that "it is critically important that federal judges do not suffer from conflicts that could call into question their impartiality." Memorandum at 4, *Nimitz Technologies LLC v. CNET Media Inc., et al.*, No. 1:22-cv-413 (D. Del Nov. 30, 2024), https://fingfx.thomsonreuters.com/gfx/legaldocs/lgpdkwzxzvo/frankel-nimitzfundingdisclosure—connollyorder11.30.22.pdf.

31. ABA, *Rule 2.11: Disqualification*, AMERICANBAR.ORG (July 15, 2020), https://www.americanbar.org/groups/professional_responsibility/publications/model_code_of_judicial_conduct/model_code_of_judicial_conduct_canon_2/rule2_11disqualification/.

undermine trust in the justice system, but forcing a judge who has been handling a case to step aside also creates inefficiencies in the judicial system, which already suffers from a backlog of cases and a shortage of judges.[32] And third, late disclosure of litigation funding after an adjudication may discredit a plaintiff's arguments and call into question the reliability of the adjudication. For example, if a plaintiff prevails after making a "David vs. Goliath" argument to the jury that the large defendant should be punished, but it is later revealed (inadvertently or otherwise) that the plaintiff's case was in fact financed by a large entity with deep pockets, the fairness of the adjudication is clearly undermined.

Despite these problems, there are currently no federal laws or regulations requiring the disclosure of litigation funders.[33] Some states have laws regulating or requiring disclosure of litigation financers. However, those efforts are largely directed to consumer litigation financing involving an individual plaintiff or class of plaintiffs, not to commercial litigation financing such as in patent lawsuits.[34] And efforts to amend the Federal Rules of Civil Procedure to mandate disclosure of third-party litigation funders have not yet succeeded. A decade ago, the U.S. Chamber of Commerce Institute for Legal Reform first recommended amending Rule 26, but the advisory committee

32. US Courts, *The Need for Additional Judgeships: Litigants Suffer When Cases Linger*, USCOURTS.GOV (Nov. 18, 2024), https://www.uscourts.gov/data-news/judiciary-news/2024/11/18/need-additional-judgeships-litigants-suffer-when-cases-linger.

33. *See* STATEMENT OF THE U.S. CHAMBER OF COMMERCE INSTITUTE FOR LEGAL REFORM, *supra* note 15.

34. Sean Keller & Jonathan Stroud, *Litigation Funding Disclosure and Patent Litigation*, 33 FED. CIR. BAR J. 77, 91-92 (2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4527378; Unified Patents, *supra* note 4.

determined that more information was needed regarding the evolving field of litigation finance.[35] Continued efforts by the Chamber and others have so far failed to move the needle in the face of opposition camps who argue that disclosure is unnecessary because funding enables plaintiffs to sustain meritorious cases and funding decisions are only made after ensuring the validity of the claims.[36]

In short, the absence of laws requiring disclosure of funders results in a system that allows funders to act anonymously, incentivizes and facilitates a high number of meritless lawsuits, hurts innovators' abilities to adequately defend themselves and thus impairs innovation, and presents national security risks. The current patchwork landscape of state-level regulation means litigation funders can easily skirt existing disclosure rules by filing in venues that disfavor such regulation. More uniform regulation is needed, as is more uniformity amongst courts in leveraging existing deterrence mechanisms, including sanctions and fees, to prevent frivolous lawsuits and hold those who file them responsible.

IV. COURTS SHOULD REQUIRE THE DISCLOSURE OF PATENT LITIGATION FUNDERS AND PENALIZE FUNDERS WHO BRING MERITLESS CASES

Defendants have a right to know whom they are truly litigating against—information that can speed the resolution of cases and identify any potential national security risks posed by

35. *Another Effort To Amend Federal Rule 26 With A One-Sizie-Fits-All Litigation Finance Disclosure Requirement Does Not Persuade The Federal Rules Advisory Committee*, ABOVETHELAW.COM (Jan. 20, 2022), https://abovethelaw.com/2022/01/another-effort-to-amend-federal-rule-26-with-a-one-size-fits-all-litigation-finance-disclosure-requirement-does-not-persuade-the-federal-rules-advisory-committee/.

36. *Id*.

investment-backed litigation. Litigation funders should be held accountable for meritless cases they fund: They receive the upside when their cases are successful; they should also pay for the harm caused by their meritless cases. Although it is theoretically possible in today's system for courts to require disclosure of patent funders and to hold accountable investment firms financing patent lawsuits, it rarely happens in practice.

There are multiple ways to tackle this problem and thereby improve the litigation system, including (1) mandating upfront disclosure of third-party funders and (2) judges more consistently using their existing authority to impose fees and sanctions against funders who bring meritless claims.

A. Courts Should Require Disclosure of Third-Party Funders

To prevent funders from hiding behind shell NPEs which are effectively fronts for the funders, courts should require disclosure of funders and allow discovery into the funders and their relationship with the named plaintiff. Such disclosure requirements could be implemented through (1) federal legislation, (2) amending the Federal Rules of Civil Procedure, and (3) court-level regulation.

1. Federal Legislation

Efforts to pass federal legislation mandating disclosure of third-party litigation funders remain a priority for some members of Congress. Rep. Darrell Issa (R-CA) last year introduced The Litigation Funding Transparency Act of 2024, to require disclosure of outside funding in civil cases.[37] The bill failed to

37. Litigation Transparency Act of 2024, 118th Cong. (2024), https://issa.house.gov/sites/evo-subsites/issa.house.gov/files/evo-media-document/TPLF%20DD.pdf; *Issa Introduces Discussion Draft of Legislation Reforming Third-Party Financed Civil Litigation*, ISSA.HOUSE.GOV (Jul. 11, 2024),

move, but Issa is not alone. In July, Rep. James Comer (R-KY), who Chairs the Committee on Oversight and Accountability, asked the Judicial Conference to enact disclosure rules for federal courts.[38] In 2023, Senators John Kennedy (R-LA) and Joe Manchin (D-WV) attempted to pass legislation to require the disclosure of any foreign person or entity acting as a litigation funder, require production of the funding agreement, and ban litigation funding from a foreign state or sovereign wealth fund.[39] While these attempts have been unsuccessful thus far, they indicate there is a simmering concern within Congress regarding the issue of third-party litigation funding.

2. Amending the Federal Rules of Civil Procedure

Uniform disclosure of third-party funders may also be effectuated by amending the Federal Rules of Civil Procedure ("FRCP"). The FRCP do not currently require disclosure of third-party litigation funders, but the FRCP do contain other relevant disclosure mandates under which requiring disclosure of litigation funders may be incorporated. Specifically, Rule 7.1 requires parties to disclose any significant ownership stake, meaning any parent corporation and any publicly held corporation owning 10% or more of its stock.[40] Litigation funders are analogous to the corporate entities covered by Rule 7.1 because funders also have an interest in the outcome of the litigation (and

---

https://issa.house.gov/media/press-releases/issa-introduces-discussion-draft-legislation-reforming-third-party-financed; Seigal, *supra* note 1.

38. Seigel, *supra* note 1.

39. Protecting Our Courts from Foreign Manipulating Act of 2023, S. 2805, 118th Cong. (2023); *Manchin introduce bipartisan Protecting Our Courts from Foreign Manipulation Act to end overseas meddling in U.S. litigation*, KENNEDY.SENATE.GOV (Sept. 14, 2023), https://www.kennedy.senate.gov/public/2023/9/kennedy-manchin-introduce-bipartisan-protecting-our-courts-from-foreign-manipulation-act-to-end-overseas-meddling-in-u-s-litigation.

40. FED. R. CIV. P. 7.1(a)(1).

often a far more significant interest than the corporate entities already covered by the rules). Mandating corporate disclosure promotes transparency and ensures fairness in the judicial process, and the same rationale supports requiring plaintiffs to disclose sources of litigation funding. Investor-funded patent litigation has become a dominating force in patent litigation, and litigation finance is an exploding industry that is projected to reach up to a $30 billion valuation by 2030.[41] For the same reasons underpinning the FRCP's existing corporate disclosure requirements, the growing ubiquity of the litigation finance industry warrants a change to the federal rules to mandate disclosure of litigation funders.

While past efforts to amend the FRCP have not succeeded, momentum may be picking up. The U.S. Judicial Conference Advisory Committee on Civil Rules recently agreed to create a subcommittee to study implementing a nationwide federal third-party funder disclosure rule.[42] This came on the heels of the U.S. Chamber of Commerce's Rules Suggestion asking the Committee to implement a "simple, effective, and predictable rule for [third-party litigation funding] disclosure."[43] Similar to federal legislative efforts, it remains to be seen whether these most recent attempts will prevail. The creation of a

41. *Id*.

42. Josh Landau, *U.S. Judicial Conference Makes Progress on Litigation Finance Transparency*, PATENTPROGRESS.ORG (Oct. 5, 2024), https://patentprogress.org/2024/10/u-s-judicial-conference-makes-progress-on-litigation-finance-transparency/; Seigel, *supra* note 1.

43. Lawyers for Civil Justice & U.S. Chamber of Commerce Institute for Legal Reform, *Rules Suggestion to the Advisory Committee on Civil Rules*, 2 (Oct. 2, 2024), https://www.uscourts.gov/sites/default/files/24-cv-v_suggestion_from_lcj_and_ilr_-_rule_26_tplf.pdf.

subcommittee is only the beginning of what will likely be a multi-year process.[44]

3. Court-Level Regulation

Until a larger legislative effort succeeds, courts should take it upon themselves to require disclosure of third-party funders and allow discovery into these parties under the basic premise that a defendant is entitled to know their accuser. Some federal district courts and judges have already done so, issuing local rules and standing orders that require disclosure of litigation funders or ordering discovery regarding litigation funding in specific cases. More courts should follow this example.

Chief Judge Colm Connolly of the District of Delaware issued a standing order that expanded on FRCP 7.1's existing disclosure requirements by mandating that, in all cases before him, law firms disclose "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."[45] Judge Connolly's order addresses concerns regarding abuse of courts and the lack of transparency about who is making litigation decisions and who is the real party in interest before the court.[46] Judge Connolly also issued a second Standing Order Regarding Third-

44. Requiring disclosure does not necessarily also require that funding relationships be admissible. In many cases, such funding relationships may well be relevant and should be admissible as evidence. But that is a determination judges should have the discretion to make on a case-by-case basis.

45. Standing Order Regarding Disclosure Statements Required By FEDERAL RULE OF CIVIL PROCEDURE 7.1 (D. Del. Apr. 18, 2022).

46. Memorandum at 2-5, *Nimitz Technologies LLC v. CNET Media Inc., et al.* (No. 1:22-cv-00413-CFC), Nov. 30, 2024, https://fingfx.thomsonreuters.com/gfx/legaldocs/lgpdkwzxzvo/frankel-nimitzfundingdisclosure—connollyorder11.30.22.pdf.

Party Litigation Funding Arrangements requiring "the filing of a statement if any third-party litigation funding exists in a case," and allowing for additional discovery in cases where the funder has authority to make litigation decisions.[47] The District of New Jersey has a similar local rule that also requires disclosure of third-party funders and allows for additional discovery.[48] The Northern District of California has a local rule that requires parties to certify all parties interested in class action lawsuits.[49]

As judges have begun allowing discovery into litigation funding,[50] it has unearthed exactly the types of shell games that one might expect and that disclosure rules should be designed to prevent. NPE plaintiffs have been discovered to be complete shell companies, in which the previously anonymous funder has the only real interest in the litigation. Absent the court allowing discovery, this would have remained hidden. For example, in recent patent litigation in the District of Delaware, Judge Connolly, after receiving evidence regarding whether three plaintiff LLCs had violated his standing disclosure order, discovered that the nominal owners of the LLCs were individuals with almost no connection to the litigation.[51] In fact, one was

47. *Id*. at 6-7 (citing Standing Order Regarding Third-Party Litigation Funding Arrangements (D. Del. Apr. 18, 2022)).

48. Disclosure of Third-Party Litigation Funding, N.J. L. CIV. R. 7.1.1.

49. Disclosure of Conflicts and Interested Entities and Persons, N.D. CAL. L. CIV. R. 3-15.

50. *Nelson v. Millennium Lab'ys, Inc.*, No. 2:12-CV-01301-SLG, 2013 WL 11687684, at *6 (D. Ariz. May 17, 2013) (ordering production of plaintiff's fee agreements); *Yousefi v. Delta Elec. Motors, Inc.*, No. C13-1632RSL, 2015 WL 11217257, at *2 (W.D. Wash. May 11, 2015) (denying motion in limine to exclude evidence regarding litigation funding source because such evidence may be relevant to witness credibility and bias).

51. Michael Shapiro, *Judge's Litigation Funding Probe Reveals IP Edge's Human Toll*, BLOOMBERG LAW (Dec. 4, 2023, 5:01 AM), https://news.bloomberg

owned by a surgeon's assistant, another by a food truck operator, and the third by a software salesman, none of whom had any real connection to the litigation other than collecting checks, evidenced by the food truck operator, Hau Bui, who was offered a passive income of 5 percent of the money made from the lawsuit.[52] As it turned out, these LLCs were all affiliated with IP Edge, a patent monetization company that buys patents to assert in litigation against various companies. IP Edge was found to have a 90 percent stake in the plaintiff LLCs' recoveries. None of this would have come to light absent Judge Connolly's standing orders and the permitted active discovery into the funders.

Practices like those of Judge Connolly remain rare in the federal system, which should treat this issue more uniformly across the nation. Federal legislation or an amendment to the FRCP is necessary to establish such a uniform system and require disclosure of third-party litigation funding to promote fairness and transparency in litigation. Until such legislation or a FRCP amendment occurs, it will be up to courts to promote these values by implementing their own rules and orders to require such disclosures and allow for discovery into litigation funders.

B. Courts Should Leverage Existing Authority to Impose Fee Shifting and Sanctions on Litigation Funders Who Bring Meritless Cases

To deter funders and attorneys from leveraging shell NPEs to bring meritless claims, courts should more uniformly impose penalties such as fees and sanctions. While courts rarely impose fees and sanctions, they do have the authority to do so under,

---

law.com/ip-law/judges-litigation-funding-probe-reveals-ip-edges-human-toll.

52. Memorandum Opinion at 38, *Nimitz Technologies LLC v. CNET Media Inc., et al.* (No. 1:22-cv-00413-CFC), Nov. 27, 2023, https://www.ded.uscourts.gov/sites/ded/files/opinions/21-1247_3.pdf.

for example, 35 U.S.C. § 285 and *Octane Fitness, LLC v. ICON Health & Fitness, Inc.*[53]

The so-called "American rule" generally prohibits fee shifting in patent litigation, requiring each party to bear its own attorney's fees regardless of who wins the case, except in "exceptional cases."[54] The Supreme Court, in *Octane*, defined "exceptional cases" as ones that "stand[] out from others with respect to the substantive strength of the party's litigating position. . . or the unreasonable manner in which the case was litigated."[55] Courts should use this authority to find that meritless cases financed by litigation funders are exceptional and warrant an award of attorney fees to correct misaligned incentives and ensure funders behind meritless lawsuits face consequences.

The traditional argument in support of the American rule is that fee shifting would impose too great a burden on smaller plaintiffs, who, if they were on the hook for fees if they lost, would be deterred from bringing even meritorious cases.[56] That rationale makes sense in the context of individual, smaller plaintiffs and research supports this reasoning. A study of lawsuits filed in the Intellectual Property Enterprise Court ("IPEC") in England and Wales found that patent case filings increased after a shift away from the pure English "loser pays" rule to a rule that capped costs awards,[57] indicating *lower* risks of attorney fee

53. 572 U.S. 545 (2014).

54. 35 U.S.C. § 285.

55. *Octane*, 572 U.S. at 554.

56. David A. Root, *Attorney Fee Shifting in America: Comparing, Contrasting, and Combining the American Rule and English Rule*, 15 IND. INT'L & COMP. L. REV. 583, 616 (2004-2005).

57. Christian Helmers, Yassine Lefouili, Brian J Love & Luke McDonagh, *The Effect of Fee Shifting on Litigation: Evidence from a Policy Innovation in Intermediate Cost Shifting*, 23 AM. L. & ECON. REV. 56 (Mar. 19, 2021).

awards make parties *more likely* to come to court. Stated differently, the risk of paying a defendant's legal costs if you lose is, in practice, a litigation deterrent.

But that rationale no longer applies when plaintiffs are backed by well-funded, VC-like entities. The concern that even meritorious suits could be deterred by a loser-pays rule has little relevance to investor-funded patent lawsuits. In these cases, the institutional funders can afford to pay litigation costs and fees if they lose, so there is little risk that fee-shifting would deter *meritorious* claims. Instead, fee shifting would correct the lopsided incentives that currently promote the filing of a high number of lawsuits under the strategy of needing just one case to succeed to generate a massive payoff. Courts should therefore consider litigation funding when analyzing whether a case is "exceptional" and warrants an award of fees and costs under § 285 and *Octane*. Courts should presumptively award such fees and costs in cases that are determined to lack merit and that were financed by litigation funders.

Judges should have the authority to impose sanctions and fees for bringing meritless cases *on litigation funders themselves*, not simply the plaintiffs, when the funders act effectively as the real parties in interest while hiding behind plaintiff shell companies.[58] "Real party in interest" is a term of art referring to a

58. *See, e.g.*, *Unsuitable Litigation: Oversight of Third-Party Litigation Funding, Before the Committee on Oversight and Accountability United State House of Representatives* at 4, 7, (Sept. 13, 2023) (statement of Maya Steinitz, Professor of Law and R. Butler Gordon Scholar in International Law Boston University Law School), https://oversight.house.gov/wp-content/uploads/2023/09/MSteinitz_Testimony-Before-the-House-of-Representatives-Sept.-11-2023.pdf; *Nimitz Techs. LLC v. CNET Media, Inc.*, No. CV 21-1247-CFC, 2022 WL 17338396, at *15 (D. Del. Nov. 30, 2022) (questioning whether the litigation funder was "the real client whose interests were being served"); *Ohio Cellular Products Corp. v. Adams USA, Inc.*, 175 F.3d 1343, 1352 (Fed. Cir. 1999), rev'd sub nom. *Nelson v. Adams USA, Inc.*, 529 U.S. 460, 472 (2000).

party that holds a substantive right to bring a claim, whose interests may be represented by another.[59] Generally, courts have found that interest in a litigation or control over litigation alone is insufficient to warrant real party in interest status.[60] Rather, the right to sue stems from the substantive law that controls the action—it is based on whether the plaintiff "has a significant interest in the particular action."[61] It follows then that patent litigation funders should not be able to evade real party in interest status and avoid fees and sanctions by merely hiding behind a shell NPE. In some cases, but for the shell NPE, which may have little to no interest or involvement in the litigation beyond being a placeholder plaintiff entity that legally owns the asserted patent, the funders would be the real party in interest—the named plaintiffs holding a substantive right to sue as the owner of the patent. When funders set up these shell LLCs to insulate themselves from real party in interest status, courts should find that the litigation finance agreement, which facilitates this sleight of hand that insulates funders from liability for sanctions and fees,

---

59. *U.S. ex. rel. Eisenstein v. City of New York, New York*, 556 U.S. 928, 934-35 (2009) (citing FED. R. CIV. P. 17(a)).

60. *See, e.g.*, *Eaton Corp. v. Westport Ins. Co.*, 332 F.R.D. 585, 589 (E.D. Wis. 2019) ("the real party in interest is not necessarily the party with an economic interest in the suit. . .[i]f it were, then every liability insurer would always be substituted for its insured as the real party defendant in interest. Likewise, when the plaintiff is a corporation, the plaintiff's shareholders would have to be substituted as the real parties in interest."); *WM Mobile Bay Environmental Center, Inc. v. City of Mobile*, 446 F.Supp.3d 937, 953 (S.D. Ala. 2020) ("a party to the contract may sue for the breach. The fact that Waste Away is the parent company and holds all the stock of WM Mobile does not change the fact that. . .WM Mobile is the real party in interest").

61. *In re Camp Lejuene Water Litigation*, 719 F.Supp.3d 486, 492 (E.D.N.C. 2024).

effectively imposes real party in interest status on funders insofar as the funders can be held liable for their meritless cases.

The attorneys responsible for filing frivolous lawsuits on behalf of shell plaintiff LLCs should also not get off scot-free. Unified Patents, an industry organization, has argued that these shell company attorneys should be subject to liability under § 285 because they often control or allow non-parties to control patent litigations.[62] The Federal Circuit's recent decision in *Dragon Intellectual Property LLC, v. Dish Network LLC*,[63] however, is a step backward because it insulates attorneys from § 285 fees even in objectively baseless cases. Such an approach is untenable when applied to third-party funded patent litigation because it protects the shell company attorneys who should bear responsibility for litigation that is structured to insulate and hide the real party in interest. Moreover, *Dragon* conflicts with the Supreme Court's jurisprudence in *Nelson v. Adams USA, Inc.*[64] In *Nelson*, the Court reversed a lower court's determination that a plaintiff's shareholder could be joined as a third party from whom fees could be collected, but the Court was nevertheless clear that its decision "surely does not insulate" the third party "from liability."[65] The *Dragon* court distinguished *Nelson* on the grounds the third party therefore was not counsel for either party.[66] That distinction, however, is tenuous because *Nelson* made no such distinction when finding that the third party (a

62. *See* Brief for Unified Patents as Amicus Curiae, *supra* note 8, at 3 ("Today, much of patent litigation is driven and controlled by lawyers and other non-party actors.").

63. 101 F.4th 1366 (Fed. Cir 2024).

64. 529 U.S. 460 (2000).

65. *Id*. at 472 ("Our decision surely does not insulate Nelson [a third party] from liability.").

66. 101 F.4th at 1373.

class that, on its face, should include attorneys) was not so insulated.

In short, judges can and should use their existing authority to deter frivolous lawsuits by imposing fees and sanctions not only on plaintiffs but on litigation funders themselves for bringing meritless claims. Until broader legislative efforts succeed in mandating disclosure of third-party funders, stepping up sanctions and fees is the strongest deterrent to reduce meritless investor-funded patent claims.

V. CONCLUSION

Meritless investment-backed patent litigation is imposing a high tax on innovation and thereby hurting the patent system and American innovation. Requiring disclosure and discovery of third-party funders and enforcing existing rules that impose fees and sanctions on meritless cases will help to correct the misaligned incentives between the judicial and economic systems that are facilitating the growth of investment firms funding baseless lawsuits in pursuit of a big payday.