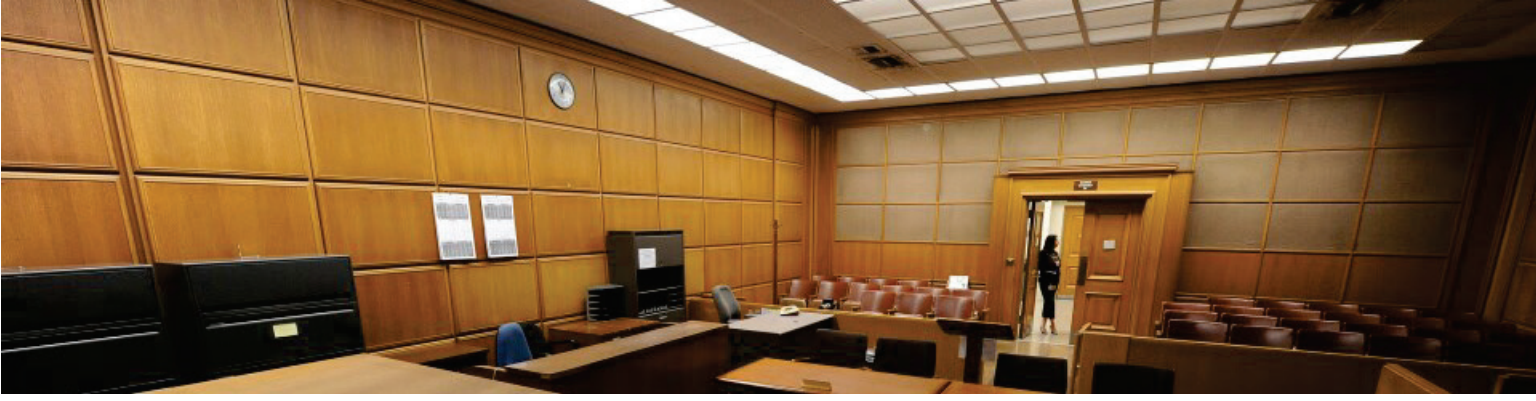

ROBYN BECK/AFP/Getty Images

Bloomberg Law®

How Litigation Funding Disclosure Rules Affect NPE Filings

Litigation by non-practicing entities has increased in the last five years, with most cases being filed in two federal districts in Texas. Latham & Watkins' Rick Frenkel and Cecilia Sanabria discuss why, and whether litigation disclosure requirements affect choice of venue.

Despite a slight drop in the first quarter of 2022, the year-to-date filings through October by non-practicing entities are roughly the same compared to 2021. NPEs are organizations or individuals that acquire patents without producing products, but collect royalties from companies infringing on their patent rights.

Overall, NPE litigation has increased in the past five years and is here to stay. But where are NPEs filing and why? And with the rise of litigation funding, how will different disclosure and discovery requirements in different jurisdictions affect NPE filings?

The US District Court for the Western District of Texas remains the most popular patent district, with the majority of cases involving NPEs, according to 2022 data. The district traces its popularity to Judge Alan Albright of the Waco division. Albright is the only district judge in that division and also a former patent litigator with patentee-friendly rules.

A recent ruling by the chief judge of the Western District, however, now randomly assigns cases throughout the district and has lowered the filing rate in the second half of 2022.

The Eastern District of Texas takes second place, with Delaware and the Northern District of Illinois also popular districts for NPEs. Delaware and Illinois typically provide a lengthy time before substantive deadlines, allowing NPEs bent on licensing more time to negotiate a deal.

And both districts are common locations for business incorporations and offices, making these viable venues after the US Supreme Court's landmark TC Heartland decision clarifying where patent cases may be filed.

Why File in a Specific District

Time-to-trial and patent owner success can provide insight into why NPEs turn to certain districts. In the last five years, the average time to trial in the Western and the Eastern Districts of Texas was 24 months, compared to 33 months in Delaware and 43 months in the Northern District of Illinois.

Despite the longer time-to-trial, for non-ANDA (abbreviated new drug application) cases, the Northern District of Illinois has roughly five times more patent-owner winning outcomes than the Western and the Eastern Districts of Texas.

Other venue considerations include litigation funding and the funders' need to recover their investments. Still unclear is whether the varying corporate disclosure requirements and discovery rulings relevant to litigation funders in different jurisdictions affect where NPE cases are filed.

Funding Disclosure Rules by District

The Northern District of California was one of the first districts to tackle litigation funding disclosures, adopting Local Rule 3-15 in 2017. The rule sets requirements for disclosure of non-party interested entities or persons, including those having "a financial interest of any kind in the subject matter in controversy or a party to the proceeding."

The District of New Jersey followed in 2021, enacting Civil Rule 7.1.1, which requires disclosure of third-party litigation funding.

Chief Judge Colm Connolly, of the District of Delaware, entered a standing order in April 2022 requiring parties to identify funders, their interest, and terms and conditions related to the funders' approval if necessary to make litigation or settlement decisions. Connolly's order also allows discovery into arrangements with funders for good cause.

However, six months after the order's enactment, in an action involving disclosures that did not identify the owners of the patent holder's LLC, Connolly invited briefing on several issues regarding litigation funding disclosures.

This includes whether the court had authority to issue the April order, and how the court could assure no conflicts of interest were precluding it from presiding over the case without knowing the identity of the true owners of the patent holder. A hearing is set for December.

In Illinois, courts have also ordered discovery relating to litigation funders, explaining that in patent cases such discovery could be relevant to the patents' value.

Not all jurisdictions have implemented such procedures or adopted such discovery views.

In October, the Western District of Texas denied relief for discovery into litigation funders in connection with a transfer motion.

Similarly, earlier this year the Eastern District of Texas denied discovery into litigation funding agreements. The court found that the defendant attempted to engage in a fishing expedition, which shifted the burden on standing to the plaintiff prior to a good-faith challenge by the defendant.

Impact of Corporation Laws

Will corporate laws have an impact on the litigation funding requirements courts ultimately adopt? So far, that does not seem to be the case.

For instance, Delaware only requires identification of registered agents (rather than members) when forming limited liability companies. Delaware's Connolly, however, has required more in disclosures.

Conversely, in Texas, a certificate of formation for companies and partnerships requires identification of the names and addresses of members or partners. Texas courts trend toward the opposite, protecting the identity of litigation funders and entities having a financial interest in the outcome of a case.

Federal Rules and Discovery

Putting aside jurisdiction-specific laws and rules, the Federal Rules of Civil Procedure set the standard for relevance in discovery. Discovery rulings across the country highlight that courts are applying that standard differently when addressing the relevance of litigation funding identification and arrangements.

Some courts grant discovery into litigation funders as relevant to standing, patent valuation, and conflicts of interest. Others require more, and refuse such discovery based on generic assertions of relevance not specific to the specific case.

As NPE litigation remains strong, in the wake of the post-TC Heartland venue rules, NPEs continue to determine their preferred venue. For NPEs that want a lengthy runway for negotiating deals but do not mind disclosing financial interests, Delaware, Illinois, and California seem preferable.

But for NPEs focused on shorter time to trial who do not want financial interests disclosed, Texas may be a better option—if those NPEs can make venue stick.

This article does not necessarily reflect the opinion of Bloomberg Industry Group, Inc., the publisher of Bloomberg Law and Bloomberg Tax, or its owners.

Author Information

Rick Frenkel is a partner in Latham & Watkins' Intellectual Property Litigation practice, representing clients in litigation and other IP disputes, providing analysis and preventative counseling, and advising on license agreements and mergers and acquisitions.

Cecilia Sanabria is a partner in Latham & Watkins' IP Litigation practice, representing clients across all phases of patent litigation and arbitration, and counseling clients on IP issues in pre-product launch, business acquisitions, and licensing issues.