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ALERT

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U.S. Supreme Court Argument on "Reverse Payments" Suggests Potential for Compromise Holding Not Advocated by FTC or Pharmaceuticals Industry

The Supreme Court granted certiorari in *Federal Trade Commission v. Watson Pharmaceuticals, Inc.* (re-captioned *Federal Trade Commission v. Actavis, Inc.*) to address whether reverse payment agreements common in Hatch-Waxman litigations are presumptively anticompetitive and unlawful. Oral argument before the Supreme Court was held on March 25, 2013, and attended by Loeb & Loeb's Antitrust Department co-chair, Michael Jahnke. This alert briefly summarizes the arguments and questions from the bench and explains why the Supreme Court may be headed toward a compromise between the positions advocated by the parties.

The Court granted *certiorari* because the U.S. Courts of Appeal have split on the proper way to evaluate reverse payment agreements under antitrust law. The Federal, Second, and Eleventh Circuits found that reverse payment agreements did not constitute an antitrust violation, relying on the "scope of the patent" evaluation approach in analyzing the agreements.[1] Under this approach, reverse payment agreements are not anticompetitive if the effects of the settlement fall "within the scope of the exclusionary potential of the patent."[2] These Circuits have also found that the reverse payment agreements are legal as long as the settlement is within the scope of the patent, the settlement is not the result of a sham litigation, and the patent was not obtained by fraud.[3] On the other hand, the Third and Sixth Circuits apply a "quick look rule of reason" test, which applies a rebuttable presumption that reverse payment agreements are an unreasonable restraint of trade.[4] The Third Circuit reasoned that the presumption could be rebutted by showing that either (1) the payment was for some purpose other than delayed entry, or (2) the payment offered a competitive benefit.[5]

At oral argument, the FTC (represented by the Department of Justice) urged the Court to adopt the Third Circuit's position. It referred to agreements where one company pays another not to compete as "a paradigmatic antitrust violation" and applied that label to payments by the branded company plaintiff to the generic defendant as part of settling a patent infringement suit. The FTC urged the Court to apply the "quick look" test and place the burden on the defendants to justify that the reverse payment agreement is not anticompetitive. It also claimed the "scope of the patent" test went too far in essentially never finding a reverse payment agreement anticompetitive, as long as the settlement did not extend the competition restriction past the patent expiration date. Yet it also suggested that a traditional "rule of reason" test would be too difficult for district

1 *See, e.g., Joblove v. Barr Labs., Inc. (In re Tamoxifen Citrate Antitrust Litig.)*, 466 F.3d 187, 206 (2d Cir. 2006); *Valley Drug Co. v. Geneva Pharms.*, 344 F.3d 1294, 1303-1308 (11th Cir. 2003); *Schering-Plough Corp. v. FTC*, 402 F.3d 1056, 1065-66 (11th Cir. 2005); *FTC v. Watson Pharmaceuticals, Inc.*, 677 F.3d 1298, 1309-1310 (11th Cir. 2012); *Ark. Carpenters Health & Welfare Fund v. Bayer AG (In re Ciprofloxacin Hydrochloride Antitrust Litig.)*, 544 F.3d 1323, 1336 (Fed. Cir. 2008).

2 *FTC v. Watson Pharmaceuticals, Inc.*, 677 F.3d 1298, 1309 (11th Cir. 2012).

3 *See, e.g., In re Tamoxifen Citrate Antitrust Litig.*, 466 F.3d at 207-213; *In re Ciprofloxacin Hydrochloride Antitrust Litig.*, 544 F.3d at 1336.

4 *La. Wholesale Drug Co. v. Hoechst Marion Roussel, Inc. (In re Cardizem CD Antitrust Litig.)*, 332 F.3d 896, 907-909 (6th Cir. 2003); *In re K-Dur Antitrust Litig.*, 686 F.3d 197, 214-218 (3rd Cir. 2012).

5 *In re K-Dur Antitrust Litig.*, 686 F.3d at 218.

courts to apply, given the breadth of factors relating to the anticompetitive effect of the agreement.

On the other hand, Respondents argued that the Court has found anticompetitive effects only in instances where the patent holder was trying to control something that it never could by simply exercising its patent. Thus, Respondents argued that the scope of the patent test is the proper test, because the reverse payment agreements do not attempt to exercise rights not granted to the patent holder under the patent. They also argued that there is no "intermediary test" between the per se rule and the rule of reason - such as the FTC's proffered "quick look" test - because that would require a difficult decision about whether or not the plaintiff in a Hatch-Waxman litigation would have won or lost if the case had not been settled. Further, Respondents suggested that a test with several factors - as suggested by Justice Breyer - would result in unpredictability.

In attempting to reconcile these two positions, the Court expressed many different views, some of which arguably reflected a lack of detailed understanding of the industry. Justice Scalia, for example, labeled Hatch-Waxman a "mistake" and asked why the Court should be required to "overturn understood antitrust laws" to correct that mistake. Expressing some sympathy for the FTC's position, Justice Sotomayor indicated that in the context of a reverse payment one can readily conclude that the parties are sharing profits, because the "infringer" is not paying for a right. Justice Kagan ventured that "splitting monopoly profits" injures customers without negatively impacting either the generic or brand companies. When Respondents argued that the "splitting profits" view is valid only if settlements consistently paid the generic until the end of the patent, Justice Kagan responded "if we give you the rule that you're suggesting we give you, that is going to be the outcome, because this is going to be the incentive of both the generic and the brand name manufacturer in every single case, to split monopoly profits in this way to the detriment of all consumers."

Yet the Justices also found fault with the FTC's test. Justice Sotomayor labeled "unnecessary" the notion that "the mere existence of a reverse payment" presumptively changes the burden to the defendant, as suggested by the "quick look" test, and she questioned why a more traditional "rule of reason" analysis wouldn't work. Justice Breyer was also concerned that the FTC's proposed test was "rigid" and would introduce "a whole set of complex per se burden of proof rules that I have never seen in other antitrust cases" and create an "administrative monster." He argued that a district court judge could easily analyze the anticompetitive effects of a settlement agreement, as judges consider in other antitrust cases, under the traditional "rule of reason." Justice Kennedy believed that the "quick look" test would be difficult and awkward to apply, especially given the failure to distinguish between settlement of a very weak patent and a very strong patent. Likewise, Justice Scalia said that analyzing the anticompetitive effect of reverse payment agreements without assessing the strength of the patent ignored "the elephant in the room." Justice Sotomayor agreed that, in practice, a weak patent is the greatest inducement for the patent holder to enter into a reverse royalty payment, which causes the greatest amount of customer injury.

In a series of questions that may point the Court toward a compromise view, Justice Breyer reiterated his view that a district court judge could easily analyze the anticompetitive effects of a settlement agreement under a traditional "rule of reason" analysis applied in other antitrust cases without getting into the "kitchen sink." He specifically listed several factors relevant to such an analysis, such as the purpose of the payment, the litigation costs, the cost of introducing new products, and the different assessments of drug market value. This view seemed to have Justice Sotomayor's support and no obvious objection from other Justices, unlike the criticisms leveled across the board at the parties' proposed tests.

Thus, the Court appeared unconvinced by both the "quick look" test set forth by the FTC and the "scope of the patent" test set forth by the Respondents. In a compromise that may seem like the path of least resistance, the Court may move toward a more traditional "rule of reason" approach to analyzing the anticompetitive effect of reverse royalty agreements in Hatch-Waxman cases. Whichever route is taken, the Court indicated that the test should include analysis of the strength of the patent (or the strength of the underlying infringement litigation).

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