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ANTITRUST

Expert Analysis

‘Reverse Payments’ Shot Down in Third Circuit

Declining to follow a decade-long line of appellate decisions, the U.S. Court of Appeals for the Third Circuit ruled that the settlement of a patent infringement dispute between rival drug makers that involved a payment to the alleged infringer likely violated antitrust laws. The Third Circuit also decided that health care providers lacked standing to bring federal antitrust claims against a hypodermic products supplier because they bought the products from distributors, who had the right to seek recovery instead.

Other antitrust developments of note included the U.S. Court of Appeals for the Seventh Circuit’s dismissal of a complaint by injured college football players challenging an NCAA rule prohibiting the award of multi-year scholarships and the U.S. Court of Appeals for the Sixth Circuit’s reinstatement of price discrimination claims brought against an electricity supplier in Ohio.

Patent Settlements

Bucking a trend among the federal appellate courts, most notably the U.S. Court of Appeals for the Eleventh Circuit, the Third Circuit ruled that “reverse payment” settlements of patent disputes should be judged under a “quick look” rule of reason standard that arguably renders such arrangements presumptively unlawful. In these kinds of agreements, labeled ‘pay-for-delay’ settlements by the Federal Trade Commission, pharmaceutical companies settle patent disputes with a payment from the maker of the patented, brand-name drug to the company seeking to introduce a generic substitute of the branded drug and the generic rival delays entering the market until a specified date. Such a settlement avoids determination of whether the patent is invalid or would be infringed by the introduction of a generic.

In this case, Schering-Plough Corporation developed a drug used to treat potassium deficiencies and subsequently Upsher-Smith Laboratories announced its intent to introduce a generic, leading to an infringement suit. The suit was settled with an agreement providing, among other things, that Upsher would refrain from marketing its generic drug for several years (after which it would be licensed to sell the generic drug), that Upsher would grant Schering licenses to other drugs, and that Schering would pay Upsher $60 million.

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By
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Following an administrative trial, the FTC ruled that the settlement preserved Schering’s monopoly in violation of antitrust law. The drug companies appealed to the Eleventh Circuit, as they could appeal the FTC order to any circuit court and the Eleventh Circuit had previously rendered a decision favorable to drug companies in a similar case. The Eleventh Circuit reversed, stating that the settlement fell within the scope of the patent’s coverage and thus did not violate antitrust law. *Schering-Plough v. FTC*, 402 F.3d 1056 (2005). The Eleventh Circuit’s analysis began with the presumption that patents issued by the Patent Office are valid and entitle the patent holder to exclude others until the end of a given patent’s term, including through “reverse payment” settlements.

Separate from the FTC’s challenge, various drug wholesalers and retailers brought private suits challenging the settlement in federal court in New Jersey, within the Third Circuit, an arguably more plaintiff-friendly circuit. The district court granted summary judgment to the defendants, following the Eleventh Circuit’s framework. The plaintiffs appealed, and the Third Circuit reversed, rejecting the ‘scope of the patent’ analysis adopted by the Eleventh, Second and Federal circuits. The Third Circuit panel stated that the scope of the patent test was too deferential to patent holders and expressed concern that settlements could be used to protect invalid or weak patents.

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The Third Circuit added that the judicial preference for settlement, one of the factors in the other circuits’ decisions not to disturb the challenged settlement agreements, should not “displace countervailing public policy objectives or, in this case, Congress’s determination…that litigated patent challenges are necessary to protect consumers from unjustified monopolies by name brand drug manufacturers.”

The Third Circuit’s test, which the panel termed a “quick look rule of reason” analysis, requires the finder of fact to “treat any payment from a patent holder to a generic patent challenger who agrees to delay entry into the market as prima facie evidence of an unreasonable restraint of trade.” This presumption may be rebutted by a showing that the payment was “(1) for a purpose other than delayed entry or (2) offers some pro-competitive benefit.”

The Third Circuit’s approach stands in stark contrast to the one taken for about a decade by the majority of circuits, including the Eleventh Circuit in its recent decision, *FTC. v. Watson Pharmaceuticals*, 677 F.3d 1298 (11th Cir. 2012) (reported in the May 17, 2012, Antitrust column, “Resale Price Maintenance Examined Under State Laws”). Those courts concluded that ‘reverse payment’ settlements do not violate antitrust laws so long as competition is restrained only within the scope of the patent’s coverage and there is no evidence of fraud or a sham.

In re K-Dur Antitrust Litigation, Nos. 10-2077, 10-2079, 10-4571, 2012-2 CCH Trade Cases ¶77,971 (July 16, 2012)

Comment: The ruling establishing a presumption of illegality should not be understood to apply broadly to settlement agreements in general, as these “reverse payment” settlements arise within an atypical setting, given (1) the substantial price differential between brand name and generic drugs, and (2) the Hatch-Waxman Act, which is intended to encourage patent challenges in order to incentivize the introduction of generic drugs.

The long-term impact of the ruling remains to be seen as the Supreme Court may agree to review this decision in light of the circuit split, possibly together with the Eleventh Circuit’s *Watson* decision, which that circuit refused to rehear en banc. The Supreme Court may hear a unified voice from the federal antitrust authorities this time around: Unlike the Department of Justice under a prior administration, which refused to join the FTC’s position on these issues before the Supreme Court, the department submitted an amicus brief in this case advocating for presumptively unlawful treatment with respect to “reverse payment” settlements.

Direct-Purchaser Rule

A three-judge appellate panel of the Third Circuit held that a group of hospitals, clinics and other health care providers lacked standing under the direct-purchaser rule to pursue federal antitrust claims against defendant Becton Dickinson, a producer of hypodermic products. The health care providers alleged that Becton used various anticompetitive practices to eliminate competition and achieve a monopoly position in the hypodermic product market.

The federal district court in New Jersey found that the health care providers were the direct purchasers of such products and therefore had exclusive standing to pursue the federal antitrust claims. After analyzing the distribution chain of the hypodermic products, the appellate panel reversed, finding that a second group of plaintiffs, composed of the distributors of Becton's hypodermic products, were the direct purchasers and therefore had standing to bring suit. Accordingly, the distributors' settlement with Becton would not be disturbed.

The Third Circuit reasoned that "only the immediate buyer of a product has standing to maintain a federal antitrust claim" in accordance with the Supreme Court's direct-purchaser rule. Basing its analysis upon a case decided subsequent to the district court's decision, the appellate panel focused upon the "mechanics of the distribution chain" for Becton's hypodermic products.

Given that (1) the health care providers placed their orders for Becton hypodermic products through the distributors; (2) the final sales price of such products was negotiated by the distributors separately with the health care providers; (3) the products were physically shipped to the health care providers by the distributors; and (4) the distributors received payment directly from the health care providers, who did not send payments to Becton, the Third Circuit found that the distributors, rather than the health care providers, were direct purchasers of the hypodermic products.

In re: Hypodermic Products Antitrust Litigation, No. 11-3122, 2012-1 CCH Trade Cases ¶77,914 (June 5, 2012) (not designated for publication).

College Football

Former college football players who suffered career-ending injuries after their first year of college brought suit against the National Collegiate Athletic Association claiming that the association's rule prohibiting the award of multi-year scholarships violated antitrust laws. They claimed that but for that rule, and a rule limiting the number of scholarships that a college can award, they would have obtained multi-year scholarships and would not have had to pay for college after they were injured and their scholarships were not renewed.

The district court dismissed the complaint for failure to properly define a cognizable relevant market and the Seventh Circuit affirmed on slightly different grounds. The appellate court began by observing that unlike other procompetitive rules that serve to preserve amateurism or are necessary for the product of college football to exist, such as the NCAA's eligibility rules, the prohibition on multi-year scholarships was not presumptively lawful. The Seventh Circuit panel noted that the multi-year prohibition seemed to be aimed at containing costs and that such scholarships were permissible before 1973. (The NCAA recently repealed the ban on multi-year scholarships.)

The Seventh Circuit stated that since the challenged rules were not presumptively lawful and also restricted output, they could be reviewed under an abbreviated standard. However, while the quick look doctrine "permits plaintiffs to forgo any strict showing of market power, and thus a specific definition," the Seventh Circuit noted that "the existence of a relevant market cannot be dispensed with" and that the complaint could not survive a motion to dismiss without some description of the "rough contours" of a relevant and cognizable commercial market. The panel observed that the Sherman Act is intended for and only applies to commercial transactions.

The appellate court found that the market for bachelor's degrees—even if it were properly identified in the complaint—is not a cognizable because payment of tuition does not guarantee a degree, "as many unhappy undergraduates can attest." Instead, students pay (or provide athletic services) for the opportunity to earn a bachelor's degree. The court noted that the market for student-athlete labor could be a cognizable commercial market, but was not identified in the complaint.

Agnew v. NCAA, No. 11-3066, 2012-1 CCH Trade Cases ¶77,939 (June 18, 2012)

A three-judge appellate panel of the Third Circuit held that a group of hospitals, clinics and other health care providers lacked standing under the direct-purchaser rule to pursue federal antitrust claims against defendant Becton Dickinson, a producer of hypodermic products.

Price Discrimination

A complaint asserting price discrimination claims under the Robinson-Patman Act against Duke Energy, a provider of retail electricity services, was held by a three-judge panel of the Sixth Circuit to sufficiently allege injury and competitive disadvantage to survive a motion to dismiss on the pleadings. Plaintiffs, consisting of individuals and businesses in Ohio, alleged that through the use of payments or rebates to favored customers, Duke discriminated in price between different purchasers of its electricity. The district court dismissed the complaint based on the filed-rate doctrine, among other jurisdictional grounds, and the Sixth Circuit reversed.

The appellate panel first observed that the filed-rate doctrine did not bar the claims because the doctrine precludes challenges to the reasonableness of a rate filed with an administrative agency, yet the complaint contested the legality of rebate payments made outside the rate scheme.

The Sixth Circuit then turned to the sufficiency of the complaint and reasoned that to survive a motion to dismiss on a Robinson-Patman Act claim, plaintiffs must allege (1) that the defendant "discriminated in price between different purchasers of commodities of like grade and quality," and (2) that the effect of such discrimination was "to substantially lessen competition or tend to create a monopoly in any line of commerce." The court noted that plaintiffs' complaint alleged with specificity how the discrimination occurred and benefited favored customers on a continuous basis from 2005 to 2009 and that the complaint further alleged that a subclass of plaintiffs who competed in the same market as the favored customers had lost profits as a result of the discriminatory rebates.

The panel rejected Duke's contention that electricity did not constitute a commodity within the meaning of the Robinson-Patman Act, noting that the Sixth Circuit had previously indicated that electricity was a commodity on the basis that it could be produced, felt, and stored. The panel further rejected Duke's argument that the Robinson-Patman Act applies solely to the resale of a purchased product, emphasizing that longstanding case precedent has held that the Robinson-Patman Act is violated where a seller discriminates in price between different purchasers.

Most significantly, the Sixth Circuit rejected defendants' contention that plaintiffs failed to adequately allege competitive harm, noting that the Supreme Court has held that a reasonable possibility that alleged price discrimination has harmed competition is sufficient under the Robinson-Patman Act, and that it is not required that plaintiffs prove that the alleged discrimination has in fact harmed competition. The Sixth Circuit concluded that plaintiffs adequately alleged injury and competitive disadvantage sufficiently to survive a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6).

Williams v. Duke Energy International, No. 10-3604, 2012-1 CCH Trade Cases ¶77,913 (June 4, 2012)

Premerger Notification

A South Korea executive pled guilty to charges that he obstructed justice by falsifying documents included in the premerger filing submitted to the Department of Justice to provide notification of a proposed combination of automatic teller machine (ATM) manufacturers. He agreed to serve five months in a U.S. prison.

The department stated that the executive altered and directed others to alter documents related to the proposed transaction as well as pre-existing business and strategic plans. The Korean corporation also pled guilty in October 2011 and paid a $200,000 fine, a reduced amount due to the company's cooperation and disclosure of the wrongdoing. The proposed merger was abandoned.

United States v. Kyoungwon Pyo, 12-cr-00118-RLW, CCH Trade Reg. Rep. ¶45,112 No. 5290 (D.D.C. July 2, 2012)

Comment: Although in the past civil penalties have been imposed for failure to submit documents in premerger filings, this is the first time that a jail sentence has been imposed.