California Supreme Court to Determine Whether "Delay For Pay" Settlements in Patent Disputes Violate the Antitrust Provisions of The Cartwright Act

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Historically, contending parties have settled patent infringement cases by agreeing that the allegedly infringing party will not manufacture the product at issue during the term of the patentee's existing patent in return for payments from the patentee. Such settlements, termed "reverse payment" settlements or "pay for delay," have previously been challenged as violations of the federal Sherman Antitrust Act. In 2013, the United States Supreme Court addressed the federal antitrust issue in *FTC v. Actavis, Inc*. (2013) ____ U.S. ____, 133 S.Ct. 2223, 186 L.Ed.2d 343 ("*Actavis*"), and held that reverse payment settlement agreements could be anticompetitive. This question is pending as to California's state antitrust statute (the Cartwright Act) before the California Supreme Court in *In re Cipro Cases I and II*, Cal. Supreme Court Case No. S198616 (opinion below at (2011) 200 Cal.App.4th 442 ["*Cipro*"]). Whether the California Supreme Court adopts the same approach for an alleged violation of California's Cartwright Act remains for determination.

FTC V. ACTAVIS, INC. - (United States Supreme Court)

In *Actavis*, the FTC sued Sovay Pharmaceuticals who obtained a patent in 2003 for a brand-name drug Androgel which increases testosterone levels in men. Subsequently, other manufacturers sought to bring a generic version of Androgel to market. Sovay initiated an infringement action against the generic manufacturers with the parties ultimately settling the litigation. Among other things, the generic manufacturers agreed not to bring a generic version of Androgel to market until 2015 (65 months prior to the expiration of Solvay's patent). In return, Solvay agreed to pay certain sums to the generic manufacturers – one of whom was to receive $19-30 million annually for nine years.

The Federal Trade Commission (FTC) claimed that the settlement agreement violated section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, which encompasses activity that violates the federal Sherman Antitrust Act, 15 U.S.C. § 1, et seq. The district court dismissed the FTC's claim and the Eleventh Circuit affirmed. The court of appeals stated: "[A]bsent sham litigation or fraud in obtaining the patent, a reverse payment settlement is immune from antitrust attack so long as its anticompetitive effects fall within the scope of the exclusionary potential of the patent." (*Actavi*s, 233 S.Ct. at p. 2230.) In other words, if all the settlement does is assure the patent holder the monopoly granted by the patent for the term of the patent, there is no antitrust violation. Patent holders have a "lawful right to exclude others from the market." Thus a patent "conveys the right to cripple competition." (*Ibid*.) According to the court of appeals, while recognizing that if the parties were not to settle, the patent might be declared invalid (along with the legal monopoly permitted by the patent and the predicate for the settlement), public policy favoring settlements nonetheless should foreclose courts from insisting that the parties continue to litigate the validity of the patent to avoid antitrust liability.

The Supreme Court reversed and remanded. It rejected the argument that so long as the reverse payment simply vindicated the legal monopoly that the patent granted there would be no antitrust violation. It did so because that argument presupposed the validity of the patent. If the patent were not valid, the reverse payment settlement is nothing more than an unlawful division of, or exclusion from, the relevant drug market. (See, e.g., *Palmer v. BRG of Ga., Inc.* (1990) 498 U.S. 46, 50 [agreement to divide territorial markets held "unlawful on its face."].) According to the court, "[t]he payment in effect amounts to a purchase by the patentee of the exclusive right to sell its product, a right it already claims but would lose if the patent litigation were to continue and the patent were held invalid or not infringed by the generic product." (*Actavis*, 133 S.Ct. at p. 2234.)

Additionally, commenting on the size of the payment in the case, the Court observed that "[t]he rationale behind a payment of this size cannot in every case be supported by traditional settlement considerations. The payment may instead provide strong evidence that the patentee seeks to induce the generic challenger to abandon its claims with a share of its monopoly profits that would otherwise be lost in the competitive market."
On the other hand, the Court acknowledged that the payment may be justified where it reflects traditional settlement considerations, such as avoided litigation costs or fair value for services. The Court emphasized that a defendant to an antitrust claim, in the context of a rule of reason analysis, may show legitimate justifications for the reverse payment and its amount. However, courts should look at whether the patentee is using monopoly profits from its patent to pay an alleged infringer to avoid the risk of patent invalidation or a finding of non-infringement. Speaking to the purpose of a reverse payment settlement, the Court stated: "If the basic reason is a desire to maintain and to share patent-generated monopoly profits, then, in the absence of some other justification, the antitrust laws are likely to forbid the arrangement." (*Actavis*, 133 S.Ct. at p.2237.)

One practical problem with the Court's discussion of the legitimate motivations for settlement is that the Court gave virtually no consideration to the value of settling a case to avoid the risk (however large or small) of an adverse determination. "The owner of a particularly valuable patent might contend, of course, that even a small risk of invalidity justifies a large payment. But, be that as it may, the payment (if otherwise unexplained) likely seeks to prevent the risk of competition." (*Actavis*, 133 S.Ct. at p. 2236.) Cost avoidance is not the only, or necessarily the principal, reason for settlement. The uncertainty of result before the trier of fact (whether judge or jury) is a very strong impetus to settle litigation. Yet, the Court placed very little value on it.

It remains to be seen what effect Actavis will have on settlements of patent infringement cases and whether a procedural mechanism will be developed to legitimize pay for delay settlements short of an antitrust action in which the legitimacy of the patent is litigated.

IN RE CIPRO CASES I AND II - (California Supreme Court)

Cipro involved an antitrust challenge to a reverse payment settlement involving the antibiotic Cipro. This suit action is part of a complicated series of actions in both state and federal court. The federal court had determined that the federal antitrust claims were illegitimate for reasons similar to the basis for the Eleventh Circuit's decision in Actavis. At the time of the federal appellate decisions, the Supreme Court had not ruled in *Actavis*.

As to the California Cartwright Act antitrust claims, the state superior court and the California Court of Appeal applied the same reasoning as the federal court of appeals in *Actavis*. First, the Court of Appeal held that the reverse payment settlements were not per se a violation of the Cartwright Act. "considering the important public polices underlying patent law and favoring the settlement of patent litigation and the fact that the Cipro agreement did not restrain competition outside the exclusionary zone of the . . . . patent [at issue], we cannot view the Cipro agreements as lacking any redeeming virtue. Accordingly, we conclude they are not unlawful per se." (*Cipro*, 200 Cal.App.4th at p. 467.)\

The Court of Appeal also held that the agreements did not violate the Cartwright Act under a rule of reason analysis. Relying upon pre *FTC v. Actavis, Inc*. federal authority, the court stated: "we conclude that unless a patent was procured by fraud, or a suit for its enforcement was objectively baseless, a settlement of the enforcement suit does not violate the Cartwright Act if the settlement restrains competition only within the scope of the patent." (*Cipro*, 200 Cal.App.4th at p. 467.) That an underlying infringement action is "baseless" requires a showing that (a) the lawsuit was objectively baseless in the sense that no reasonable litigant could realistically expect success on the merits, and (b) that the litigant's subjective motivation for bringing the action was a sham seeking to conceal a knowing attempt to interfere with a competitor. The Court of Appeal concluded that the plaintiffs had not made such a showing.

In another twist, the Court of Appeal found that the issue of whether the underlying patent infringement suit was objectively baseless **due to the patentee's inequitable conduct in procuring the patent at issue** was preempted by federal patent law, unless the patentee committed fraud on the Patent Office. Federal district courts, not a state court, possessed exclusive jurisdiction over this issue. This is a problematical point. What the Court of Appeal did not discuss is how a plaintiff, pursuing a state law antitrust challenge to a reverse payment settlement based in part on inequitable conduct before the Patent Office, establishes jurisdiction and standing in federal court to litigate that conduct.

On this point, plaintiffs argued that the Court of Appeal was improperly conflating jurisdiction and preemption issues. They asserted that state courts have historically addressed patent issues which were ancillary to other issues pending in state court. The problem for plaintiffs, however, is that where the antitrust issue before the state court also involves the validity of the patent, the patent issue is more than ancillary and would seem to be subject to the exclusive jurisdiction of the federal courts.

The California Supreme Court granted review on February 15, 2012. In September 2012, the court stayed briefing pending the outcome of certain United States Supreme Court cases. The court lifted the stay on June 26, 2013 and requested supplemental letter briefs addressing *FTC v. Actavis, Inc*. which had decided June 17, 2013. On July 10, 2013, the court issued a further stay order pending settlement proceedings involving some of the parties in the trial court. The court then lifted this stay on December 13, 2013, setting, inter alia a time limit on amicus briefs and replies as of April 24, 2014. The court has not set a date for oral argument.

It must be noted that the California Supreme Court has repeatedly held that federal Sherman Act cases have limited authority in substantively interpreting California's Cartwright Act. While California courts may seek guidance from Sherman Act cases, those cases are not controlling. The California Court of Appeal opinion in the Cipro Cases was well reasoned. Whether the California Supreme Court adopts its analysis or is swayed by the force of the United States Supreme Court's decision in *FTC v. Actavis* presents an interesting question. Best guess is that the California court will adopt the United States Supreme Court's reasoning in *Actavis*. However, should it do so, the state court will need to address the patent preemption issue and the jurisdictional ability of a state court to address patent issues.