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Competition Policy and the Patent System

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INNOVATION AND COMPETITION POLICY, Chapter 4 (2d): COMPETITION POLICY AND THE PATENT SYSTEM

Herbert Hovenkamp

This book of CASES AND MATERIALS ON INNOVATION AND COMPETITION POLICY is intended for educational use. The book is free for all to use subject to an open source license agreement. It differs from IP/antitrust casebooks in that it considers numerous sources of competition policy in addition to antitrust, including those that emanate from the intellectual property laws themselves, and also related issues such as the relationship between market structure and innovation, the competitive consequences of regulatory rules governing technology competition such as net neutrality and interconnection, misuse, the first sale doctrine, and the Digital Millennium Copyright Act (DMCA). Chapters will be updated frequently. The author uses this casebook for a three-unit class in *Innovation and Competition Policy* taught at the University of Iowa College of Law and available to first year law students as an elective. The table of contents is as follows (click on chapter title to retrieve it):

INNOVATION AND COMPETITION POLICY: CASES AND MATERIALS

HERBERT HOVENKAMP

CHAPTER 4 (2d)
COMPETITION POLICY AND THE PATENT SYSTEM

WALKER PROCESS EQUIP., INC. V. FOOD MACH. & CHEM. CORP.
382 U.S. 172 (1965)

Mr. Justice CLARK delivered the opinion of the Court.

The question before us is whether the maintenance and enforcement of a patent obtained by fraud on the Patent Office may be the basis of an action under § 2 of the Sherman Act, and therefore subject to a treble damage claim by an injured party under § 4 of the Clayton Act. The respondent, Food Machinery, & Chemical Corp. (hereafter Food Machinery), filed this suit for infringement of its patent No. 2,328,655 covering knee-action swing diffusers used in aeration equipment for sewage treatment systems. Petitioner, Walker Process Equipment, Inc. (hereafter Walker), denied the infringement and counterclaimed for a declaratory judgment that the patent was invalid. After discovery, Food Machinery moved to dismiss its complaint with prejudice because the patent had expired. Walker then amended its counterclaim to charge that Food Machinery had 'illegally monopolized interstate and foreign commerce by fraudulently and in bad faith obtaining and maintaining its patent well knowing that it had no basis for a patent.' It alleged fraud on the basis that Food Machinery had sworn before the Patent Office that it neither knew nor believed that its invention had been in public use in the United States for more than one year prior to filing its patent application when, in fact, Food Machinery was a party to prior use within such time. The counterclaim further asserted that the existence of the patent had deprived Walker of business that it would have otherwise enjoyed. Walker prayed that Food Machinery's conduct be declared a violation of the antitrust laws and sought recovery of treble damages.

… We have concluded that the enforcement of a patent procured by fraud on the Patent Office may be violative of §2 of the Sherman Act

provided the other elements necessary to a § 2 case are present. In such event the treble damage provisions of § 4 of the Clayton Act would be available to an injured party.

As the case reaches us, the allegations of the counterclaim, as to the fraud practiced upon the Government by Food Machinery as well as the resulting damage suffered by Walker are taken as true. We, therefore, move immediately to a consideration of the legal issues presented.

Both Walker and the United States, which appears as amicus curiae, argue that if Food Machinery obtained its patent by fraud and thereafter used the patent to exclude Walker from the market through 'threats of suit' and prosecution of this infringement suit, such proof would establish a prima facie violation of § 2 of the Sherman Act. On the other hand, Food Machinery says that a patent monopoly and Sherman Act monopolization cannot be equated; the removal of the protection of a patent grant because of fraudulent procurement does not automatically result in a § 2 offense. Both lower courts seem to have concluded that proof of fraudulent procurement may be used to bar recovery for infringement, *Precision Instrument Mfg. Co. v. Automotive Maintenance Machinery Co.*, 324 U.S. 806 (1945), but not to establish invalidity. As the Court of Appeals expressed the proposition, 'only the government may 'annul or set aside' a patent,' citing *Mowry v. Whitney*, 14 Wall. 434 (1872). It went on to state that no case had 'decided, or hinted that fraud on the Patent Office may be turned to use in an original affirmative action, instead of as an equitable defense. Since Walker admits that its anti-trust theory depends on its ability to prove fraud on the Patent Office, it follows that Walker's second amended counterclaim failed to state a claim upon which relief could be granted.

We have concluded, first, that Walker's action is not barred by the rule that only the United States may sue to cancel or annul a patent. It is true that there is no statutory authority for a private annulment suit and the invocation of the equitable powers of the court might often subject a patentee 'to innumerable vexatious suits to set aside his patent.' *Mowry*, 81 U.S. at 441. But neither reason applies here. Walker counterclaimed under the Clayton Act, not the patent laws. While one of its elements is the fraudulent procurement of a patent, the action does not directly seek the patent's annulment. The gist of Walker's claim is that since Food Machinery obtained its patent by fraud it cannot enjoy the limited exception to the prohibitions of § 2 of the Sherman Act, but must answer under that section

and § 4 of the Clayton Act in treble damages to those injured by any monopolistic action taken under the fraudulent patent claim. Nor can the interest in protecting patentees from 'innumerable vexatious suits' be used to frustrate the assertion of rights conferred by the antitrust laws. It must be remembered that we deal only with a special class of patents, i.e., those procured by intentional fraud.

Under the decisions of this Court a person sued for infringement may challenge the validity of the patent on various grounds, including fraudulent procurement. E.g., *Precision Instrument Mfg. Co. v. Automotive Maintenance Machinery Co.*, 324 U.S. 806 (1945); *Hazel-Atlas Co. v. Hartford-Empire Co.*, 322 U.S. 238 (1944); *Keystone Driller Co. v. General Excavator Co.*, 290 U.S. 240 (1933). In fact, one need not await the filing of a threatened suit by the patentee; the validity of the patent may be tested under the Declaratory Judgment Act, 28 U.S.C. § 2201 (1964 ed.). At the same time, we have recognized that an injured party may attack the misuse of patent rights. *See, e.g., Mercoid Corp. v. Mid-Continent Investment Co.*, 320 U.S. 661 (1944). To permit recovery of treble damages for the fraudulent procurement of the patent coupled with violations of § 2 accords with these long-recognized procedures. It would also promote the purposes so well expressed in *Precision Instrument*, 324 U.S. at 816:

> 'A patent by its very nature is affected with a public interest.]It] is an exception to the general rule against monopolies and to the right to access to a free and open market. The far-reaching social and economic consequences of a patent, therefore, give the public a paramount interest in seeing that patent monopolies spring from backgrounds free from fraud or other inequitable conduct and that such monopolies are kept within their legitimate scope.'

Walker's counterclaim alleged that Food Machinery obtained the patent by knowingly and willfully misrepresenting facts to the Patent Office. Proof of this assertion would be sufficient to strip Food Machinery of its exemption from the antitrust laws. By the same token, Food Machinery's good faith would furnish a complete defense. This includes an honest mistake as to the effect of prior installation upon patentability-so-called 'technical fraud.'

To establish monopolization or attempt to monopolize a part of trade or commerce under § 2 of the Sherman Act, it would then be necessary to appraise the exclusionary power of the illegal patent claim in terms of the

relevant market for the product involved. Without a definition of that market, there is no way to measure Food Machinery's ability to lessen or destroy competition. It may be that the device-knee-action swing diffusers - used in sewage treatment systems does not comprise a relevant market. There may be effective substitutes for the device, which do not infringe the patent. This is a matter of proof, as is the amount of damages suffered by Walker.

As respondent points out, Walker has not clearly articulated its claim. It appears to be based on a concept of per se illegality under § 2 of the Sherman Act. But in these circumstances, the issue is premature. As the Court summarized in *White Motor Co. v. United States*, 372 U.S. 253 (1963), the area of per se illegality is carefully limited. We are reluctant to extend it on the bare pleadings and absent examination of market effect and economic consequences.

However, even though the per se claim fails at this stage of litigation, we believe that the case should be remanded for Walker to clarify the asserted violations of § 2 and to offer proof thereon. The trial court dismissed its suit not because Walker failed to allege the relevant market, the dominance of the patented device therein, and the injurious consequences to Walker of the patent's enforcement, but rather on the ground that the United States alone may 'annul or set aside' a patent for fraud in procurement. The trial court has not analyzed any economic data. Indeed, no such proof has yet been offered because of the disposition below. In view of these considerations, as well as the novelty of the claim asserted and the paucity of guidelines available in the decided cases, this deficiency cannot be deemed crucial. Fairness requires that on remand Walker have the opportunity to make its § 2 claims more specific, to prove the alleged fraud, and to establish the necessary elements of the asserted § 2 violation.

Reversed and remanded.

NOTES AND QUESTIONS

1. Consider the pre-trial events that transpired in *Walker Process*. Originally, Food Machinery filed suit for infringement of its patent against Walker Process, who in turn denied infringement and counterclaimed for a declaratory judgment that the patent was invalid. Once Food Machinery discovered its patent had expired, it moved to dismiss its complaint against Walker Process with prejudice. A dismissal with prejudice means that Food

Machinery would not again be able to claim Walker Process infringed on this specific patent. Moreover, since Food Machinery's patent had expired, Walker Process was able to use the patent's technology free of charge. If Food Machinery was in fact estopped from bringing any additional infringement claims for this patent, why would Walker Process continue with its inequitable conduct coutnerclaim suit? Was Walker Process actually trying to invalidate the expired patent because it believe Food Machinery had 'illegally monopolized interstate and foreign commerce by fraudulently and in bad faith obtaining and maintaining its patent well knowing that it had no basis for a patent,' or do you think there was some other motive behind the suit

2. In order to make out an antitrust claim for monopolization by seeking to enforce a bad patent one must also meet the structural requirements for the monopolization or attempt to monopolize offense under §2 of the Sherman Act – namely, market power and proof that the conduct, if likely to run its course, would maintain or create durable monopoly. Is that likely to happen when the patent has expired? Of course, "success" occurs when the fraud is not discovered, something that is much more likely to occur when the defect in the patent does not appear on the record. Patents that are invalid because they are anticipated by prior art that the patent applicant neglected to include in the application present one kind of problem Some prior art consists of earlier patents, and these are readily available to both a patent examiner and also to third parties. Other prior art may be much more difficult to locate – such as publications in obscure journals written in foreign languages. Much more threatening are omissions that are *not* on the public record at all. For example, the "on sale" bar at issue in both *Walker Process* and the *Dippin' Dots* case, infra, provides that "A person shall be entitled to a patent unless (b) the invention was … on sale in this country, more than one year prior to the date of the application." 35 U.S.C. § 102. The problem with prior sales is that they typically do not appear on the patent application record at all, may be known only to the applicant, and are discovered by third parties only by luck.

3. In most cases the antitrust challenge to an infringement action is presented as a counterclaim to the infringement suit itself. If such counterclaims are classified as "compulsory" they must be brought as counterclaims or will be barred by principles of res judicata. If, however, the antitrust counterclaim is permissive, then failure to bring it will not preclude a subsequent and independent antitrust challenge to the infringement action. See Federal Rule of Civil Procedure 13(a):

> A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction.

Most courts find *Walker Process* style counterclaims to be compulsory. The Second Circuit's decision in Critical-Vac Filtration Corp. v. Minuteman Intl., Inc., 233 F.3d 697 (2d Cir. 2000), cert. denied, 532 U.S. 1019 (2001), distinguished between antitrust counterclaims to the infringement suit, which should be treated as compulsory, from claims and defenses of patent misuse (see Ch. 7), which might be treated as permissive. The Supreme Court's controversial decision in *Mercoid Corp. v. Mid-Continent Inv. Co.*, 320 U.S. 661 (1944), had treated the latter as permissive, and the Second Circuit felt obliged to reconcile it with emergent doctrine holding that antitrust counterclaims to infringement actions are best regarded as compulsory. The second circuit reasoned:

> Antitrust claims based on patent misuse, such as the counterclaims in *Mercoid*, are likely to involve factual issues distinct from those involved in patent infringement litigation between the same parties….In contrast, antitrust claims based on patent invalidity, such as C-Vac's claims in the instant case, will generally involve the same factual issues as those involved in patent infringement litigation between the same parties….

Is this persuasive? Some misuse claims raise precisely the same issues as those that arise in an antitrust claim and all necessary facts are known to the infringement defendant at the time of the infringement suit. For example, perhaps the infringement plaintiff requires the defendant to use tied, staple commodities with the patent, and its failure to do so forms the basis for the infringement claim. In such cases there is no reason not to make the antitrust counterclaim compulsory. In other cases—such as when the patent is procured by fraud but the facts are not revealed until after the infringement suit has run its course—justice is poorly served by a rule that prevents a subsequent antitrust challenge.

When the facts supporting the antitrust counterclaim are the same as

those supporting the infringement defense, a compulsory counterclaim rule economizes on judicial resources and tends toward the efficient resolution of disputes. For example, if the defense is that the theory of infringement is legally frivolous, the patent is clearly invalid or has expired, or the defendant's technology is obviously not infringing, then many of the facts necessary to support the antitrust counterclaim are implicit in the defense itself. Other facts, such as market power or the dangerous probability of success in achieving it can be developed through discovery.

Making antitrust counterclaims compulsory is less sensible, however, when the facts needed to support the counterclaim are not sufficiently known at the time the infringement action is brought. In such cases a compulsory counterclaim rule requires the infringement defendant to bring an antitrust claim that would be treated as unfounded or even frivolous if brought through the usual process. The outcome is particularly serious if the facts needed to support the antitrust counterclaim are not known until after the filing deadline for counterclaims has passed or, worse yet, after the trial is over. Evidence about prior sales, as in Walker Process, is not on the record and might be discovered only after the infringement suit is complete.

4. Under the *Noerr-Pennington* doctrine, which antedates *Walker Process*, "[a] party who petitions the government for redress generally is immune from antitrust liability." *Cheminor Drugs, Ltd. v. Ethyl Corp.*, 168 F.3d 119, 122 (3d Cir.), *cert. denied*, 528 U.S. 871 (1999). The petitioner is immune from liability even if there is an improper purpose or motive. *See E.R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127, 138 (1961) (even if the petitioner's sole purpose was to destroy its competition through passage of legislation, petitioner would be immune); *Prof'l Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc.*, 508 U.S. 49, 56 (1993). *Noerr-Pennington* immunity applies to actions, which might otherwise violate the Sherman Act under the reasoning that "the federal antitrust laws do not regulate the conduct of private individuals in seeking anticompetitive action from the government." *Omni*, 499 U.S. at 379-80. Specifically, the antitrust laws are designed for the business world and "are not at all appropriate for application in the political arena." *Noerr*, 365 U.S. at 141.

In *Walker Process*, however, the Supreme Court held that the enforcement of a patent procured by fraud on the PTO may strip the patent holder of its normal *Noerr-Pennington* defense to an antitrust counterclaim. What impact do you think this decision had on business planning?

Specifically, how would you advice clients seeking to petition the government for redress after *Walker Process* was decided? Suppose A is your client and B is A's competitor. A holds a very valuable patent that essentially is the reason his company is doing so well. However, B is engaging highly anticompetitive conduct that is threatening the success of your client's company in addition to running him out of business. If A came to you, asking whether or not to petition the government for redress, what advice would you give him? Would your advice change if he discloses the fact that he had sold his patented product prior to one year before his patent was issued?

DIPPIN' DOTS, INC. V. MOSEY
476 F.3d 1337 (C.A. Fed 2007)

GAJARSA, Circuit Judge.

This is a patent infringement and antitrust case dealing with a unique ice cream product. Plaintiffs Dippin' Dots, Inc. and Curt D. Jones (collectively "DDI") appeal from the district court's claim construction and summary judgment of noninfringement of U.S. Patent No. 5,126,156 ("the ′156 patent") and from the judgment following jury trial that all claims of that patent are obvious, that the patent is unenforceable due to inequitable conduct during prosecution, and that DDI violated the antitrust laws by asserting a patent that had been procured through fraud on the Patent Office. We affirm the judgments of noninfringement, obviousness, and unenforceability, but reverse as to the antitrust counterclaim.

I. BACKGROUND

The ′156 patent, covering subject matter invented by plaintiff Jones and exclusively licensed to plaintiff Dippin' Dots, is directed to a process for making a form of cryogenically prepared novelty ice cream product. Claim 1, the only independent claim, reads:

> A method of preparing and storing a free-flowing, frozen alimentary dairy product, comprising the steps of:
>
> [(1)] preparing an alimentary composition for freezing;
>
> [(2)] dripping said alimentary composition into a freezing chamber;

> [(3)] freezing said dripping alimentary composition into beads;
>
> [(4)] storing said beads at a temperature at least as low as -20° F. so as to maintain said beads free-flowing for an extended period of time;
>
> [(5)] bringing said beads to a temperature between substantially -10° F. and -20° F. prior to serving; and
>
> [(6)] serving said beads for consumption at a temperature between substantially -10° F. and -20° F. so that said beads are free flowing when served.

′156 patent col.6 ll.41-57 (numbering added for reference). DDI has commercialized this process. The ice cream it produces, sold under the Dippin' Dots brand, is known to patrons of amusement parks, stadiums, shopping malls, and the like….

Much of the debate in this case centers on the import of sales made at the Festival Market mall in Lexington, Kentucky, more than a year before DDI filed its patent application. Sales made more than one year before the patent's priority date implicate the on-sale bar of 35 U.S.C. § 102(b). For the ′156 patent, this critical date is March 6, 1988. Starting on July 24, 1987, Jones sold cryogenically-prepared, largely beaded ice cream at the Festival Market. During Jones's time at Festival Market, which lasted at least until July 29th, over 800 customers purchased his beaded ice cream and others received free samples. The customers were permitted to leave with the product and were not restricted by any kind of confidentiality agreement. Jones later testified that his main goal at the Festival Market was to "get ... test-marketing information" and not to further develop technical aspects of his product such as particular temperature ranges for storage and service.

It is undisputed that the Festival Market sales were never disclosed to the Patent and Trademark Office ("PTO") during prosecution of the ′156 patent. The declaration of commercial success which ultimately persuaded the examiner to grant the patent contained a sworn statement by Jones that "[t]he initial sales were in March of 1988," which was on or after the critical date.

Jones testified that at Festival Market he only practiced the first three

steps of the claimed method, not the storing, bringing, or serving steps. He testified that he considered the evidence of what had happened at Festival Market to be irrelevant to patentability. The attorney who prosecuted the ′156 patent, Warren Schickli, testified that he considered the sales to have been experimental since the process as practiced at Festival Market could not be feasibly commercially exploited. He also testified that the Festival Market ice cream was not sold for "direct consumption" under the meaning of Claim 1, because the ice cream was too cold to eat comfortably when initially given to the consumer.

The controversy in this case began when several of DDI's distributors severed their relationship, found alternative manufacturing sources, and entered into competition against DDI. DDI initiated a series of patent infringement lawsuits against its new competitors in various judicial districts. In this appeal, the defendants fall into two primary categories: the "manufacturing parties" who make the competing ice cream product and the "distributing parties" who sell it to consumers. The defendants counterclaimed for violation of § 2 of the Sherman Act due to DDI's allegation of patent infringement based on a fraudulently acquired patent. This type of antitrust claim has become known as a " *Walker Process* " claim, named for the Supreme Court's decision in *Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.*, 382 U.S. 172, 177 (1965). The various suits were consolidated by the Judicial Panel on Multi-District Litigation for pretrial proceedings before the United States District Court for the Northern District of Georgia. That court adopted in large part an earlier-recommended claim construction by a special master. *In re Dippin' Dots Patent Litig.*, 249 F.Supp.2d 1346 (N.D.Ga.2003). It issued summary judgment of noninfringement both literally, *id.* at 1368, and via the doctrine of equivalents, *id.* at 1370-71. It refused to grant summary judgment to any party on invalidity, *id.* at 1362, 1364, or on inequitable conduct, *id.* at 1365.

After the pretrial proceedings in the Northern District of Georgia were completed, the case was remanded to the United States District Court for the Northern District of Texas…. That court conducted a jury trial on the issues of invalidity, unenforceability, and antitrust violations by DDI. By special verdict, the jury found that the sales by Jones prior to March 1988 could be asserted against the patent as prior art and that all claims of the ′156 patent were invalid as obvious. The jury also found that both Jones and Schickli had, with intent to deceive, made material misrepresentations or omissions in violation of the duty of candor to the PTO. It also determined

that defendants Mini Melts, Inc. and Frosty Bites Distribution had proven all required elements of their antitrust counterclaim, including the requisite fraud on the PTO. However, it found no antitrust damages, granting the counterclaim plaintiffs zero dollars in damages on their Sherman Act counterclaim….. In its final judgment dated February 28, 2005, it awarded attorney fees under the Clayton Act to defendant Frosty Bites Distribution ("FBD") in the amount of $676,675.46….

In its amended brief, DDI appeals the claim construction and summary judgment of noninfringement, the refusal to overturn the jury verdict of obviousness and liability under the antitrust laws, the finding of inequitable conduct, and the award of attorneys' fees under the Clayton Act granted to FBD. We have jurisdiction under 28 U.S.C. § 1295(a)(1).

We have stated that "[a] patent may be rendered unenforceable for inequitable conduct if an applicant, with intent to mislead or deceive the examiner, fails to disclose material information or submits materially false information to the PTO during prosecution." *Digital Control Inc. v. The Charles Mach. Works,* 437 F.3d 1309, 1313 (Fed.Cir.2006). The party urging unenforceability must show by clear and convincing evidence that the applicant met "thresholds of both materiality and intent." *Molins PLC v. Textron,* 48 F.3d 1172, 1178 (Fed.Cir.1995). Where, as here, those factual findings were made by the district court, we review them for clear error. *Id.* The ultimate determination of inequitable conduct is committed to the sound discretion of the trial court. We review for abuse of that discretion. *Union Pac. Res. Co. v. Chesapeake Energy Corp.,* 236 F.3d 684, 693-94 (Fed.Cir.2001).

The first prong of the inequitable conduct test, materiality, is clearly met here. As discussed, the Festival Market sales render the ′156 patent invalid for obviousness. Had those sales been disclosed to the PTO, the patent may or may not have issued. At the very least, the existence of such sales prior to the critical date is a matter that "a reasonable examiner would have considered ... important in deciding whether to allow the ... application." *Dayco Prods., Inc. v. Total Containment, Inc.,* 329 F.3d 1358, 1363 (Fed.Cir.2003); *see also Digital Control,* 437 F.3d at 1316 (holding that "reasonable examiner" standard remains sufficient ground for inequitable conduct materiality even after 1992 amendment of 37 C.F.R. § 1.56).

The question of deceptive intent is a more difficult one, but we find no clear error in the district court's determination on this point. " 'Smoking

gun' evidence is not required in order to establish an intent to deceive.... Rather, this element of inequitable conduct[ ] must generally be inferred from the facts and circumstances surrounding the applicant's overall conduct." *Paragon Podiatry Lab., Inc. v. KLM Labs. Inc.*, 984 F.2d 1182, 1189 (Fed.Cir.1993). We have noted that omission of sales made before the critical date is especially problematic:

> Absent explanation, the evidence of a knowing failure to disclose sales that bear all the earmarks of commercialization reasonably supports an inference that the inventor's attorney intended to mislead the PTO. The concealment of sales information can be particularly egregious because, unlike the applicant's failure to disclose, for example, a material patent reference, the examiner has no way of securing the information on his own.

Id. at 1193. While DDI wholly neglected to disclose the Festival Market sales to the PTO, it enthusiastically touted sales made after the critical date as evidence of the commercial appeal of its process. That combination of action and omission permits an inference of the minimum, threshold level of intent required for inequitable conduct. The evidence to support a finding of intent may not be particularly strong here. However, the district court was permitted to balance the relatively weak evidence of intent together with the strong evidence that DDI's omission was highly material to the issuance of the ′156 patent and to find that on balance, inequitable conduct had occurred. Such a finding, as an exercise of the district court's equitable powers, is within its discretion. *See Molins*, 48 F.3d at 1178 ("Once threshold findings of materiality and intent are established, the court must weigh them to determine whether the equities warrant a conclusion that inequitable conduct occurred."). We perceive no abuse of discretion here. The district court's inequitable conduct finding is correct.

The defendants in this case counterclaimed against DDI for violation of § 2 of the Sherman Act, and the same jury that found the patent obvious found DDI liable on that counterclaim. Proof that a patentee has "obtained the patent by knowingly and willfully misrepresenting facts to the Patent Office ... [is] sufficient to strip [the patentee] of its exemption from the antitrust laws." *Walker Process Equip., Inc. v. Food Mach. & Chem. Corp.*, 382 U.S. 172, 177 (1965). A party who asserts such a fraudulently obtained patent may be subject to an antitrust claim. If a patentee asserts a patent claim and the defendant can demonstrate the required fraud on the PTO, as well as show that "the other elements necessary to a § 2 case are present,"

the defendant-counterclaimant is entitled to treble damages under the antitrust laws. *Id.* at 175.

The first barrier for a *Walker Process* claimant to clear is the requirement that the patent be obtained through actual fraud upon the PTO. This question is governed by Federal Circuit law. *Nobelpharma AB v. Implant Innovations, Inc.*, 141 F.3d 1059, 1068 (Fed.Cir.1998) (*en banc* in relevant part). A finding of inequitable conduct does not by itself suffice to support a finding of *Walker Process* fraud, because "inequitable conduct is a broader, more inclusive concept than the common law fraud needed to support a *Walker Process* counterclaim." *Nobelpharma*, 141 F.3d at 1069. To demonstrate *Walker Process* fraud, a claimant must make higher threshold showings of both materiality and intent than are required to show inequitable conduct. *Id.* at 1070-71; *C.R. Bard, Inc. v. M3 Sys., Inc.*, 157 F.3d 1340, 1364 (Fed.Cir.1998) (*Walker Process* claimant "must make a greater showing of scienter and materiality than when seeking unenforceability based on conduct before the Patent Office"). Furthermore, a finding of *Walker Process* fraud cannot result from an equitable balancing between the two factors; a strong showing of one cannot make up for a deficiency in the other. *Nobelpharma*, 141 F.3d at 1071. The difference in breadth between inequitable conduct and *Walker Process* fraud admits the possibility of a close case whose facts reach the level of inequitable conduct, but not of fraud before the PTO. This is such a case.

The heightened standard of materiality in a *Walker Process* case requires that the patent would not have issued but for the patent examiner's justifiable reliance on the patentee's misrepresentation or omission. *C.R. Bard*, 157 F.3d at 1364. The defendants have established materiality even under this strict threshold, since the evidence supports a finding that the patent would not have issued if DDI had disclosed the Festival Market sales to the PTO. The difficulty comes in establishing that the omission of those sales was done with fraudulent intent. DDI did make certain statements to the PTO that would have been more completely accurate had it included information about the Festival Market sales. For instance, it suggested that its method was "the first method to allow serving of a completely free flowing frozen alimentary dairy product for direct consumption by consumers." That statement would have been more helpful to the PTO if it had also disclosed that the first free-flowing sales had arguably happened at Festival Market, but the statement was not actually false. Likewise, DDI argued against obviousness by pointing out that none of the cited references taught free-flowing service. Again, this statement would have better

informed the PTO if it had clarified that elsewhere in the prior art, such service arguably existed, but again, the statement was true. The problem was not with its falsity but with its incompleteness.

Ultimately, the defendants' fraud case here is built only upon DDI's omission of the Festival Market sales from the prosecution record. While *Walker Process* intent may be inferred from the facts and circumstances of a case, "[a] mere failure to cite a reference to the PTO will not suffice." *Nobelpharma*, 141 F.3d at 1071. This is not to say that an omission always reduces to "mere failure to cite." We acknowledged in *Nobelpharma* "that omissions, as well as misrepresentations, may in limited circumstances support a finding of *Walker Process* fraud ... because a fraudulent omission can be just as reprehensible as a fraudulent misrepresentation." 141 F.3d at 1070. We believe, though, that to find a prosecution omission fraudulent there must be evidence of intent separable from the simple fact of the omission. A false or clearly misleading prosecution statement may permit an inference that the statement was made with deceptive intent. For instance, evidence may establish that a patent applicant knew one fact and presented another, thus allowing the fact finder to conclude that the applicant intended by the misrepresentation to deceive the examiner. That is not the case with an omission, which could happen for any number of nonfraudulent reasons-the applicant could have had a good-faith belief that disclosure was not necessary, or simply have forgotten to make the required disclosure. In this case, DDI argues that it did not disclose the Festival Market sales to the PTO because it believed that the product there was made without practicing the "storing," "bringing," or "serving" steps of the claim within the specified temperature ranges, and that therefore the Festival Market sales were merely cumulative to other prior art references which also lacked those three steps. The jury was of course allowed to disbelieve or discount evidence tending to support this claim. However, the defendants submitted no evidence of their own-aside from the absence of the Festival Market sales from the prosecution record-which affirmatively shows DDI's fraudulent intent. That intent cannot be shown merely from the absence of evidence, which would come about from the jury's discounting DDI's explanation.

Nobelpharma serves as a good example of the sort of facts that do prove *Walker Process* fraud by omission. In that case, the inventors had transmitted to their Swedish patent agent a draft patent application which included a citation to a book written by the patentee in 1977. *Nobelpharma*, 141 F.3d at 1062. That book was eventually held to anticipate the patent. *Id.*

at 1072. The agent "deleted all reference to the 1977 Book from the patent application that was ultimately filed in Sweden" and then also failed to mention the book in the U.S. application that led to the patent at issue. *Id.* at 1062. When pressed on the issue at trial, the agent "could not explain, even in retrospect, why he deleted all reference to the 1977 Book." *Id.* at 1072. We found that the evidence of actual deletion by the patent agent gave the jury reasonable ground to find intent to defraud by the patentees.

There is no similarly strong evidence that the omission in this case was fraudulent. It might be argued that because the omitted reference was so important to patentability, DDI must have known of its importance and must have made a conscious decision not to disclose it. That argument has some force, but to take it too far would be to allow the high materiality of the omission to be balanced against a lesser showing of deceptive intent by the patentee. Weighing intent and materiality together is appropriate when assessing whether the patentee's prosecution conduct was inequitable. *Molins*, 48 F.3d at 1178. However, when *Walker Process* claimants wield that conduct as a "sword" to obtain antitrust damages rather than as a mere "shield" against enforcement of the patent, *Nobelpharma*, 141 F.3d at 1070, they must prove deceptive intent independently. The defendants have not done so here to the extent necessary for a reasonable jury to find *Walker Process* fraud. The finding of fraud on the PTO is therefore reversed.

DDI also argues that the antitrust judgment must be reversed because the jury was not presented with sufficient evidence of the definition of the relevant market. Fraudulent acquisition of the asserted patent strips the *Walker Process* defendant of its antitrust immunity, but that is the beginning, not the end, of the inquiry. The counterclaimant must also show the basic elements of an antitrust violation defined by the regional circuit's law, including that the patentee's behavior was directed to a relevant product market. *Unitherm Food Sys., Inc. v. Swift-Eckrich, Inc.,* 375 F.3d 1341, 1363 (Fed.Cir.2004), *rev'd on other grounds,* 546 U.S. 394 (2006). In this case, DDI's antitrust immunity remains intact due to insufficient evidence of fraud. We therefore reach neither DDI's argument on this point nor the defendants' argument that DDI waived the market definition issue by failing to raise it below.

With the judgment of antitrust liability reversed, the grant of attorney's fees under § 4 of the Clayton Act must be vacated.

NOTES AND QUESTIONS

1. The Federal Circuit insisted on something more than simply lying about barring prior sales in order to ratchet the defendant's misrepresentation from inequitable conduct to an antitrust violation. But what about the fact that years later – after the evidence of the barring sales had grown stale and could be found only by luck – the patentee filed an infringement suit? Shouldn't the antitrust issue be evaluated as of the time the allegedly anticompetitive conduct took place rather than during the patent application process?

2. *Bifurcation. Walker Process* suits are typically raised as counterclaims to patent infringement litigation. Federal Rule of Civil Procedure 42(b) provides that courts may bifurcate a trial even where related patent and antitrust claims are consolidated for purposes of discovery and pretrial under Rule 42(a). In this instance, the bifurcated claims are tried separately but are not considered severed. *Dante Disparte v. Corp. Exec. Bd.,* 223 F.R.D. 7 (D.D.C. 2004).

> When deciding whether or not to bifurcate claims, courts are given discretion and generally focus on whether "both parties, using different triers of fact, could prevail on their respective claims without prejudicing the other party or arriving at inconsistent results." *Dante Disparte*, 223 F.R.D. at 12. Today, bifurcation is common in patent cases that involve antitrust counterclaims and the Federal Circuit has referred to the process as "standard" in cases involving the two claims. *See Hewlett-Packard Co. v. GenRAd, Inc.*, 882 F.Supp. 1141, 1157 (D. Mass. 1995) ("courts often separate patent issues from antitrust counterclaim suits"); *Alarm Device Mfg. Co. v. Alarm Prods. Int'l.,* 60 F.D.R. 199, 202 (E.D.N.Y 1973) ("[m]ore often than not, separate trials of patent validity-infringement claims and misuse-antitrust claims have been found to be salutary").

IGT V. ALLIANCE GAMING CORP.
2012 WL 6554712 (Fed. Cir. Dec. 17, 2012)

REYNA, Circuit Judge.

IGT owns several patents related to "wheel games," a type of casino gaming machine containing a secondary bonus game incorporating a

spinning wheel. IGT sued Alliance Gaming Corp., Bally Gaming International, Inc., and Bally Gaming, Inc. (collectively, "Bally") for infringement of these patents, and Bally counterclaimed under state and federal antitrust laws. The district court denied the motions for summary judgment on the antitrust issues, granted the motions that the patents were invalid and not infringed, and certified the patent issues for interlocutory appeal. This court affirmed. On remand, the district court granted summary judgment against Bally on its antitrust counterclaims. Because the undisputed facts are insufficient to establish the existence of a relevant antitrust market in wheel games, we affirm….

As a threshold issue in any monopolization claim, the court must identify the relevant market. *M.A.P. Oil Co. v. Texaco Inc.*, 691 F.2d 1303, 1306 (9th Cir.1982). "The relevant market is the field in which meaningful competition is said to exist." *Image Technical Servs., Inc. v. Eastman Kodak Co.*, 125 F.3d 1195, 1202 (9th Cir.1997). "Market definition can be broadly characterized in terms of the 'cross-elasticity of demand' for or 'reasonable interchangeability' of a given set of products or services." *M.A.P. Oil*, 691 F.2d at 1306 (quoting *United States v. E.I. du Pont de Nemours*, 351 U.S. 377, 395 (1956)). Definition of the relevant market is a question of fact. *Theme Promotions, Inc. v. News Am. Mktg. FSI*, 546 F.3d 991, 1002 (9th Cir.2008).

Both Bally and IGT provided extensive evidence that wheel games compete in the broader gaming machine market. Mr. Isaacs, Bally's corporate designee on the wheel game market, stated that he thought "just about anything may have potentially displaced the Bally wheel game." Bally's former Vice President of Business Development explained that Bally's wheel game "compete[d] with everything that's on the floor. The way it works is that you sell a machine and it competes against everything there."

Bally did not rebut this evidence. As Bally has failed to produce evidence to show there is a genuine issue of material fact that wheel games compete with all gaming machines, the district court did not resolve a disputed factual issue. *See Rebel Oil Co. v. Atl. Richfield Co.*, 51 F.3d 1421, 1435 (9th Cir.1995) (citing *Celotex Corp. v. Catrett*, 477 U.S. 317, 324 (1986)).

The district court rejected wheel games as a relevant market because a market limited to wheel games would not encompass all economic

substitutes. Focusing on the same undisputed evidence that supported its conclusion that wheel games compete with all gaming machines—specifically, that "casinos mix and match products to maximize floor-space revenue generation"—the court reasoned that "the relevant market is significantly broader than 'wheel games' because there is ample evidence that non-wheel games compete with wheel games." The court rejected Bally's argument that this competition does not prevent wheel games from being a relevant market, concluding that "[b] ecause all gaming machines compete, wheel games are not an economically distinct submarket." Bally argues this was error because (1) the existence of some substitution does not preclude wheel games from being a submarket, and (2) the analysis focused on functional, rather than economic, substitution. We address each point in turn.

As discussed above, Bally does not dispute that wheel games compete with all gaming machines. Bally does argue, however, that it was error for the district court to conclude that this competition prevented wheel games from being a relevant market. As authority for this argument, Bally points to *Unitherm Food Sys., Inc. v. Swift–Eckrich, Inc.*, in which this court, applying Tenth Circuit law, said: "For every product, substitutes exist. But a relevant market cannot meaningfully encompass that infinite range." 375 F.3d 1341, 1364 (Fed.Cir.2004) (quoting *Times–Picayune Publ'g Co. v. United States*, 345 U.S. 594, 613 n. 31 (1953)), *rev'd on other grounds*, 546 U.S. 394 (2006). The truth of this proposition is evident, as is the question it suggests: where should the courts draw the line? The remainder of the quotation from *Times–Picayune* suggests an answer: "The circle must be drawn narrowly to exclude any other product to which, within reasonable variations in price, only a limited number of buyers will turn; in technical terms, products whose cross-elasticities of demand are small." *Times–Picayune*, 345 U.S. at 613, n. 31. This simply refers to the well-settled relevant market inquiry focusing on economic substitution.

Bally argues that it has shown a lack of economic substitution by satisfying what is known as the small but significant and non-transitory increase in price test ("SSNIP"). Under this test, Bally argues that the relevant question is "whether the degree of substitutability between the two products is sufficiently great that it would restrain a hypothetical monopolist from profitably imposing a substantial price increase." Even assuming that SSNIP by itself is the proper test,[1] Bally has not alleged facts

[1] As support for its assertion that SSNIP is the controlling test, Bally cites *Theme Promotions*, which did allow that "[d] etermining the relevant market can involve" an

that would satisfy it. Bally contends that introduction of wheel games forced IGT to lower its prices. From this assertion, Bally argues that IGT's prior prices were supracompetitive. We accept both of these assertions as true. But Bally next asserts that these supracompetitive prices represented a SSNIP. With this we cannot agree. Bally has not explained what the baseline price for wheel games was from which IGT imposed a SSNIP. Although Bally implies that the baseline price should be similar to non-wheel games, no evidence supports this. Indeed, in a differentiated market, one would expect the prices for two differentiated products to be different. Having failed to establish such a baseline, Bally cannot successfully argue that IGT imposed a SSNIP. Furthermore, if we regard the supracompetitive prices as a baseline, Bally has shown that the prices decreased, not that they increased. Thus, even if the Guidelines test governs here, Bally has failed to put forth evidence that would satisfy it.

We also reject Bally's argument that the district court improperly focused on technological substitutions. The basis for this argument is the district court's statement that "it is undisputed that the relevant functionality of gaming machines is revenue generation." The court made this statement in the context of its description of the differentiated market of gaming machines in which wheel games compete. We hold that the court based its ultimate conclusion on competition, not on functionality, and that its recognition of meaningful competition was not error.

In addition to its argument that wheel games is a relevant market, Bally also contends that the *Brown Shoe* factors establish wheel games as a submarket.[2] "[A] lthough the general market must include all economic substitutes, it is legally permissible to premise antitrust allegations on a submarket." *Newcal Indus., Inc. v. Ikon Office Solution*, 513 F.3d 1038, 1045 (9th Cir.2008); *Thurman Indus., Inc. v. Pay 'N Pak Stores, Inc.*, 875 F.2d 1369, 1374 (9th Cir.1989) ("In limited settings ... the relevant product market may be narrowed beyond the boundaries of physical interchangeability and cross-price elasticity to account for identifiable submarkets...."). To the extent that the standard for defining a submarket

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SSNIP analysis, among other things. 546 F.3d at 1002. But the discussion of SSNIP in Theme Promotions was premised on *United States v. Oracle Corp.*, 331 F.Supp.2d 1098 (N.D.Cal.2004), which in turn was elaborating on the Department of Justice's Horizontal Merger Guidelines ("the Guidelines"). The Ninth Circuit has stated that the Guidelines are not binding on the courts. *See Olin Corp. v. FTC*, 986 F.2d 1295, 1300 (9th Cir.1993).

[2] We assume, although Bally does not explicitly say so, that Bally's argument is that wheel games are a submarket of all gaming machines.

differs from the standard for defining a market, it is embodied in the *Brown Shoe* factors.[3] In *Brown Shoe*, the Supreme Court listed several "practical indicia" of an economically distinct submarket: "industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." 370 U.S. at 325. "[T]he *Brown Shoe* indicia are practical aids for identifying the areas of actual or potential competition and ... their presence or absence does not decide automatically the submarket issue." *Thurman*, 875 F.2d at 1375. "Whether isolating a submarket is justified turns ultimately upon whether the factors used to define the submarket are 'economically significant.'" *Id.* (quoting *Int'l Tel. & Tel. Corp. v. General Tel. & Elec. Corp.*, 518 F.2d 913, 932 (9th Cir.1975)).

The undisputed facts, however, are insufficient to establish the existence of a submarket under the *Brown Shoe* factors. By definition, the "peculiar characteristic" distinguishing wheel games from other games is the wheel-shaped secondary bonus. It is undisputed that there are no unique production facilities or specialized vendors for wheel games versus ordinary gaming machines; one can just as easily produce a gaming machine with a square bonus as one with a circular bonus. This factor is particularly important in this case. *See Brown Shoe*, 370 U.S. at 325 n. 42 ("The cross-elasticity of production facilities may also be an important factor in defining a product market."); *Rebel Oil*, 51 F.3d at 1436 ("[D]efining a market on the basis of demand considerations alone is erroneous."); *Calnetics Corp. v. Volkswagen of Am., Inc.*, 532 F.2d 674, 691 (9th Cir.1976) ("[F]ailure to consider production cross-elasticity [i]s inconsistent with the views of the Supreme Court and of this circuit."); *see generally* Areeda ¶ 561, at 360–64. It is also undisputed that there are no distinct customers: wheel games, like all gaming machines, are purchased by casinos.

Bally's argument rests entirely on a single *Brown Shoe* factor: that "there is substantial evidence that game players, casinos, and IGT all view wheel games as a separate economic activity from non-wheel games." Bally

[3] A leading antitrust treatise suggests that the two inquiries are the same. *See* IIB Phillip E. Areeda, John L. Solow & Herbert Hovenkamp, Antitrust Law ¶ 533c (3d ed.2007) [hereinafter Areeda]. Although at least one district court in the Ninth Circuit has adopted this position, *see United States v. Oracle Corp.*, 331 F.Supp.2d 1098, 1118–19 (N.D.Cal.2009), we are aware of no Ninth Circuit case that has done so. *See Newcal*, 513 F.3d at 1045 (identifying the *Brown Shoe* factors as one way of showing that a submarket is economically distinct). In any event, we have already determined that Bally did not meet its burden to show that there was a relevant market in wheel games.

bases this argument primarily on evidence that some players prefer wheel games and that, accordingly, casinos allocate a specific percentages of their floor space to different types of games, including to wheel games. But evidence of player preference for wheel games says nothing about whether there is a public or industry perception that wheel games constitute a separate market; to the contrary, it is in harmony with the rest of the evidence that gaming machines are a differentiated market and that wheel games compete with all gaming machines to accommodate the spectrum of player preferences.

In addition to its market definition arguments, Bally contends that the district court erred by resolving factual disputes on summary judgment. In particular, Bally contends that IGT and its experts "have repeatedly and consistently testified that non-wheel games are not substitutes for wheel games." Although Bally provides no further explanation, we understand this argument to refer to statements IGT and its experts made in support of its patent damages theory.

To prove its patent damages, IGT chose to seek lost profits under the *Panduit* test. Under the *Panduit* factors, IGT was required to prove the absence of acceptable non-infringing substitutes. *See Rite–Hite Corp. v. Kelly Co.*, 56 F.3d 1538, 1545 (Fed.Cir.1995) (en banc) (citing *Panduit Corp. v. Stahlin Bros. Fibre Works, Inc.*, 575 F.2d 1152 (6th Cir.1978)). By claiming that the wheel feature was critical, IGT was able to argue that there were no non-infringing substitutes for its wheel game, and that every infringing game sold represented a loss of profits to IGT. According to Bally, by making this argument, "IGT has admitted that there are no substitutes for wheel games and that non-wheel games are not in the same market as wheel games." We disagree.

Even under the summary judgment standard, Troxel's (IGT's patent damages expert) opinion that there were no non-infringing technological substitutes cannot be read to mean that there were no economic substitutes. To do so, Troxel's opinion would need to be able to support a reasonable inference that no economic substitution existed. But, as Bally acknowledges, Troxel simply "relied on Bally's assertion that wheel games are an antitrust market." Because Troxel simply assumed that the market was co-extensive with the patent, however, such an inference would be unreasonable. *See Rebel Oil*, 51 F.3d at 1435 ("In the context of antitrust law, if there are undisputed facts about the structure of the market that render the inference economically unreasonable, the expert opinion is

insufficient to support a jury verdict."). And, as discussed above, even if wheel games are a relevant market, the high supply elasticity rendered demand elasticity immaterial. *Id.* at 1436 (holding that excessive supply elasticity rendered it "immaterial that consumers do not regard the products as substitutes, that a price differential exists, or that the prices are not closely correlated."). We therefore conclude that the district court's order did not resolve disputed issues of material fact.

The undisputed facts in this case show that meaningful competition exists between wheel games and all gaming machines. Furthermore, even viewing all evidence in the light most favorable to Bally, the *Brown Shoe* factors do not support a conclusion that wheel games should be considered a separate submarket. The district court correctly granted summary judgment that a wheel game market did not exist, and the decision is hereby

AFFIRMED

BRYSON, Circuit Judge, dissenting.

… Bally has shown that IGT was charging supracompetitive prices before Bally entered the wheel game market and that Bally's entrance into the market pressured IGT to lower its prices to a competitive level. Ron Rivera, IGT's Senior Vice President of Sales, testified that IGT successfully rebuffed calls for discounts on its wheel games before Bally began manufacturing wheel games, but that it was forced to acquiesce in those demands when customers were able to buy Bally's wheel games. IGT admits that the discounts were the direct and sole result of Bally introducing its wheel games into the market. The fact that IGT's wheel games were subject to price pressure only when other wheel games entered the market indicates that consumers were willing to incur monopolistic pricing without shifting demand to non-wheel games, i.e., that there was very little, if any, cross-elasticity of demand between wheel games and non-wheel games.

IGT's own expert, Richard Troxel, admitted that he saw no need to calculate cross-elasticity of demand because there was such strong demand for wheel games independent of demand for non-wheel games: "[T]he wheel has such a demand and drawing power for consumers that ... it seemed to me that the price elasticity was not the issue. Price elasticity occurs when you have products that are of a nature that price is going to make a difference to the consumer, and whether or not they would move to a different type of product or not. In this case the wheel was what they

wanted." That evidence indicates that there was demand for wheel games separate from casino gaming machines generally and that consumers would rather bear a small but significant non-transitory increase in price than switch to non-wheel games.

That analysis is consistent with the evidence from Bally's expert, Gregory Adams. While referring to IGT's economic data, he stated that the margin and profit per unit for wheel games is higher than for non-wheel games and that "the demand for wheel games appears to differ from the demand for non-wheel games, even when controlling for [all other variables]." Those statements and the economic data underlying them provide further support for Bally's contention that wheel games form a separate product market.

IGT asserts that Bally was required to calculate cross elasticity of demand and that Bally's failure to do so is fatal to its claim. The case law, however, does not mandate such a showing by an antitrust plaintiff. *See, e.g.*, *Knutson v. Daily Review, Inc.*, 548 F.2d 795, 804 (9th Cir.1976) (plaintiffs did not have to "produce a numerical value of the cross-elasticity of demand" to prove a relevant market; "[p]roofs of the [*Brown Shoe*] factors ... would have sufficed")…. *[S]ee also Ericsson, Inc. v. Harris Corp.*, 352 F.3d 1369, 1376–78 (Fed.Cir.2003) (crediting expert who purportedly "failed to calculate the cross-elasticities of demand" and finding that the "failure to present all of the economic evidence that Harris now identifies does not mean that Ericsson failed to present sound economic evidence"). Bally's evidence indicates a clear absence of cross-elasticity of demand between wheel and non-wheel games that obviates the need to quantify the degree of the elasticity.

The majority contends that Bally's relevant market argument fails because it has not offered evidence as to the baseline prices for wheel games from which IGT obtained a premium based on its allegedly monopolistic practices. But Bally offered evidence that, when it introduced wheel games into the market, IGT was required to reduce its prices, and that evidence included the amount by which those prices were reduced when competitive wheel games became available. That is precisely the kind of evidence that shows the effect of the allegedly monopolistic conduct on the market. *See* 2B Philip E. Areeda et al., Antitrust Law: An Analysis of Antitrust Principles and Their Application ¶¶ 533b, 563a (3d ed. 2007) (" Areeda ").

IGT's evidence of lost profits due to patent infringement provides a further indication that the relevant market is limited to wheel games. *See Panduit Corp. v. Stahlin Bros. Fibre Works, Inc.*, 575 F.2d 1152 (6th Cir.1978). In making its case for damages in the form of lost profits, IGT asserted that there were no acceptable noninfringing substitutes for its wheel games. Mr. Troxel testified that there were no non-wheel game substitutes and that Bally's wheel games replaced IGT's wheel games on a one-for-one basis. Because " Panduit's second factor, properly applied, ensures that any proffered alternative competes in the same market for the same customers as the infringer's product[,]" *BIC Leisure Prods., Inc. v. Windsurfing Int'l, Inc.*, 1 F.3d 1214, 1219 (Fed.Cir.1993), the lack of any acceptable non-infringing alternatives strongly suggests that the market consisted of only IGT's and Bally's wheel games. In other words, IGT's evidence that there were no alternatives to which consumers could shift their demand other than Bally's products is evidence that the relevant market was limited to wheel games.

IGT's higher prices and profit margins on wheel games cannot be attributed simply to normal economic performance in a differentiated product market that includes wheel and non-wheel games. The court in *United States v. Oracle Corp.*, 331 F.Supp.2d 1098, 1116 (N.D.Cal.2004), addressed that issue persuasively, explaining why monopolistic rents do not survive in a differentiated market lacking barriers to entry:

> Like a seller in a perfect competitive market, however, sellers in a "competitive" differentiated products market do not obtain monopoly rents. In differentiated product markets with few barriers to entry, firms will introduce products that are increasingly close, although not perfect substitutes, for the other products in the market. The introduction of additional products causes the demand curve faced by each seller to shift downward and leftward until, at long run equilibrium, the demand curve intersects the average cost curve of the seller (defined as economists define costs to include a reasonable profit) eliminating the monopolistic rent....

Although close substitutes, such as reel bonus games and tower bonus games, had been introduced, casinos still sought out wheel games despite the higher prices for those products, indicating the existence of a separate market for wheel games. If a product is priced higher than similar competing products, rational costminimizing consumers will shift to the lower-priced similar products, even if the lower-priced products differ

somewhat from the preferred product. If, instead, there are no similar or acceptable alternatives (as occurs in a monopolized market or where patent protection bars the introduction of competitive alternatives), consumers will bear the increased price for the preferred product because there are no satisfactory alternatives to which demand can be shifted.

Because IGT's patents barred potential competitors from marketing wheel games, the majority's reference to supply elasticity is beside the point.[4] The majority argues that the fact that there are no unique production facilities or specialized vendors for wheel games indicates that there is production cross-elasticity and thus elasticity of supply. But the existence of IGT's patents barred competitors from producing wheel games regardless of how easy it would have been to do so. The whole point of IGT's obtaining patent protection for wheel games was to limit the economic effects of supply elasticity.

Bally's evidence was sufficient to create a genuine issue of material fact as to whether IGT used its patents to maintain a monopoly in a market that was sufficiently separate from the market for other slot machines that IGT was able to demand monopolistic prices over an extended period of time. It is not enough to say that IGT's wheel games competed with other bonus games or other slot machines in general. It could equally be said that IGT's machines competed with other casino games or even with entertainment activities generally. But that does not overcome Bally's showing that there was a discrete market for wheel games within the overall slot machine, gaming, and entertainment markets, as demonstrated by the persistent monopolistic prices that resulted from the patent-based curtailment of supply and the customer-preference driven specificity of demand. *See* Areeda § 533c, at 255.[5]

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[4] Supply elasticity is a theory that neither party advanced. In fact, IGT argued that "the critical question in determining an antitrust product market is the " 'cross elasticity" of demand' between products.... Stated differently, the relevant antitrust market is the smallest group of products for which a hypothetical monopolist could profitably impose a 'small but significant and nontransitory increase in price' (SSNIP)." The majority not only assigns weight to the allegedly high supply elasticity for wheel games but, in discussing demand elasticity, disparages the same test that IGT believed to be "the critical question" in resolving this issue.

[5] *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421 (9th Cir.1995), on which the majority relies, stands for the unremarkable proposition that a high degree of supply elasticity can bear on the relevant market inquiry and may even be determinative in some cases. In that case the court found that full-serve gas stations were potential competitors of self-serve stations—and thus belonged in the relevant market—because full-serve stations could "easily convert their full-serve pumps, at virtually no cost, into self-serve, cash-only

In light of the record evidence summarized above, I conclude that Bally has presented sufficient evidence for a reasonable finder of fact to find that the relevant product market is limited to wheel games. The relevant market inquiry seeks to determine the scope of the market in which a monopolist can exert market power over buyers. Bally alleges, and has introduced evidence to prove, that IGT had market power over buyers in supplying wheel games. I therefore respectfully dissent.

NOTES AND QUESTIONS

1. What of the fact that when the infringement defendant entered the market the infringement plaintiff was forced to cut its prices? That indicates that the competition between the two was much closer than the competition with other (i.e., non-wheel) games, does it not? Should that be enough to support a conclusion of market power?

2. The SSNIP test ("small but significant and non-transitory increase in price") comes from the government Merger Guidelines, which query whether a merger might injure competition by imposing such a price increase. See HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE § 3.1 (4th ed. 2011). If the grouping of sales in which the merger occurs could experience such a price increase profitably, then that grouping is a relevant market. The test does not work very well for monopolist's however, because it is often the case that the monopolist is already charging a monopoly price to begin with. What about margins. The dissent noted that the margins on wheel games were higher than on non-wheel games. A "margin" is the difference between a cost measure, typically marginal cost or variable cost, and the amount of revenue that the seller obtains from the sale.

The use of margins is particularly problematic when a large component in a product consists of intellectual property rights, where the costs of making an additional unit are very small. For example, in the case of a pure software product, such as Microsoft Office, the costs of making

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pumps, expanding output and thus constraining any attempt by [the alleged monopolist] to charge supracompetitive prices for self-serve gasoline." *Id.* at 1436. Critically, however, nothing prevented the full-serve stations from making that change to their business in order to deter or rein in potentially monopolistic pricing by self-serve stations. Here, by contrast, potential suppliers were discouraged from entering the wheel game market by vigorous enforcement of the very patents that are being attacked as unlawful.

one additional unit are very close to zero when the copy is being downloaded, or the costs of a DVD plus packaging when it is being sold in a physical package. Nevertheless, the product might claim a price of, say, $200. The games in this case were a combination of physical product, some elements of which were patented, and also software.

3. Supply elasticity, or cross-elasticity of supply, refers to whether rivals can develop the alleged dominant firm's product in response to its higher (monopoly) profits. As the dissent points out, patents can reduce elasticity of supply by making it more difficult to copy a firm's products. The question is complicated, however. Sometimes a firm can easily invent around a patent, and then the patent offers little protection from market entry. Sometimes the patent adds so little value to a product that others can compete without employing the device or technology that the patent protects.

IN RE DDAVP DIRECT PURCHASER ANTITRUST LITIGATION
585 F.3d 677 (2nd Cir. 2009)

JOHN M. WALKER, JR., Circuit Judge:

This case presents a novel question of standing that lies at the junction of antitrust and patent law. The plaintiffs, direct purchasers of desmopressin acetate tablets (sold under the name DDAVP), filed this class action in the Southern District of New York against the defendants Ferring B.V., Ferring Pharmaceuticals (collectively, "Ferring"), and Aventis Pharmaceuticals ("Aventis"),alleging that Ferring and Aventis abused the patent system to unlawfully maintain a monopoly over DDAVP. Ferring developed, patented, and manufactures DDAVP, and Aventis holds FDA approval for DDAVP tablets as well as a license from Ferring to market and sell the drug. The plaintiffs alleged that Ferring and Aventis inflated the price of DDAVP by suppressing generic competition for the tablets in violation of the antitrust laws. The district court dismissed the suit, concluding that the plaintiffs both lacked antitrust standing and had failed to state a claim upon which relief could be granted. This appeal followed…..

In 2002, Ferring filed a patent infringement suit against Barr Laboratories, Inc. ("Barr"), which came before the same district judge who later presided over this action…. Ferring's suit failed. On summary judgment, the district court found that the ′398 patent, rather than having

been infringed by Barr, was unenforceable due to inequitable conduct before the PTO by Ferring and its agents…. The Federal Circuit affirmed. *See Ferring B.V. v. Barr Labs., Inc.* (" Ferring I"), 437 F.3d 1181 (Fed.Cir.2006)….

Less than two months after the Federal Circuit's February 2006 ruling, the direct purchaser plaintiffs filed the instant suit. … The plaintiffs claim that the lack of competing, generic versions of DDAVP injured them by forcing them to pay monopolistic prices for the drug.

Ferring and Aventis jointly moved to dismiss the complaint on the basis that, inter alia, the plaintiffs lacked standing to assert their claimed antitrust violations. …

… As an initial matter, the district court noted the lack of binding precedent "with regard to the specific issue of whether purchaser plaintiffs like those in this case have standing to assert a *Walker Process* claim." *Id*. at 10-11. The district court then held that the plaintiffs lacked antitrust standing for their Walker Process claim because the ′398 patent had not been enforced against them, and they were not competitors of Ferring or Aventis.

The defendants argue that the plaintiffs lack standing to pursue this action. We review questions of standing de novo. *Comer v. Cisneros*, 37 F.3d 775, 787 (2d Cir.1994). In addition to demonstrating Article III standing, an antitrust plaintiff must also establish antitrust standing. *See Paycom Billing Servs., Inc. v. Mastercard Int'l, Inc*., 467 F.3d 283, 290 (2d Cir.2006). We analyze antitrust standing under a two-part test: a plaintiff must show (1) antitrust injury, which is "injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants' acts unlawful," *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.,* 429 U.S. 477, 489 (1977), and (2) that he is a proper plaintiff in light of four "efficient enforcer" factors:

> (1) the directness or indirectness of the asserted injury; (2) the existence of an identifiable class of persons whose self-interest would normally motivate them to vindicate the public interest in antitrust enforcement; (3) the speculativeness of the alleged injury; and (4) the difficulty of identifying damages and apportioning them among direct and indirect victims so as to avoid duplicative recoveries.

In his case, the plaintiffs are purchasers of the defendants' product who allege being forced to pay supra-competitive prices as a result of the defendants' anticompetitive conduct. Such an injury plainly is "of the type the antitrust laws were intended to prevent." *Brunswick*, 429 U.S. at 489; *see also AGC*, 459 U.S. at 530 ("Congress was primarily interested in creating an effective remedy for consumers who were forced to pay excessive prices by the giant trusts and combinations that dominated certain interstate markets."). Although the defendants' conduct at issue targeted their competitors, such as Barr, the plaintiffs' claimed injury of higher prices was "inextricably intertwined" with the conduct's anti-competitive effects and thus "flow[ed] from that which makes defendants' acts unlawful." *Blue Shield of Va. v. McCready*, 457 U.S. 465, 484 1982) (internal quotation marks omitted). Antitrust injury is therefore present.

As for the "efficient enforcer" factors that bear on whether the plaintiffs are "proper" antitrust plaintiffs, spelled out in *Volvo*, each favors granting antitrust standing. With respect to the first factor, directness of injury, even though the plaintiffs' injuries were derivative of the direct harm experienced by the defendants' competitors, harming competitors was simply a means for the defendants to charge the plaintiffs higher prices. *See Id.* at 478-79,; *In re Warfarin Sodium Antitrust Litig.*, 214 F.3d 395, 400-01 (3d Cir.2000). This factor supports the plaintiffs' standing.

As for the second factor, motivation, the defendants argue that their competitors are the parties most motivated to enforce the antitrust laws, because the competitors were most directly impacted by the alleged anticompetitive behavior. They note that we declined to find antitrust standing in *Paycom* in part because the plaintiff there was "not an entity whose self-interest would most 'motivate [it] to vindicate the public interest in antitrust enforcement.' " 467 F.3d at 294 (quoting *AGC*, 459 U.S. at 542) (alteration in original). But this argument overlooks the fact that the *Paycom* court asked if the plaintiff was an entity most motivated by self-interest, not the entity most motivated by self-interest. *See Id.* The second factor simply looks for a class of persons naturally motivated to enforce the antitrust laws. "Inferiority" to other potential plaintiffs can be relevant, but it is not dispositive. *See Andrx Pharms., Inc. v. Biovail Corp., Int'l*, 256 F.3d 799, 816 (D.C.Cir.2001). Even if the competitors might be the most motivated, the plaintiffs are also significantly motivated due to their "natural economic self-interest" in paying the lowest price possible. *See Daniel v. Am. Bd. of Emergency Med.*, 428 F.3d 408, 444 (2d Cir.2005) (internal quotation marks omitted).

Moreover, the defendants' competitors, unlike the plaintiffs, would be seeking lost profits, not overcharges. Lost profits are the difference between the competitive price and what the competitors' costs would have been, while overcharges are the difference between the defendants' supra-competitive price and the competitive price. Denying the plaintiffs a remedy in favor of a suit by competitors would thus be "likely to leave a significant antitrust violation undetected or unremedied." *AGC*, 459 U.S. at 542; *see also Andrx Pharms.*, 256 F.3d at 817 (noting that lost profits and overcharges are distinct injuries). The second factor supports standing.

Tuning to speculativeness, the third factor, the defendants argue that the plaintiffs' allegations rest upon tenuous assumptions about the beneficial effects of generic competition. The assumptions are not as speculative as the defendants suggest. That no other manufacturer would have obtained a patent on the drug is a fair assumption, we think, given that "[t]he reluctance of the PTO to issue the ′398 patent was evident" in advance of the defendants' inequitable conduct. *Ferring I*, 437 F.3d at 1186. And that generic manufacturers would have decided to compete for DDAVP sales is self-evident: manufacturers sought approval for generic DDAVP when the ′398 patent was still enforceable. It may be difficult to account precisely for the likely effects of generic competition, but we have little doubt that those effects can be sufficiently estimated and measured here. *See Geneva Pharms. Tech. Corp. v. Barr Labs. Inc.*, 386 F.3d 485, 499 (2d Cir.2004) (listing literature analyzing generic drug competition). This is especially so when "[t]he most elementary conceptions of justice and public policy require that the wrongdoer shall bear the risk of the uncertainty which his own wrong has created." *Bigelow v. RKO Radio Pictures*, 327 U.S. 251, 265 (1946). Like the first two factors, the third factor supports the plaintiffs' antitrust standing.

As for the fourth factor, the potential for duplicative recovery, the difference between lost profits and overcharges is again relevant. Even assuming some overlap between lost profits and overcharges (as could occur if generic manufacturers charged more than the competitive price), the two are conceptually different measures that we think can be fairly apportioned in order to avoid duplicative recoveries. *See Andrx Pharms.*, 256 F.3d at 817. This factor also supports the plaintiffs' antitrust standing.

In sum, then, although the relative weight given to each factor is imprecise, *see, e.g., Daniel*, 428 F.3d at 443, the plaintiffs would be

efficient enforcers under any formulation. What complicates the standing question, however, is the centrality of the alleged *Walker Process* fraud to the plaintiffs' case. *Walker Process* claims are based on a fraudulently obtained patent, and are typically brought as counterclaims in patent infringement suits: the plaintiff claims the defendant infringed his patent, and the defendant responds that the patent was invalid as fraudulently obtained, and that the plaintiff's enforcement efforts violate *Walker Process*. *See Nobelpharma AB v. Implant Innovations, Inc.*, 141 F.3d 1059, 1067 (Fed.Cir.1998). If a patent is valid, a *Walker Process* claim cannot stand.

Outside of an infringement suit counterclaim, a patent's validity can be challenged only by a party (1) producing or preparing to produce the patented product, and (2) being threatened or reasonably likely to be threatened with an infringement suit. *See, e.g., Cordis Corp. v. Medtronic, Inc.*, 835 F.2d 859, 862 (Fed.Cir.1987). As purchasers of DDAVP, the plaintiffs do not satisfy these requirements and cannot directly challenge the ′398 patent's validity. As the district court noted, whether the plaintiffs have standing to bring their *Walker Process* claim, when a court has yet to find the ′398 patent fraudulently obtained, is a question of first impression.

The defendants acknowledge that *Walker Process* standing might be warranted for a purchaser when a patent has already been held to have been fraudulently procured. But the defendants urge us to hold that, when dealing with a patent not yet found to be fraudulently obtained, a party has *Walker Process* standing only if that party also has standing to challenge the patent's validity. They argue that giving *Walker Process* standing to the plaintiffs, who cannot directly challenge the ′398 patent's validity, could result in an avalanche of patent challenges, because direct purchasers otherwise unable to challenge a patent's validity could do so simply by dressing their patent challenge with a *Walker Process* claim….

Walker Process itself, of course, reflects a willingness to let antitrust liability impact the patent system. However, the defendants argue that *Walker Process* is the product of the Supreme Court's careful balancing of antitrust and patent policies, a balance which should not be upset and under which *Walker Process* plaintiffs must be independently able to first prove the patent's fraudulent procurement. Yet the language of *Walker Process* does not necessarily suggest such a limit:

> While one of [the claim's] elements is the fraudulent procurement of a patent, the action does not directly seek the

> patent's annulment. The gist of Walker's claim is that since Food Machinery obtained its patent by fraud it cannot enjoy the limited exception to the prohibitions of § 2 of the Sherman Act, but must answer under that section ... to those injured by any monopolistic action taken under the fraudulent patent claim. Nor can the interest in protecting patentees from 'innumerable vexatious suits' be used to frustrate the assertion of rights conferred by the antitrust laws.

To be sure, the *Walker Process* Court also noted that allowing antitrust recovery "accord[ed]" with the "long-recognized procedures" that controlled how parties could challenge a patent's validity, thereby suggesting that the Court may not have envisioned expanding the universe of potential patent challengers.

Nonetheless, we are reluctant to embrace the defendants' position because we are wary of creating the potential "to leave a significant antitrust violation undetected or unremedied." As the defendants would have it, direct purchasers would be able to recover antitrust damages from a fraudulent patentee only after that patentee first loses on a fraudulent procurement claim. This asks too much of the generic competitors and other potential patent challengers, who may not have the strategic interest or the resources to start or win such a battle, or who may be presented with strong incentives to settle their challenge by patent holders seeking not only to preserve their patent's enforceability, but also to avoid potential *Walker Process* liability. See C. Scott Hemphill, *Paying for Delay: Pharmaceutical Patent Settlement as a Regulatory Design Problem*, 81 N.Y.U. L.Rev. 1553, 1616 (2006) (noting how "an innovator has an especially strong incentive to pay to neutralize ... potential competition" when a generic manufacturer first files an ANDA).

Although settlements between patent holders and generic manufacturers that delay generic entry into the market may themselves invite antitrust liability, a plaintiff must be able to show the settled litigation to have been a sham in order to succeed. *See Tamoxifen*, 466 F.3d at 208-09 ("In such a case, so long as the patent litigation is neither a sham nor otherwise baseless, the patent holder is seeking to arrive at a settlement in order to protect that to which it is presumably entitled: a lawful monopoly over the manufacture and distribution of the patented product."). A purchaser seeking to challenge the settlement by showing the underlying infringement litigation to be a sham would need to attach antitrust liability to the patent enforcement efforts-a move that would raise the same standing issues

presented by this case. Thus, not only are there strong potential settlement incentives, but these settlements could be shielded from purchaser attack….

On the other hand, we do not pass lightly over the defendants' objections to expanding the universe of patent challengers. The risk of disturbing the incentives for innovation dictates that we tread carefully. As a result, we decline to decide whether purchaser plaintiffs per se have standing to raise *Walker Process* claims. In this case, the plaintiffs are challenging an already tarnished patent. We are able to grant them antitrust standing without altering the typical limits on who can start a challenge to a patent's validity. We therefore hold only that purchaser plaintiffs have standing to raise *Walker Process* claims for patents that are already unenforceable due to inequitable conduct. The district court erred by concluding to the contrary.

Granting standing to the plaintiffs does not resolve this appeal, because the district court also concluded that the plaintiffs had failed to state a claim. "We review the district court's dismissal of a complaint for failure to state a claim de novo, accepting as true all facts alleged in the complaint and drawing all inferences in favor of the plaintiff...." *Faulkner v. Beer*, 463 F.3d 130, 133 (2d Cir.2006) (internal quotation marks omitted). "[O]nly a complaint that states a plausible claim for relief survives a motion to dismiss." *Ashcroft v. Iqbal*, 129 S.Ct. 1937, 1950 (2009). We believe that the plaintiffs meet this standard for their antitrust claim under each of their four theories.

Walker Process fraud, the plaintiffs' first theory, requires:

> (1) a representation of a material fact, (2) the falsity of that representation, (3) the intent to deceive or, at least, a state of mind so reckless as to the consequences that it is held to be the equivalent of intent (scienter), (4) a justifiable reliance upon the misrepresentation by the party deceived which induces him to act thereon, and (5) injury to the party deceived as a result of his reliance on the misrepresentation.

Nobelpharma, 141 F.3d at 1069-70. A fraudulent omission, which "can be just as reprehensible as a fraudulent misrepresentation," can be sufficient to "support a finding of *Walker Process* fraud."

A party "alleging fraud or mistake ... must state with particularity the circumstances constituting fraud or mistake." Fed.R.Civ.P. 9(b). The

plaintiffs argue that they have pled each element with sufficient specificity. They alleged a series of "highly material" omissions, without which "the ′398 patent would not have issued." The Federal Circuit agreed on the "high[ ] material[ity]" of the omissions when it found the ′398 patent unenforceable. *Ferring I*, 437 F.3d at 1194. The *Ferring I* litigation also addressed the third element of intent, as the district court found "clear and convincing evidence of an intent to mislead the examiners." *Ferring B.V.*, 2005 WL 437981, at 9. Reliance and injury, the fourth and fifth elements, are straightforward here: the PTO was justified in relying on the information the defendants provided, and injury is a "matter of course whenever the other four elements are met." *Unitherm Food Sys., Inc. v. Swift-Eckrich, Inc.*, 375 F.3d 1341, 1361 (Fed.Cir.2004), *rev'd on other grounds, 546* U.S. 394 (2006). Thus, the plaintiffs contend the district court's dismissal on the pleadings was erroneous….

The defendants next argue that the plaintiffs must allege evidence of intent distinct from the omission itself. While a false or clearly misleading statement can permit an inference of deceptive intent, a misrepresentation in the form of an omission is more likely to be innocent and cannot support *Walker Process* fraud without "evidence of intent separable from the simple fact of the omission." *Dippin' Dots, Inc. v. Mosey*, 476 F.3d 1337, 1347 (Fed.Cir.2007). The issue in the initial infringement litigation was inequitable conduct, not *Walker Process* fraud. Moreover, the district court in that litigation correctly noted that high materiality could overcome a lesser showing of intent. *Ferring B.V.*, 2005 WL 437981, at 9; *see Brasseler, U.S.A. I, L.P. v. Stryker Sales Corp.*, 267 F.3d 1370, 1380-81 (Fed.Cir.2001). While such balancing is impermissible with *Walker Process* claims, we think the plaintiffs' allegations are nonetheless sufficient. Dippin' Dots concerned findings, not pleadings, *see* 476 F.3d at 1341-42; even if the district court's findings in the Ferring I litigation could not satisfy Dippin' Dots, the plaintiffs' pleadings could plausibly lead to additional findings that would satisfy Dippin' Dots, which is all that is required at this stage of the litigation….

We likewise conclude that the sham litigation claim has been adequately alleged. In order to state a claim for sham litigation, the plaintiffs need to allege that "the litigation in question is: (i) 'objectively baseless,' and (ii) 'an attempt to interfere directly with the business relationships of a competitor through the use of the governmental process ... as an anticompetitive weapon.' " *Primetime 24 Joint Venture v. Nat'l Broadcasting Co.*, 219 F.3d 92, 100-01 (2d Cir.2000) (citing *Prof'l Real*

Estate Investors, Inc. v. Columbia Pictures Indus., Inc., 508 U.S. 49, 60 (1993)). Based on the same facts alleged to sustain a *Walker Process* claim, we find that in the circumstances of this case, the plaintiffs' allegations are also sufficient to make out a sham litigation claim. The defendants effectively concede as much. *See* Brief of Defendants-Appellees Ferring B.V. and Ferring Pharms. at 38 ("[A] sham litigation claim here not only requires proof that defendants defrauded the PTO, but also that they knew their misconduct before the PTO had rendered the patent invalid.... [Plaintiffs'] 'sham' litigation allegation is thus substantively duplicative of their patent fraud claim....").

Overall, the plaintiffs have stated an antitrust claim upon which relief may be granted….

RITZ CAMERA & IMAGE, LLC v. SANDISK CORP.
700 F.3d 503 (Fed. Cir. 2012)

BRYSON, Circuit Judge.

This case comes to us on an interlocutory appeal from the United States District Court for the Northern District of California. The certified question concerns the limits on standing to bring so-called *Walker Process* antitrust claims. The Supreme Court in Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp., 382 U.S. 172 (1965), held that antitrust liability may attach when a party uses a patent to obtain or preserve a monopoly if the patent was procured through intentional fraud on the Patent and Trademark Office ("PTO"). The question in this case is whether an antitrust action against the owner of a patent, based on the *Walker Process* theory of liability, can be brought by a direct purchaser of goods that are protected by the patent, even if the purchaser faces no threat of an action for patent infringement and has no other basis to seek a declaratory judgment holding the patent invalid or unenforceable. We hold that the district court was correct to rule that a direct purchaser is not categorically precluded from bringing a Walker Process antitrust claim, even if it would not be entitled to seek declaratory relief against the patentee under the patent laws.

Defendant SanDisk allegedly controls about three quarters of the market for NAND flash memory. Flash memory is a computer chip that can be erased and reprogrammed; NAND is a particular type of flash memory. The capacity of NAND flash memory to store large amounts of data and to rewrite the contents of that data has led to its widespread use in consumer

products such as digital cameras, mobile phones, and USB drives. SanDisk holds patent rights needed to make NAND products. With those patents, SanDisk manufactures and sells flash memory products and also licenses the technology to other manufacturers. Retailers such as plaintiff Ritz Camera & Image, LLC, purchase flash memory products from SanDisk and its licensees.

In June 2010, Ritz filed suit on behalf of itself and a class of direct purchasers of NAND flash memory, alleging that SanDisk had violated Section 2 of the Sherman Act, 15 U.S.C. § 2. The complaint alleged that SanDisk had fraudulently procured two patents central to its flash memory business—U.S. Patent Nos. 5,172,338 and 5,991,517 ("the ′338 and ′517 patents")—by failing to disclose known prior art and making affirmative misrepresentations to the PTO. Ritz further alleged that SanDisk established its monopoly position by enforcing those patents against its competitors and by threatening the competitors' customers. Ritz contends that those actions have caused direct purchasers to pay inflated, supracompetitive prices for NAND flash memory products.

SanDisk moved to dismiss the complaint. Among its arguments, SanDisk asserted that Ritz lacked standing to bring a Walker Process antitrust claim based on the invalidity or unenforceability of SanDisk's patents, because Ritz faced no threat of an infringement action and had no other basis to bring a declaratory judgment action challenging the patents.[6]

The district court rejected SanDisk's argument. The court acknowledged that Walker Process claims normally are brought by competitors of the patentee as counter claims in patent infringement actions. However, the court noted that the Supreme Court's decision in *Walker Process* "places no limitation on the class of plaintiffs eligible to bring [such claims]." Moreover, the court was not persuaded by SanDisk's

[6] The Supreme Court in Medimmune, Inc. v. Genentech, Inc., 549 U.S. 118, 127 (2007), rejected our "reasonable apprehension of suit" test for declaratory judgment standing and held that the proper test is whether "there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment." See SanDisk Corp. v. STMicroelectronics, Inc., 480 F.3d 1372, 1380 (Fed.Cir.2007). Ritz does not claim that it could have brought a declaratory judgment action against SanDisk seeking relief under the patent laws.

contention that expressly authorizing direct purchasers to bring *Walker Process* claims "could result in an avalanche of patent challenges" because such claims are "rare" and because the Supreme Court rejected the same argument in *Walker Process*. In the course of its opinion, the court pointed out that allegations of fraud relating to the ′338 and ′517 patents had survived a motion for summary judgment in a different litigation, which "raise[s] at least some question as to the validity of the subject patent[s]."...

SanDisk's appeal is limited to a single question: Whether direct purchasers who cannot challenge a patent's validity or enforceability through a declaratory judgment action (and have not been sued for infringement, and so cannot assert invalidity or unenforceability as a defense in the infringement action) may nevertheless bring a *Walker Process* antitrust claim that includes as one of its elements the need to show that the patent was procured through fraud. SanDisk contends that allowing parties such as Ritz to use a *Walker Process* antitrust lawsuit to challenge patents would represent an unjustifiable expansion of the *Walker Process* doctrine and would undermine well-recognized limitations on standing to bring a declaratory judgment action challenging a patent. We disagree.

Walker Process set forth two conditions for antitrust liability based on the fraudulent procurement of a patent. First, the plaintiff must show that the defendant procured the relevant patent by knowing and willful fraud on the PTO or (in the case of an assignee) that the defendant maintained and enforced the patent with knowledge of the fraudulent manner in which it was obtained. Second, the plaintiff must prove all the elements otherwise necessary to establish a Sherman Act monopolization charge.... With the first condition, the Court made clear that the invalidity of the patent was not sufficient; a showing of intentional fraud in its procurement was required. With the second condition, the Court incorporated the rules of antitrust law generally. As Justice Harlan stated in his concurring opinion, "as to this class of improper patent monopolies, antitrust remedies should be allowed room for full play." The "full play" of antitrust remedies encompasses the standing requirements that apply in the antitrust setting, see, e.g., Associated Gen. Contractors of Cal., Inc. v. Cal. State Council of Carpenters, 459 U.S. 519, 537–46 (1983); In re DDAVP Direct Purchaser Antitrust Litig., 585 F.3d 677, 688 (2d Cir.2009), including the recognition that direct purchasers are not only eligible to sue under the antitrust laws, but have been characterized as "preferred" antitrust plaintiffs.

Nothing in *Walker Process* supports SanDisk's argument that the

rules governing standing to bring patent validity challenges should be imported into an antitrust case simply because one element of the antitrust cause of action requires proof of improper procurement of a patent. In fact, the Supreme Court in *Walker Process* rejected an argument closely analogous to SanDisk's argument here. The Court stated that it found no merit in the proposition that rules defining who may bring suit "to cancel or annul a patent" should also dictate the boundaries of antitrust standing. Notwithstanding the fact that "one of its elements is the fraudulent procurement of a patent," the Court explained, an antitrust claim under the Clayton Act is not a claim under the patent laws. Rather, "the gist of [the antitrust] claim is that since [the defendant] obtained its patent by fraud it cannot enjoy the limited exception to the prohibitions of § 2 of the Sherman Act, but must answer under that section and § 4 of the Clayton Act in treble damages to those injured by any monopolistic action taken under the fraudulent patent claim." The Court did not suggest that the class of "those injured by any monopolistic action" should be limited to those within that class who would have standing to bring an independent challenge to the patents at issue.

In arguing that the right to bring a *Walker Process* claim should be governed by the standing requirements of the Declaratory Judgment Act rather than traditional antitrust standing requirements, SanDisk relies on the Court's statement in *Walker Process* that permitting a plaintiff to bring an antitrust claim based on a fraudulently procured patent "accords with ... long-recognized procedures." Because that statement follows a brief survey of cases concerning patent validity disputes, SanDisk argues that it evinces the Court's intent to limit the class of potential antitrust plaintiffs to those who could contest a patent's validity directly. The quoted sentence, however, does not say what SanDisk claims. The context makes clear that the sentence in question simply explains that recognizing a cause of action for an antitrust claim based on a fraudulently procured patent is not inconsistent with patent law rules permitting challenges to patently validity or patent misuse. Nothing in that sentence, or elsewhere in the Court's opinion, suggests that the standing limitations on direct actions to challenge patent validity should be imported into antitrust actions predicated on fraudulently procured patents.

Noting the distinction between patent and antitrust actions drawn in *Walker Process*, this court and others have declined to apply limitations on patent invalidity suits to *Walker Process* antitrust actions. In Hydril Co. v. Grant Prideco LP, 474 F.3d 1344 (Fed.Cir.2007), this court refused to apply

the standing limitation on declaratory judgment actions challenging a patent's validity to the context of a *Walker Process* claim. Similarly, the Second Circuit has held that direct purchasers had standing to pursue their *Walker Process* claim despite the fact that, as purchasers, they could not directly challenge the patent's validity.[7] The D.C. Circuit has likewise allowed a Walker Process claim to proceed even though the patentee had disclaimed the patent and thus the plaintiff faced no risk of an infringement suit. Oetiker v. Jurid Werke, GmbH, 556 F.2d 1 (D.C.Cir.1977). The rule urged by SanDisk—to limit *Walker Process* antitrust claimants to competitors who could bring a declaratory judgment action attacking a patent's validity—would conflict with all of those decisions.

SanDisk argues that allowing direct purchasers to bring Walker Process claims would authorize an intolerable end-run around the patent laws because parties unable to pursue invalidity claims could achieve the same result by way of a Sherman Act claim. We do not share SanDisk's concern. A *Walker Process* antitrust claim is a separate cause of action from a patent declaratory judgment action. It is governed by principles of antitrust law, and there is nothing novel about the fact that it includes as one of its elements the need to prove a violation that is not independently actionable between the same parties. *Walker Process* explained that while one of the elements of the antitrust claim is the fraudulent procurement of a patent, the action "does not directly seek the patent's annulment." Ritz's claim likewise seeks relief under the antitrust laws; it does not directly seek to invalidate SanDisk's patents or render them unenforceable, even though

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[7] [In re DDAVP Direct Purchaser Antitrust Litig., 585 F.3d 677, 688 (2d Cir.2009)], The Second Circuit "decline[d] to decide whether purchaser plaintiffs per se have standing to raise *Walker Process* claims," and held "only that purchaser plaintiffs have standing to raise *Walker Process* claims for patents that are already unenforceable due to inequitable conduct." 585 F.3d at 691–92. The district court in this case noted that claims of intentional fraud against the ′338 and ′ 517 patents had previously survived a motion for summary judgment in another case. We see no reason to limit the scope of *Walker Process* standing to cases in which the patents have been "tarnished" in another proceeding. *Walker Process* contains no such limitation, and applying such a requirement would have the undesirable effect of subjecting injured parties' claims to the litigation strategies of others. It would also be likely to generate unproductive wrangling over what counts as a sufficiently "tarnished" patent to support a Walker Process claim.

that would likely be the practical effect if Ritz were to prevail on its *Walker Process* claim.

Moreover, as to SanDisk's assertion that granting standing to direct purchasers would trigger a flood of litigation and stem innovation, the Supreme Court rejected the same argument in *Walker Process* when it explained that "the interest in protecting patentees from 'innumerable vexatious suits' [cannot] be used to frustrate the assertion of rights conferred by the antitrust laws." As the Court explained, *Walker Process* claims "deal only with a special class of patents, i.e., those procured by intentional fraud," and "cannot well be thought to impinge upon the policy of the patent laws to encourage inventions and their disclosure," (Harlan, J., concurring). Particularly in light of the demanding proof requirements of a *Walker Process* claim, we are not persuaded by SanDisk's "flood of litigation" argument.

In sum, *Walker Process* recognizes a clear distinction between claims that arise under the antitrust laws and those that arise under the patent laws. Because direct purchasers are generally permitted to bring antitrust actions, and because the *Walker Process* decision did not preclude purchasers from bringing this particular type of antitrust claim, we hold that Ritz's status as a direct purchaser gives it standing to pursue its *Walker Process* claim even if it could not have sought a declaratory judgment of patent invalidity or unenforceability.

AFFIRMED.

NOTES AND QUESTIONS

1. Why shouldn't customers of a patented product have a general right to challenge the validity of a patent when they are paying an overcharge or suffering a loss in product variety as a result? One answer, of course, is that the Patent Act contains no equivalent to §4 of the Clayton Act, which permits any "person who shall be injured" by an antitrust violation to sue for damages. The Declaratory Judgment Action is not a good substitute because it requires an "actual controversy." 28 U.S.C. §2201. What of the fact that an ongoing customer of a patented good acquires an implied license to use any incorporated patents. A licensee generally does have standing to bring a declaratory judgment action challenging the validity of a licensed patent, although the cases have generally involved manufacturing licensees, not simply product purchasers. MedImmune, Inc. v. Genentech, Inc., 549 U.S. 118 (2007). The difference between such a challenge and an

antitrust challenge such as the one in *Ritz Camera* could be significant. The antitrust plaintiffs in *Ritz* must still make out all of the other elements of an antitrust violation, including monopoly power, which typically requires costly definition of a relevant market. By contrast, a simple validity challenge requires only a showing that a patent is not enforceable.

2. Under *Ritz* a plaintiff's burden could still be substantial. See, e.g., the Federal Circuit's decision in *Therasense*, reprinted *infra*.

3. The Federal Circuit has exclusive jurisdiction over "an appeal from a final decision of a district court of the United States . . . if the jurisdiction of that court was based in whole or part, on 28 U.S.C. § 1338." 28 U.S.C. 1295(a)(1). Section 1338 grants federal district courts jurisdiction over patent cases. 28. U.S.C. 1338(a). This, even in cases involving both patent and non-patent claims, the Federal Circuit will have exclusive jurisdiction if a patent law claim appears on the face of the plaintiff's well-pleaded complaint. *See Korody-Colyer Corp. v. General Motors Corp.,* 486 U.S. 800, 808-09 (1998).

However, if assertion of a fraudulent patent is an act of monopolization, then one would anticipate that consumers must pay higher prices. Further antitrust's private action provision, §4 of the Clayton Act, gives a claim to "any person" who is injured by an antitrust violation. 15 U.S.C. §15. Since customers are typically not the targets of infringement actions, the case does not "arise" under the Patent Act and the appeal will go to the regional Circuit rather than the Federal Circuit.

4. "Reverse Payment" settlements make a particularly strong case for granting standing to consumers, do they not. The issue of reverse payment settlements is discussed further in the notes after the *Arkansas Carpenters Health and Welfare Fund v. Bayer AG*, 604 F.3d 98 (2nd Cir. 2010), reprinted *infra*. Suppose the patentee of a drug, Alpha, files a patent infringement suit against the only plausible rival, Beta, and the two settle the dispute by an arrangement under which the patentee pays the rival not to produce the patented product. If the patent is invalid the two firms have effectively agreed to divide up a monopoly, just as a cartel would, rather than competing with each other. That leaves consumers as the most likely private challengers.

THERASENSE, INC. V. BECTON, DICKINSON AND CO.

649 F.3d 1276 (Fed. Cir. 2011)

RADER,Chief Judge.

The United States District Court for the Northern District of California found U.S. Patent No. 5,820,551 ("the '551 patent") unenforceable due to inequitable conduct…. The ′551 involves disposable blood glucose test strips for diabetes management. These strips employ electrochemical sensors to measure the level of glucose in a sample of blood. When blood contacts a test strip, glucose in the blood reacts with an enzyme on the strip, resulting in the transfer of electrons from the glucose to the enzyme. A mediator transfers these electrons to an electrode on the strip. Then, the electrons flow from the strip to a glucose meter, which calculates the glucose concentration based on the electrical current…..

Abbott filed the original application leading to the ′551 patent in 1984. Over thirteen years, that original application saw multiple rejections for anticipation and obviousness…. [*During this time Abbott through its agents made claims in the United States patent proceedings that were inconsistent with factual assertions it made in claims before the European Patent Office [EPO]; this inconsistency was the basis of the inequitable conduct claim. – ed.*]

Inequitable conduct is an equitable defense to patent infringement that, if proved, bars enforcement of a patent. This judge-made doctrine evolved from a trio of Supreme Court cases that applied the doctrine of unclean hands to dismiss patent cases involving egregious misconduct: *Keystone Driller Co. v. General Excavator Co.*, 290 U.S. 240 (1933), *Hazel–Atlas Glass Co. v. Hartford–Empire Co.*, 322 U.S. 238 (1944), *overruled on other grounds by Standard Oil Co. v. United States*, 429 U.S. 17 (1976), and *Precision Instrument Manufacturing Co. v. Automotive Maintenance Machinery Co.*, 324 U.S. 806 (1945).

Keystone involved the manufacture and suppression of evidence. 290 U.S. at 243. The patentee knew of "a possible prior use" by a third party prior to filing a patent application but did not inform the PTO. *Id.* at 243. After the issuance of the patent, the patentee paid the prior user to sign a false affidavit stating that his use was an abandoned experiment and bought his agreement to keep secret the details of the prior use and to suppress

evidence….

The Supreme Court explained that if the corrupt transaction between the patentee and the prior user had been discovered… "the court undoubtedly would have been warranted in holding it sufficient to require dismissal" [of a subsequent infringement suit].

Like *Keystone, Hazel–Atlas* involved both the manufacture and suppression of evidence. 322 U.S. at 240. Faced with "apparently insurmountable Patent Office opposition," the patentee's attorneys wrote an article describing the invention as a remarkable advance in the art and had William Clarke, a well-known expert, sign it as his own and publish it in a trade journal. After the patentee submitted the Clarke article to the PTO in support of its application, the PTO allowed a patent to issue.

The patentee brought suit against Hazel–Atlas Glass Co. ("Hazel–Atlas"), alleging infringement of this patent. The district court found no infringement. On appeal, the patentee's attorneys emphasized the Clarke article, and the Third Circuit reversed the district court's judgment, holding the patent valid and infringed. The patentee then went to great lengths to conceal the false authorship of the Clarke article, contacting Clarke multiple times, including before and after Hazel–Atlas's investigators spoke to him. After Hazel–Atlas settled with the patentee, the patentee paid Clarke a total of $8,000. These facts surfaced in a later suit.

On the basis of these newly-discovered facts, Hazel–Atlas petitioned the Third Circuit to vacate its judgment, but the court refused. The Supreme Court reversed. The Supreme Court explained that if the district court had learned of the patentee's deception before the PTO, it would have been warranted in dismissing the patentee's case under the doctrine of unclean hands. … Accordingly, the Supreme Court vacated the judgment against Hazel–Atlas and reinstated the original judgment dismissing the patentee's case.

In *Precision,* the patentee suppressed evidence of perjury before the PTO and attempted to enforce the perjury-tainted patent….

The district court found that Automotive had unclean hands and dismissed the suit. The Seventh Circuit reversed. The Supreme Court reversed the Seventh Circuit's decision, explaining that dismissal was warranted because not only had the patentee failed to disclose its knowledge of perjury to the

PTO, it had actively suppressed evidence of the perjury and magnified its effects.

The unclean hands cases of *Keystone*, *Hazel–Atlas*, and *Precision* formed the basis for a new doctrine of inequitable conduct that developed and evolved over time. Each of these unclean hands cases before the Supreme Court dealt with particularly egregious misconduct, including perjury, the manufacture of false evidence, and the suppression of evidence…. As the inequitable conduct doctrine evolved from these unclean hands cases, it came to embrace a broader scope of misconduct, including not only egregious affirmative acts of misconduct intended to deceive both the PTO and the courts but also the mere nondisclosure of information to the PTO. Inequitable conduct also diverged from the doctrine of unclean hands by adopting a different and more potent remedy—unenforceability of the entire patent rather than mere dismissal of the instant suit.

In line with this wider scope and stronger remedy, inequitable conduct came to require a finding of both intent to deceive and materiality. *Star Scientific Inc. v. R.J. Reynolds Tobacco Co.*, 537 F.3d 1357, 1365 (Fed.Cir.2008). To prevail on the defense of inequitable conduct, the accused infringer must prove that the applicant misrepresented or omitted material information with the specific intent to deceive the PTO. The accused infringer must prove both elements—intent and materiality—by clear and convincing evidence. If the accused infringer meets its burden, then the district court must weigh the equities to determine whether the applicant's conduct before the PTO warrants rendering the entire patent unenforceable….

As inequitable conduct emerged from unclean hands, the standards for intent to deceive and materiality have fluctuated over time. In the past, this court has espoused low standards for meeting the intent requirement, finding it satisfied based on gross negligence or even negligence. *See Driscoll v. Cebalo*, 731 F.2d 878, 885 (Fed.Cir. 1984) ("Where they knew, or should have known, that the withheld reference would be material to the PTO's consideration, their failure to disclose the reference is sufficient proof of the existence of an intent to mislead the PTO."); *Orthopedic Equip. Co., Inc. v. All Orthopedic Appliances, Inc.*, 707 F.2d 1376, 1383–84 (Fed.Cir.1983) (requiring only gross negligence to sustain a finding of intent). This court has also previously adopted a broad view of materiality, using a "reasonable examiner" standard based on the PTO's 1977 amendment to Rule

56. *See Am. Hoist & Derrick Co. v. Sowa & Sons, Inc.*, 725 F.2d 1350, 1362 (Fed.Cir.1984); *see also* 37 C.F.R. § 1.56 (1977) (a reference is material if "there is a substantial likelihood that a reasonable examiner would consider it important in deciding whether to allow the application to issue as a patent"). Further weakening the showing needed to establish inequitable conduct, this court then placed intent and materiality together on a "sliding scale." *Am. Hoist*, 725 F.2d at 1362. This modification to the inequitable conduct doctrine held patents unenforceable based on a reduced showing of intent if the record contained a strong showing of materiality, and vice versa. In effect, this change conflated, and diluted, the standards for both intent and materiality.

This court embraced these reduced standards for intent and materiality to foster full disclosure to the PTO. This new focus on encouraging disclosure has had numerous unforeseen and unintended consequences. Most prominently, inequitable conduct has become a significant litigation strategy. A charge of inequitable conduct conveniently expands discovery into corporate practices before patent filing and disqualifies the prosecuting attorney from the patentee's litigation team. Moreover, inequitable conduct charges cast a dark cloud over the patent's validity and paint the patentee as a bad actor. Because the doctrine focuses on the moral turpitude of the patentee with ruinous consequences for the reputation of his patent attorney, it discourages settlement and deflects attention from the merits of validity and infringement issues…. Inequitable conduct disputes also "increas[e] the complexity, duration and cost of patent infringement litigation that is already notorious for its complexity and high cost." Brief and Appendix of the American Bar Ass'n as Amicus Curiae at 9.

Perhaps most importantly, the remedy for inequitable conduct is the "atomic bomb" of patent law. Unlike validity defenses, which are claim specific, inequitable conduct regarding any single claim renders the entire patent unenforceable. *Kingsdown Med. Consultants, Ltd. v. Hollister Inc.*, 863 F.2d 867, 877 (Fed.Cir.1988). Unlike other deficiencies, inequitable conduct cannot be cured by reissue, *Aventis*, 525 F.3d at 1341, n. 6, or reexamination, *Molins PLC v. Textron, Inc.*, 48 F.3d 1172, 1182 (Fed.Cir.1995). Moreover, the taint of a finding of inequitable conduct can spread from a single patent to render unenforceable other related patents and applications in the same technology family. *See, e.g., Consol. Aluminum Corp. v. Foseco Int'l Ltd.*, 910 F.2d 804, 808–12 (Fed.Cir.1990). Thus, a finding of inequitable conduct may endanger a substantial portion of a company's patent portfolio.

A finding of inequitable conduct may also spawn antitrust and unfair competition claims. *See Dow Chemical Co. v. Exxon Corp.*, 139 F.3d 1470, 1471 (Fed.Cir.1998) (unfair competition claim); *Walker Process Equip., Inc. v. Food Mach. & Chem. Corp.*, 382 U.S. 172, 178 (1965) (antitrust action for treble damages). Further, prevailing on a claim of inequitable conduct often makes a case "exceptional," leading potentially to an award of attorneys' fees under 35 U.S.C. § 285. *Brasseler, U.S.A. I, L.P. v. Stryker Sales Corp.*, 267 F.3d 1370, 1380 (Fed.Cir.2001). A finding of inequitable conduct may also prove the crime or fraud exception to the attorney-client privilege. *See In re Spalding Sports Worldwide, Inc.*, 203 F.3d 800, 807 (Fed.Cir.2000).

With these far-reaching consequences, it is no wonder that charging inequitable conduct has become a common litigation tactic. One study estimated that eighty percent of patent infringement cases included allegations of inequitable conduct. Committee Position Paper at 75; *see also* Christian Mammen, *Controlling the "Plague": Reforming the Doctrine of Inequitable Conduct*, 24 BERKELEY TECH. L.J. 1329, 1358 (2009)…..

While honesty at the PTO is essential, low standards for intent and materiality have inadvertently led to many unintended consequences, among them, increased adjudication cost and complexity, reduced likelihood of settlement, burdened courts, strained PTO resources, increased PTO backlog, and impaired patent quality. This court now tightens the standards for finding both intent and materiality in order to redirect a doctrine that has been overused to the detriment of the public.

To prevail on a claim of inequitable conduct, the accused infringer must prove that the patentee acted with the specific intent to deceive the PTO. *Star*, 537 F.3d at 1366 (citing *Kingsdown*, 863 F.2d at 876). A finding that the misrepresentation or omission amounts to gross negligence or negligence under a "should have known" standard does not satisfy this intent requirement. "In a case involving nondisclosure of information, clear and convincing evidence must show that the applicant *made a deliberate decision* to withhold a *known* material reference." In other words, the accused infringer must prove by clear and convincing evidence that the applicant knew of the reference, knew that it was material, and made a deliberate decision to withhold it….

Intent and materiality are separate requirements. *Hoffmann–La Roche*,

Inc. v. Promega Corp., 323 F.3d 1354, 1359 (Fed.Cir.2003). A district court should not use a "sliding scale," where a weak showing of intent may be found sufficient based on a strong showing of materiality, and vice versa. Moreover, a district court may not infer intent solely from materiality. Instead, a court must weigh the evidence of intent to deceive independent of its analysis of materiality. Proving that the applicant knew of a reference, should have known of its materiality, and decided not to submit it to the PTO does not prove specific intent to deceive.

Because direct evidence of deceptive intent is rare, a district court may infer intent from indirect and circumstantial evidence. However, to meet the clear and convincing evidence standard, the specific intent to deceive must be "the single most reasonable inference able to be drawn from the evidence." Indeed, the evidence "must be sufficient to *require* a finding of deceitful intent in the light of all the circumstances." Hence, when there are multiple reasonable inferences that may be drawn, intent to deceive cannot be found.

Because the party alleging inequitable conduct bears the burden of proof, the "patentee need not offer any good faith explanation unless the accused infringer first ... prove[s] a threshold level of intent to deceive by clear and convincing evidence." The absence of a good faith explanation for withholding a material reference does not, by itself, prove intent to deceive.

This court holds that, as a general matter, the materiality required to establish inequitable conduct is but-for materiality. When an applicant fails to disclose prior art to the PTO, that prior art is but-for material if the PTO would not have allowed a claim had it been aware of the undisclosed prior art. Hence, in assessing the materiality of a withheld reference, the court must determine whether the PTO would have allowed the claim if it had been aware of the undisclosed reference. In making this patentability determination, the court should apply the preponderance of the evidence standard and give claims their broadest reasonable construction. Often the patentability of a claim will be congruent with the validity determination—if a claim is properly invalidated in district court based on the deliberately withheld reference, then that reference is necessarily material because a finding of invalidity in a district court requires clear and convincing evidence, a higher evidentiary burden than that used in prosecution at the PTO. However, even if a district court does not invalidate a claim based on a deliberately withheld reference, the reference may be material if it would have blocked patent issuance under the PTO's different evidentiary

standards.

As an equitable doctrine, inequitable conduct hinges on basic fairness. "[T]he remedy imposed by a court of equity should be commensurate with the violation." *Columbus Bd. of Educ. v. Penick*, 443 U.S. 449, 465 (1979). Because inequitable conduct renders an entire patent (or even a patent family) unenforceable, as a general rule, this doctrine should only be applied in instances where the patentee's misconduct resulted in the unfair benefit of receiving an unwarranted claim. *Star*, 537 F.3d at 1366 ("[j]ust as it is inequitable to permit a patentee who obtained his patent through deliberate misrepresentations or omissions of material information to enforce the patent against others, it is also inequitable to strike down an entire patent where the patentee committed only minor missteps or acted with minimal culpability"). After all, the patentee obtains no advantage from misconduct if the patent would have issued anyway…..

In this case, the district court held the ′551 patent unenforceable for inequitable conduct because Abbott did not disclose briefs it submitted to the EPO regarding the European counterpart of the ′382 patent. *Trial Opinion* at 1127. Because the district court found statements made in the EPO briefs material under the PTO's Rule 56 materiality standard, not under the but-for materiality standard set forth in this opinion, this court vacates the district court's findings of materiality. On remand, the district court should determine whether the PTO would not have granted the patent but for Abbott's failure to disclose the EPO briefs…..

The district court found intent to deceive based on the absence of a good faith explanation for failing to disclose the EPO briefs. However, a "patentee need not offer any good faith explanation unless the accused infringer first ... prove[s] a threshold level of intent to deceive by clear and convincing evidence." The district court also relied upon the "should have known" negligence standard in reaching its finding of intent…. Because the district court did not find intent to deceive under the knowing and deliberate standard set forth in this opinion, this court vacates the district court's findings of intent. On remand, the district court should determine whether there is clear and convincing evidence demonstrating that [the United States applicant] knew of the EPO briefs, knew of their materiality, and made the conscious decision not to disclose them in order to deceive the PTO…..

NOTES AND QUESTIONS

1. In a dissenting opinion, Judge Bryson took issue with the majority's standard for determining whether the conduct at issue is sufficiently material to render the patent suit unenforceable. Judge Bryson pointed out that:

> Since its first days, this court has looked to the PTO's disclosure rule, Rule 56, 37 C.F.R. § 1.56, as the standard for defining materiality in inequitable conduct cases involving the failure to disclose material information. In its current form, that rule provides that information is material not only if it establishes a prima facie case of unpatentability, but also if it refutes or is inconsistent with a position the applicant takes before the PTO with respect to patentability. *Id*. at 22.

Judge Bryson argued that the PTO's materiality standard set for in its disclosure rule should be followed because, " the PTO is in the best position to know what information examiners need to conduct effective and efficient examinations," and that, "the higher standard of materiality adopted by the majority will not provide appropriate incentives for patent applicants to comply with the disclosure obligations the PTO places upon them." *Id*. at 22. Moreover, citing Rule 56's legislative history:

> At the time it adopted the 1992 revision to Rule 56, the PTO considered the possibility of adopting a "but for" test of materiality of the sort that the majority has adopted today. The Office rejected that test, concluding that adopting such a narrow standard "would not cause the Office to obtain the information it needs to evaluate patentability so that its decisions may be presumed correct by the courts." Duty of Disclosure, 57 Fed.Reg. at 2023. *Id*. at 31.

Additionally, argued Judge Bryson, the majority "does not merely reform the doctrine of inequitable conduct, but comes close to abolishing it altogether." *Id.* at 24. In reference to the majority's new standard, he states, "[t]his court has repeatedly rejected the 'but for' test as too restrictive in light of the policies served by the inequitable conduct doctrine."

2. *The proper role of equity courts.* Judge O'Malley also wrote a separate opinion. He argued that "when addressing the types of conduct that should

be deemed of sufficient concern to allow for a finding of inequitable conduct, both the majority and dissent strain too hard to impose hard and fast rules." Judge O'Malley offered the following test for materiality:

> (1) but for the conduct (whether it be in the form of an affirmative act or intentional non-disclosure), the patent would not have issued (as Chief Judge Rader explains that concept in the majority opinion); (2) the conduct constitutes a false or misleading representation of fact (rendered so either because the statement made is false on its face or information is omitted which, if known, would render the representation false or misleading); or (3) the district court finds that the behavior is so offensive that the court is left with a firm conviction that the integrity of the PTO process as to the application at issue was wholly undermined.

Judge O'Malley refused to weigh in on the policy debate between the majority and dissenters concerning litigation abuses surrounding the improper use of the inequitable conduct doctrine. "Policy concerns cannot … justify adopting broad legal standards that diverge from doctrines explicated by the Supreme Court."

EON-NET LP v. FLAGSTAR BANCORP

653 F.3d 1314 (Fed. Cir. 2011)

… [T]he district court found that Eon–Net's litigation misconduct and its filing of a baseless infringement action in bad faith for an improper purpose warranted an exceptional case finding. We conclude that the district court did not clearly err in so finding and address each category of conduct below.

Litigation Misconduct

The district court's opinion recounted numerous instances of litigation misconduct. First, the district court found that Eon–Net and its counsel destroyed relevant documents prior to the initiation of its lawsuit against Flagstar and that Eon–Net intentionally did not implement a document retention plan. *Exceptional Case Order*, at 17–18. As recounted by the district court, Eon–Net's principal, Mitchell Medina, testified with regard to document retention, collection, and production that "I don't save anything so I don't have to look" and further testified that Eon–Net and Millennium

"have adopted a document retention policy which is that we don't retain any documents" because those companies have "evolved into patent enforcement companies which are involved in the business of litigation." … it is undisputed that Medina and ultimately Eon–Net had an independent duty to preserve evidence during the ongoing lawsuits, *see Sensonics, Inc. v. Aerosonic Corp.*, 81 F.3d 1566, 1575 (Fed.Cir.1996), and, in light of Medina's testimony, it was not clear error for the district court to conclude that Eon–Net did not observe that duty.

Filing Objectively Baseless Litigation in Bad Faith

Eon–Net also challenges the district court's finding that Eon–Net pursued baseless infringement allegations in bad faith and for an improper purpose….

... [T]he written description repeatedly defines the invention as a system for processing information that originates from hard copy documents, and, under this construction, it is undisputed that Flagstar does not infringe any asserted claim of the ′697, ′673, and ′162 patents. Thus, because the written description clearly refutes Eon–Net's claim construction, the district court did not clearly err in finding that Eon–Net pursued objectively baseless infringement claims…..

In addition to finding that Eon–Net filed an objectively baseless infringement action, the district court also determined that Eon–Net filed the lawsuit in bad faith and for an improper purpose. *Exceptional Case Order*, at 16–17. In particular, the district court found that Eon–Net's case against Flagstar had "indicia of extortion" because it was part of Eon–Net's history of filing nearly identical patent infringement complaints against a plethora of diverse defendants, where Eon–Net followed each filing with a demand for a quick settlement at a price far lower than the cost to defend the litigation.

The record supports the district court's finding that Eon–Net acted in bad faith by exploiting the high cost to defend complex litigation to extract a nuisance value settlement from Flagstar. At the time that the district court made its exceptional case finding, Eon–Net and its related entities, Millennium and Glory, had filed over 100 lawsuits against a number of diverse defendants alleging infringement of one or more patents from the Patent Portfolio. Each complaint was followed by a "demand for a quick settlement at a price far lower than the cost of litigation, a demand to which

most defendants apparently have agreed." In this case, as with the other cases, Eon–Net offered to settle using a license fee schedule based on the defendant's annual sales: $25,000 for sales less than $3,000,000; $50,000 for sales between $3,000,000 and $20,000,000; and $75,000 for sales between $20,000,000 and $100,000,000. *Rule 11 Sanctions Order,* at 3–4.

Meritless cases like this one unnecessarily require the district court to engage in excessive claim construction analysis before it is able to see the lack of merit of the patentee's infringement allegations. … In this case, Flagstar expended over $600,000 in attorney fees and costs to litigate this case through claim construction. Viewed against Eon–Net's $25,000 to $75,000 settlement offer range, it becomes apparent why the vast majority of those that Eon–Net accused of infringement chose to settle early in the litigation rather than expend the resources required to demonstrate to a court that the asserted patents are limited to processing information that originates from a hard copy document. Thus, those low settlement offers—less than ten percent of the cost that Flagstar expended to defend suit—effectively ensured that Eon–Net's baseless infringement allegations remained unexposed, allowing Eon–Net to continue to collect additional nuisance value settlements….

In addition to its ability to impose high costs to defend against its meritless claims, Eon–Net placed little at risk when filing suit. As a non-practicing entity, Eon–Net was generally immune to counterclaims for patent infringement, antitrust, or unfair competition because it did not engage in business activities that would potentially give rise to those claims. And while Eon–Net risked licensing revenue should its patents be found invalid or if a court narrowly construed the patents' claims to exclude valuable targets, Eon–Net did not face any business risk resulting from the loss of patent protection over a product or process. Its patents protected only settlement receipts, not its own products.

Eon–Net argues that it is not improper for a patentee to vigorously enforce its patent rights or offer standard licensing terms, and Eon–Net is correct. But the appetite for licensing revenue cannot overpower a litigant's and its counsel's obligation to file cases reasonably based in law and fact and to litigate those cases in good faith. Here, the district court did not clearly err when it found that Eon–Net filed an objectively baseless infringement action against Flagstar and brought that action in bad faith, specifically to extract a nuisance value settlement by exploiting the high cost imposed on Flagstar to defend against Eon–Net's baseless claims. It

also appears that in filing this case, Zimmerman merely followed the direction of his client, Medina, who Zimmerman characterized at oral argument as "difficult to control." But an attorney, in addition to his obligation to his client, also has an obligation to the court and should not blindly follow the client's interests if not supported by law and facts. In these circumstances, coupled with the district court's supported findings regarding Eon–Net's litigation misconduct, we conclude that the district court did not clearly err in its exceptional case finding.

Rule 11 Sanctions

Eon–Net also appeals the district court's imposition of Rule 11 sanctions. We apply the law of the regional circuit, here the Ninth Circuit, to review an award of Rule 11 sanctions. *Power Mosfet Techs., L.L.C. v. Siemens AG,* 378 F.3d 1396, 1406–07 (Fed.Cir.2004). Before a district court awards Rule 11 sanctions under Ninth Circuit law, the district court must determine that the complaint is "legally or factually 'baseless' from an objective perspective" and that the attorney failed to conduct a "reasonable and competent inquiry" before filing the complaint. *Christian v. Mattel, Inc.,* 286 F.3d 1118, 1127 (9th Cir.2002) (quoting *Buster v. Greisen,*104 F.3d 1186, 1190 (9th Cir.1997)). We review all aspects of a district court's imposition of Rule 11 sanctions under an abuse of discretion standard. *Cooter & Gell v. Hartmax Corp.,* 496 U.S. 384, 405 (1990).

The district court imposed Rule 11 sanctions against Zimmerman and Eon–Net because it found that Eon–Net's infringement allegations were legally baseless and that Eon–Net and Zimmerman failed to perform a reasonable pre-suit investigation. Eon–Net argues that its claim construction was not objectively baseless. As explained above, however, the district court did not clearly err in concluding that Eon–Net's infringement allegations were objectively baseless, and, for the same reasons, the district court did not abuse its discretion in finding that Eon–Net's infringement allegations were legally baseless.

NOTES AND QUESTIONS

1. Suppose a patent holder came to you intending to file a patent infringement suit against a competitor. After review of the relevant document available at the time, you decide the case does have merit and submit the complaint. However, since litigation, like life, never goes according to plan, new evidence is brought to your attention during the

discovery process that seriously calls into question the validity of your client's patent. What would you do with this new information? Do you have a duty to disclose this evidence to opposing counsel? Would any of your answers change if you were the attorney who drafted the patent application? *See* Rule 26(a)(1)(A) of the Federal Rules of Civil Procedure.

2. The "exceptional case" procedure emanates from the Patent Act, 35 U.S.C. §285, which states that "The court in exceptional cases may award reasonable attorneys fees to the prevailing party." The rule can be applied to either party. See Brasseler, U.S.A. I, L.P. v. Stryker Sales Corp., 267 F.3d 1370, 1380 (Fed. Cir. 2001); and see Christopher A. Cotropia, *Modernizing Patent Law's Inequitable Conduct Doctrine*, 24 BERKELEY TECH.L.J. 723 (2009).

3. *Attorney-Client Privilege*. In this case, both EON-Net and its counsel destroyed documents relevant to litigation, a clear violation of both discovery and ethics rules. However, whether or not attorney-client communication is privileged is a very common discovery issue in patent infringement litigation. Why might you think this is such a common occurrence? Whatever the reason may be, when faced with this issue, the court has the challenge of balancing the need for discovery against the policy "encourag[ing] full and frank communication between attorneys and their clients and thereby promote broader public interest in the observance of law and administration of justice." *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981).

Additionally, what if you client *tells* you information that may call into question the validity of their patent? Is that communication protected or will you be obligated to disclose the information to opposing counsel? Additionally, what if the patent holder discloses that he did in fact engage in fraudulent conduct in his dealings with the Patent and Trademark Office. Would your answer change if he initially acted fraudulently but has since stopped? What if he stopped his conduct but the impact of his actions is still occurring? On how lawyers respond to these and related issues, see William T. Gallagher, *IP Legal Ethics in the Everyday Practice of Law: an Empirical Perspective on Patent Litigators*, 10 JOHN MARSHALL REV. INTEL.PROP.L. 309 (2011).

RAMBUS, INC. v.. FEDERAL TRADE COMMISSION

522 F.3d 456 (D.C.Cir. 2008)

WILLIAMS, Senior Circuit Judge:

Rambus Inc. develops computer memory technologies, secures intellectual property rights over them, and then licenses them to manufacturers in exchange for royalty payments. In 1990, Rambus's founders filed a patent application claiming the invention of a faster architecture for dynamic random access memory ("DRAM"). In recent years, Rambus has asserted that patents issued to protect its invention cover four technologies that a private standard-setting organization ("SSO") included in DRAM industry standards.

Before an SSO adopts a standard, there is often vigorous competition among different technologies for incorporation into that standard. After standardization, however, the dynamic typically shifts, as industry members begin adhering to the standard and the standardized features start to dominate. In this case, 90% of DRAM production is compliant with the standards at issue, and therefore the technologies adopted in those standards-including those over which Rambus claims patent rights-enjoy a similar level of dominance over their alternatives.

After lengthy proceedings, the Federal Trade Commission determined that Rambus, while participating in the standard-setting process, deceptively failed to disclose to the SSO the patent interests it held in four technologies that were standardized. Those interests ranged from issued patents, to pending patent applications, to plans to amend those patent applications to add new claims; Rambus's patent rights in all these interests are said to be sufficiently connected to the invention described in Rambus's original 1990 application that its rights would relate back to its date.

Rambus petitions for review. We grant the petition, holding that the Commission failed to sustain its allegation of monopolization. Its factual conclusion was that Rambus's alleged deception enabled it *either* to acquire a monopoly through the standardization of its patented technologies rather than possible alternatives, *or* to avoid limits on its patent licensing fees that the SSO would have imposed as part of its normal process of standardizing patented technologies. But the latter-deceit merely enabling a monopolist to charge higher prices than it otherwise could have charged-would not in

itself constitute monopolization. We also address whether there is substantial evidence that Rambus engaged in deceptive conduct at all, and express our serious concerns about the sufficiency of the evidence on two particular points.

* * *

During the early 1990s, the computer hardware industry faced a "memory bottleneck": the development of faster memory lagged behind the development of faster central processing units, and this risked limiting future gains in overall computer performance. To address this problem, Michael Farmwald and Mark Horowitz began collaborating during the late 1980s and invented a higher-performance DRAM architecture. Together, they founded Rambus in March 1990 and filed Patent Application No. 07/510,898 ("the ′898 application") on April 18, 1990.

As originally filed, the ′898 application included a 62-page written description of Farmwald and Horowitz's invention, 150 claims, and 15 technical drawings. Under the direction of the Patent Office, acting pursuant to 35 U.S.C. § 121, Rambus effectively split the application into several (the original one and 10 " divisionals"). Thereafter, Rambus amended some of these applications and filed additional continuation and divisional applications.

While Rambus was developing a patent portfolio based on its founders' inventions, the computer memory industry was at work standardizing DRAM technologies. The locus of those efforts was the Joint Electron Device Engineering Council ("JEDEC")-then an "activity" of what is now called the Electronics Industries Alliance ("EIA") and, since 2000, a trade association affiliated with EIA and known as the JEDEC Solid State Technology Association. Any company involved in the solid state products industry could join JEDEC by submitting an application and paying annual dues, and members could receive JEDEC mailings, participate in JEDEC committees, and vote on pending matters.

One JEDEC committee, JC 42.3, developed standards for computer memory products. Rambus attended its first JC 42.3 meeting as a guest in December 1991 and began formally participating when it joined JEDEC in February 1992. At the time, JC 42.3 was at work on what became JEDEC's synchronous DRAM ("SDRAM") standard. The committee voted to approve the completed standard in March 1993, and JEDEC's governing body gave its final approval on May 24, 1993. The

SDRAM standard includes two of the four technologies over which Rambus asserts patent rights-programmable CAS latency and programmable burst length.

Despite SDRAM's standardization, its manufacture increased very slowly and asynchronous DRAM continued to dominate the computer memory market, so JC 42.3 began to consider a number of possible responses-among them specifications it could include in a next-generation SDRAM standard. As part of that process, JC 42.3 members received a survey ballot in October 1995 soliciting their opinions on features of an advanced SDRAM-which ultimately emerged as the double data rate ("DDR") SDRAM standard. Among the features voted on were the other two technologies at issue here: on-chip phase lock and delay lock loops ("on-chip PLL/DLL") and dual-edge clocking. The Committee tallied and discussed the survey results at its December 1995 meeting, which was Rambus's last as a JEDEC member. Rambus formally withdrew from JEDEC by letter dated June 17, 1996, saying (among other things) that the terms on which it proposed to license its proprietary technology "may not be consistent with the terms set by standards bodies, including JEDEC." Complaint Counsel's Exhibit ("CX") 887.

JC 42.3's work continued after Rambus's departure. In March 1998 the committee adopted the DDR SDRAM standard, and the JEDEC Board of Directors approved it in 1999. This standard retained SDRAM features including programmable CAS latency and programmable burst length, and it added on-chip PLL/DLL and dual-edge clocking; DDR SDRAM, therefore, included all four of the technologies at issue here.

Starting in 1999, Rambus informed major DRAM and chipset manufacturers that it held patent rights over technologies included in JEDEC's SDRAM and DDR SDRAM standards, and that the continued manufacture, sale, or use of products compliant with those standards infringed its rights. It invited the manufacturers to resolve the alleged infringement through licensing negotiations. A number of manufacturers agreed to licenses, see Opinion of the Commission ("Liability Op."), *In re Rambus,* Docket No. 9302, at 48 n. 262 (July 31, 2006) (discussing cases); others did not, and litigation ensued, *see id.* at 17-21.

On June 18, 2002, the Federal Trade Commission filed a complaint under § 5(b) of the FTC Act, 15 U.S.C. § 45(b), charging that Rambus engaged in unfair methods of competition and unfair or deceptive acts or practices in

violation of the Act, *see id.* § 45(a). Specifically, the Commission alleged that Rambus breached JEDEC policies requiring it to disclose patent interests related to standardization efforts and that the disclosures it did make were misleading. By this deceptive conduct, it said, Rambus unlawfully monopolized four technology markets in which its patented technologies compete with alternative innovations to address technical issues relating to DRAM design-markets for latency, burst length, data acceleration, and clock synchronization technologies.

Proceedings began before an administrative law judge, who in due course dismissed the Complaint in its entirety. Initial Decision ("ALJ Op.") at 334 (Feb. 23, 2004). He concluded that Rambus did not impermissibly withhold material information about its intellectual property, *id.* at 260-86, and that, in any event, there was insufficient evidence that, if Rambus had disclosed all the information allegedly required of it, JEDEC would have standardized an alternative technology.

Complaint Counsel appealed the ALJ's Initial Decision to the Commission, which reopened the record to receive additional evidence and did its own plenary review. *See* Liability Op. at 17, 21. On July 31, 2006 the Commission vacated the ALJ's decision and set aside his findings of fact and conclusions of law. *Id.* at 21. The Commission found that while JEDEC's patent disclosure policies were "not a model of clarity," *id.* at 52, members expected one another to disclose patents and patent applications that were relevant to technologies being considered for standardization, *plus* (though the Commission was far less clear on these latter items) planned amendments to pending applications or "anything they're working on that they potentially wanted to protect with patents down the road," *id.* at 56; see generally *id.* at 51-59, 66. Based on this interpretation of JEDEC's disclosure requirements, the Commission held that Rambus willfully and intentionally engaged in misrepresentations, omissions, and other practices that misled JEDEC members about intellectual property information "highly material" to the standard-setting process. *Id.* at 68; see also *id.* at 37-48 (outlining Rambus's "Chronology of Concealment").

The Commission focused entirely on the allegation of monopolization. In particular, the Commission held that the evidence and inferences from Rambus's purpose demonstrated that "but for Rambus's deceptive course of conduct, JEDEC either would have excluded Rambus's patented technologies from the JEDEC DRAM standards, or would have demanded

RAND assurances [*i.e.*,assurances of 'reasonable and nondiscriminatory' license fees], with an opportunity for *ex ante* licensing negotiations." *Id.* at 74; see also *id.* at 77, 118-19. Rejecting Rambus's argument that factors other than JEDEC's standards allowed Rambus's technologies to dominate their respective markets, *id.* at 79-96, the Commission concluded that Rambus's deception of JEDEC "significantly contributed to its acquisition of monopoly power," *id.* at 118.

After additional briefing by the parties, see *id.* at 119-20, the Commission rendered a separate remedial opinion and final order. It held that it had the authority in principle to order compulsory licensing, but that remedies beyond injunctions against future anticompetitive conduct would require stronger proof that they were necessary to restore competitive conditions. Remedy Op. at 2-11. Applying that more demanding burden to Complaint Counsel's claims for relief, the Commission refused to compel Rambus to license its relevant patents royalty-free because there was insufficient evidence that "absent Rambus's deception" JEDEC would have standardized non-proprietary technologies instead of Rambus's; thus, Complaint Counsel had failed to show that such a remedy was "necessary to restore competition that would have existed in the 'but for' world." *Id.* at 12; see also *id.* at 13, 16. Instead, the Commission decided to compel licensing at "reasonable royalty rates," which it calculated based on what it believed would have resulted from negotiations between Rambus and manufacturers before JEDEC committed to the standards. *Id.* at 16-25. The Commission's order limits Rambus's royalties for three years to 0.25% for JEDEC-compliant SDRAM and 0.5% for JEDEC-compliant DDR SDRAM (with double those royalties for certain JEDEC-compliant, non-DRAM products); after those three years, it forbids any royalty collection….

Rambus challenges the Commission's determination that it engaged in unlawful monopolization-and thereby violated § 5 of the FTC Act-on a variety of grounds, of which two are most prominent. First, it argues that the Commission erred in finding that it violated any JEDEC patent disclosure rules and thus that it breached any antitrust duty to provide information to its rivals. Second, it asserts that even if its nondisclosure contravened JEDEC's policies, the Commission found the consequences of such nondisclosure only in the alternative: that it prevented JEDEC *either* from adopting a non-proprietary standard, *or* from extracting a RAND commitment from Rambus when standardizing its technology. As the latter would not involve an antitrust violation, says Rambus, there is an insufficient basis for liability.

We find the second of these arguments to be persuasive, and conclude that the Commission failed to demonstrate that Rambus's conduct was exclusionary under settled principles of antitrust law. Given that conclusion, we need not dwell very long on the substantiality of the evidence, which we address only to express our serious concerns about the breadth the Commission ascribed to JEDEC's disclosure policies and their relation to what Rambus did or did not disclose.

* * *

In this case under § 5 of the FTC Act, the Commission expressly limited its theory of liability to Rambus's unlawful monopolization of four markets in violation of § 2 of the Sherman Act, 15 U.S.C. § 2. *See* Liability Op. at 27 n. 124; *see also FTC v. Cement Inst.*, 333 U.S. 683 (1948) (§ 5 reaches all conduct that violates § 2 of the Sherman Act). Therefore, we apply principles of antitrust law developed under the Sherman Act, and we review the Commission's construction and application of the antitrust laws *de novo*.

It is settled law that the mere existence of a monopoly does not violate the Sherman Act. *See Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004); *United States v. Microsoft Corp.*, 253 F.3d 34, 58 (D.C.Cir.2001) (en banc) (*per curiam*). In addition to "the possession of monopoly power in the relevant market," the offense of monopolization requires " 'the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historical accident.' " *Trinko*, 540 U.S. at 407 (quoting *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966)); *Microsoft*, 253 F.3d at 50 (same). In this case, Rambus does not dispute the nature of the relevant markets or that its patent rights in the four relevant technologies give it monopoly power in each of those markets. The critical question is whether Rambus engaged in exclusionary conduct, and thereby acquired its monopoly power in the relevant markets unlawfully.

To answer that question, we adhere to two antitrust principles that guided us in *Microsoft*. First, "to be condemned as exclusionary, a monopolist's act must have 'anticompetitive effect.' That is, it must harm the competitive *process* and thereby harm consumers. In contrast, harm to one or more *competitors* will not suffice."

The Commission held that Rambus engaged in exclusionary conduct consisting of misrepresentations, omissions, and other practices that

deceived JEDEC about the nature and scope of its patent interests while the organization standardized technologies covered by those interests. Had Rambus fully disclosed its intellectual property, "JEDEC either would have excluded Rambus's patented technologies from the JEDEC DRAM standards, or would have demanded RAND assurances, with an opportunity for *ex ante* licensing negotiations." But the Commission did not determine that one or the other of these two possible outcomes was the more likely. The Commission's conclusion that Rambus's conduct was exclusionary depends, therefore, on a syllogism: Rambus avoided one of two outcomes by not disclosing its patent interests; the avoidance of either of those outcomes was anticompetitive; therefore Rambus's nondisclosure was anticompetitive.

We assume without deciding that avoidance of the first of these possible outcomes was indeed anticompetitive; that is, that if Rambus's more complete disclosure would have caused JEDEC to adopt a different (open, non-proprietary) standard, then its failure to disclose harmed competition and would support a monopolization claim. But while we can assume that Rambus's nondisclosure made the adoption of its technologies somewhat more likely than broad disclosure would have, the Commission made clear in its remedial opinion that there was insufficient evidence that JEDEC would have standardized other technologies had it known the full scope of Rambus's intellectual property. *See* Remedy Op. 12. Therefore, for the Commission's syllogism to survive-and for the Commission to have carried its burden of proving that Rambus's conduct had an anticompetitive effect-we must also be convinced that if Rambus's conduct merely enabled it to avoid the other possible outcome, namely JEDEC's obtaining assurances from Rambus of RAND licensing terms, such conduct, alone, could be said to harm competition.

Deceptive conduct-like any other kind-must have an anticompetitive effect in order to form the basis of a monopolization claim. "Even an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws," without proof of "a dangerous probability that [the defendant] would monopolize a particular market." *Brooke Group*, 509 U.S. at 225. Even if deception raises the price secured by a seller, but does so without harming competition, it is beyond the antitrust laws' reach. Cases that recognize deception as exclusionary hinge, therefore, on whether the conduct impaired rivals in a manner tending to bring about or protect a defendant's monopoly power. In *Microsoft*, for example, we found Microsoft engaged in anticompetitive

conduct when it tricked independent software developers into believing that its software development tools could be used to design cross-platform Java applications when, in fact, they produced Windows-specific ones. The deceit had caused "developers who were opting for portability over performance ... unwittingly [to write] Java applications that [ran] only on Windows." 253 F.3d at 76. The focus of our antitrust scrutiny, therefore, was properly placed on the resulting harms to competition rather than the deception itself….

But an otherwise lawful monopolist's use of deception simply to obtain higher prices normally has no particular tendency to exclude rivals and thus to diminish competition. Consider, for example, *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128 (1998), in which the Court addressed the antitrust implications of allegations that NYNEX's subsidiary, New York Telephone Company, a lawful monopoly provider of local telephone services, charged its customers higher prices as result of fraudulent conduct in the market for the service of removing outdated telephone switching equipment (called "removal services"). Discon had alleged that New York Telephone (through its corporate affiliate, Materiel Enterprises) switched its purchases of removal services from Discon to a higher-priced independent firm (AT & T Technologies). Materiel Enterprises would pass the higher fees on to New York Telephone, which in turn passed them on to customers through higher rates approved by regulators. The nub of the deception, Discon alleged, was that AT & T Technologies would provide Materiel Enterprises with a special rebate at year's end, which it would then share with NYNEX. *Id.* By thus hoodwinking the regulators, the scam raised prices for consumers; Discon, which refused to play the rebate game, was driven out of business. Discon alleged that this arrangement was anticompetitive and constituted both an agreement in restraint of trade in violation of § 1 of the Sherman Act and a conspiracy to monopolize the market for removal services in violation of § 2.

As to Discon's § 1 claim, the Court held that where a single buyer favors one supplier over another for an improper reason, the plaintiff must "allege and prove harm, not just to a single competitor, but to the competitive process." *Id.* at 135; see generally *id.* at 133-37. Nor, as Justice Breyer wrote for a unanimous Court, would harm to the consumers in the form of higher prices change the matter: "We concede Discon's claim that the [defendants'] behavior hurt consumers by raising telephone service rates. But that consumer injury naturally flowed not so much from a less competitive market for removal services, as from the exercise of market

power that is *lawfully* in the hands of a monopolist, namely, New York Telephone, combined with a deception worked upon the regulatory agency that prevented the agency from controlling New York Telephone's exercise of its monopoly power." *Id.* at 136.

Because Discon based its § 2 claim on the very same allegations of fraud, the Court vacated the appellate court's decision to uphold that claim because "[u]nless those agreements harmed the competitive process, they did not amount to a conspiracy to monopolize." ….

While the Commission's brief doesn't mention *NYNEX*, much less try to distinguish it, it does cite *Broadcom Corp. v. Qualcomm Inc.*,501 F.3d 297 (3d Cir. 2007), which in turn had cited the Commission's own "landmark" decision in the case under review here, *Id.* at 311.There the court held that a patent holder's intentionally false promise to a standard-setting organization that it would license its technology on RAND terms, "coupled with [the organization's] reliance on that promise when including the technology in a standard," was anticompetitive conduct, on the ground that it increased "the likelihood that patent rights will confer monopoly power on the patent holder." *Id.* at 314; accord *id.* at 315-16. To the extent that the ruling (which simply reversed a grant of dismissal) rested on the argument that deceit lured the SSO away from non-proprietary technology, see *id.*, it cannot help the Commission in view of its inability to find that Rambus's behavior caused JEDEC's choice; to the extent that it may have rested on a supposition that there is a cognizable violation of the Sherman Act when a lawful monopolist's deceit has the effect of raising prices (without an effect on competitive structure), it conflicts with *NYNEX*.

Here, the Commission expressly left open the likelihood that JEDEC would have standardized Rambus's technologies *even if Rambus had disclosed* its intellectual property. Under this hypothesis, JEDEC lost only an opportunity to secure a RAND commitment from Rambus. But loss of such a commitment is not a harm to competition from alternative technologies in the relevant markets. *See* 2 Hovenkamp et al., IP & Antitrust § 35.5 at 35-45 (Supp. 2008) [hereinafter "IP & Antitrust"] ("[A]n antitrust plaintiff must establish that the standard-setting organization would not have adopted the standard in question but for the misrepresentation or omission."). Indeed, had JEDEC limited Rambus to reasonable royalties and required it to provide licenses on a nondiscriminatory basis, we would expect *less* competition from alternative technologies, not more; high prices and constrained output tend to attract

competitors, not to repel them.

Scholars in the field have urged that if nondisclosure to an SSO enables a participant to obtain higher royalties than would otherwise have been attainable, the "overcharge can properly constitute competitive harm attributable to the nondisclosure," as the overcharge "will distort competition in the downstream market." 2 Hovenkamp, et al., IP & Antitrust § 35.5 at 35-47. The contention that price-raising deception has downstream effects is surely correct, but that consequence was equally surely true in *NYNEX* (though perhaps on a smaller scale) and equally obvious to the Court. The Commission makes the related contention that because the ability to profitably restrict output and set supracompetitive prices is the *sine qua non* of monopoly power, any conduct that permits a monopolist to avoid constraints on the exercise of that power must be anticompetitive. But again, as in *NYNEX*, an otherwise lawful monopolist's end-run around price constraints, even when deceptive or fraudulent, does not alone present a harm to competition in the monopolized market.

Thus, if JEDEC, in the world that would have existed but for Rambus's deception, would have standardized the very same technologies, Rambus's alleged deception cannot be said to have had an effect on competition in violation of the antitrust laws; JEDEC's loss of an opportunity to seek favorable licensing terms is not as such an antitrust harm. Yet the Commission did not reject this as being a possible-perhaps even the more probable-effect of Rambus's conduct. We hold, therefore, that the Commission failed to demonstrate that Rambus's conduct was exclusionary, and thus to establish its claim that Rambus unlawfully monopolized the relevant markets.

* * *

Our conclusion that the Commission failed to demonstrate that Rambus inflicted any harm on competition requires vacatur of the Commission's orders. But the original complaint also included a count charging Rambus with other unfair methods of competition in violation of § 5(a) of the FTC Act. While the Commission dropped this aspect of its case and focused on a theory of liability premised on unlawful monopolization, *see* Liability Op. at 27 n. 124, at least one Commissioner suggested that a "stand-alone" § 5 action would have had a "broader province" than a Sherman Act case. *See* Concurring Opinion of Commissioner Jon Leibowitz at 18, 21, Docket No. 9302 (Jul. 31, 2006). Because of the chance of further proceedings on remand, we express briefly our serious concerns about strength of the

evidence relied on to support some of the Commission's crucial findings regarding the scope of JEDEC's patent disclosure policies and Rambus's alleged violation of those policies.

In noting our concerns, we recognize, of course, that the Commission's findings are conclusive so long as they are supported by substantial evidence. *See* 15 U.S.C. § 45(c); *see also Polygram Holding,* 416 F.3d at 33. The Commission's findings are murky on both the relevant margins: what JEDEC's disclosure policies were, and what, within those mandates, Rambus failed to disclose.

First, the Commission evidently could find that Rambus violated JEDEC's disclosure policies only by relying quite significantly on participants' having been obliged to disclose their work in progress on *potential* amendments to pending applications, as that work became pertinent. The Commission's counsel confirmed as much at oral argument. Transcript of Oral Argument at 37-38. Indeed, the parties stipulated that as of Rambus's last JEDEC meeting it held no patents that were essential to the manufacture or use of devices complying with any JEDEC standard, and that when JEDEC issued the SDRAM standard Rambus had no pending patent claims that would necessarily have been infringed by a device compliant with that standard.

The case *appears* (and we emphasize *appears,* as the Commission's opinion leaves us uncertain of its real view) to turn on the idea that JEDEC participants were obliged to disclose not merely relevant patents and patent applications, but also their work in progress on amendments to pending applications that included new patent claims. We do not see in the record any formal finding that the policies were so broad, but the Commission's opinion points to testimony of witnesses that might be the basis of such a finding. Five former JC 42.3 participants testified (in some cases ambiguously) that they understood JEDEC's written policies, requiring the disclosure of *pending* applications, to also include a duty to disclose work in progress on *unfiled* amendments to those applications, and JEDEC's general counsel testified that he believed a firm was required to disclose *plans* to amend if supported by the firm's current interpretation of an extant application. JEDEC participants did not have unanimous recollections on this point, however, and the Commission noted that another JC 42.3 member testified that there was no duty to disclose work on future filings.

Reading these statements as interpretations of JEDEC's written policies seems to significantly stretch the policies' language. The most disclosure-friendly of those policies is JEDEC Manual No. 21-I, published in October 1993, which refers to "the obligation of all participants to inform the meeting of any knowledge they may have of any patents, or pending patents, that might be involved in the work they are undertaking." CX 208 at 19; see also *id.* at 19 ("For the purpose of this policy, the word 'patented' also includes items and processes for which a patent has been applied and may be pending."), 27 (referring to "technical information covered by [a] patent or pending patent"). This language speaks fairly clearly of disclosure obligations related to patents and pending patent applications, but says nothing of unfiled work in progress on potential amendments to patent applications. We don't see how a few strands of trial testimony would persuade the Commission to read this language more broadly, especially as at least two of the five participants cited merely stated that disclosure obligations reached anything in the patent "process"-which leaves open the question of when that "process" can be said to begin. *See* Joint Appendix 1908-09 (testimony of Desi Rhoden); *id.* at 2038 (testimony of Brett Williams).

Alternatively, to the extent the Commission reads this testimony not to broaden the interpretation of Manual 21-I, but rather to provide evidence of disclosure expectations that extended beyond those incorporated into written policies, a different problem may arise. As the Federal Circuit has said, JEDEC's patent disclosure policies suffered from "a staggering lack of defining details." *Rambus Inc. v. Infineon Technologies AG,* 318 F.3d 1081, 1102 (Fed.Cir.2003); *see also* Liability Op. at 52 (stating that the record shows that JEDEC's patent policies "are not a model of clarity"). Even assuming that any evidence of unwritten disclosure expectations would survive a possible narrowing effect based upon the written directive of Manual 21-I, the vagueness of any such expectations would nonetheless remain an obstacle. One would expect that disclosure expectations ostensibly requiring competitors to share information that they would otherwise vigorously protect as trade secrets would provide "clear guidance" and "define clearly what, when, how, and to whom the members must disclose." *Infineon,* 318 F.3d at 1102. This need for clarity seems especially acute where disclosure of those trade secrets itself implicates antitrust concerns; JEDEC involved, after all, collaboration by *competitors.* Cf. *Allied Tube & Conduit Corp. v. Indian Head, Inc.,* 486 U.S. 492, 500 (1988) (stating that because SSO members have incentives to restrain competition, such organizations "have traditionally been objects

of antitrust scrutiny"); *Am Soc'y of Mech. Eng'rs v. Hydrolevel Corp.*, 456 U.S. 556, 571 (1982) (noting that SSOs are "rife with opportunities for anticompetitive activity"). In any event, the more vague and muddled a particular expectation of disclosure, the more difficult it should be for the Commission to ascribe competitive harm to its breach. *See* 2 IP & Antitrust § 35.5 at 35-51 ("[A]lthough antitrust can serve as a useful check on abuses of the standard-setting process, it cannot substitute for a general enforcement regime for disclosure rules.").

The Commission's conclusion that Rambus engaged in deceptive conduct affecting the inclusion of on-chip PLL/DLL and dual-edge clocking in the DDR SDRAM standard, which JEDEC adopted more than two years after Rambus's last JC 42.3 meeting, presents an additional, independent concern. To support this conclusion, the Commission looked to a technical presentation made to JC 42.3 in September 1994, and the survey balloting of that committee in October 1995 on whether to proceed with the consideration of particular features (including the two Rambus technologies ultimately adopted), finding that Rambus deliberately failed to disclose patent interests in any of the named technologies. Liability Op. 42-44. This finding is evidently the basis, so far as DDR SDRAM is concerned, of its conclusion that Rambus breached a duty to disclose.

Once again, the Commission has taken an aggressive interpretation of rather weak evidence. For example, the October 1995 survey ballot gauged participant interest in a range of technologies and did not ask those surveyed about their intellectual property (as did the more formal ballots on proposed standards). *See* CX 260. The Commission nonetheless believes that every member of JC 42.3-membership that included most of the DRAM industry-was duty-bound to disclose *any* potential patents they were working on that related to *any* of the questions posed by the survey. The record shows, however, that the only company that made a disclosure at the next meeting was the one that formally presented the survey results. *See* Liability Op. at 44-45; ALJ Op. at 58 ¶ 401 (citing Joint Exhibit 28, at 6). For reasons similar to those that make vague but broad disclosure obligations among competitors unlikely, it seems to us unlikely that JEDEC participants placed themselves under such a sweeping and early duty to disclose, triggered by the mere chance that a technology might someday (in this case, more than two years later) be formally proposed for standardization.

* * *

We set aside the Commission's orders and remand for further proceedings consistent with this opinion.

NOTES AND QUESTIONS

1. Other aspects of the standard setting process are covered in Chapter Nine.

2. *Spoliation and the Duty to Preserve*. As noted earlier, Rambus did not initially file its patent application with claims explicitly directed at SDRAM, however, after Rambus decide to leave JEDEC, it amended its claims to cover the SDRAM technology adopted as the standard by JEDEC. As one may be able to assume, the patents stemming from the original application and its amendments have been the subjects of numerous suits. Recently, the Federal Circuit issued opinions addressing Rambus's alleged spoliation of relevant evidence for patents claiming priority to the 07/510,898 application. Prior the Federal Circuits decision, the District of Delaware and the Northern District of Califorina courts issued two inconsistent opinions regarding Rambus's duty to preserve evidence. *See Micoron Technology, Inc. v. Rambus Inc.*, 645 F.3d 1311 (Fed. Cir. 2011) and *Hynix Semiconductor Inc. v. Rambus Inc*., 645 F.2d 1336 (Fed. Cir. 2011).

The facts of both cases uncovered that Rambus established a document retention policy as an integral part its litigation strategy against probable infringers of its patents in April of 1998. *Micron*, 645 F.3d at 1316-18. Additionally, throughout the year, Rambus destroyed email backup tapes and in September it held its first "Shed Day," destroying 400 boxes of documents. *Id.* at 18. In June 1999, the first patent suit was filed.

In *Micron*, a Delaware court had held that Rambus committed intentional spoliation and declared several of its patents unenforceable. *Micron*, 645 F.3d at 1322. In *Hynix*, a California court concluded that Rambus destroyed documents before the duty to preserve, thus no spoliation had occurred. *Hynix*, 645 F.3d at 1347.

The Federal Circuit affirmed the Delaware's court's spoliation findings, while reversing and remanding for a remedy. But the court reversed the California court's decision, remanding for reconsideration of the spoliation issue. In its opinion, the Federal Circuit declared that whether litigation is reasonably foreseeable and thus triggers a duty to preserve is an "objective standard, asking not whether the party in fact reasonably foresaw litigation,

but whether a reasonable party in the same factual circumstances would have reasonably foreseen litigation." *Micron*, 645 F.3d at 1320-21. The Federal Circuit then went on to explain that the reasonably foreseeable test is "a flexible fact-specific standard," and does not trigger the duty to preserve when litigation is merely possible or "from the mere existence of a potential claim." Additionally, the court rejected the standard that litigation be "imminent, or probable without significant contingencies." *Hynix,* 645 F.3d at 1345.

The Federal Circuit made clear that there is a duty to preserve relevant evidence but what exactly does "relevant" entail? Rule 26(b)(1) of the Federal Rules of Civil Procedure define the scope of discovery as "any nonprivileged matter that is relevant to any party's claim or defense - including the existence, description, nature, custody, condition, and location of any documents or other tangible things and the identity and location of persons who know of any discoverable matter." Fed. R. Civ. P. 26(b)(1). Additionally, the Federal Circuit has held that "relevance" under Rule 26(b)(1) "is construed more broadly for discovery that for trial[,]" and that in most instances, the trial court should err on side of permitting discovery. *Truswal Sys. Corp. v. Hydro-Air Eng'g*, 813 F.2d 1207, 1211-12 (Fed. Cir. 1987).

Considering the definitions provided by the Federal Rules of Civil Procedure and the Federal Circuit, what impact do you think a *Walker Process* or sham litigation claim will have on discovery?

PHARMACEUTICAL PATENT SETTLEMENTS AND "PAY FOR DELAY"

FEDERAL TRADE COMMISSION v. ACTAVIS, INC.
133 S.Ct. 2223 (2013)

BREYER, J., delivered the opinion of the Court, in which KENNEDY, GINSBURG, SOTOMAYOR, and KAGAN, JJ., joined. ROBERTS, C.J., filed a dissenting opinion, in which SCALIA and THOMAS, JJ., joined. ALITO, J., took no part in the consideration or decision of the case.

Justice BREYER delivered the opinion of the Court.

Company A sues Company B for patent infringement. The two companies settle under terms that require (1) Company B, the claimed

infringer, not to produce the patented product until the patent's term expires, and (2) Company A, the patentee, to pay B many millions of dollars. Because the settlement requires the patentee to pay the alleged infringer, rather than the other way around, this kind of settlement agreement is often called a "reverse payment" settlement agreement. And the basic question here is whether such an agreement can sometimes unreasonably diminish competition in violation of the antitrust laws....

In this case, the Eleventh Circuit dismissed a Federal Trade Commission (FTC) complaint claiming that a particular reverse payment settlement agreement violated the antitrust laws. In doing so, the Circuit stated that a reverse payment settlement agreement generally is "immune from antitrust attack so long as its anticompetitive effects fall within the scope of the exclusionary potential of the patent." And since the alleged infringer's promise not to enter the patentee's market expired before the patent's term ended, the Circuit found the agreement legal and dismissed the FTC complaint. In our view, however, reverse payment settlements such as the agreement alleged in the complaint before us can sometimes violate the antitrust laws. We consequently hold that the Eleventh Circuit should have allowed the FTC's lawsuit to proceed.

I

A

Apparently most if not all reverse payment settlement agreements arise in the context of pharmaceutical drug regulation, and specifically in the context of suits brought under statutory provisions allowing a generic drug manufacturer (seeking speedy marketing approval) to challenge the validity of a patent owned by an already-approved brand-name drug owner. See Brief for Petitioner 29; 12 P. Areeda & H. Hovenkamp, Antitrust Law ¶ 2046, p. 338 (3d ed. 2012) (hereinafter Areeda); Hovenkamp, Sensible Antitrust Rules for Pharmaceutical Competition, 39 U.S.F.L.Rev. 11, 24 (2004). We consequently describe four key features of the relevant drug-regulatory framework established by the Drug Price Competition and Patent Term Restoration Act of 1984, 98 Stat. 1585, as amended. That Act is commonly known as the Hatch–Waxman Act.

First, a drug manufacturer, wishing to market a new prescription drug, must submit a New Drug Application to the federal Food and Drug Administration (FDA) and undergo a long, comprehensive, and costly testing process, after which, if successful, the manufacturer will receive marketing approval from the FDA. See 21 U.S.C. § 355(b)(1) (requiring,

among other things, "full reports of investigations" into safety and effectiveness; "a full list of the articles used as components"; and a "full description" of how the drug is manufactured, processed, and packed).

Second, once the FDA has approved a brand-name drug for marketing, a manufacturer of a generic drug can obtain similar marketing approval through use of abbreviated procedures. The Hatch–Waxman Act permits a generic manufacturer to file an Abbreviated New Drug Application specifying that the generic has the "same active ingredients as," and is "biologically equivalent" to, the already-approved brand-name drug.... In this way the generic manufacturer can obtain approval while avoiding the "costly and time-consuming studies" needed to obtain approval "for a pioneer drug."... The Hatch–Waxman process, by allowing the generic to piggy-back on the pioneer's approval efforts, "speed[s] the introduction of low-cost generic drugs to market," thereby furthering drug competition.

Third, the Hatch–Waxman Act sets forth special procedures for identifying, and resolving, related patent disputes. It requires the pioneer brand-name manufacturer to list in its New Drug Application the "number and the expiration date" of any relevant patent. See 21 U.S.C. § 355(b)(1). And it requires the generic manufacturer in its Abbreviated New Drug Application to "assure the FDA" that the generic "will not infringe" the brand-name's patents....

[The generic] can certify that any relevant patents have expired. It can request approval to market beginning when any still-in-force patents expire. Or, it can certify that any listed, relevant patent "is invalid or will not be infringed by the manufacture, use, or sale" of the drug described in the Abbreviated New Drug Application. Taking this last-mentioned route (called the "paragraph IV" route), automatically counts as patent infringement... and often "means provoking litigation."..... If the brand-name patentee brings an infringement suit within 45 days, the FDA then must withhold approving the generic, usually for a 30–month period, while the parties litigate patent validity (or infringement) in court. If the courts decide the matter within that period, the FDA follows that determination; if they do not, the FDA may go forward and give approval to market the generic product. See 21 U.S.C. § 355(j)(5)(B)(iii).

Fourth, Hatch–Waxman provides a special incentive for a generic to be the first to file an Abbreviated New Drug Application taking the

paragraph IV route. That applicant will enjoy a period of 180 days of exclusivity (from the first commercial marketing of its drug). See § 355(j)(5)(B)(iv) (establishing exclusivity period). During that period of exclusivity no other generic can compete with the brand-name drug. If the first-to-file generic manufacturer can overcome any patent obstacle and bring the generic to market, this 180–day period of exclusivity can prove valuable, possibly "worth several hundred million dollars." Hemphill, Paying for Delay: Pharmaceutical Patent Settlement as a Regulatory Design Problem, 81 N.Y.U. L.Rev. 1553, 1579 (2006).... The 180–day exclusivity period, however, can belong only to the first generic to file. Should that first-to-file generic forfeit the exclusivity right in one of the ways specified by statute, no other generic can obtain it. See § 355(j)(5)(D).

B

1

In 1999, Solvay Pharmaceuticals, a respondent here, filed a New Drug Application for a brand-name drug called AndroGel. The FDA approved the application in 2000. In 2003, Solvay obtained a relevant patent and disclosed that fact to the FDA, 677 F.3d, at 1308, as Hatch–Waxman requires....

Later the same year another respondent, Actavis, Inc. (then known as Watson Pharmaceuticals), filed an Abbreviated New Drug Application for a generic drug modeled after AndroGel. Subsequently, Paddock Laboratories, also a respondent, separately filed an Abbreviated New Drug Application for its own generic product. Both Actavis and Paddock certified under paragraph IV that Solvay's listed patent was invalid and their drugs did not infringe it. A fourth manufacturer, Par Pharmaceutical, likewise a respondent, did not file an application of its own but joined forces with Paddock, agreeing to share the patent litigation costs in return for a share of profits if Paddock obtained approval for its generic drug.

Solvay initiated paragraph IV patent litigation against Actavis and Paddock. Thirty months later the FDA approved Actavis' first-to-file generic product, but, in 2006, the patent-litigation parties all settled. Under the terms of the settlement Actavis agreed that it would not bring its generic to market until August 31, 2015, 65 months before Solvay's patent expired (unless someone else marketed a generic sooner). Actavis also agreed to promote AndroGel to urologists. The other generic manufacturers made roughly similar promises. And Solvay agreed to pay millions of dollars to each generic—$12 million in total to Paddock; $60 million in total to Par;

and an estimated $19–$30 million annually, for nine years, to Actavis. See App. 46, 49–50, Complaint ¶¶ 66, 77. The companies described these payments as compensation for other services the generics promised to perform, but the FTC contends the other services had little value. According to the FTC the true point of the payments was to compensate the generics for agreeing not to compete against AndroGel until 2015. See id., at 50–53, Complaint ¶¶ 81–85.

2

On January 29, 2009, the FTC filed this lawsuit against all the settling parties, namely, Solvay, Actavis, Paddock, and Par. The FTC's complaint (as since amended) alleged that respondents violated § 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, by unlawfully agreeing "to share in Solvay's monopoly profits, abandon their patent challenges, and refrain from launching their low-cost generic products to compete with AndroGel for nine years." .. The District Court held that these allegations did not set forth an antitrust law violation....

The Court of Appeals for the Eleventh Circuit affirmed the District Court. It wrote that "absent 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." 677 F.3d, at 1312. The court recognized that "antitrust laws typically prohibit agreements where one company pays a potential competitor not to enter the market." See also Palmer, 498 U.S., at 50 (agreement to divide territorial markets held "unlawful on its face"). But, the court found that "reverse payment settlements of patent litigation presen[t] atypical cases because one of the parties owns a patent."... Patent holders have a "lawful right to exclude others from the market"; thus a patent "conveys the right to cripple competition." The court recognized that, if the parties to this sort of case do not settle, a court might declare the patent invalid. But, in light of the public policy favoring settlement of disputes (among other considerations) it held that the courts could not require the parties to continue to litigate in order to avoid antitrust liability.

The FTC sought certiorari. Because different courts have reached different conclusions about the application of the antitrust laws to Hatch–Waxman–related patent settlements, we granted the FTC's petition. Compare, e.g., id., at 1312 (case below) (settlements generally "immune from antitrust attack"); In re Ciprofloxacin Hydrochloride Antitrust Litigation, 544 F.3d 1323, 1332–1337 (C.A.Fed.2008) (similar); In re

Tamoxifen Citrate Antitrust Litigation, 466 F.3d 187, 212–213 (C.A.2 2006) (similar), with In re K–Dur Antitrust Litigation, 686 F.3d 197, 214–218 (C.A.3 2012) (settlements presumptively unlawful).

II
A

Solvay's patent, if valid and infringed, might have permitted it to charge drug prices sufficient to recoup the reverse settlement payments it agreed to make to its potential generic competitors. And we are willing to take this fact as evidence that the agreement's "anticompetitive effects fall within the scope of the exclusionary potential of the patent." But we do not agree that that fact, or characterization, can immunize the agreement from antitrust attack.

For one thing, to refer, as the Circuit referred, simply to what the holder of a valid patent could do does not by itself answer the antitrust question. The patent here may or may not be valid, and may or may not be infringed. "[A] valid patent excludes all except its owner from the use of the protected process or product," United States v. Line Material Co., 333 U.S. 287, 308 (1948). And that exclusion may permit the patent owner to charge a higher-than-competitive price for the patented product. But an invalidated patent carries with it no such right. And even a valid patent confers no right to exclude products or processes that do not actually infringe. The paragraph IV litigation in this case put the patent's validity at issue, as well as its actual preclusive scope. The parties' settlement ended that litigation. The FTC alleges that in substance, the plaintiff agreed to pay the defendants many millions of dollars to stay out of its market, even though the defendants did not have any claim that the plaintiff was liable to them for damages. That form of settlement is unusual. And, for reasons discussed in Part II–B, *infra*, there is reason for concern that settlements taking this form tend to have significant adverse effects on competition.

Given these factors, it would be incongruous to determine antitrust legality by measuring the settlement's anticompetitive effects solely against patent law policy, rather than by measuring them against procompetitive antitrust policies as well. And indeed, contrary to the Circuit's view that the only pertinent question is whether "the settlement agreement ... fall[s] within" the legitimate "scope" of the patent's "exclusionary potential," this Court has indicated that patent and antitrust policies are both relevant in determining the "scope of the patent monopoly"—and consequently

antitrust law immunity—that is conferred by a patent.

Thus, the Court in *Line Material* explained that "the improper use of [a patent] monopoly," is "invalid" under the antitrust laws and resolved the antitrust question in that case by seeking an accommodation "between the lawful restraint on trade of the patent monopoly and the illegal restraint prohibited broadly by the Sherman Act." To strike that balance, the Court asked questions such as whether "the patent statute specifically gives a right" to restrain competition in the manner challenged; and whether "competition is impeded to a greater degree" by the restraint at issue than other restraints previously approved as reasonable. See also United States v. United States Gypsum Co., 333 U.S. 364, 390–391 (1948) (courts must "balance the privileges of [the patent holder] and its licensees under the patent grants with the prohibitions of the Sherman Act against combinations and attempts to monopolize")... In short, rather than measure the length or amount of a restriction solely against the length of the patent's term or its earning potential, as the Court of Appeals apparently did here, this Court answered the antitrust question by considering traditional antitrust factors such as likely anticompetitive effects, redeeming virtues, market power, and potentially offsetting legal considerations present in the circumstances, such as here those related to patents. See Part II–B, infIra. Whether a particular restraint lies "beyond the limits of the patent monopoly" is a conclusion that flows from that analysis and not, as the Chief Justice suggests, its starting point. Post, at 2239, 2241 – 2242 (dissenting opinion).

For another thing, this Court's precedents make clear that patent-related settlement agreements can sometimes violate the antitrust laws. In United States v. Singer Mfg. Co., 374 U.S. 174 (1963), for example, two sewing machine companies possessed competing patent claims; a third company sought a patent under circumstances where doing so might lead to the disclosure of information that would invalidate the other two firms' patents. All three firms settled their patent-related disagreements while assigning the broadest claims to the firm best able to enforce the patent against yet other potential competitors. The Court did not examine whether, on the assumption that all three patents were valid, patent law would have allowed the patents' holders to do the same. Rather, emphasizing that the Sherman Act "imposes strict limitations on the concerted activities in which patent owners may lawfully engage," it held that the agreements, although settling patent disputes, violated the antitrust laws. And that, in important part, was because "the public interest in granting patent monopolies" exists only to the extent that "the public is given a novel and useful invention" in

"consideration for its grant." Id., at 199 (White, J., concurring). See also United States v. New Wrinkle, Inc., 342 U.S. 371, 378 (1952) (applying antitrust scrutiny to patent settlement); Standard Oil Co. (Indiana) v. United States, 283 U.S. 163 (1931) (same).

Similarly, both within the settlement context and without, the Court has struck down overly restrictive patent licensing agreements—irrespective of whether those agreements produced supra-patent-permitted revenues. We concede that in United States v. General Elec. Co., 272 U.S. 476, 489 (1926), the Court permitted a single patentee to grant to a single licensee a license containing a minimum resale price requirement. But in *Line Material*, *supra*, the Court held that the antitrust laws forbid a group of patentees, each owning one or more patents, to cross-license each other, and, in doing so, to insist that each licensee maintain retail prices set collectively by the patent holders. The Court was willing to presume that the single-patentee practice approved in General Electric was a "reasonable restraint" that "accords with the patent monopoly granted by the patent law," but declined to extend that conclusion to multiple-patentee agreements: "As the Sherman Act prohibits agreements to fix prices, any arrangement between patentees runs afoul of that prohibition and is outside the patent monopoly." In *New Wrinkle*, 342 U.S., at 378, the Court held roughly the same, this time in respect to a similar arrangement in settlement of a litigation between two patentees, each of which contended that its own patent gave it the exclusive right to control production. That one or the other company (we may presume) was right about its patent did not lead the Court to confer antitrust immunity. Far from it, the agreement was found to violate the Sherman Act.

Finally in Standard Oil Co. (Indiana), the Court upheld cross-licensing agreements among patentees that settled actual and impending patent litigation, 283 U.S., at 168, which agreements set royalty rates to be charged third parties for a license to practice all the patents at issue (and which divided resulting revenues). But, in doing so, Justice Brandeis, writing for the Court, warned that such an arrangement would have violated the Sherman Act had the patent holders thereby "dominate[d]" the industry and "curtail[ed] the manufacture and supply of an unpatented product." These cases do not simply ask whether a hypothetically valid patent's holder would be able to charge, e.g., the high prices that the challenged patent-related term allowed. Rather, they seek to accommodate patent and antitrust policies, finding challenged terms and conditions unlawful unless patent law policy offsets the antitrust law policy strongly favoring competition.

Thus, contrary to the dissent's suggestion, there is nothing novel about our approach. What does appear novel are the dissent's suggestions that a patent holder may simply "pa[y] a competitor to respect its patent" and quit its patent invalidity or noninfringement claim without any antitrust scrutiny whatever, and that "such settlements ... are a well-known feature of intellectual property litigation." Closer examination casts doubt on these claims. The dissent does not identify any patent statute that it understands to grant such a right to a patentee, whether expressly or by fair implication. It would be difficult to reconcile the proposed right with the patent-related policy of eliminating unwarranted patent grants so the public will not "continually be required to pay tribute to would-be monopolists without need or justification." Lear, Inc. v. Adkins, 395 U.S. 653, 670 (1969).

And the authorities cited for this proposition (none from this Court, and none an antitrust case) are not on point. Some of them say that when Company A sues Company B for patent infringement and demands, say, $100 million in damages, it is not uncommon for B (the defendant) to pay A (the plaintiff) some amount less than the full demand as part of the settlement—$40 million, for example. See Schildkraut, Patent–Splitting Settlements and the Reverse Payment Fallacy, 71 Antitrust L.J. 1033, 1046 (2004) (suggesting that this hypothetical settlement includes "an implicit net payment" from A to B of $60 million— i.e., the amount of the settlement discount). The cited authorities also indicate that if B has a counterclaim for damages against A, the original infringement plaintiff, A might end up paying B to settle B's counterclaim. Cf. Metro–Goldwyn Mayer, Inc. v. 007 Safety Prods., Inc., 183 F.3d 10, 13 (C.A.1 1999) (describing trademark dispute and settlement). Insofar as the dissent urges that settlements taking these commonplace forms have not been thought for that reason alone subject to antitrust liability, we agree, and do not intend to alter that understanding. But the dissent appears also to suggest that reverse payment settlements— e.g., in which A, the plaintiff, pays money to defendant B purely so B will give up the patent fight—should be viewed for antitrust purposes in the same light as these familiar settlement forms. See post, at 2231 – 2232. We cannot agree. In the traditional examples cited above, a party with a claim (or counterclaim) for damages receives a sum equal to or less than the value of its claim. In reverse payment settlements, in contrast, a party with no claim for damages (something that is usually true of a paragraph IV litigation defendant) walks away with money simply so it will stay away from the patentee's market. That, we think, is something quite different. Cf. Verizon Communications, Inc. v. Law Offices of Curtis V.

Trinko, LLP, 540 U.S. 398, 408 (2004) ("[C]ollusion" is "the supreme evil of antitrust").

Finally, the Hatch–Waxman Act itself does not embody a statutory policy that supports the Eleventh Circuit's view. Rather, the general procompetitive thrust of the statute, its specific provisions facilitating challenges to a patent's validity, see Part I–A, supra, and its later-added provisions requiring parties to a patent dispute triggered by a paragraph IV filing to report settlement terms to the FTC and the Antitrust Division of the Department of Justice, all suggest the contrary. Those interested in legislative history may also wish to examine the statements of individual Members of Congress condemning reverse payment settlements in advance of the 2003 amendments. See, e.g., 148 Cong. Rec. 14437 (2002) (remarks of Sen. Hatch) ("It was and is very clear that the [Hatch–Waxman Act] was not designed to allow deals between brand and generic companies to delay competition"); 146 Cong. Rec. 18774 (2000) (remarks of Rep. Waxman) (introducing bill to deter companies from "strik[ing] collusive agreements to trade multimillion dollar payoffs by the brand company for delays in the introduction of lower cost, generic alternatives").

B

The Eleventh Circuit's conclusion finds some degree of support in a general legal policy favoring the settlement of disputes. ... The Circuit's related underlying practical concern consists of its fear that antitrust scrutiny of a reverse payment agreement would require the parties to litigate the validity of the patent in order to demonstrate what would have happened to competition in the absence of the settlement. Any such litigation will prove time consuming, complex, and expensive. The antitrust game, the Circuit may believe, would not be worth that litigation candle.

We recognize the value of settlements and the patent litigation problem. But we nonetheless conclude that this patent-related factor should not determine the result here. Rather, five sets of considerations lead us to conclude that the FTC should have been given the opportunity to prove its antitrust claim.

First, the specific restraint at issue has the "potential for genuine adverse effects on competition." Indiana Federation of Dentists, 476 U.S., at 460–461 (citing 7 Areeda ¶ 1511, at 429 (1986)). The 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. Suppose, for example, that the exclusive right to sell produces $50 million in supracompetitive profits per year for the patentee. And suppose further that the patent has 10 more years to run. Continued litigation, if it results in patent invalidation or a finding of noninfringement, could cost the patentee $500 million in lost revenues, a sum that then would flow in large part to consumers in the form of lower prices.

We concede that settlement on terms permitting the patent challenger to enter the market before the patent expires would also bring about competition, again to the consumer's benefit. But settlement on the terms said by the FTC to be at issue here—payment in return for staying out of the market—simply keeps prices at patentee-set levels, potentially producing the full patent-related $500 million monopoly return while dividing that return between the challenged patentee and the patent challenger. The patentee and the challenger gain; the consumer loses. Indeed, there are indications that patentees sometimes pay a generic challenger a sum even larger than what the generic would gain in profits if it won the paragraph IV litigation and entered the market. See Hemphill, 81 N.Y.U. L.Rev., at 1581. See also Brief for 118 Law, Economics, and Business Professors et al. as Amici Curiae 25 (estimating that this is true of the settlement challenged here). The 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 claim with a share of its monopoly profits that would otherwise be lost in the competitive market.

But, one might ask, as a practical matter would the parties be able to enter into such an anticompetitive agreement? Would not a high reverse payment signal to other potential challengers that the patentee lacks confidence in its patent, thereby provoking additional challenges, perhaps too many for the patentee to "buy off?" Two special features of Hatch–Waxman mean that the answer to this question is "not necessarily so." First, under Hatch–Waxman only the first challenger gains the special advantage of 180 days of an exclusive right to sell a generic version of the brand-name product. See Part I–A, supra. And as noted, that right has proved valuable—indeed, it can be worth several hundred million dollars. See Hemphill, supra, at 1579; Brief for Petitioner 6. Subsequent challengers cannot secure that exclusivity period, and thus stand to win significantly less than the first if they bring a successful paragraph IV challenge. That is, if subsequent litigation results in invalidation of the patent, or a ruling that the patent is

not infringed, that litigation victory will free not just the challenger to compete, but all other potential competitors too (once they obtain FDA approval). The potential reward available to a subsequent challenger being significantly less, the patentee's payment to the initial challenger (in return for not pressing the patent challenge) will not necessarily provoke subsequent challenges. Second, a generic that files a paragraph IV after learning that the first filer has settled will (if sued by the brand-name) have to wait out a stay period of (roughly) 30 months before the FDA may approve its application, just as the first filer did. See 21 U.S.C. § 355(j)(5)(B)(iii). These features together mean that a reverse payment settlement with the first filer (or, as in this case, all of the initial filers) "removes from consideration the most motivated challenger, and the one closest to introducing competition." Hemphill, supra, at 1586. The dissent may doubt these provisions matter, post, at 2234 – 2236, but scholars in the field tell us that "where only one party owns a patent, it is virtually unheard of outside of pharmaceuticals for that party to pay an accused infringer to settle the lawsuit." 1 H. Hovenkamp, M. Janis, M. Lemley, & C. Leslie, IP and Antitrust § 15.3, p. 15–45, n. 161 (2d ed. Supp. 2011). It may well be that Hatch–Waxman's unique regulatory framework, including the special advantage that the 180–day exclusivity period gives to first filers, does much to explain why in this context, but not others, the patentee's ordinary incentives to resist paying off challengers (i.e., the fear of provoking myriad other challengers) appear to be more frequently overcome. See 12 Areeda ¶ 2046, at 341 (3d ed. 2010) (noting that these provisions, no doubt unintentionally, have created special incentives for collusion).

Second, these anticompetitive consequences will at least sometimes prove unjustified. See 7 id., ¶ 1504, at 410–415 (3d ed. 2010); California Dental Assn. v. FTC, 526 U.S. 756, 786–787 (1999) (Breyer, J., concurring in part and dissenting in part). As the FTC admits, offsetting or redeeming virtues are sometimes present. Brief for Petitioner 37–39. The reverse payment, for example, may amount to no more than a rough approximation of the litigation expenses saved through the settlement. That payment may reflect compensation for other services that the generic has promised to perform—such as distributing the patented item or helping to develop a market for that item. There may be other justifications. Where a reverse payment reflects traditional settlement considerations, such as avoided litigation costs or fair value for services, there is not the same concern that a patentee is using its monopoly profits to avoid the risk of patent invalidation or a finding of noninfringement. In such cases, the parties may have provided for a reverse payment without having sought or brought about the

anticompetitive consequences we mentioned above. But that possibility does not justify dismissing the FTC's complaint. An antitrust defendant may show in the antitrust proceeding that legitimate justifications are present, thereby explaining the presence of the challenged term and showing the lawfulness of that term under the rule of reason. See, e.g., Indiana Federation of Dentists, supra, at 459; 7 Areeda ¶¶ 1504a–1504b, at 401–404 (3d ed. 2010).

Third, where a reverse payment threatens to work unjustified anticompetitive harm, the patentee likely possesses the power to bring that harm about in practice. See id., ¶ 1503, at 392–393. At least, the "size of the payment from a branded drug manufacturer to a prospective generic is itself a strong indicator of power"—namely, the power to charge prices higher than the competitive level. 12 id., ¶ 2046, at 351. An important patent itself helps to assure such power. Neither is a firm without that power likely to pay "large sums" to induce "others to stay out of its market." Ibid. In any event, the Commission has referred to studies showing that reverse payment agreements are associated with the presence of higher-than-competitive profits—a strong indication of market power.

Fourth, an antitrust action is likely to prove more feasible administratively than the Eleventh Circuit believed. The Circuit's holding does avoid the need to litigate the patent's validity (and also, any question of infringement). But to do so, it throws the baby out with the bath water, and there is no need to take that drastic step. That is because it is normally not necessary to litigate patent validity to answer the antitrust question (unless, perhaps, to determine whether the patent litigation is a sham, see 677 F.3d, at 1312). An unexplained large reverse payment itself would normally suggest that the patentee has serious doubts about the patent's survival. And that fact, in turn, suggests that the payment's objective is to maintain supracompetitive prices to be shared among the patentee and the challenger rather than face what might have been a competitive market—the very anticompetitive consequence that underlies the claim of antitrust unlawfulness. 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. And, as we have said, that consequence constitutes the relevant anticompetitive harm. In a word, the size of the unexplained reverse payment can provide a workable surrogate for a patent's weakness, all without forcing a court to conduct a detailed exploration of the validity of the patent itself. 12 Areeda ¶ 2046, at 350–

352.

Fifth, the fact that a large, unjustified reverse payment risks antitrust liability does not prevent litigating parties from settling their lawsuit. They may, as in other industries, settle in other ways, for example, by allowing the generic manufacturer to enter the patentee's market prior to the patent's expiration, without the patentee paying the challenger to stay out prior to that point. Although the parties may have reasons to prefer settlements that include reverse payments, the relevant antitrust question is: What are those reasons? 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.

In sum, a reverse payment, where large and unjustified, can bring with it the risk of significant anticompetitive effects; one who makes such a payment may be unable to explain and to justify it; such a firm or individual may well possess market power derived from the patent; a court, by examining the size of the payment, may well be able to assess its likely anticompetitive effects along with its potential justifications without litigating the validity of the patent; and parties may well find ways to settle patent disputes without the use of reverse payments. In our view, these considerations, taken together, outweigh the single strong consideration—the desirability of settlements—that led the Eleventh Circuit to provide near-automatic antitrust immunity to reverse payment settlements.

III

The FTC urges us to hold that reverse payment settlement agreements are presumptively unlawful and that courts reviewing such agreements should proceed via a "quick look" approach, rather than applying a "rule of reason." See California Dental, 526 U.S., at 775, n. 12 ("Quick-look analysis in effect" shifts to "a defendant the burden to show empirical evidence of procompetitive effects"); 7 Areeda ¶ 1508, at 435–440 (3d ed. 2010). We decline to do so. In California Dental, we held (unanimously) that abandonment of the "rule of reason" in favor of presumptive rules (or a "quick-look" approach) is appropriate only where "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets." 526 U.S., at 770 (BREYER, J., concurring in part and dissenting in part). We do not believe that reverse payment settlements, in the context we here discuss, meet this criterion.

That is because the likelihood of a reverse payment bringing about anticompetitive effects depends upon its size, its scale in relation to the payor's anticipated future litigation costs, its independence from other services for which it might represent payment, and the lack of any other convincing justification. The existence and degree of any anticompetitive consequence may also vary as among industries. These complexities lead us to conclude that the FTC must prove its case as in other rule-of-reason cases.

To say this is not to require the courts to insist, contrary to what we have said, that the Commission need litigate the patent's validity, empirically demonstrate the virtues or vices of the patent system, present every possible supporting fact or refute every possible pro-defense theory. As a leading antitrust scholar has pointed out, " '[t]here is always something of a sliding scale in appraising reasonableness,'" and as such " 'the quality of proof required should vary with the circumstances.' " California Dental, supra, at 780 (quoting with approval 7 Areeda ¶ 1507, at 402 (1986)).

As in other areas of law, trial courts can structure antitrust litigation so as to avoid, on the one hand, the use of antitrust theories too abbreviated to permit proper analysis, and, on the other, consideration of every possible fact or theory irrespective of the minimal light it may shed on the basic question—that of the presence of significant unjustified anticompetitive consequences. See 7 id., ¶ 1508c, at 438–440. We therefore leave to the lower courts the structuring of the present rule-of-reason antitrust litigation. We reverse the judgment of the Eleventh Circuit. And we remand the case for further proceedings consistent with this opinion.

It is so ordered.

Chief Justice ROBERTS, with whom Justice SCALIA and Justice THOMAS join, dissenting.

Solvay Pharmaceuticals holds a patent. It sued two generic drug manufacturers that it alleged were infringing that patent. Those companies counterclaimed, contending the patent was invalid and that, in any event, their products did not infringe. The parties litigated for three years before settling on these terms: Solvay agreed to pay the generics millions of dollars and to allow them into the market five years before the patent was set to expire; in exchange, the generics agreed to provide certain services (help

with marketing and manufacturing) and to honor Solvay's patent. The Federal Trade Commission alleges that such a settlement violates the antitrust laws. The question is how to assess that claim.

A patent carves out an exception to the applicability of antitrust laws. The correct approach should therefore be to ask whether the settlement gives Solvay monopoly power beyond what the patent already gave it. The Court, however, departs from this approach, and would instead use antitrust law's amorphous rule of reason to inquire into the anticompetitive effects of such settlements. This novel approach is without support in any statute, and will discourage the settlement of patent litigation. I respectfully dissent.

I

The point of antitrust law is to encourage competitive markets to promote consumer welfare. The point of patent law is to grant limited monopolies as a way of encouraging innovation. Thus, a patent grants "the right to exclude others from profiting by the patented invention." Dawson Chemical Co. v. Rohm & Haas Co., 448 U.S. 176 (1980). In doing so it provides an exception to antitrust law, and the scope of the patent— i.e., the rights conferred by the patent—forms the zone within which the patent holder may operate without facing antitrust liability.

This should go without saying, in part because we've said it so many times. Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp., 382 U.S. 172, 177 (" 'A patent ... is an exception to the general rule against monopolies' "); United States v. Line Material Co., 333 U.S. 287, 300 (1948) ("[T]he precise terms of the grant define the limits of a patentee's monopoly and the area in which the patentee is freed from competition"); United States v. General Elec. Co., 272 U.S. 476, 485 (1926) ("It is only when ... [the patentee] steps out of the scope of his patent rights" that he comes within the operation of the Sherman Act); Simpson v. Union Oil Co. of Cal., 377 U.S. 13, 24 (1964) (similar). Thus, although it is per se unlawful to fix prices under antitrust law, we have long recognized that a patent holder is entitled to license a competitor to sell its product on the condition that the competitor charge a certain, fixed price. See, e.g., General Elec. Co.

We have never held that it violates antitrust law for a competitor to refrain from challenging a patent. And by extension, we have long recognized that the settlement of patent litigation does not by itself violate

the antitrust laws. Standard Oil Co. (Indiana) v. United States, 283 U.S. 163 (1931) ("Where there are legitimately conflicting claims or threatened interferences, a settlement by agreement, rather than litigation, is not precluded by the [Sherman] Act"). Like most litigation, patent litigation is settled all the time, and such settlements—which can include agreements that clearly violate antitrust law, such as licenses that fix prices, or agreements among competitors to divide territory—do not ordinarily subject the litigants to antitrust liability. See 1 H. Hovenkamp, M. Janis, M. Lemley, & C. Leslie, IP and Antitrust § 7.3, pp. 7–13 to 7–15 (2d ed. 2003).

The key, of course, is that the patent holder—when doing anything, including settling—must act within the scope of the patent. If its actions go beyond the monopoly powers conferred by the patent, we have held that such actions are subject to antitrust scrutiny. See, e.g., United States v. Singer Mfg. Co., 374 U.S. 174, 196–197 (1963). If its actions are within the scope of the patent, they are not subject to antitrust scrutiny, with two exceptions concededly not applicable here: (1) when the parties settle sham litigation, cf. Professional Real Estate Investors, Inc. v. Columbia Pictures Industries, Inc., 508 U.S. 49, 60–61 (1993); and (2) when the litigation involves a patent obtained through fraud on the Patent and Trademark Office. Walker Process Equipment, supra, at 177.

Thus, under our precedent, this is a fairly straight-forward case. Solvay paid a competitor to respect its patent—conduct which did not exceed the scope of its patent. No one alleges that there was sham litigation, or that Solvay's patent was obtained through fraud on the PTO. As in any settlement, Solvay gave its competitors something of value (money) and, in exchange, its competitors gave it something of value (dropping their legal claims). In doing so, they put an end to litigation that had been dragging on for three years. Ordinarily, we would think this a good thing.

II

Today, however, the Court announces a new rule. It is willing to accept that Solvay's actions did not exceed the scope of its patent. But it does not agree that this is enough to "immunize the agreement from antitrust attack." Ibid. According to the majority, if a patent holder settles litigation by paying an alleged infringer a "large and unjustified" payment, in exchange for having the alleged infringer honor the patent, a court should employ the antitrust rule of reason to determine whether the settlement violates antitrust law.

The Court's justifications for this holding are unpersuasive. First, the majority explains that "the patent here may or may not be valid, and may or may not be infringed." Because there is "uncertainty" about whether the patent is actually valid, the Court says that any questions regarding the legality of the settlement should be "measur[ed]" by "procompetitive antitrust policies," rather than "patent law policy." This simply states the conclusion. The difficulty with such an approach is that a patent holder acting within the scope of its patent has an obvious defense to any antitrust suit: that its patent allows it to engage in conduct that would otherwise violate the antitrust laws. But again, that's the whole point of a patent: to confer a limited monopoly. The problem, as the Court correctly recognizes, is that we're not quite certain if the patent is actually valid, or if the competitor is infringing it. But that is always the case, and is plainly a question of patent law.

The majority, however, would assess those patent law issues according to "antitrust policies." According to the majority, this is what the Court did in Line Material— i.e., it "accommodat[ed]" antitrust principles and struck a "balance" between patent and antitrust law. But the Court in Line Material did no such thing. Rather, it explained that it is "well settled that the possession of a valid patent or patents does not give the patentee any exemption from the provisions of the Sherman Act beyond the limits of the patent monopoly." It then, in the very next sentence, stated that "[b]y aggregating patents in one control, the holder of the patents cannot escape the prohibitions of the Sherman Act." Ibid. That second sentence follows only if such conduct—the aggregation of multiple patents—goes "beyond the limits of the patent monopoly," which is precisely what the Court concluded. See id., at 312 ("There is no suggestion in the patent statutes of authority to combine with other patent owners to fix prices on articles covered by the respective patents" (emphasis added)). The Court stressed, over and over, that a patent holder does not violate the antitrust laws when it acts within the scope of its patent. See id., at 305 ("Within the limits of the patentee's rights under his patent, monopoly of the process or product by him is authorized by the patent statutes"); id., at 310 ("price limitations on patented devices beyond the limits of a patent monopoly violate the Sherman Act" (emphasis added)).

The majority suggests that "[w]hether a particular restraint lies 'beyond the limits of the patent monopoly' is a conclusion that flows from" applying traditional antitrust principles. It seems to have in mind a regime

where courts ignore the patent, and simply conduct an antitrust analysis of the settlement without regard to the validity of the patent. But a patent holder acting within the scope of its patent does not engage in any unlawful anticompetitive behavior; it is simply exercising the monopoly rights granted to it by the Government. Its behavior would be unlawful only if its patent were invalid or not infringed. And the scope of the patent—i.e., what rights are conferred by the patent—should be determined by reference to patent law. While it is conceivable to set up a legal system where you assess the validity of patents or questions of infringement by bringing an antitrust suit, neither the majority nor the Government suggests that Congress has done so.

Second, the majority contends that "this Court's precedents make clear that patent-related settlement agreements can sometimes violate the antitrust laws." For this carefully worded proposition, it cites Singer Manufacturing Co., United States v. New Wrinkle, Inc., 342 U.S. 371 (1952), and Standard Oil Co. (Indiana). But each of those cases stands for the same, uncontroversial point: that when a patent holder acts outside the scope of its patent, it is no longer protected from antitrust scrutiny by the patent.

To begin, the majority's description of Singer is inaccurate. In Singer, several patent holders with competing claims entered into a settlement agreement in which they cross-licensed their patents to each other, and did so in order to disadvantage Japanese competition. See 374 U.S., at 194–195 (finding that the agreement had "a common purpose to suppress the Japanese machine competition in the United States" According to the majority, the Court in Singer "did not examine whether, on the assumption that all three patents were valid, patent law would have allowed the patents' holders to do the same." Rather, the majority contends, Singer held that this agreement violated the anti-trust laws because "in important part ... 'the public interest in granting patent monopolies' exists only to the extent that 'the public is given a novel and useful invention' in 'consideration for its grant.' " Ibid. (quoting Singer, 374 U.S., at 199 (White, J., concurring)). But the majority in *Singer* certainly did ask whether patent law permitted such an arrangement, concluding that it did not. See id., at 196–197 (reiterating that it "is equally well settled that the possession of a valid patent or patents does not give the patentee any exemption from the provisions of the Sherman Act beyond the limits of the patent monopoly " and holding that "those limitations have been exceeded in this case" (emphasis added; internal quotation marks omitted)); see also

Hovenkamp § 7.2b, at 7–8, n. 15 (citing *Singer* as a quintessential case in which patent holders were subject to antitrust liability because their settlement agreement went beyond the scope of their patents and thus conferred monopoly power beyond what the patent lawfully authorized).

New Wrinkle is to the same effect. There, the Court explained that because "[p]rice control through cross-licensing [is] barred as beyond the patent monopoly," an "arrangement ... made between patent holders to pool their patents and fix prices on the products for themselves and their licensees ... plainly violate[s] the Sherman Act." 342 U.S., at 379, 380. As the Court further explained, a patent holder may not, " 'acting in concert with all members of an industry ... issue substantially identical licenses to all members of the industry under the terms of which the industry is completely regimented, the production of competitive unpatented products suppressed, a class of distributors squeezed out, and prices on unpatented products stabilized.' " Id., at 379–380 (quoting United States v. United States Gypsum Co., 333 U.S. 364, 400 (1948)). The majority here, however, ignores this discussion, and instead categorizes the case as "applying antitrust scrutiny to [a] patent settlement."

Again, in Standard Oil Co. (Indiana), the parties settled claims regarding "competing patented processes for manufacturing an unpatented product," which threatened to create a monopoly over the unpatented product. 283 U.S., at 175. The Court explained that "an exchange of licenses for the purpose of curtailing the ... supply of an unpatented product, is beyond the privileges conferred by the patents."

The majority is therefore right to suggest that these "precedents make clear that patent-related settlement agreements can sometimes violate the antitrust laws." The key word is sometimes. And those some times are spelled out in our precedents. Those cases have made very clear that patent settlements—and for that matter, any agreements relating to patents—are subject to antitrust scrutiny if they confer benefits beyond the scope of the patent. This makes sense. A patent exempts its holder from the antitrust laws only insofar as the holder operates within the scope of the patent. When the holder steps outside the scope of the patent, he can no longer use the patent as his defense. The majority points to no case where a patent settlement was subject to antitrust scrutiny merely because the validity of the patent was uncertain. Not one. It is remarkable, and surely worth something, that in the 123 years since the Sherman Act was passed, we have never let antitrust law cross that Rubicon.

Next, the majority points to the "general procompetitive thrust" of the Hatch–Waxman Act, the fact that Hatch–Waxman "facilitat[es] challenges to a patent's validity," and its "provisions requiring parties to [such] patent dispute [s] ... to report settlement terms to the FTC and the Antitrust Division of the Department of Justice." The Hatch–Waxman Act surely seeks to encourage competition in the drug market. And, like every law, it accomplishes its ends through specific provisions. These provisions, for example, allow generic manufacturers to enter the market without undergoing a duplicative application process; they also grant a 180–day monopoly to the first qualifying generic to commercially market a competing product. See 21 U.S.C. §§ 355(j)(2)(A)(ii), (iv), 355(j)(5)(B)(iv). So yes, the point of these provisions is to encourage competition. But it should by now be trite—and unnecessary—to say that "no legislation pursues its purposes at all costs" and that "it frustrates rather than effectuates legislative intent simplistically to assume that whatever furthers the statute's primary objective must be the law." Rodriguez v. United States, 480 U.S. 522, 525–526 (1987) (per curiam). It is especially disturbing here, where the Court discerns from specific provisions a very broad policy—a "general procompetitive thrust," in its words—and uses that policy to unsettle the established relationship between patent and antitrust law. Indeed, for whatever it may be worth, Congress has repeatedly declined to enact legislation addressing the issue the Court takes on today.

In addition, it is of no consequence that settlement terms must be reported to the FTC and the Department of Justice. Such a requirement does not increase the role of antitrust law in scrutinizing patent settlements. Rather, it ensures that such terms are scrutinized consistent with existing antitrust law. In other words, it ensures that the FTC and Antitrust Division can review the settlements to make sure that they do not confer monopoly power beyond the scope of the patent.

The majority suggests that "[a]pparently most if not all reverse payment settlement agreements arise in the context of pharmaceutical drug regulation." Ante, at 2227. This claim is not supported empirically by anything the majority cites, and seems unlikely. The term "reverse payment agreement"—coined to create the impression that such settlements are unique—simply highlights the fact that the party suing ends up paying. But this is no anomaly, nor is it evidence of a nefarious plot; it simply results from the fact that the patent holder plaintiff is a defendant against an invalidity counterclaim—not a rare situation in intellectual property

litigation. Whatever one might call them, such settlements—paying an alleged infringer to drop its invalidity claim—are a well-known feature of intellectual property litigation, and reflect an intuitive way to settle such disputes. See Metro–Goldwyn Mayer, Inc. v. 007 Safety Prods., Inc., 183 F.3d 10, 13 (C.A.1 1999); see also Schildkraut, Patent–Splitting Settlements and the Reverse Payment Fallacy, 71 Antitrust L.J. 1033, 1033, 1046–1049 (2004); Brief for Actavis 54, n. 20 (citing examples). To the extent there are not scores and scores of these settlements to point to, this is because such settlements—outside the context of Hatch–Waxman—are private agreements that for obvious reasons are generally not appealed, nor publicly available.

The majority suggests that reverse-payment agreements are distinct because "a party with no claim for damages ... walks away with money simply so it will stay away from the patentee's market." Again a distinction without a difference. While the alleged infringer may not be suing for the patent holder's money, it is suing for the right to use and market the (intellectual) property, which is worth money.

Finally, the majority complains that nothing in "any patent statute" gives patent-holders the right to settle when faced with allegations of invalidity. But the right to settle generally accompanies the right to litigate in the first place; no one contends that drivers in an automobile accident may not settle their competing claims merely because no statute grants them that authority. The majority suggests that such a right makes it harder to "eliminat[e] unwarranted patent grants." Ibid. That may be so, but such a result—true of all patent settlements—is no reason to adjudicate questions of patent law under antitrust principles. Our cases establish that antitrust law has no business prying into a patent settlement so long as that settlement confers to the patent holder no monopoly power beyond what the patent itself conferred—unless, of course, the patent was invalid, but that again is a question of patent law, not antitrust law.

In sum, none of the Court's reasons supports its conclusion that a patent holder, when settling a claim that its patent is invalid, is not immunized by the fact that it is acting within the scope of its patent. And I fear the Court's attempt to limit its holding to the context of patent settlements under Hatch–Waxman will not long hold.

III

The majority's rule will discourage settlement of patent litigation. Simply put, there would be no incentive to settle if, immediately after settling, the parties would have to litigate the same issue—the question of patent validity—as part of a defense against an antitrust suit. In that suit, the alleged infringer would be in the especially awkward position of being for the patent after being against it.

This is unfortunate because patent litigation is particularly complex, and particularly costly. As one treatise noted, "[t]he median patent case that goes to trial costs each side $1.5 million in legal fees" alone. Hovenkamp § 7.1c, at 7–5, n. 6. One study found that the cost of litigation in this specific context—a generic challenging a brand name pharmaceutical patent—was about $10 million per suit. See Herman, Note, The Stay Dilemma: Examining Brand and Generic Incentives for Delaying the Resolution of Pharmaceutical Patent Litigation, 111 Colum. L.Rev. 1788, 1795, n. 41 (2011) (citing M. Goodman, G. Nachman, & L. Chen, Morgan Stanley Equity Research, Quantifying the Impact from Authorized Generics 9 (2004)).

The Court acknowledges these problems but nonetheless offers "five sets of considerations" that it tells us overcome these concerns: (1) sometimes patent settlements will have " 'genuine adverse effects on competition' "; (2) "these anticompetitive consequences will at least sometimes prove unjustified"; (3) "where a reverse payment threatens to work unjustified anticompetitive harm, the patentee likely possesses the power to bring that harm about in practice"; (4) "it is normally not necessary to litigate patent validity to answer the antitrust question" because "[a]n unexplained large reverse payment itself would normally suggest that the patentee has serious doubts about the patent's survival," and using a "payment ... to prevent the risk of competition ... constitutes the relevant anticompetitive harm"; and (5) parties may still "settle in other ways" such as "by allowing the generic manufacturer to enter the patentee's market prior to the patent's expiration, without the patentee paying the challenger to stay out prior to that point."

Almost all of these are unresponsive to the basic problem that settling a patent claim cannot possibly impose unlawful anticompetitive harm if the patent holder is acting within the scope of a valid patent and therefore permitted to do precisely what the antitrust suit claims is unlawful. This means that in any such antitrust suit, the defendant (patent holder) will want to use the validity of his patent as a defense—in other words, he'll

want to say "I can do this because I have a valid patent that lets me do this." I therefore don't see how the majority can conclude that it won't normally be "necessary to litigate patent validity to answer the antitrust question," unless it means to suggest that the defendant (patent holder) cannot raise his patent as a defense in an antitrust suit. But depriving him of such a defense—if that's what the majority means to do—defeats the point of the patent, which is to confer a lawful monopoly on its holder.

The majority seems to think that even if the patent is valid, a patent holder violates the antitrust laws merely because the settlement took away some chance that his patent would be declared invalid by a court. See ante ("payment ... to prevent the risk of competition ... constitutes the relevant anticompetitive harm." This is flawed for several reasons.

First, a patent is either valid or invalid. The parties of course don't know the answer with certainty at the outset of litigation; hence the litigation. But the same is true of any hard legal question that is yet to be adjudicated. Just because people don't know the answer doesn't mean there is no answer until a court declares one. Yet the majority would impose antitrust liability based on the parties' subjective uncertainty about that legal conclusion.

The Court does so on the assumption that offering a "large" sum is reliable evidence that the patent holder has serious doubts about the patent. Not true. A patent holder may be 95% sure about the validity of its patent, but particularly risk averse or litigation averse, and willing to pay a good deal of money to rid itself of the 5% chance of a finding of invalidity. What is actually motivating a patent holder is apparently a question district courts will have to resolve on a case-by-case basis. The task of trying to discern whether a patent holder is motivated by uncertainty about its patent, or other legitimate factors like risk aversion, will be made all the more difficult by the fact that much of the evidence about the party's motivation may be embedded in legal advice from its attorney, which would presumably be shielded from discovery.

Second, the majority's position leads to absurd results. Let's say in 2005, a patent holder sues a competitor for infringement and faces a counterclaim that its patent is invalid. The patent holder determines that the risk of losing on the question of validity is low, but after a year of litigating, grows increasingly risk averse, tired of litigation, and concerned about the company's image, so it pays the competitor a "large" payment in exchange

for having the competitor honor its patent. Then let's say in 2006, a different competitor, inspired by the first competitor's success, sues the patent holder and seeks a similar payment. The patent holder, recognizing that this dynamic is unsustainable, litigates this suit to conclusion, all the way to the Supreme Court, which unanimously decides the patent was valid. According to the majority, the first settlement would violate the antitrust laws even though the patent was ultimately declared valid, because that first settlement took away some chance that the patent would be invalidated in the first go around. Under this approach, a patent holder may be found liable under antitrust law for doing what its perfectly valid patent allowed it to do in the first place; its sin was to settle, rather than prove the correctness of its position by litigating until the bitter end.

Third, this logic—that taking away any chance that a patent will be invalidated is itself an antitrust problem—cannot possibly be limited to reverse-payment agreements, or those that are "large." Ibid. The Government's brief acknowledges as much, suggesting that if antitrust scrutiny is invited for such cash payments, it may also be required for "other consideration" and "alternative arrangements." For example, when a patent holder licenses its product to a licensee at a fixed monopoly price, surely it takes away some chance that its patent will be challenged by that licensee. According to the majority's reasoning, that's an antitrust problem that must be analyzed under the rule of reason. But see General Elec. Co., 272 U.S., at 488 (holding that a patent holder may license its invention at a fixed price). Indeed, the Court's own solution—that patent holders should negotiate to allow generics into the market sooner, rather than paying them money—also takes away some chance that the generic would have litigated until the patent was invalidated.

Thus, although the question posed by this case is fundamentally a question of patent law— i.e., whether Solvay's patent was valid and therefore permitted Solvay to pay competitors to honor the scope of its patent—the majority declares that such questions should henceforth be scrutinized by antitrust law's unruly rule of reason. Good luck to the district courts that must, when faced with a patent settlement, weigh the "likely anticompetitive effects, redeeming virtues, market power, and potentially offsetting legal considerations present in the circumstances."

IV

The majority invokes "procompetitive antitrust policies" but misses

the basic point that patent laws promote consumer interests in a different way, by providing protection against competition. As one treatise explains:

> "The purpose of the rule of reason is to determine whether, on balance, a practice is reasonably likely to be anticompetitive or competitively harmless—that is, whether it yields lower or higher marketwide output. By contrast, patent policy encompasses a set of judgments about the proper tradeoff between competition and the incentive to innovate over the long run. Antitrust's rule of reason was not designed for such judgments and is not adept at making them."

Hovenkamp § 7.3, at 7–13 (footnote omitted).

The majority recognizes that "a high reverse payment" may "signal to other potential challengers that the patentee lacks confidence in its patent, thereby provoking additional challenges." It brushes this off, however, because of two features of Hatch–Waxman that make it " 'not necessarily so.' " First, it points out that the first challenger gets a 180–day exclusive period to market a generic version of the brand name drug, and that subsequent challengers cannot secure that exclusivity period—meaning when the patent holder buys off the first challenger, it has bought off its most motivated competitor. There are two problems with this argument. First, according to the Food and Drug Administration, all manufacturers who file on the first day are considered "first applicants" who share the exclusivity period. Thus, if ten generics file an application to market a generic drug on the first day, all will be considered "first applicants." See 21 U.S.C. § 355(j)(5)(B)(iv)(II)(bb); see also FDA, Guidance for Industry: 180–Day Exclusivity When Multiple ANDAs Are Submitted on the Same Day 4 (July 2003). This is not an unusual occurrence. See Brief for Generic Pharmaceutical Association as Amicus Curiae 23–24 (citing FTC data indicating that some drugs "have been subject to as many as sixteen first-day" generic applications; that in 2005, the average number of first-day applications per drug was 11; and that between 2002 and 2008, the yearly average never dropped below three first-day applications per drug).

Second, and more fundamentally, the 180 days of exclusivity simply provides more incentive for generic challenges. Even if a subsequent generic would not be entitled to this additional incentive, it will have as much or nearly as much incentive to challenge the patent as a potential challenger would in any other context outside of Hatch–Waxman, where there is no 180–day exclusivity period. And a patent holder who gives away

notably large sums of money because it is, as the majority surmises, concerned about the strength of its patent, would be putting blood in water where sharks are always near.

The majority also points to the fact that, under Hatch–Waxman, the FDA is enjoined from approving a generic's application to market a drug for 30 months if the brand name sues the generic for patent infringement within 45 days of that application being filed. Ante, at 2235 (citing 21 U.S.C. § 355(j)(5)(B)(iii)). According to the majority, this provision will chill subsequent generics from challenging the patent (because they will have to wait 30 months before receiving FDA approval to market their drug). But this overlooks an important feature of the law: the FDA may approve the application before the 30 months are up "if before the expiration of [the 30 months,] the district court decides that the patent is invalid or not infringed." § 355(j)(5)(B)(iii)(I). And even if the FDA did not have to wait 30 months, it is far from clear that a generic would want to market a drug prior to obtaining a judgment of invalidity or noninfringement. Doing so may expose it to ruinous liability for infringement.

The irony of all this is that the majority's decision may very well discourage generics from challenging pharmaceutical patents in the first place. Patent litigation is costly, time consuming, and uncertain. See Cybor Corp. v. FAS Techs., Inc., 138 F.3d 1448, 1476, n. 4 (C.A.Fed.1998) (opinion of Rader, J.) (en banc) (discussing study showing that the Federal Circuit wholly or partially reversed in almost 40 percent of claim construction appeals in a 30–month period); Brief for Generic Pharmaceutical Association as Amicus Curiae 16 (citing a 2010 study analyzing the prior decade's cases and showing that generics prevailed in 82 cases and lost in 89 cases). Generics "enter this risky terrain only after careful analysis of the potential gains if they prevail and the potential exposure if they lose." Taking the prospect of settlements off the table—or limiting settlements to an earlier entry date for the generic, which may still be many years in the future—puts a damper on the generic's expected value going into litigation, and decreases its incentive to sue in the first place. The majority assures us, with no support, that everything will be okay because the parties can settle by simply negotiating an earlier entry date for the generic drug manufacturer, rather than settling with money. Ante, at 2246 – 2247 . But it's a matter of common sense, confirmed by experience, that parties are more likely to settle when they have a broader set of valuable things to trade.

V

The majority today departs from the settled approach separating patent and antitrust law, weakens the protections afforded to innovators by patents, frustrates the public policy in favor of settling, and likely undermines the very policy it seeks to promote by forcing generics who step into the litigation ring to do so without the prospect of cash settlements. I would keep things as they were and not subject basic questions of patent law to an unbounded inquiry under antitrust law, with its treble damages and famously burdensome discovery.... I respectfully dissent.

NOTES AND QUESTIONS

1. Interestingly all eight Justices (Justice Alito did not participate) appear to agree that consumer welfare is the goal of the antitrust laws. That perspective dominates Justice Breyer's opinion for the Court, but even Chief Justice Roberts states early in his dissent that "The point of antitrust law is to encourage competitive markets to promote consumer welfare." A strict consumer welfare approach measures antitrust violations by their impact on consumers, including reduced market output, higher prices, or reduced innovation. A "total welfare" approach looks at effects on everyone, including producers. For example, a practice that increases prices by $1 million but that produces offsetting efficiency gains to producers of $1.2 million would be lawful under a total welfare approach even though consumers are injured. The welfare goals of the antitrust laws have been the subject of an enormous scholarly debate for decades. However, the courts almost uniformly follow a consumer welfare principle and *Actavis* is in line with that tradition. See Herbert Hovenkamp, *Implementing Antitrust's Welfare Goals*, 81 FORDHAM L.REV. 2471 (2013).

2. An unanticipated consequence of the Hatch-Waxman Act was to set up little two-firm cartels between the pioneer patentee and the first generic entrant. Guaranteed freedom from entry by a third competitor for 180 days following the generic firm's production, they have a strong incentive to perpetuate any monopoly the patent (assuming its validity) creates rather than enter into competition. Further, until *Actavis* the general rule favored settlements of patent infringement disputes, even tolerating settlements that divided markets, as these do. For two firms agreeing with each other, their joint profit-maximizing output and price is exactly the same as that of a monopolist, and sharing these monopoly profits is more profitable in nearly every case than competing. For example, suppose manufacturing costs to

both parties are 50 cents per unit. The monopoly price is 90 cents per unit. When the generic enters, if the two firms behave competitively the price will drop to 50 cents and they will each earn only a competitive return. By contrast, if they settle via a payment for delayed entry, the two firms will share the 40 cents in monopoly profits for a time, at consumers' expense. The ironic result is that it is more profitable for the generic to settle than even to win the lawsuit outright, which would make the market competitive. The parties might of course achieve a similar result if the generic produced and the two firms colluded on the product price. The statute does not permit price collusion, however, and as a result it would be per se violation of the antitrust laws. So the Hatch-Waxman settlement somewhat resembles the story of two price-fixers who shut down one of their plants and produce the cartel output from the remaining plant.

Generally speaking, patent settlements are devices for addressing the risk of a legal outcome that is unfavorable to the pioneer patentee, such as a finding of invalidity. In the typical infringement case the patentee discounts the risk of losing the lawsuit into an agreement that typically includes a license to the infringer to produce under the patent at a specified royalty. One significant difference between conventional settlements and reverse payment settlements is that the ordinary settlement is an output increasing event, making both patentee and licensee into producers. By contrast, a reverse payment settlement presumptively reduces output by preserving production only by the pioneer while raising its costs.

In general, pioneer pharmaceutical patents are strong and relatively durable, preventing far few problems of interpretation and validity than, say, information technologies patents. See JAMES BESSEN & MICHAEL J. MEURER, PATENT FAILURE: HOW JUDGES, BUREAUCRATS, AND LAWYERS PUT INNOVATORS AT RISK 138-146 (2009). Most Hatch-Waxman settlements are not on original pioneer molecules, however. They are typically on "evergreened" extension patents for new uses, new dosages, new forms of delivery, and the like. The failure rate of these patents is much higher, and the incentives to profit from the bilateral monopoly accordingly greater. Indeed, while the invalidity rate of litigated patents is an already-too-high 40%, the invalidity rate of pharmaceutical patents litigated under paragraph IV of the Hatch-Waxman process is nearly double that, 73% (FTC, *Generic Drug Entry Prior to Patent Expiration* (2002),, available at http://www.ftc.gov/os/2002/07/genericdrugstudy.pdf. In *Actavis* the drug patent was on a particular gel formulation of a drug that was established and widely available but whose patent had expired. As a

result the formulation may not have met patent law's novelty requirement. The drug itself was in the public domain, and gel formulations of drugs have been well known for decades.

3. Consider the range of options open to the Court, ranging from least to most restrictive:

a. Any settlement, including ones that involve pay-for-delay, is immune from antitrust attack if it is facially "within the scope of the patent." For example, if a patent has six years remaining and the pay-for-delay exclusion agreement runs only five years, then the payment is lawful because the patent standing alone would have kept the infringer out of the market in any event. Under this approach the court may not second guess the settlement by inquiring into the validity of the patent or the defendant's actual infringement; the settlement itself shields these queries from the court, with a possible exception for egregious situations involving obviously invalid patents. That is, it creates an "almost unrebuttable presumpton of patent validity," and thus "assumes away the question being litigated in the underlying patent suit...." In re K–Dur Antitrust Litigation, 686 F.3d 197, 214 (C.A.3 2012) (rejecting "scope of the patent" approach). This is the approach that many lower courts have taken, including the Eleventh Circuit decision that the Supreme Court reversed, and it is consistent with a long tradition of federal judicial deference to settlements of patent infringement disputes. *See* 12 HERBERT HOVENKAMP, ANTITRUST LAW ¶2046 (3d ed. 2012). On the course taken by earlier decisions, see HERBERT HOVENKAMP, MARK D. JANIS, MARK A. LEMLEY, AND CHRISTOPHER LESLIE, IP AND ANTITRUST §15.3 (2d ed. Supp. 2013) Justice Breyer acknowledged a "general legal policy favoring the settlement of disputes."

b. A settlement payment that seems very large in proportion to litigation risks is a sign that something is wrong with the patent. It is likely either invalid or not infringed. This should be construed as an invitation to open the question that courts traditionally avoid in challenges to settlements. They should look more closely at the underlying patent and the infringement action in order to determine whether the settlement is really a good faith attempt to manage litigation and business risk, given the general uncertainty of patent infringement lawsuit outcomes. Or is this simply an attempt to continue an unjustified stream of monopoly profits, albeit with two firms sharing it rather than one? Possibilities for this close look have included direct judicial evaluation of the patent or perhaps a call for re-examination by

the USPTO. See CHRISTINA BOHANNAN AND HERBERT HOVENKAMP, CREATION WITHOUT RESTRAINT: PROMOTING LIBERTY AND RIVALRY IN INNOVATION 93-96 (2012) (noting limitations on this approach); Gregory Dolin, *Reverse Settlements as Patent Invalidity Signals*, 24 HARV. J. L. & TECH. 281 (2011) (defending it).

c. A "large" settlement exclusion payment disproportionate to litigation risk can be unlawful under antitrust's rule of reason, without inquiry into whether the patent is actually invalid or not infringed, and even if the settlement agreement does not go "beyond the scope" of the patent's nominal coverage. The plaintiff has the burden of showing both market power and competitive harm.

d. Same as c, except a large payment triggers a "quick look," or truncated, antitrust analysis in which the plaintiff can enjoy presumptions about market power or anticompetitive effect. The defendant has the burden of defending against these and showing offsetting defenses.

e. Pay-for-delay settlements are unlawful per se -- that is, the plaintiff need prove only that such an agreement exists; power and anticompetitive effects need not be proven.

The Supreme Court chose option c. Most lower courts had chosen some version of option a. Although a minority had chosen either d or e.

4. Nevertheless, just how different is the "rule of reason" that Justice Breyer insisted must apply in this case and the "quick look" that the FTC had requested? The Supreme Court in general, but Justice Breyer in particular, has never been a big fan of "quick look" antitrust analysis. The question of truncated antitrust analysis actually revolves around two issues. The first is the assignment of burdens of proof, while the second is the question of what kind of evidence is necessary for the plaintiff to carry its burden. On the first, the majority rejected the FTC's request that once an unreasonably large payment was shown the burden shifted to the defendant to justify it. On the second question, however, the Court also held that power could be inferred from a very large payment -- indicating that a relevant market need not be defined and a market share need not be computed. Second, it held that anticompetitive effects in the form of higher consumer prices could also be inferred from the high payment. The defenses that the Court acknowledged were that the payment was no larger than reasonably anticipated litigation costs, and that the generic was in fact

contracting to provide services to the pioneer (probably distribution and marketing) whose fair market value equalled the excess payment. Note that the one defense that the Court did *not* acknowledge was that the patent was valid. In fact, the Court repeatedly stated that patent validity *vel non* was not an essential aspect of the antitrust case.

5. Although Justice Breyer did not reach the issue, one important query in rule of reason cases is whether a less restrictive alternative exists to a challenged restraint found to pose a significant risk of competitive harm. Wouldn't it be a less restrictive alternative for the pioneer patentee and the generic to enter into an agreement under which the generic paid a license fee and produced the drug in competition with the patentee? That is a typical outcome in patent infringement suits and rarely raises competitive problems. The licensing arrangement adds an additional purchaser. The more doubtful the validity of the patent, the lower the license fee will be. Further, license arrangements of this sort – unlike pay-for-delay settlements – are expressly authorized by the Patent Act. See 35 U.S.C. §261.

6. The majority and dissent disputed whether pay-for-delay settlements are a unique feature of Hatch-Waxman (majority) or are in fact relatively common among patent settlements generally (dissent). The question is important because traditional settlements (generic pays for a license to produce) are generally procompetitive, and that would make them a less restrictive alternative. Chief Justice Roberts cited a law review article and the defendant's brief, which cited some non-Hatch-Waxman cases as examples of pay-for-delay settlements. None of the cases involved patents. Two were trademark cases in which the parties settled with reverse payments in the $150,000 - $300,000 range after the district courts had denied preliminary injunctions. But $300,000 is very likely less than the prospective cost of litigation. See MGM, Inc. v. 007 Safety Prods., Inc., 183 F.3d 10 (1st Cir. 1999); Time Prods., Ltd. v. Toy Biz, Inc., 38 F.3d 660 (2d Cir. 1994). The third case was also a trademark case in which Microsoft made a $20,000,000 exit payment to a firm that produced an open source computer operating system called "Lindows." (probably a combination of "Linux" and "Windows"). Microsoft had already lost a request for a preliminary injunction twice, and the district court had ruled that a jury should decide whether the name "Windows" was generic, and thus in the public domain. The United States Patent Trademark Office had twice held that the name Windows was generic, but then changed its mind without explanation. In sum, the litigation risk for Windows was not merely that the defendant could keep the name Lindows, but that the

Windows name would go into the public domain. $20,000,000 was a small price to pay.

7. Language in the majority's opinion may carry the *Actavis* holding beyond the Hatch-Waxman context. Most importantly is Justice Breyer's distinction between practices that are authorized by the Patent Act and those that are not. If a particular provision (1) appears anticompetitive; and (2) is not authorized by the Patent Act, then the decision may permit an antitrust challenge even though the patents in question are valid. One good example is product price fixing in settlement agreements. In the much criticized decision in United States v. General Elec. Co., 272 U.S. 476 (1926), the Supreme Court approved a license agreement in which patentee GE licensed Westinghouse to manufacture light bulbs and stipulated the price at which the bulbs must be sold by Westinghouse's retailers. Justice Breyer read the decision very narrowly, stating that it "permitted a single patentee to grant to a single licensee a license containing a minimum resale price requirement." *Actavis*, 133 S.Ct. at 2232. This limitation to a single licensor and a single licensee very likely overrules decisions such as E. Bement & Sons v. National Harrow Co., 186 U.S. 70 (1902), which permitted all the firms making a product to cross-license their patents and stipulate the resale price of the product.

8. Under ordinary antitrust rules, both the pioneer patentee and the generic could be held liable in damages for an unlawful pay-for-delay settlement. While the antitrust laws offer some relief for "coerced" participants in a conspiracy (such as dealers upon whom tying arrangements or unlawful resale price maintenance are imposed), the generic company in these cases is hardly coerced. It is a willing participant very likely in a position to earn more under the settlement than it could be entering into competitive production. Consumer damages in private actions would ordinarily be measured by the overcharge, and under the ordinary antitrust rules of joint and several liability, both defendants would individually and together be liable for the damage award. Under federal antitrust law "indirect" purchasers could not collect damages, although they could obtain an injunction. Since most pharmaceutical drugs are distributed through pharmacies and other health care suppliers, consumers would be indirect purchasers. So in these cases the pharmacies and other direct purchasers could sue for damages, but not consumers. However, the antitrust law of many states permits indirect purchasers to claim damages. See 2A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶¶346, 395 (4th ed. 2014).

NOTE
PATENT VS. TRADEMARK SETTLEMENTS

In Clorox Co. v. Sterling Winthrop, Inc., 117 F.3d 50 (2d Cir. 1997), the court approved a settlement agreement in a trademark infringement suit involving the brand names "Lysol" and "Pine-Sol." Lysol was the senior mark, antedating Pine-Sol (at the time called "Pinesol") by several decades. When the owners of Pinesol, who were sellers of household chemicals, attempted to register the mark the examiner in the United States Patent and Trademark Office denied registration, concluding that there was a similarity between the "Pi" sound in Pinesol and the "Ly" sound in Lysol that could confuse customers. When the owners of Pinesol continued to use it without registration, the owner of Lysol sued for trademark infringement.

The parties entered a settlement agreement under which the owners of Pinesol agreed to use that name only in chemicals that had pine oil as an active ingredient, to use a distinctive picture of an evergreen tree on the label, and to change the name of their products to "Pine-Sol," thus keeping the "Pine" and the "Sol" separate. More than fifteen years later a new dispute arose when the owners of the revised Pine-Sol mark began to use it on aerosol spray disinfectants, which competed directly with Lysol products. The parties revised their agreement but controversy continued to erupt as Pine-Sol added new products to its line.

Clorox, the subsequent owner of Pine-Sol finally brought an action in 1987, alleging that the product agreement in the settlement agreement no longer served a useful purpose because the distinctiveness of the two labels was clearly established in consumers' minds. As a result the settlement agreement was nothing more than a naked market division agreement, per se unlawful under the antitrust laws.

The court held that the agreement remained enforceable. The agreement did not restrict either party from making any *product* but only from using a particular name on that product:

> The trademark agreement at issue here does no more than regulate how the name PINE-SOL may be used; it does not in any way restrict Clorox from producing and selling products that compete directly with the LYSOL brand, so long as they are marketed under a brand name other than PINE-SOL. Accordingly, at

> first blush it would not appear to restrict Clorox's, much less any other competitor's, ability to compete in the markets LYSOL products allegedly dominate.

The court rejected Clorox's "megabrand" theory – namely, that certain trademarks are so attractive and well recognized in the eyes of customers that they confer significant advantages over those making similar products but not having the same market. Further,

> … there is no evidence to support the theory that only Clorox is capable of competing against LYSOL products in the alleged markets LYSOL dominates. The overall household cleaning industry is the battleground of some of the largest corporations in the country, wielding numerous megabrands. The industry is made up of firms with the resources to develop new products and market them, as these companies have repeatedly done. In the past, these companies regularly bought and sold trademarks, as this case illustrates, as changing economic conditions dictated. See id. at 26. Each of these major corporations, like Clorox, has significant goodwill attached to its own name, and to the trademarks it owns.
>
> … Nothing here suggests that the other large companies that produce cleaning products are incapable of successfully investing their resources, in the form of capital and brand name equity, to enter the markets LYSOL products allegedly dominate. Clorox has presented no evidence to the contrary.

Note the important differences between a trademark settlement and a patent settlement. First, a trademark settlement with a product division agreement excludes only from the brand name, not from the product itself. As a result, new product entry by both the settlement party and by others is unrestricted. By contrast, a patent settlement excludes from the technology covered by the patent(s) in dispute, which in some cases may involve the ability to manufacture the product itself. For example, in pharmaceutical settlements such as the one in the principal case the patents in question may cover the "molecule," or the entire product, and may effectively perpetuate a monopoly in the pioneer patentee. On the other side, the patent settlement excludes only for the duration of the patent. Once it has expired others are free to make and market the formerly patented product. By contrast, a trademark is of indefinite duration.