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By Chahira Solh and Ezra Salami
Co-Chairs, ABA YLD Committee on Antitrust Law

Happy Fall! The rest of 2016 looks to be busy for the Antitrust Law Committee. We have a number of exciting Committee Programs planned, including a joint program with the Canadian Bar Association. We are also looking forward to hosting a series of informal "networking events" (a.k.a. happy hours) across the United States, including Los Angeles, Dallas, and Washington, D.C., and hope to meet many of you in person.

We are always looking for ways to help committee members develop their own brand as well as learn more about antitrust and consumer protection issues. We are currently soliciting volunteers to speak on upcoming teleconference panels and to contribute to our 101-Series articles, so if you have any interest in speaking or writing on antitrust topics please let us know.

As always, we encourage you to communicate with any of our leadership if you are interested in getting more involved with the Committee. We also hope that you access and join in our programs and read our 101-Series articles when you need introductory information on key antitrust and consumer protection topics.

Sincerely,
Chahira and Ezra
Antitrust Law Committee Co-Chairs
Three Years After FTC v. Actavis: The Evolving Landscape Surrounding Reverse Settlements
By: Vahe Mesropyan and James Miller

In the 2013 landmark decision, Federal Trade Commission v. Actavis, 133 S. Ct. 2223 (2013), the United States Supreme Court held that reverse settlements may be subject to antitrust scrutiny. In short, a reverse settlement (or a pay-for-delay settlement) occurs when a patent holder brings a patent infringement suit, but then settles the case by paying the alleged patent infringer to stay out of the market. Following the precedent set by Actavis, subsequent decisions have extended the scope of settlements that constitute reverse payments in violation of antitrust laws. This article will track how Actavis has extended to non-cash settlements, and has also been interpreted to apply to state competition and consumer protection laws.

Background

In Actavis, the Federal Trade Commission (“FTC”) sued Solvay Pharmaceuticals Inc.—a drug manufacturer—and several generic manufacturers, which had each sought to introduce a generic version of a drug manufactured by Solvay under the Abbreviated New Drug Application process as provided by the Hatch-Waxman Act. The FTC alleged that Solvay brought a patent infringement suit against the generic manufacturers and ultimately paid large sums of money to settle the case in exchange for the generic manufacturers’ agreement to stay out of the market for several years. The FTC argued that the settlement was anticompetitive and designed to keep competitors out of the market, and not merely an enforcement of Solvay's patent rights. The district court dismissed the challenge in favor of the drug manufacturers, and the Eleventh Circuit affirmed the dismissal. The Supreme Court, however, held that the lower court erred in dismissing the FTC’s challenge of the settlement, observing that such reverse settlements could be anticompetitive and should therefore be analyzed under the rule of reason if large and unjustified.

Prior to Actavis, courts generally did not invalidate reverse settlements, reasoning that they fell within the scope of the exclusionary potential of the patent. However, the Actavis Court set precedent when it concluded that, because such settlements prevent the adjudication of the patent’s actual validity and scope, they should be scrutinized under the antitrust laws’ traditional “rule of reason.” (Actavis, 133 S. Ct. at 2237.) The Court provided five reasons why the settlement in question could have been anticompetitive and held cash settlements that were “large and unjustified” were potentially anticompetitive. However, the Court stopped short of providing a bright-line rule of reason analysis for lower courts to apply. Since Actavis, district courts and state courts have struggled with the broad implications of the decision, which is no surprise. As Chief Justice John Roberts stated in the dissent, “[g]ood luck to the district courts” that must analyze reverse settlements based on the Court’s discussion in Actavis.

Post-Actavis Decisions Have Extended Antitrust Scrutiny to Non-Cash Settlements

In earlier years, pay-for-delay cases typically challenged settlements involving large cash payments by the branded manufacturer to a would-be generic manufacturer. Subsequent to Actavis, challenges to settlements under pay-for-delay theories have expanded to include
non-cash consideration provided in exchange for the generic challenger’s delayed entry to the market.

The Third Circuit was the first court of appeals to issue a decision post-Actavis. It held that non-cash settlements could constitute a “payment” under Actavis, and are thereby subject to a rule of reason analysis. *King Drug of Florence, Inc. v. Smithkline Beecham Corp.*, 791 F.3d 388, 403-04 (3d Cir. 2015) (holding that Actavis condemns payments that “negatively impact consumer welfare by preventing the risk of competition”). In *King Drug*, in exchange for the generic manufacturer’s delayed entry, the branded manufacturer granted the generic early entry shortly before expiration of the patent and agreed not to launch any authorized generics during that period of exclusivity. The court found that the no authorized generic (“no-AG”) agreement in question could constitute a payment under Actavis, stating “[t]he no-AG agreement transfers the profits the patentee would have made from its authorized generic to the settling generic – plus potentially more, in form of higher prices, because there will now be generic monopoly instead of a duopoly.” (*Id.* at 405).

For the most part, district courts have agreed that non-cash settlements, such as no-AG agreements, are within the scope of Actavis, and in February 2016, the First Circuit became the second appellate court to make such a finding. (*See In re Loestrin*, 814 F.3d 538, 549-50 (rejecting the lower court’s holding that only reverse settlements involving cash fall within the scope of Actavis and citing eight decisions from district courts across the country holding the same).)

However, the presence of a no-AG agreement may not itself conclusively compel a finding of anticompetitive harm. The district court in *In re Wellbutrin*, 133 F. Supp. 3d 734, 754 (E.D. Penn. 2015), agreed with the defendants in that matter and granted summary judgment, finding that the settlement at issue—which included a no-AG provision—did not rise to the level of an antitrust violation. That decision is likely attributable to the overall reasonableness of the analyzed settlement, which involved, among other procompetitive provisions: (1) permitting patent litigation brought by one of the generic manufacturers to continue, which—if successful—would result in immediate market entry for all generics; (2) the patent-holder granting two sublicenses to produce a version of its patented drug, which is good for consumers; and (3) relatively early generic entry, even if the underlying patent was held to be valid. (*See Id.* at 746-48.)

In analyzing the potential anticompetitive effects of the no-AG provision, the *Wellbutrin* court found significant the fact that no settlement agreement was ever contemplated between the parties that did not involve such a provision. (*Id.* at 756-57.) Consequently, the court was not convinced that “generic competition would have occurred earlier” absent the settlement. *Id.* In other words, the *Wellbutrin* court declined to give the settlement agreement terms a “quick look” and declare that the mere existence of a no-AG provision resulted in anticompetitive harm; it instead grappled with alternate hypothetical litigation scenarios in assessing whether consumers were actually harmed by the allegedly anticompetitive settlement provision. (*Id.* at 756-58.) Citing Actavis, the court explicitly refused to make a finding that reverse settlements are presumptively unlawful. (*See Actavis*, 133 S. Ct. at 2234 (“settlement on terms permitting the patent challenger to enter the market before the patent expires would also bring about competition . . . to the consumer’s benefit.”).) The court reasoned that settlement itself may entail procompetitive benefits, and therefore each challenged settlement should undergo a full rule of reason analysis. (*Wellbutrin*, 133 F. Supp. 3d at 757.)

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Finally, the *Wellbutrin* court found significant the fact that the FTC had an opportunity to object to the settlement, but did not object. (*Id.* at 749.) However, the FTC filed an amicus brief with the Third Circuit on appeal specifically stating that the district court’s reliance on FTC’s inaction was flawed and that the FTC supports the notion that no-AG settlements fall within the scope of *Actavis*. Subsequently, the FTC solidified its position on no-AG settlements when it challenged two no-AG settlements in March 2016. (*See Federal Trade Commission v. Endo Pharmaceuticals Inc. et al.*, No. 2:16-cv-01440-PD (E.D. Pa. March 31, 2016).)

In sum, the First and Third Circuit’s decisions, as well as the FTC’s decision to challenge no-AG settlements, evidence a trend towards expanding the scope of *Actavis* to include non-cash settlements. The federal courts have not yet established a test, but courts seem likely to invalidate settlements that appear “large and unjustified” on their face, and each settlement will be analyzed in a case-by-case basis. However, the manufacturers involved in *King Drug* have asked the Supreme Court to review the Third Circuit’s decision and on June 6, 2016, the Supreme Court asked the United States government to weigh in on its position. Therefore, there is some indication of the Supreme Court’s willingness to make a conclusive finding on the relevance of non-cash settlements in the context of reverse settlements.

**Actavis Has Been Extended To Apply To State Antitrust Laws**

The theories advanced by *Actavis* have been extended to challenges of reverse settlements under state competition and consumer protection laws. Attorneys General and private litigants have filed lawsuits challenging reverse settlements across the country. Although there is no established rule of reason analysis test in the federal courts, one California Supreme Court decision provides some guidance. The California Supreme Court in *In re Cipro Cases I & II*, 61 Cal. 4th 116 (2015), held reverse payment cases could be brought under California’s competition laws. The challenged settlement involved a large cash payment by the branded manufacturer to the generic manufacturer. The California Supreme Court established a four-part test necessary to establish a prima facie case of an antitrust violation. The plaintiff must establish that:

1. the settlement includes a limit on the generic challenger’s entry into the market;
2. the settlement includes cash or equivalent financial consideration flowing from the brand to the generic challenger; and the consideration exceeds
3. the value of goods and services other than any delay in market entry provided by the generic challenger to the brand, as well as
4. the brand’s expected remaining litigation costs absent settlement.

(*Id.* at 151 [emphasis in original].)

The court further explained that “once a plaintiff has shown an agreement involving a reverse payment and delay [the first two elements], the defendants have the burden of coming forward with evidence of litigation costs and the value of collateral products and services” since the defendants are more likely to have this information. (*Id.* at 153.)

Although the test is only applicable in California, the California Supreme Court’s establishment of a clear rule of reason test for analyzing reverse settlements has potential implications in federal jurisdictions. A New Jersey district court has already adopted the analytical framework established by the California Supreme Court. (*See In re K-Dur Antitrust* © 2016 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.
Furthermore, there is evidence that challenges of reverse settlements under *Actavis* theories are extending to actions brought by local prosecutors. On October 4, 2016, California’s Orange County district attorney, with the assistance of a private law firm, filed a lawsuit against a group of pharmaceutical companies alleging they conspired to delay the entry of generic versions of Niaspan. (See *The People of the State of California v. Abbott Laboratories et al.*, Case No. 30-2016-00879117 (Cal. Super. Ct. October 4, 2016).) The district attorney alleges that, in order to settle a patent infringement suit, the brand manufacturer agreed to make payments to the would-be generic manufacturer over an eight year period in exchange for that generic manufacturer’s agreeing not to introduce a generic version of Niaspan. The district attorney seeks to recover restitution payments for injured consumers as well as civil penalties. This suit is taking place concurrent with a multidistrict litigation in a Pennsylvania federal court in which direct purchaser and end-payor plaintiffs are challenging the Niaspan settlement based upon similar allegations.

**Conclusion**

Cases interpreting the Supreme Court’s decision in *Actavis* demonstrate that the full scope of the decision is far from established. The cases surveyed above indicate that courts are willing to expand the applicability of *Actavis*, but are taking a case-by-case approach due to the lack of higher court guidance on reverse settlement analyses. The California Supreme Court’s establishment—and a New Jersey district court’s subsequent adoption—of a four-part test gives hope that there may soon be a bright-line approach for analyzing reverse settlements under the rule of reason. Ideally, such a test will govern both cash and non-cash reverse settlements. Furthermore, there is strong evidence that challenges of reverse settlements under theories advanced by *Actavis* are continually extending to state causes of action, and that regulators at the local, state and federal level view these settlements with some suspicion. Therefore, companies and practitioners should closely monitor the development of the case law in this area.

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Competition Scrutiny of Digital Marketplace Intensifies as EU Signals Potential Enforcement of Vertical Restraints on E-commerce

By: Benjamin Wastler and Brendan Sepulveda

On October 6, the European Commission (the “Commission” or “EC”) presented the results of the Preliminary Report (the “Report”) on the E-commerce Sector Inquiry released on September 15 during a public event in Brussels. The sector inquiry was launched in May 2015, under European Union (“EU”) competition rules (Article 101 of the Treaty on the Functioning of the EU and Article 17 of Regulation 1/2003), but forms part of the EU’s Digital Single Market Strategy to develop a better understanding the competitive effects of electronic commerce of consumer goods and digital content in the EU.

The Report highlights the increasing significance of e-commerce in Europe. The EU is the largest e-commerce market in the world, and in spite of rapid growth, only 15% of Europeans aged 16 to 74 engaged in cross-border e-commerce, which suggests the presence of potential barriers to access of goods and services online from Member States. The Commission's findings are based on the responses received from thousands of questionnaires it sent to companies selling products and content online to investigate whether potentially anticompetitive contractual restrictions prevail.

The aim of the Digital Market Strategy is to achieve enhanced access for consumers and businesses to online goods and services across Europe and to remove unjustified barriers to entry into the marketplace. The four specific goals of the E-commerce Sector Inquiry are to (1) gain a more comprehensive understanding of competition issues, market dynamics, and business challenges in cross-border e-commerce; (2) provide guidance to businesses through subsequent enforcement, if appropriate; (3) analyze the legal framework governing online vertical restraints; and (4) complement legislative initiatives.

The Report is the second update on the EU’s investigation of e-commerce. In March the Commission released its initial findings which showed that “geo-blocking”—the practice of restricting the sales of consumer goods and access to digital content across borders—is widespread in the EU due to unilateral decisions of suppliers of goods and sellers of copyrights, as well as cross-border sales restrictions inserted in supply contracts and limits to the scope of licensing agreements. The sector inquiry found that 38% of the responding retailers selling consumer goods online use geo-blocking, and 68% of digital content providers replied that they geo-block users located in other EU Member States. The Report provides a broader overview of the primary competition-related trends in e-commerce and identifies possible competition concerns while further probing into the phenomenon of geo-blocking.

The Report will be open to public consultation for a period of two months, and stakeholders are invited to submit comments until November 18, 2016. The Commission plans to publish its final report in the first quarter of 2017.

Key Preliminary Findings: Goods

The Commission highlighted several foundational principles regarding e-commerce in goods, and applied these principles to its Report findings. First, the Commission noted that price transparency is vital in that it directly affects consumer behavior—it lowers consumers’ searching costs and allows consumers to quickly compare price information between offline and
online channels. This price transparency, in turn, leads to increased price competition as between offline and online channels. The Report noted, however, that price transparency also allows competitors to monitor each other’s prices—nearly 80% of retailers that use software to track competitors’ prices adjust their own prices to those of their competitors. Interestingly, over 40% of retailers in the consumer electronics, household appliances, and computer games markets reported modifying prices in this way on at least a daily basis.

Second, the Report also highlighted the increased popularity of new e-commerce distribution channels, like online marketplaces, and noted that the emergence of new online channels affects manufacturers and retailers distribution and pricing strategies. The Commission found that manufacturers want tighter control over distribution through regulating price and quality of distribution—64% of manufacturer respondents reported that they opened their own online retail shops in the last 10 years as a reaction to the growth of e-commerce.

Third, manufacturers are also becoming more selective with regard to their online distribution systems in an effort to tightly control retailer quality and to prevent sale to unauthorized retailers—56% of the respondent manufacturers reported that they make use of selective distribution for at least part of their products and fully two-thirds of the manufacturer respondents with selective distribution introduced new criteria regarding how retailers should sell or advertise products online. Respondents in the household appliances and sports/outdoor markets indicated the highest degree of selective distribution.

The Report further notes that manufacturers are increasingly turning to vertical restraints (e.g., pricing and channel restrictions) to control online distribution, with pricing limitations as the most popular among all respondents. The Report’s preliminary findings also show that 36% of the retailers surveyed use geo-blocking measures in order to restrict cross-border online sales, and nearly 12% of retailers have contractual cross-border sales restrictions in at least one of their product categories. Finally, the report also commented on manufacturers’ concern that certain large online retailers’ increasing market shares are providing the retailers with stronger negotiating positions to insist on profit margin or otherwise ensure that minimum prices are applied throughout the distribution network.

**Key Preliminary Findings: Digital Content**

Copyright protection in the European Union is “territorial” in that exclusive rights are enforced by national copyrights laws of the Member States rather than EU law. In order to distribute copyrighted digital content, a “digital content provider,” such as broadcaster or publisher, generally must obtain a license from the “right holders” of such content, such as film producers or record labels. The sector inquiry aimed to identify territorial restrictions and geo-blocking in the online distribution of digital content, and to examine the prevailing copyright licensing models for online distribution and their impact on competition. The probe further focused on “exclusive licensing” amid concerns that it, under certain conditions, could result in barriers to market entry or the reduction of competition at the distribution level.

The report concluded that the key factor affecting competition in digital content markets is the availability of licenses from the right holders, which is largely determined by the scope of rights between right holders and digital content providers in licensing agreements. Copyright licensing agreements in the EU are frequently complex and exclusive. Licensing rights are restricted according to transmission technologies, timing of releases, and territories. Rights relating to technologies limit the ways that digital content providers are allowed to transmit

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content, i.e., via online, cable, or satellite transmission, as well as the ways that users may receive content, i.e., via television set, computer, or mobile streaming devices. The temporal scope of rights is defined by “release windows” that distinguish between the different periods of time during which digital content providers are allowed to offer digital content. Territorial rights refer to the geographic area or areas in which a digital content provider may lawfully offer a product.

The preliminary results of the sector inquiry reveal that these contractual restrictions are the norm in digital content markets. For example, more than 60% of respondents to the Commission’s questionnaire reported that they contractually agreed with rights holders to geoblock users from other Member States from accessing their online digital content. In addition, many of these licensing agreements contain clauses enabling the right holder to monitor the implementation of geo-blocking measures, suspend distribution, or even terminate the licensing agreement or request compensation, where measures are not implemented in accordance with the rights holders’ requirements. The Preliminary Report found that these contractual restrictions may inhibit new entrants from securing licenses to provide digital content online, regardless of whether they are already active in other geographic markets.

The Commission concluded that digital content providers seeking to enter a market may also have difficulty obtaining licenses due to the relatively long and stable exclusive contractual relationships between right holders and established digital content providers. The duration of the vast majority of licensing agreements with digital content providers was for at least two and up to ten years. New entrants’ inability to access rights that are the object of long-term exclusive licensing agreement between their competitors and right holders may be exacerbated by contractual clauses in the licensing agreements such as first negotiation clauses, automatic renewal clauses, and other similar clauses.

The Preliminary Report noted, however, that vertical restraints such as exclusivity in licensing agreements could alleviate the problem of asymmetric information in the context of capital provision. This concern is particularly applicable in digital content markets, where one may encounter high uncertainty on the demand side and high sunk production costs on the supply side.

The Commission concluded that it will assess licensing practices on an ad hoc basis, taking into account the characteristics of the specific product and geographic markets, whether the licensing practices restrict competition, market power at different levels of the supply chain, and whether enforcement of the EU competition rules by the Commission is necessary in order to ensure effective competition. For instance, if geo-blocking is the result of agreements between right holders and digital content providers, it may restrict competition in the Single Market in breach of the EU antitrust rules, but any Commission enforcement measure against geo-blocking would also include an analysis of potential justifications for restrictions that have been identified.

**Significance for U.S. Companies**

U.S. companies doing business in the EU should take note of the results of the EC’s Report. Antitrust sector inquiries are often contentious and result in significant EC enforcement action. The most recent sector inquiry—into the pharmaceutical industry—called into question the practice of extending a drug’s patent protection to prevent the manufacture of generic drugs and resulted in separate enforcement actions against individual companies. Additionally, the EC
already has pending antitrust action in relation to access of digital content. In January 2014 the EC opened an investigation into geo-blocking in the film industry, including the practices of the five major US movie studios—20th Century Fox, Warner Bros, Sony Pictures, NBC Universal and Viacom’s Paramount Pictures—as well as Sky UK. The inquiry examined restrictions in contracts that allegedly prevent consumers from purchasing subscriptions outside of a movie studio’s home market. Also, given the Report’s emphasis on manufacturers’ preference for price restrictions and competitors’ e-commerce price matching, these areas may be ripe for EU enforcement in the coming months and years.

In a speech delivered in conjunction with the Preliminary Report’s release, the Commissioner for Competition, Margrethe Vestager, cautioned that the report “should be a trigger for companies to review their current distribution contracts and bring them in line with EU competition rules if they are not.” She added that some companies reevaluated their contracts during the sector inquiry. U.S. companies engaged in the sale of goods or distribution of digital content in the EU would be wise to do the same.

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