State Courts Continue to Wrestle with Resale Price Maintenance After Leegin

Kansas Supreme Court Upends Resale Price Maintenance and Kansas Rule of Reason Standard

New York Appellate Court Holds that Resale Price Maintenance Is Not Automatically Illegal

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For nearly a century, federal antitrust law (the Sherman Act) prohibited resale price maintenance (RPM or vertical price fixing) agreements as a per se illegal form of price-fixing. See 15 U.S.C. § 1 (1997). In 2007, however, the Supreme Court’s Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007) (Leegin I), held that RPM arrangements are not illegal per se under the Sherman Act. In so doing, the Court overturned Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911). Instead, RPM agreements are subject to “rule of reason” analysis, which allows RPM if its procompetitive benefits outweigh its anticompetitive effects.¹

Despite the passage of almost five years since the Supreme Court’s decision, it is unclear what, if any, long-term effect Leegin I will have, particularly with respect to state antitrust laws and the cases filed alleging claims under those laws. While many states interpret their antitrust laws in conformity with federal law, some states specifically prohibit RPM agreements, including states like Maryland that enacted per se statutes in response to Leegin I.² Furthermore, the attorneys general of a number of states – most prominently New York and California – have taken the position that their state antitrust statutes continue to condemn RPM as per se illegal even after the Leegin decision.

In the past week, there have been two significant developments in the evolving law governing RPM. On the one hand, the Kansas Supreme Court held that RPM is per se unlawful under Kansas state law, and adopted a slew of unusual and pro-plaintiff positions. On the other hand, the New York intermediate appellate court rejected the New York attorney general’s arguments that New York law condemns RPM as per se unlawful.

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THE KANSAS CASE

On May 4, 2012, in one of the remaining cases challenging Lee- gin’s alleged RPM practices, *O’Brien v. Leegin Creative Leather Products, Inc.*, No. 101,000 (*Leegin II*), the Kansas Supreme Court has made one thing clear – RPM is *per se* illegal in Kansas.

Leegin is a manufacturer and retailer of fashion accessories, including handbags, belts, wallets, and luggage. Leegin markets its accessories through company-owned and independent retail stores. The court described a variety of RPM programs requiring the retailer to acknowledge that non-compliance was grounds for termination or to commit to selling products for the suggested retail price.

The plaintiffs, a class of consumers who purchased Leegin accessories, presented the testimony of an expert economist who, among other things, found no evidence that a cartel existed among Leegin’s retailers or that the retailers requested implementation of the RPM programs. Plaintiffs’ expert also concluded that Leegin’s RPM agreements “necessarily raised the price at which consumers may purchase its products” and that these higher prices were not offset by benefits to competition or consumers. The plaintiffs argued that Leegin was engaged in vertical price fixing and horizontal price fixing agreements by virtue of its role as a dual distributor with company-owned stores, and that both forms of price fixing are *per se* illegal under Kansas state antitrust law.

Leegin, relying on *Leegin I* and Kansas courts’ historical reliance on federal antitrust law as persuasive, among other things, argued that *Leegin I* and the rule of reason should apply and that Plaintiffs failed to demonstrate the requisite antitrust injury. Seventeen Leegin retailers submitted affidavits that they would not discount regardless of whether a RPM policy was in place. Further, the class representative testified that she owns numerous other brands of accessories, thus admitting that Leegin had substantial competition in Kansas.

First, with respect to the standard applicable to Leegin’s RPM programs, the Kansas Supreme Court made clear that the Kansas antitrust statutes do not expressly reference the rule of reason and proceeded to overrule more than 60 years of Kansas case law by holding that the rule of reason does not apply to vertical price fixing, and, arguably, does not apply to vertical restraints more broadly. Although the only restraints at issue in *Leegin II* were RPM arrangements, the court overruled two earlier Kansas

In recognition of the potentially disruptive effect of the Kansas Supreme Court’s decision in *O’Brien v. Leegin Creative Leather Products, Inc.*, proposed legislation will be introduced in that state’s legislature. Based on the information available at this time, the proposed statute will mandate that Kansas law be interpreted in the same manner as Section 1 of the Sherman Act. In addition, the current proposal seeks to bar class actions and to apply the new legislation retroactively to pending litigation, including *Leegin II*:

An Act concerning the restraint of trade.

**New Section 1.** The purpose of this Act is to correct the erroneous interpretation of the Kansas Restraint of Trade Act, article 1 of Chapter 50 of the Kansas Statutes Annotated, and amendments thereto, made in *O’Brien v. Leegin Creative Leather Products, Inc.*, No. 101,000, 2012 WL1563976 (Kan. Sup. Ct., May 4, 2012), to prevent wasteful litigation that would likely result if that erroneous decision is not corrected, to forestall those potentially affected by that erroneous decision from ceasing or refusing to do business in Kansas in order to avoid potential liability and to minimize conflicts between the Kansas Restraint of Trade Act and Section 1 of Sherman Act, 15 U.S.C. § 1 and reduce uncertainty as to the law applicable to commerce in Kansas.

**New Section 2.** An arrangement, contract, agreement, trust, understanding or combination shall not be deemed a trust, and shall not be deemed unlawful, void, prohibited, or wrongful under any provision of article 1 of Chapter 50 of the Kansas Statutes Annotated, and amendments thereto, if that arrangement, contract, agreement, trust, understanding or combination is or would be deemed a reasonable restraint of trade or commerce under Section 1 of the Sherman Act, 15 U.S.C. § 1, as interpreted by the federal judiciary. This section shall apply retroactively in any pending or future litigation.

**New Section 3.** Any private action to enforce any provision of article 1 of Chapter 50 of the Kansas Statutes shall not be brought as a class action. This section shall apply retroactively in any pending or future litigation.
Supreme Court decisions, both of which analyzed the non-price vertical restraints at issue under the rule of reason.

Second, the court read the antitrust injury requirement so broadly that antitrust plaintiffs in Kansas need not produce evidence of actual impact, i.e., evidence that they themselves were actually overcharged as the result of the illegal conduct. Instead, the Kansas Supreme Court held that expert testimony based on academic theory and economic literature regarding the general effect of vertical price fixing alone was sufficient to create a genuine issue of material fact with respect to antitrust injury.

Third, the Kansas court left open the possibility that the RPM agreements of manufacturers with downstream operations that compete with their resellers could be treated as horizontal, rather than vertical, price fixing. The Kansas Supreme Court acknowledged that every federal appellate court has rejected this view, but declined to follow this weight of authority.

Thus, in one fell swoop, the Kansas Supreme Court apparently rejected three basic rules of federal antitrust law. Even if later courts soften the court’s ruling in other respects, Leegin II clearly makes RPM agreements per se illegal in Kansas, further complicating manufacturers’ efforts to manage through agreements the resale price of their products. After Leegin II, for manufacturers that do not want to sell through discounters, the safest course is to use clearly and carefully written and consistently applied unilateral resale pricing policies.

The New York Case

The New York courts have taken the opposite tack, rejecting the attempts of the state attorney general to establish New York as a jurisdiction categorically banning RPM. The New York attorney general (NYAG) launched a series of high-profile investigations of alleged RPM agreements under New York state law and brought a civil enforcement action against Tempur-Pedic for allegedly maintaining illegal RPM agreements with retailers. However, on May 8, 2012, the New York Supreme Court Appellate Division (the intermediate appellate court) delivered a significant blow to the NYAG’s efforts to curb RPM, holding that RPM policies are not per se unlawful under New York law and affirming the dismissal of the case against Tempur-Pedic.

See People v. Tempur-Pedic Int’l, Inc., 30 Misc. 3d 986, 916 N.Y.S.2d 900 (2011). The NYAG appealed. The appellate court, in a brief opinion, rejected all of the NYAG’s arguments and affirmed the dismissal of the case. The court “first found that [N.Y.] General Business Law § 369-a does not make RPMs illegal as a matter of law” because “there is nothing in the [statute’s] text to declare those contract provisions to be illegal or unlawful; rather the statute provides that such provisions are simply unenforceable in the courts of this state.” The appellate court noted that multiple federal district courts had similarly construed Section 369-a, citing, for example, WorldHomeCenter.com, Inc. v. Franke Consumer Prods., 2011 WL 2565284, 2011 US Dist LEXIS 67798 (S.D.N.Y. 2011).

In the alternative, even assuming that New York law absolutely forbids RPM agreements, the court found that the NYAG had failed to demonstrate the existence of an RPM arrangement. The court rejected the NYAG’s contention that Tempur-Pedic’s minimum advertised pricing policy constituted an RPM agreement as “[a]dvertising agreements cannot be the subject of a vertical RPM claim, because they do not restrain resale prices, but merely restrict advertising.” The court further concluded that “[i]n any event, the evidence [NYAG] tendered did not support a conclusion that RPM agreements were reached between Tempur-Pedic and its retailers, but merely that Tempur-Pedic enacted its minimum price policy and that its retailers independently determined to acquiesce to the pricing scheme in order to continue carrying Tempur-Pedic’s products.”
While the Tempur-Pedic case is the first appellate test of the NYAG’s position, it is significant that New York’s highest court – the Court of Appeals – has not yet weighed in. Until there is a ruling from the New York Court of Appeals, there remains a risk that a different appellate panel, either state of federal, could still agree with the NYAG that New York categorically prohibits RPM agreements. Nevertheless, there is a growing tide of case law holding that New York law, like federal law, does not treat RPM agreements as per se illegal.

ENDNOTES

1 Leegin I did not change the fact that the per se rule would still apply to claims that a horizontal agreement to implement RPM existed among competitors at either the manufacturer or reseller level. Id. at 886.

2 See Michael A. Lindsay, Overview of State RPM, http://www.antitrustsource.com [under References] (summarizing RPM-related state law). There also continues to be proposed federal legislation pending to overrule Leegin I and declaring RPM illegal per se under the Sherman Act.

FTC Suffers Another Blow in its Attack on ‘Pay-For-Delay’ Settlements

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The Federal Trade Commission (FTC) suffered another defeat in its war against “reverse payment” or “pay-for-delay” drug patent litigation settlements with a ruling by the Eleventh Circuit affirming the dismissal of FTC v. Watson Pharmaceuticals, Inc., No. 10-12729, 2012 U.S. App. LEXIS 8377 (11th Cir. April 25, 2012), a case challenging Solvay Pharmaceuticals, Inc.’s settlement with generic challengers to Solvay’s AndroGel product. In prior cases, the Eleventh Circuit held that such settlements are lawful as long as they were within the “scope of the patent” — meaning that they do not restrain competition any more than the patent itself would have.

Stuck with the “scope of the patent” test, the FTC argued that Solvay was “unlikely to prevail” in the patent litigation, and that because the settlement did not provide for immediate entry of the generic drug it was outside the patent’s scope. It urged the court to adopt a “rule that an exclusion payment is unlawful if, viewing the situation objectively as of the time of the settlement, it is more likely than not that the patent would not have blocked generic entry earlier than the agreed-upon entry date.” The court rejected this approach decisively. The Watson decision thus left undisturbed its rulings in previous cases that “reverse payment” settlements enjoy antitrust immunity absent proof that the patent litigation was a sham or the patent was obtained by fraud.

Reverse Payment Settlements

Judge Carnes’s playful opinion in Watson begins with a walk through the world of pharmaceutical patent litigation. Every company proposing to put a new drug on the market must file a New Drug Application (NDA) with the FDA if the drug is truly new to the market, or an Abbreviated New Drug Application (ANDA) if the drug is generic and chemically identical to a “pioneer drug.” A generic drug company may signal its intent to challenge the patent on a branded drug in the generic’s ANDA, triggering patent litigation among the drug companies.2

The branded and generic drug companies sometimes choose to settle with a reverse payment. “In this type of settlement, a patent holder pays the allegedly infringing generic drug company to delay entering the market until a specified date, thereby protecting the patent monopoly against a judgment that the patent is invalid or would not be infringed by the generic competitor.”3 The drug at the center of the Watson litigation was AndroGel, a gel treatment for low testosterone, sold by Solvay Pharmaceuticals, Inc. AndroGel was a highly successful product, generating nearly two billion dollars in sales starting in 2000.4
Enter generic manufacturers Watson Pharmaceuticals, Inc. and Paddock Laboratories, Inc. Watson and Paddock filed ANDAs after developing their generic versions of AndroGel. Solvay promptly filed patent infringement lawsuits. In response, Watson and Paddock challenged the validity of Solvay’s patent. While Watson’s and Paddock’s motions for summary judgment were pending, the parties reached a settlement, pursuant to which Solvay agreed to share its profits from AndroGel and the generic companies would not launch their generic versions until, crucially, five years before the expiration of Solvay’s patent.5

The FTC has long condemned deals like this as illegal agreements not to compete. The FTC’s position garnered some early support in the case law.6 The Sixth Circuit in In re Cardizem CD Antitrust Litigation, 332 F.3d 896 (6th Cir. 2003) held that the reverse payment agreement at issue in that case was a per se illegal restraint of trade under Section 1 of the Sherman Act. “There is simply no escaping the conclusion that the Agreement, all of its other conditions and provisions notwithstanding, was, at its core, a horizontal agreement to eliminate competition in the market for Cardizem CD throughout the entire United States, a classic example of a per se illegal restraint of trade.”7 But since Cardizem, every court of appeals to address the issue has rejected this view. The prevailing rule, as articulated by Watson, is 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.”8 The “exclusionary potential” is the breadth of the exclusion from competition the patent, if upheld, would allow. In other words, an agreement allowing for generic entry before patent expiration, as long as it does not prevent the generic company from marketing other products not covered by the patent, does not violate the federal antitrust laws.

The rule is a compromise between the twin policy goals of protecting competition, as Congress intended with the antitrust laws, and spurring innovation, as Congress intended with the patent laws. So long as the drug companies have patents in effect, so most courts have reasoned, the government has bestowed them with monopoly protections the benefits of which they can parcel out as they please. Only after the patents lapse will any restraints of trade imposed by the settlements exceed those allowed by the patent laws and therefore violate the antitrust laws.

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The Watson court told the FTC no means no, not unlikely. Even a patent unlikely to withstand judicial scrutiny does not have no exclusionary potential; nor does settlement indicate that a patent is likely to be defeated. “A party likely to win might not want to play the odds for the same reason that one likely to survive a game of Russian roulette might not want to take a turn. With four chambers of a seven-chamber revolver unloaded, a party pulling the trigger is likely (57 percent to 43 percent) to survive, but the undertaking is still one that can lead to undertaking.”12

The Eleventh Circuit also refused to adopt a rule requiring courts to undertake the “turducken task” of “deciding a patent case within an antitrust case about the settlement of the patent case.”13 Under the Eleventh Circuit’s precedent, the question is much simpler: Does the settlement agreement exclude competition beyond the scope of the patent? The court affirmed the case’s dismissal.

Watson has important ramifications for cases brought by private plaintiffs. These frequently allege that but for the settlement, the generic manufacturer would have won the patent litigation and therefore would have brought its drug to market earlier. After Watson, defendants will have solid support for their argument that it is inappropriate and unfeasible for courts in antitrust cases to relitigate the merits of the patent case.

The FTC is not done fighting. Nor is the battle to widen the circuit split on the treatment of reverse payment settlements over; the Third Circuit is mulling such a case right now.14 And bills are perpetually introduced in Congress that would make such deals illegal. Until those become law, or the Supreme Court rules that the settlements violate the antitrust laws, pharmaceutical companies likely will continue to enter into “reverse payment” settlements of patent litigation against would-be generic competitors.

The geography of the drug companies in question should be a first consideration. Companies with strong grounds for keeping the forum of an antitrust suit within circuits hewing to the looser “scope of the patent” standard have greater leeway in agreeing to reverse payment settlements. Once within those jurisdictions, any such settlements should fall within the bounds of the latest reverse payment decisions.

The FTC, likewise, does not consider all settlements of equal threat to competition. Obviously, those with less exclusionary effect are less likely to be targeted than those with more. Less obviously, but as Watson demonstrated, the FTC has set its sights on settlements involving patents it considers weak.15

Keeping tabs on the FTC’s moves is paramount for drug companies entering into agreements that take generic entry off the table, even for limited periods. The Watson decision, though not unexpected, is a boon for drug companies. It does not, however, fundamentally shore up the unstable landscape of antitrust enforcement in patent litigation settlements. For those that tread in this territory, it is still wise to tread with caution.

ENDNOTES

1 FTC v. Watson Pharmaceuticals, Inc., No. 10-12729, slip op. at 6-7 (11th Cir. April 25, 2012).
2 Id. at 8-9.
3 Id. at 3.
4 Id. at 10-11.
5 Id. at 13.
6 Id.
7 Cardizem, 332 F.3d at 908. The Court of Appeals for the D.C. Circuit also has adopted a per se rule banning reverse payments. See In re Andrx Pharms. Inc. v. Biocvil Corp. Int’l, 256 F.3d 799 (D.C. Cir. 2001).
8 Watson, No. 10-12729, slip op. at 30. While most developed in the Eleventh Circuit, the rule has been widely adopted. See, e.g., In re Tamoxifen Citrate Antitrust Litig., 466 F.3d 187 (2d Cir. 2006) and In re Ciprofloxacin Hydrochloride Antitrust Litig., 544 F.3d 1323 (Fed. Cir. 2008).
11 Watson, No. 10-12729, slip op. at 31.
12 Id. at 32.
13 Id. at 39.
14 In re K-Dur Antitrust Litigation, Nos. 10-2077, 10-2078, 10-2079 (3d Cir.).
15 FTC Commissioner J. Thomas Rosch has separately confirmed this tactic. J. Thomas Rosch, Comm’r, Fed. Trade Comm’n, Antitrust Evaluation of Pay-for-Delay Settlements: A Persistent Quest for Balance at 15, American Conference Institute’s Paragraph IV Disputes Conference, San Francisco, California (December 7, 2011), available at http://www.ftc.gov/speeches/rosch/111207paragraphIV.pdf (“weak or narrow patents are less able to forestall the early onset of generic competition”).

**Competition Commission of India Takes Action**

In the last few months, the Competition Commission of India (CCI) has demonstrated that it intends to vigorously enforce India’s competition law, particularly when bid rigging is detected:

- India’s antitrust authorities launched an investigation into claims that Google Inc.’s advertising operations were anticompetitive, following similar investigations opened by authorities in Argentina, Europe, South Korea, and the United States.
- Last week, CCI imposed a 3.2 billion rupees ($60 million) fine against United Phosphorous, Excel Crop Care and Sandhya Organics for rigging bids on public contracts.
- Two weeks ago, CCI fined ten explosive companies 600 million rupees ($114 million) for rigging bids on an auction run by a state-owned mining operation.
- In February, the CCI imposed a 1.65 million rupees ($31,000) for rigging bids against a public oil and gas company.

In light of this heightened activity, firms doing business in India should initiate or redouble serious compliance trainings and efforts to ensure that all employees understand that there are real consequences for engaging in anticompetitive conduct.
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