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INTELLECTUAL PROPERTY LITIGATION

Expert Analysis

Ruling on Patent Reverse Payment Settlements Draws Sharp Dissent

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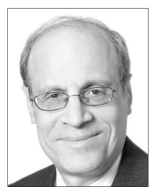

The last two months saw no fewer than three U.S. Supreme Court patent decisions, two of them illustrating the concerns of a majority of the court that patent rights not be used to stifle innovation or competition.

The only one of this trio of cases that produced a dissent (and a sharp one at that) is *Federal Trade Commission v. Actavis*, 133 S.Ct. 2223 (2013), in which the court ruled 5-3 that "reverse payment" settlement agreements, where the patent holder pays an accused infringer in return for an agreement that the infringer will not practice the invention during the term of the patent, may violate the antitrust laws.

Reverse settlements are most common in pharmaceutical patent litigation under the Hatch-Waxman Act, in which generic drug manufacturers challenge the validity, enforceability or application of patents covering brand-name drugs. A reverse settlement of such litigation typically obligates the generic manufacturer to commit to stay out of the market for all or part of the remaining patent term. In return, the patent holder makes payments to the generic manufacturer—essentially sharing some of the profit it expects to earn by marketing the branded drug without generic competition. Those settlements have drawn criticism from the regulators and consumer advocates who regard them as collusive limits on competition, but, until the *Actavis* decision, the majority of circuit courts considering the issue have held that the agreements are immune from antitrust challenge, as long as the restriction on competition does not stretch beyond the term and scope of the patent.

Justice Stephen Breyer's majority opinion in *Actavis* rejected that view, holding that a "large and unjustified" reverse payment carries the risk of "genuine adverse effects on competition," because a "payment in return for staying out of the market" might keep "prices at patentee-set levels," allowing a monopoly return "while dividing that return between the challenged patentee and the patent challenger." Those concerns, the majority found, would not be presented by a "traditional settlement," under which the generic manufacturer is allowed to enter the market at some point before the patent's expiration, but without receiving payment from the patent holder.

In determining whether a particular reverse payment is forbidden, a court is to employ the broad rule of reason applicable to restraints of trade that are not per se violations. The "likelihood of a reverse payment bringing about anticompetitive effects depends on its size, its scale in relation to the payor's anticipated future litigation costs," and "the lack of any other convincing justification."

Chief Justice John Roberts and two other dissenters (Justice Samuel Alito did not participate) would have applied a bright line rule recognizing antitrust claims only where a reverse payment gives the patent holder "monopoly power beyond what the patent already gave it." Under that view, a reverse settlement that does not require the challenger to stay out of the market after expiration of the patent would likely pass muster.

While *Actavis* does not condemn all reverse payment settlements, it will greatly inhibit them—the rule of reason test sketched out by the court is likely to result in costly litigation and unpredictable outcomes.

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In contrast to the court's division in *Actavis*, all the justices agreed in *Ass'n for Molecular Pathology v. Myriad Genetics*,133 S.Ct. 2107 (2013), a closely watched case—which generated dozens of amicus briefs—concerning the patentability of human genes. The patents at issue related to Myriad's discovery of the location and sequence of the BRCA1 and BRCA2 genes, mutations of which can greatly increase the chances of developing breast and ovarian cancer. Reversing the U.S. Court of Appeals for the Federal Circuit and disagreeing with the position of the Patent and Trademark Office, the Supreme Court held that the genes isolated from human DNA claimed in Myriad's patents were not patentable, because the "location and order" of the molecules in those genes "existed in nature before Myriad found them." "Myriad did not create anything. To be sure, it found an important and useful gene, but separating that gene from its surrounding genetic material is not an act of invention."

On the other hand, adopting a position advocated by the Solicitor General, the court held that complementary DNA (cDNA) can be patented. cDNA molecules are composed only of "exons," sequences of DNA that directly code for amino acids. cDNA is produced by eliminating "introns," sequences that do not code for amino acids. Because the court found that cDNA does not exist in nature, a "lab technician unquestionably creates something new when cDNA is made" and cDNA is patentable subject matter.

Supporters of the *Myriad* result believe it will drive down the cost of genetic testing, including testing for the BRCA mutations, while opponents warn that it will reduce incentives for genetic research and drug development.

Under the venerable doctrine of patent exhaustion, an authorized buyer of a patented product has the right to use or resell that article, but not to make new copies of it. In *Bowman v. Monsanto*, 133 S.Ct. 1761 (2013), a unanimous court held that a farmer who buys patented seeds infringes the patent when he reproduces the seeds through planting and harvesting. Monsanto holds patents on genetically altered soybean seeds that produce plants resistant to its Roundup herbicide. Vernon Hugh Bowman, an Indiana farmer, bought and planted patented seeds, and saved seeds from the resulting crops for replanting, replicating the seeds and producing Roundup-resistant crops over several seasons. The court held that Bowman had not simply used the seeds, but reproduced them, reasoning that, if the purchaser of an article "could make and sell endless copies, the patent would effectively protect the invention for just a single sale." The exhaustion doctrine is limited to the "particular item" sold "to avoid just such a mismatch between invention and reward."

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Copyright

Two influential courts rejected efforts to bring copyright infringement claims en masse, finding that actual owners of exclusive copyrights should enforce their rights individually under the Copyright Act. *Righthaven v. Hoehn*, 2013 WL 1908876 (9th Cir. May 9, 2013), held that acquisition of the bare right to sue for infringement, without transfer of an associated exclusive right, is impermissible under the Copyright Act and does not confer standing to sue. Righthaven's business model was to identify possible infringements of copyrights held by third parties, obtain limited revocable assignments of those copyrights, and then sue alleged infringers.

The assignment agreement at issue in *Hoehn* purported to "convey all ownership rights in and to [the works] to Righthaven through a Copyright Assignment so that Righthaven would be the rightful owner of the identified Work." The U.S. Court of Appeals for the Ninth Circuit found, however, that this transfer of "ownership" was ineffective to confer standing and invalid under the Copyright Act, because Righthaven had not been granted any of the exclusive rights available under the act. The Ninth Circuit's ruling would seem to create fundamental problems for the Righthaven business model.

In *Football Ass'n Premier League v. Youtube*, 2013 WL 2096411 (S.D.N.Y May 15, 2013), the Southern District of New York denied certification of two putative classes of copyright owners whose works were allegedly infringed on Youtube. The first class consisted of copyright owners whose works were infringed, blocked by Youtube after notice, and later infringed again. The second class consisted of owners of musical compositions that Youtube tracked, monetized, or identified and allowed to be used without authorization.

The court called copyright claims "poor candidates for class-action treatment," explaining that although the legal requirements and analyses are similar, every claim must be resolved upon individual facts specific to each alleged infringement. Each plaintiff was required to prove ownership, infringement, lack of fair use, and that Youtube had knowledge of the infringement and failed expeditiously to take down the work. The court also noted that the availability of statutory damages under the Copyright Act reduced the need to use a class action to allow plaintiffs to pursue small individual claims.

Trademark

Kelly-Brown v. Winfrey, 2013 WL 2360999 (2d Cir. May 31, 2013), overturned the district court's holding that Oprah Winfrey's use of the phrase "Own Your Power" qualified as fair use under the Lanham Act. Simone Kelly-Brown owns a motivational services business with the registered service mark "Own Your Power." Oprah Winfrey produced a magazine, event, and website that used the same phrase. To assert a successful fair use defense, Winfrey was required to show that the use was made (1) other than as a mark, (2) in a descriptive sense and (3) in good faith. First, the court found that Kelly-Brown plausibly alleged that Winfrey used "Own Your Power" as a mark by citing 22 different uses of the phrase, allowing the court to infer a pattern of use that could create secondary meaning. Second, without discovery the court could not conclude that "Own Your Power" is a phrase in common use, and the contents of the magazine indicated that the phrase was not used descriptively "as an exhortation for readers to take action to own their power" as Winfrey argued.

Finally, the court noted that direct evidence of intent to create confusion is not necessary, and that a plaintiff may show absence of good faith where a junior user had actual or constructive knowledge of the senior user's mark and chose to adopt a similar mark. Kelly-Brown argued that because Oprah's network had purchased the rights to the acronym "OWN" from a woman who had previously registered it, Winfrey would have conducted a trademark registration search and known that Kelly-Brown's "Own Your Power" mark was pending. Without resolving this factual dispute, the U.S. Court of Appeals for the Second Circuit held that the district court erred in holding that Winfrey had conclusively demonstrated good faith.

Hart v. Electronic Arts, 2013 WL 2161317 (3d Cir. May 21, 2013), held that Electronic Arts, Inc. (EA) violated former NCAA football player Ryan Hart's right of publicity under New Jersey law by using his likeness in a video game, rejecting EA's First Amendment defense. EA creates realistic video games that use digital avatars of real athletes. Each player's appearance and biographical and career statistics are replicated in the games. Unlike the professional athletes who are compensated for use of their images in similar video games, NCAA players are prohibited from receiving compensation. In considering EA's First Amendment arguments, the court determined that the transformative use test, as articulated by California courts in right of publicity cases, is the appropriate way to balance individual rights against First Amendment protection.

The court focused on two cases: *Winter v. DC Comics*, 69 P.3d 473 (Cal. 2003) and *No Doubt v. Activision Publishing*, 122 Cal. Rptr. 3d 297 (Cal. App. 4th 2011). In *Winter*, two musicians were depicted as half-man, half-worm comic book characters. The court found that the Winter brothers were "merely part of the raw materials from which the comic books were synthesized" and that the use was transformative. By contrast, the *No Doubt* court found that in the Band Hero game, members of the band No Doubt were used as "immutable images of the real celebrity musicians" and that "no matter what else occurs in the game during the depiction of the No Doubt avatars, the avatars perform rock songs, the same activity by which the band achieved and maintains its fame."

'Kelly-Brown v. Winfrey' overturned the district court's holding that Oprah Winfrey's use of the phrase "Own Your Power" qualified as fair use under the Lanham Act.

The *Hart* court found EA's video game to be more like No Doubt: The football players played college football in recreations of football stadiums. "The digital Ryan Hart does what the actual Ryan Hart did while at Rutgers; he plays college football, in digital recreations of college football stadiums, filled with all the trappings of a college football game. This is not transformative; the various digitized sights and sounds in the video game do not alter or transform [Hart's] identity in a significant way."

Patents

In *CLS Bank International v. Alice Corporation Pty.*, 2013 WL 1920941 (Fed. Cir. May 10, 2013), a sharply divided Federal Circuit sitting en banc rejected business method patents, media patents, and system patents claiming a computerized trading platform for conducting financial transactions, as failing to cover patent-eligible subject matter under 35 U.S.C. §101. Alice Corporation's patents related to "a computerized trading platform used for conducting financial transactions in which a third party settles obligations between a first and a second party so as to eliminate 'counterparty' or 'settlement' risk."

Four judges joined an opinion filed by Judge Alan Lourie, who found that the escrow concept in the method claims is an unpatentable abstract idea. While the system claims covered tangible devices, he found that those claims "recite[d] a handful of computer components in generic, functional terms that would encompass any device capable of performing the same ubiquitous calculation, storage, and connectivity functions required by the method claims." Three judges joined an opinion by Judge Randall Rader, who would have sustained the system patents. Rader wrote that, even if the claim covered an abstract idea, the central issue is "whether the claim covers every practical application of that abstract idea." Where "the claim is tied to a computer in such a way that the computer plays a meaningful role in the performance of the claimed invention, and the claim does not preempt virtually all uses of an underlying abstract idea, the claim is patent eligible." Judge Kimberly Moore, who joined Rader's opinion, lamented "the death of hundreds of thousands of patents, including all business method, financial system, and software patents as well as many computer implemented and telecommunications patents" under the majority's rationale.

The court's sharp disagreement as to the proper framework for considering patent eligibility for claims incorporating an abstract idea—whether to follow Lourie's lead and determine whether there is enough "genuine human contribution" added to that idea, or to focus, as Rader would, on whether the claims preempt all uses of the idea—is a strong invitation for Supreme Court review.