CHALLENGE RESTRAINTS AND THE SCOPE OF THE PATENT

By Erik Hovenkamp [1]

I. INTRODUCTION

Patents are often described as providing "the right to exclude." But this characterization obscures the more specific authorizations actually conferred by the Patent Act ("Act"). As a result, it is sometimes embraced to the detriment of sound patent policy, particularly when used as a basis for delineating the boundary between patent law and antitrust. An important example is the courts' troubled history of applying the "scope of the patent" test, which serves to provide safe harbor to competitive restraints that are authorized by patent law – or, alternatively, to deny safe harbor for (and potentially condemn[2]) restraints that are not so authorized.[3]

For example, any commercial restraints (e.g. royalty obligations) applied after patent

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[2] Such condemnation, if it occurs, need not come from antitrust; it may be supported by a holding of "patent misuse," which is prohibited by the Patent Act. See 35 U.S.C. § 271(d).

[3] See, e.g. *Carbice Corp. of Am. v. Am. Patents Dev. Corp.*, 283 U.S. 27, 33 (1931) (condemning a tie of a patented product and an unpatented product on the ground that this arrangement goes "beyond the scope of the patentee's monopoly"); *Coupe v. Royer*, 155 U.S. 565, 576 (1895); *Motion Pictures Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502 (1917). For a detailed account of the use (and abuse) of the scope of the patent test, See Herbert Hovenkamp, *The Rule of Reason and the Scope of the Patent*, 52 SAN DIEGO L. REV. 515 (2015).

expiration are outside the scope of the patent, and are virtually always held unlawful.[4] Consistent with this, some courts have focused principally on patent term as the relevant limit on patent scope. But it is clear that patent term alone is not the only important limit. For example, the courts have held that a tie of a patented product and an unpatented one may be outside the scope of the patent.[5] Similarly, a patentee is not entitled to exclude noninfringing products – for example, by paying a rival not to "invent around" its patent. The most logical and useful interpretation of the scope of the patent test is that it looks to the entirety of the Act's authorizations to ascertain what restraints the patentee is permitted to impose with its patent.[6]

This appears to have been the Supreme Court's interpretation in *Line Material*, which queried whether anything "in the patent statute specifically gives a right" to engage in the disputed conduct.[7] But not all courts have embraced this interpretation. So disfigured are some conceptions of the scope of the patent test that it is sometimes cited as a basis for antitrust immunity, when in fact it provides the clearest basis for denying safe harbor.[8] The most salient example is the dissenting opinion in the Supreme Court's recent *Actavis* decision, which echoed several lower court opinions. In *Actavis*, the majority held that "reverse payment"[9] patent settlements may violate the antitrust laws.[10] The dissent's view is that, because a patent provides the right to exclude, a patentee must be entitled to pay a rival to stop challenging its patent and stay off the market, so long as this exclusion does not extend beyond the patent term. It thus concluded that reverse payment settlements are within the scope of the patent.

The majority's treatment of the scope of the patent doctrine is more ambivalent. At one point, the opinion states that reverse payment's anticompetitive effects "may fall within the scope of the exclusionary potential of Solvay's patent, [but] this does not immunize the agreement from antitrust attack." This might be read to suggest that the dissent is correct in asserting that reverse payment is within the scope of the patent, but that antitrust may nevertheless condemn such agreements. By contrast, the Court later came much closer to the ideal application of the scope of the patent test, remarking that "[t]he dissent does not identify any patent statute" that authorizes reverse payment settlements. Here the majority seems to embrace the more logical position that the scope of the patent test should hinge on whether

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[4] See *Kimble v. Marvel Enterp., Inc.*, 135 S. Ct. 1697 (2015) (condemning post-expiration royalty obligations). The *Kimble* decision is unnecessarily restrictive. For example, if a licensee has little cash on hand, the parties may agree that the licensee will pay a smaller royalty but for a longer term that extends beyond expiration. This may not be meaningfully different from, say, a financing agreement for a car.

[5] See *Carbice Corp*., 283 U.S. at 33.

[6] See Hovenkamp, supra note __, at 534.

[7] *United States v. Line Material Co.*, 333 U.S. 287, 310–11 (1948) ("remarking that "[n]othing in the patent statute specifically gives a right to fix the price at which a licensee may vend the patented article.")

[8] A number of other scholars have similarly criticized the modern application of the scope of the patent test. See, e.g., Michael A. Carrier, Why the "Scope of the Patent" Test Cannot Solve the Drug Patent Settlement Problem, 16 STAN. TECH. L. REV. 1 (2012); Hovenkamp, note __, supra.

[9] In a reverse payment settlement, a monopolist-patentee pays a potential market entrant not to challenge its patent, and to stay off the market for some material period of time (but no longer than the date of patent expiration). They almost always occur in pharmaceutical markets, with a branded drug monopolist paying a generic manufacturer not to challenge the patents covering its drug.

[10] *FTC v. Actavis, Inc.,* 133 S. Ct. 2223 (2013).

the relevant restraint is authorized (expressly or impliedly) by any particular provision within the Act, as opposed to being merely consistent with colloquial generalizations about what patents do.

The majority's decision is correct. But it is also very narrow, and the antitrust analysis is fairly nonspecific. The Court shed little light on what particular aspects of the defendants' settlement – as distinguished from the entirety of the agreement – are critical to the antitrust claim.[11] Investigation of these more foundational issues could have helped to clarify the proper role of antitrust in other kinds of patent agreements, and to delimit the often-obscure boundary between antitrust and patent law.

This brief article lays the foundation for a more comprehensive theory of antitrust's proper role in policing patent agreements. It hinges on the distinction between ordinary patent rights and "challenge rights" – the (statutory[12]) rights of third parties to challenge patents as invalid or uninfringed. These two classes of rights serve very different policy functions. And, importantly, they receive different treatment by the Act, most notably with respect to their alienability. The result is that "challenge restraints" – contractual restrictions on the exercise of a party's challenge rights – are plainly not within the scope of the patent. Accordingly, such agreements are not entitled to safe harbor, but rather exist within antitrust's domain.[13]

Of course, this does not suggest that all challenge restraints should be condemned, regardless of context. Rather, it means that antitrust should operate as it normally does: by evaluating the reasonableness of the restraint in light of any countervailing procompetitive effects, and taking into account any salient policy concerns, including those underpinning the patent system.

II. CHALLENGE RIGHTS

The *Actavis* dissenters, along with many jurists, appear to focus exclusively on the patent rights held by the patentee when engaging the scope of the patent doctrine. But these are not the only important rights conferred by the Act. It also confers challenge rights to third parties who would like to market their products without the hovering threat of infringement liability. Section 282 of the Act permits an accused infringer to argue "noninfringement" or "invalidity of the patent" as a defense to infringement liability, and the Declaratory Judgment Act ensures that

[11] For example, the court did not articulate whether a noncash payment – for example, a promise by the patentee not to launch its own "authorized generic" drug – can support an antitrust claim, although lower courts have answered that question in the affirmative. See *SmithKline Beecham Corp. v. King Drug Co. of Florence*, 791 F.3d 388 (3d Cir. 2015) (holding that a no authorized generic agreement may violate the antitrust laws under *Actavis*); See also, Aaron S. Edlin et al., *The Actavis Inference: Theory and Practice*, 67 RUTGERS L. REV. 585, 600 (2015).

[12] 35 U.S.C. § 282(b).

[13] Two recent and insightful articles also address the antitrust implications of agreements that prevent someone from challenging a patent, although their focus is specifically on "no-challenge clauses" in conventional patent licensing agreements (generally between non-competitors), which is just one of many possible contexts in which such restrictions might be utilized. See Alan D. Miller & Michal S. Gal, *Licensee Patent Challenges*, 32 Yale J. Reg. 121 (2015); Thomas K. Cheng., *Antitrust Treatment of the No Challenge Clause*, 5 NYU J. I.P. & Ent. L. 437 (2016).

these challenges can also be raised offensively.[14] Additionally, Section 311 permits a party to challenge a patent's validity in the Patent Trial and Appeal Board. As such, a patent challenge is a privileged competitive act. However, a serious problem – which persists both in patent scholarship and the case law – is that patent challenge rights have not been recognized as distinct legal entitlements that are important in their own right. This is particularly problematic in light of the very disparate policy roles played by these two classes of rights.

The patent system seeks to elicit a desirable tradeoff between competition and the rate of innovation. In facilitating this balance, patent rights and challenge rights perform countervailing functions. Patent rights are the reward used to encourage innovation: they permit patentees to sue (and potentially enjoin) infringers; to collect damages for past infringement; and to license or assign the right to use the patented invention. By contrast, challenge rights provide a check against potential over-enforcement of patent rights, helping to clear the way for privileged competition. Accordingly, challenge rights promote the interests of competition policy, while patent rights are directed principally at encouraging invention. As such, patentees – who internalize profits, but not consumer surplus – always want patent rights to be as strong as possible, but challenge rights to be as weak as possible. By contrast, society at large is best served by an equitable balance between the two.

III. PATENT CHALLENGE RESTRAINTS

Challenge restraints – agreements that bar or penalize the exercise of a party's challenge rights – may arise in a variety of different patent agreements, and within different commercial relationships.[15] Reverse payment settlement is an obvious example, as the drug monopolist is paying the generic firm to stop challenging its patents, and to abstain from challenging them again in the future. But they may also take the form of "no challenge clauses" in ordinary patent licensing agreements between non-competitors, with the licensee agreeing not to challenge the validity of the licensed patent (or to suffer a penalty upon filing a challenge). Alternatively, rivals may agree not to challenge each other's patents, but without any party being excluded from the market. For example, in *U.S. v. Singer Mfg.*, the Supreme Court condemned an agreement in which competing sewing machine manufacturers agreed not to challenge each other's patents and to refuse to license Japanese rivals.[16]

Importantly, reciprocal promises not to challenge are not necessarily equivalent to cross-licensing. The agreement might also prevent the parties from practicing each other's patents, in which case it looks more like market division.[17] This could be accomplished by imposing reciprocal challenge restraints, but withholding any exchange of licensing rights. In such an agreement – and in reverse payment – the challenge restraint is "naked" in the sense that it is not accompanied by a technology transfer to the restrained party, which will tend to

[14] 28 U.S.C. §2201-2202.
[15] See Miller & Gal, note __, supra.
[16] *United States v. Singer Mfg. Co.*, 374 U.S. 174 (1963).
[17] Alternatively, it could be that the patents are overlapping (ostensibly implying that at least one of them is invalid), or that they cover substitute technologies, in which case there may not be the two-way technology transfer that characterizes cross-licensing.

make it more difficult to justify under the rule of reason.

The nature of the restraint may also vary. It can take the form of a waiver, which is generally the strongest restraint. Alternatively, it could consist in an economic inducement that discourages the exercise of challenge rights. For example, some licensing agreements stipulate that the license is terminated immediately if the licensee challenges the patent.[18] The nature of the restraint may be germane to antitrust analysis under the rule of reason. For instance, even if the parties are competitors with market power, it might be perfectly reasonable for them to agree simply that the potential challenger will have to reimburse the patentee's litigation expenses if it files and loses a patent challenge.

A. Antitrust Evaluation of Challenge Restraints

Consistent with the *Actavis* and *Singer* examples, the courts have occasionally adjudicated antitrust claims surrounding patent agreements that happen to involve challenge restraints. But they have failed to recognize challenge restraints as a distinct antitrust issue that is common to many of the patent agreements that have been attacked as anticompetitive. Further, some challenge restraints – namely those arising in ordinary licensing agreements between noncompeting firms – have never been recognized by the courts as a potential antitrust issue. In *Lear*, a non-antitrust case, the Supreme Court held that, as a default, licensees have the right to challenge the licensed patent.[19] This led to the widespread inclusion of challenge restraints within ordinary licensing deals. Thomas Cheng, who discusses these licensee no-challenge clauses, notes that, "[i]n the U.S., no court seems to have ruled on the legality of no challenge clauses under antitrust law."[20]

But it is easy to see that challenge restraints are exactly the kind of thing that antitrust is intended to police. A patent challenge is a privileged competitive act. And if a party has a right to perform a competitive act against a rival – for example, to expand its business into the rival's territory – the antitrust laws generally prohibit the firms from entering into an agreement that restraints that act, at least unless there is a procompetitive justification for it. Even if the agreement is vertical rather than horizontal, the restraint may be unlawful if the parties have market power and the restraint lacks a satisfactory justification. Thus, the only question is whether patent law create an exception that precludes application of the same antitrust standards to challenge restraints. The answer is no. The Act explicitly states that patent rights are generally alienable. It provides that they may be licensed or assigned, for instance. But the Act never provides that challenge rights are similarly alienable – not even impliedly.[21] Indeed, agreements that suppress challenge rights may often belie the very policies that motivated the conferral of those rights. Challenge rights are an instrument of competition policy. They serve essentially the same interests that underpin the scope of the patent doctrine: to prevent

[18] See Miller & Gal, note __, supra.
[19] *Lear, Inc. v. Adkins*, 395 U.S. 653, 670-71 (1969) (holding that there is no doctrine of "licensee estoppel" that automatically bars a licensee from challenging the licensor's patent.
[20] Cheng, note __, supra, at 447. However, the author notes that some courts have addressed the enforceability of such no challenge clauses under patent law.
[21] See also Miller & Gal, note __, supra ("patent law … does not grant [patentees] the right to be free from challenges.")

patentees from effecting unearned or overreaching restraints on commerce. It is thus ironic that some regard the suppression of challenge rights as falling within the scope of the patent.

When evaluating a patent agreement involving a challenge restraint, antitrust's proper role is to ask whether the restraint is reasonably justified in light of any procompetitive effects created by the agreement, taking into account any relevant policy concerns. It is beyond the scope of this article to present a comprehensive discussion of how antitrust ought to view different kinds of challenge restraints. But a few simple observations may prove helpful in future research efforts.

Licensing is the most obvious procompetitive efficiency that might justify a challenge restraint. In an ordinary "vertical" licensing agreement (i.e. one in which the parties are in a purely vertical relationship[22]), a challenge restraint may be reasonably justified on the ground that it eliminates a potential holdup problem. If both parties know that the licensee could use the threat of litigation opportunistically – for example, if the patentee's business falls upon hard times – then their relationship may be detached, contentious, or otherwise unstable. The prospect of a lingering litigation threat might even deter the patentee from seeking out a licensee in the first place. If the parties bargain *ex ante* – i.e. before the prospective licensee has committed itself to the patented technology – then the patentee knows that the licensee will likely have a stronger incentive to challenge the patent later on, after it has committed itself. At the margin, a patent challenge has larger expected value for the licensee if the fixed costs of implementing the patented technology are already sunk. This makes contracting precarious, because the patentee cannot be sure whether the royalty rate imposed *ex-ante* will hold up *ex post*, when the licensee may have a heightened incentive to challenge the patent. A challenge restraint could eliminate this holdup problem and facilitate commitment to the relationship.

Viewed in this light, vertical challenge restraints may operate essentially as a special case of exclusive dealing.[23] After all, the agreement commits the licensee to buy the rights to use the patented invention from the patentee, and not acquire them by other means. The only difference here, which appears largely immaterial to the antitrust inquiry, is that "other means" refers to litigation of a patent challenge, as opposed to switching to a different upstream provider.[24] This is an important point that has been missed in recent scholarship on no-challenge clauses in licensing agreements.[25] It implies that vertical challenge restraints are

[22] This implies the firms are not competitors in any relevant product market. If the parties are competitors in products, then their relationship is not purely vertical, since they are horizontally related in the product market.

[23] Exclusive dealing refers to a (usually purely vertical) agreement that restrains a party's right to transact with firms in competition with the other party. For example, a wholesaler and retailer might agree that the retailer is barred from buying any competing versions of the wholesaler's good.

[24] On the other hand, the worst interpretation of a vertical challenge restraint would be that it acts like a vertical agreement prohibiting the downstream firm from integrating into the upstream market. That would be market division, since it prevents inter-party competition in the upstream market. But a vertical challenge restraint would not prevent inter-party competition in the upstream market (a market for licensing rights), since a successful patent challenge would not transform the licensee into a competing licensor; it just eliminates the royalty obligation.

[25] See Miller & Gal; Cheng, note __, supra. Neither article discusses the instructive similarities between vertical no-challenge clauses and exclusive dealing, nor the related point that such restraints might eliminate a holdup problem. However, they do acknowledge the relevance of market power to a potential antitrust claim.

merely a novel embodiment of a well-understood antitrust issue, suggesting we can use longstanding antitrust machinery to evaluate them.

As with exclusive dealing, market power should be an important element of the antitrust claim. If there is no inter-party competition (which is true in any purely vertical relationship), challenge restraints should probably be viewed as competitively benign if the parties lack market power. Similarly, the agreement probably does not raise antitrust concerns if the patents in question are impotent to influence the relevant product market. If the agreement seems capable of impacting market structure, then it should be evaluated under the rule of reason, as with exclusive dealing and other vertical restraints.

An important aspect of the market structure analysis relates to the challenge rights of third parties. A challenge restraint does not preclude nonparty firms from challenging the relevant patents, just as an exclusive dealing agreement does not prevent third parties from contracting with alternative upstream providers. If the market is sufficiently competitive such that restraining just one producer is unlikely to threaten the product market, then there may be no viable antitrust claim. However, there may be context-specific factors such that unrestrained third party producers have a limited incentive to challenge. The best example is the Hatch-Waxman Act's provision of 180-day exclusivity to first-filling generics, which serves to diminish the incentive to challenge by later-filers.[26] Alternatively, in non-pharmaceutical markets – namely those in which products are differentiated – it may be that there are only a small number of producers in the market that actually have an interest in challenging the patent in question. For example, if a patented invention is directed at diesel car engines, then only car manufacturers that produce a large number of diesel cars have a strong interest in acquiring the patent rights. These are fundamentally antitrust questions.

One important feature of pharmaceutical markets is that products tend to be highly undifferentiated; generic drugs and their branded counterparts are essentially fungible. This makes competition very intense, suggesting that a single challenge restraint would not be very valuable if third parties were not also somehow discouraged from challenging. However, if products are differentiated, then a single challenge restraint can be profitable even if third party firms are not discouraged from bringing their own challenges. Those third party challenges would likely result in licensing agreements – the usual settlement format in most non-pharmaceutical markets. But, because products are differentiated, this does not necessarily extinguish market profits. And the original challenge restraint remains valuable, since it still serves to preclude a competing use by at least one important firm, helping to soften competition. For example, an equilibrium might involve firms entering into licensing deals with their least similar competitors (in which case licensing might enhance their joint profits), but entering into challenge restraining agreements with their closest rivals (in which case licensing might erode joint profits).

Naked challenge restraints in horizontal agreements are much harder to justify. Reverse payment settlement is a good example of this. The value of settling litigation might be regarded

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[26] This is a result of some badly drafted provisions of the Hatch-Waxman Act. See, e.g. C. Scott Hemphill & Mark A. Lemley, *Earning Exclusivity: Generic Drug Incentives and the Hatch-Waxman Act*, 77 ANTITRUST L.J. 947 (2011).

as a justification for a reverse payment settlement. (This could also justify a challenge restraint in a vertical licensing relationship.[27]) But, of course, this explanation is unsatisfactory if the payment is large and the exclusion period is long. Such characteristics suggest that the payment's role is not really to effect a settlement, but rather to forestall a patent challenge that might leave the market much more competitive. That is, the challenge restraint is being used to facilitate delay, not merely to end litigation. Another point is that, if the parties are genuinely in agreement that the patent is valid and infringed, and if litigation costs are genuinely large enough such that their avoidance constitutes a cognizable procompetitive efficiency, then litigation costs alone should be large enough to deter a repeat challenge by the defendant. That would suggest that the settlement need not include a restraint on ex post challenge rights in order to produce a stable resolution to the dispute. Note that this is not an argument about the likelihood of invalidity. Rather, the question is whether such a strong challenge restraint is reasonably necessary to effect a settlement.

The avoidance of litigation costs is not the only thing that could in principle justify a reverse settlement. A number of scholars have noted that, while a reverse payment's consumer injury is probabilistic, it offers at least at least one certain benefit to consumers: pre-expiration entry by the generic firm.[28] Most reverse settlements involve a delay period that ends prior to patent expiration, but a final judgment could result in an injunction that keeps the generic firm off the market for the full remainder of the patent term. However, in a recent article, my coauthor and I argue that the delay period that the firms will actually choose will be longer than that which leaves consumers indifferent between settlement and litigation to judgment.[29] In fact, we show this is so even in a "pure delay" settlement where the patentee gives no payment or other consideration to the generic firm (which would involve a less lengthy delay than a paid agreement). Intuitively, by preserving patent validity – which acts like an entry barrier by forcing third party generics to challenge prior to entry – the settlement will slow the rate of third party entry (relative to invalidation) for the remainder of the patent term. This increases total profits in the product market, and the patentee takes its share of these rents by demanding a longer delay period than that which would leave consumers indifferent between settlement and full litigation. Thus, in practice, reverse settlements' accommodation of pre-expiration entry will generally be insufficient to generate a net-benefit for consumers (relative to continued litigation).

Naked challenge restraints need not achieve exclusion at the product-level, as occurs in a typical reverse settlement. For example, suppose two car manufacturers each offer some patented features that are not offered by the other. The firms might have a joint interest in agreeing that they will neither challenge nor practice one another's patents, thus softening competition at the feature-level. Like reverse payment, this is essentially a form of market

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[27] If vertically related parties want to settle and begin a licensing relationship, then a challenge restrain may be helpful by eliminating the lingering threat of litigation and thereby making the relationship more stable and productive, as was already discussed above.

[28] Daniel A. Crane, Actavis, the Reverse Payment Fallacy, and the Continuing Need for Regulatory Solutions, 15 Minn. J. L. & Tech. 51, 55 (2014).

[29] Erik Hovenkamp & Jorge Lemus, *Reverse Settlement and Holdup at the Patent Office*, (submitted for publication). Available at: https://papers.ssrn.com/abstract=2814532.

division, and it may warrant antitrust intervention. But in this case the agreement does not exclude an entire product from the marketplace.

The prospect of third party challenges is less consequential in horizontal agreements involving naked challenge restraints. Third party competition is often less important in evaluating horizontal agreements that impose naked restraints on inter-party competition. For example, if two firms agree to stay out of each other's territory, they cannot hope to justify their market division agreement by pointing out that it does not stop any third parties from entering either firm's territory. Similarly, even if third parties can still challenge the relevant patent, a naked challenge restraint imposed between rivals may still warrant antitrust intervention to the extent that there is no reasonable justification for it.

IV. ACQUIRING A MORE DURABLE PATENT MONOPOLY

A patent provides a temporary monopoly over the patented technology. However, patents are probabilistic.[30] Until a patent is actually litigated to judgment, its validity – and hence its capacity to achieve exclusion through the litigation process – remains uncertain. The result is that a patent monopoly may not be very *durable*.[31] That is, the patent may not be of sufficient quality to permit the patentee to act like a true monopolist, which can set whatever terms it likes, since there are no competitive pressures to compel a more generous offering. Challenge rights entitle rivals or prospective licensees to target the patent's potential vulnerabilities. Since the patentee strongly prefers not to have its patent invalidated, it may be obliged to put up with some competition – to accept royalties when what it really wants is an injunction – or to set a lower royalty rate than it would prefer. After all, if the patentee refuses to make any such concessions, it might end up with nothing.

This result – that lower quality patents are less durable and thus impose smaller restraints in commerce – performs a socially valuable function. Judgments on patent validity are binary; each disputed claim with be held either valid or invalid. But patent quality is non-binary, since patentability criteria like novelty and nonobviousness exist along a spectrum. But because lower quality patents are less durable, the patent system can nevertheless ensure that commercial restraints are somewhat proportionate with patent quality. Importantly, however, it is challenge rights that ultimately facilitate this proportionality. If patents could not be challenged as invalid, then bad patents would be no less durable than good ones, and their exclusionary effects would be just as strong.

This sheds further light on why challenge restraints are not within the scope of the patent. The courts occasionally emphasize the enlargement of the patent monopoly – i.e. the magnification of the patent's exclusionary power – as a hallmark of restraints beyond the scope of the patent. For example, this language is used in justification of the prohibition on post-

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[30] See Mark A. Lemley & Carl Shapiro, *Probabilistic Patents*, 19 J. ECON. PERSP. 75 (2005).

[31] Aaron S. Edlin et al., note __, supra (noting that, when the "delay" period of a reverse settlement concludes, the resulting duopoly between the generic firm and the patentee is often not "durable" after the generic firm's 180 exclusivity period runs, because third party generic firms will then challenge the patent).

expiration royalty obligations.[32] But an alternative way to enlarge the patent monopoly is to increase its durability by entering into horizontal agreements that restrain the challenge rights of some prominent rivals. This makes the market less contestable, allowing the patentee to behave less competitively than it could afford to do if armed with the patent alone. As such, even under the less formal "enlargement of the patent monopoly" interpretation, challenge restraints plainly go beyond the scope of the patent.

V. THE TWO MODES OF EXCLUSION

There are two ways a patentee can exclude a rival that plans to sell a potentially-infringing product. The first is through infringement litigation. This, of course, is not certain to succeed, since it is not certain that the patent will be held valid and infringed, nor that such a holding would be remedied through an injunction order. The second possible mode of exclusion is to enter into an agreement under which patentee provides some consideration (but not a license) to the rival in exchange for a restraint on the rival's challenge rights. This is the most helpful way to characterize a reverse settlement. And, unlike infringement litigation, this approach is certain to achieve exclusion of the rival (at least in lieu of antitrust intervention), regardless of whether the patent is valid and infringed.

As such, the latter strategy can be used to achieve exclusion beyond the scope of the patent, and not only because it may facilitate exclusion based on an invalid patent. It could also be used to achieve exclusion of noninfringing competition. For example, suppose that two duopolists, *A* and *B,* know that *B*'s product almost certainly does not infringe *A*'s patent. Suppose further that, as is true in most markets, monopoly provides larger total profits than duopoly. Then, despite the parties' actual beliefs about the infringement claim, the firms can mutually benefit from an agreement (which might be stylized as a settlement) in which *A* pays *B* to give up its challenge rights. This leaves *B* defenseless against a future patent infringement claim, eliminating any incentive it might have had to try and enter the market. In fact, the agreement could accomplish this indirectly by relying on claim preclusion as an indirect restraint on *B*'s challenge rights. The settlement could simply memorialize the parties' joint agreement that the patent is valid, and that it would be infringed by *B*'s product; it might even stipulate that *B* is enjoined from making sales.[33] The default rule is that this settlement will have a claim-preclusive effect – the practical effect of which is to extinguish *B*'s right to challenge the patent – provided that it culminates in a dismissal with prejudice, or that it is entered as a consent decree.[34] The result is a robust legal barrier that keeps *B*'s noninfringing product off the market.

This clarifies why it is problematic to characterize a patent as simply conferring "the

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[32] See, e.g. *Brulotte v. Thys Co.*, 379 U.S. 29, 33 (1964) (condemning post-expiration royalty agreement on the ground that it amounts to "an effort to enlarge the monopoly of the patent.")

[33] In a recent paper on reverse settlements, my coauthor and I discuss a settlement (which was entered as a consent decree) that stated precisely these things. See Hovenkamp and Lemus, note __, supra.

[34] *Pactiv Corp. v. Dow Chemical Co.*, 449 F.3d 1227, 1231 (Fed. Cir. 2006) (holding that a settlement of litigation triggers res judicata, barring the defendant from later challenging the patent, unless the parties' settlement expressly reserves the defendant's right to challenge the patent in the future).

right to exclude." Indeed, there are two distinct ways to achieve exclusion, but only one of them is authorized by the Act. The other way – contractual restraints on challenge rights – is not so authorized, and may be used to the detriment of patent policy objectives.

VI. REMOVING THE VALIDITY QUESTION FROM THE ANTITRUST ANALYSIS

A reverse settlement harms consumers only if the patent is either invalid or uninfringed. (In what follows, I will focus on the former prong.) But a reverse settlement typically occurs before – and thus precludes – a final judgment on patent validity as between those two parties. As a consequence, antitrust intervention occurs at a time when the patent's validity remains uncertain. The *Actavis* dissenters regarded this manner of intervention as conclusory and inappropriate.[35] Their unease is echoed by a number of scholars. For example, one recent article argues that the decision is jurisprudentially unsound because it makes an implicit legal determination about patent strength based only on the parties' beliefs about how a court would rule on the validity issue.[36]

But the more common critique of antitrust intervention in reverse settlement cases seems to be that, because the patent's validity remains uncertain, the antitrust plaintiff has not made a showing that consumers are likely to suffer a but-for injury.[37] For example, in discussing the uncertain impact a patent judgment would have had on competition, one commenter writes that "the uncertain competition analysis is difficult to reconcile with standard analyses under the antitrust laws."[38] The problem with this argument is that it presumes – incorrectly – that antitrust enforcement requires proof that the defendants' agreement caused a but-for injury to consumers, as distinguished from a showing that the agreement restrains competition without justification. Antitrust violations are not like torts; they do not include harm as an element of the offense.[39] They are more similar to, say, traffic violations: they are directed at conduct itself. The exception is that private antitrust enforcement operates more like conventional tort law (at least in damages actions), because a private plaintiff must prove that the antitrust violation caused it to suffer an injury.

As this suggests, the question of whether an antitrust plaintiff must prove a consumer injury depends entirely on the nature of the enforcement. It does not hinge on the nature of the

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[35] *Actavis,* 133 S.Ct. at 2241 (disputing the majority's arguments that antitrust intervention does not compel adjudication of patent validity). A large number of scholars support the majority's contention that the patent need not be litigated to judgment. See, e.g. Edlin et al, note __, supra.

[36] Joshua Fischman, *The Circular Logic of Actavis*, 66 AM. U. L. REV. 91 (2016) (arguing that the *Actavis* decision "relies on the prediction theory of law – the widely disparaged conception of law as consisting merely of predictions about what courts will do.").

[37] See, e.g. Marc G. Schildkraut, *Patent-Splitting Settlements and the Reverse Payment Fallacy*, 71 ANTITRUST L.J. 1033, 1055-56 (2004) (advocating the need for a "traditional standard of proof" such that "any time the antitrust plaintiff fails to establish that the alleged infringer would have prevailed in the patent litigation, the court should dismiss the antitrust case.").

[38] Id.

[39] For example, Section 1 of the Sherman Act, which delimits the scope of antitrust intervention in collusive arrangements, focuses entirely on anticompetitive conduct, not consumer harm. 15 U.S.C. §1 (prohibiting every "contract, combination, … or conspiracy in restraint of trade").

restraint, nor on the distinction between per se rules and the rule of reason. Under the Sherman Act, the Department of Justice is given broad authority "to prevent and restrain violations of this Act."[40] Similarly, the Federal Trade Commission is empowered to prevent parties from "using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce."[41] These provisions authorize public enforcement based simply on a showing of anticompetitive conduct, i.e. that which unreasonably restraints competition. In contrast, a private plaintiff seeking damages must prove not only conduct "forbidden by the antitrust laws," but also "damages *by him sustained*."[42] Similarly, to obtain an injunction, he must prove "threatened loss or damage by a violation of the antitrust law."[43] The courts have interpreted these provisions to mean that a private plaintiff must prove the violation caused him to suffer an injury in order to receive damages, but that injunctive relief may be available even if he fails sufficiently to quantify the injury.[44]

As a result of these enforcement standards, antitrust courts frequently condemn agreements without inquiring into their (often speculative) likelihood of injuring consumers. In broad outline, if an agreement restrains some competitive activity, and if the defendants fail to offer a satisfactory justification for it, then an antitrust court may condemn the agreement on these findings alone. The most conspicuous example of this is the absence of a market power requirement for price-fixing claims. If two firms fix prices, they injure consumers only if they command sufficient market power to influence the market. But the courts do not require evidence to that effect in order to find a violation.

However, the more instructive analogue is naked market division in territories. Suppose that two car dealers, *A* and *B*, currently operate in neighboring states, but stumble into one another at a trade association gathering. Dealer *A* offers *B* $25K if it agrees never to expand into *A*'s state, despite the fact that *A* does not know whether *B* would otherwise have expanded in its direction. And *B* accepts the offer, despite not knowing whether it would otherwise have wanted to expand into *A*'s territory. This market division agreement is plainly unlawful. And yet the probability of consumer harm is completely uncertain. We do not know whether *B* would have moved into *A*'s territory but for the agreement, which is just like saying that we do not know whether a patent would have been invalidated but for a reverse settlement. The point is that this uncertainty is not germane to the antitrust claim. There is no procompetitive justification for the restraint on *B*'s right to enter *A*'s territory, and hence antitrust intervention does not require a showing that consumers are likely to suffer a but-for injury.

The same logic applies to challenge restraints. A patent challenge is a privileged competitive act, just like expansion into a rival's territory. Thus, if an agreement between competitors serves to restrain a party's challenge rights, there must be a good reason for it. If

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40 15 U.S.C. §25.

41 15 U.S.C. §45(a).

42 15 U.S.C. §15 (emphasis added).

43 15 U.S.C. §26.

44 See, e.g. *Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic*, 152 F.3d 588 (7th Cir. 1998), cert. denied, 525 U.S. 1071 (1999). Even if a private plaintiff asserts and proves a *per se* antitrust violation, it still cannot obtain damages without proving it suffered an injury. See, e.g. *Campos v. Ticketmaster*, 140 F.3d 1166, 1172 (8th Cir. 1998), cert. denied, 525 U.S. 1102 (1999).

there is not, then the court need not concern itself with the patent's uncertain validity. It is enough that the agreement creates an unjustified barrier to possible competition.

VII. CONCLUSION

This short article demonstrates that patent challenge restraints are not within the scope of the patent. This clarifies a specific – but broadly applicable – basis for applying the antitrust law to a wide range of patent agreements. Of course, this is not to suggest that patent policy concerns should not enter into the analysis. Antitrust very regularly takes patent and innovation policy concerns into account when appraising the reasonableness of private conduct. Nor indeed does this suggest that all patent challenge restraints are antitrust violations. That challenge restraints are not authorized by the Act merely suggests that they do not enjoy safe harbor. Whether such a restraint violates the antitrust laws thus depends on its reasonableness, as determined based on the nature and context of the agreement, and taking into account any applicable innovation policy concerns.