Litigation Economics and Reverse Payments: The Case for *Per Se* Illegality

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Prof. Josh Davis

USF School of Law

Overall Points

1. What's Wrong with RPs?
2. Framework → Litigation Economics.
3. RPs → Should Be *Per Se* Illegal.
4. S. 369 → Why Half a Loaf?
5. Hart v. Fuller: Positivism v. "Purposivism."

Reverse Payments

- Patent Dispute: Brand Sues Generic.
- Settlement:
  1. Compromise on generic entry date; +
  2. Payment from Brand to Generic.

Reverse Payments

- Anticompetitive Effects:
  - Brand & generic agree not to compete.
  - Share monopoly profits.
- Antitrust Violation?

Litigation Economics

Goal Is To Minimize Costs of DR:

1. Error Costs (EC): actual v. right result.

+

2. Trans. Costs (TC): Time, money, etc.

Minimizing Error Costs (EC)

Key propositions:

1. Assume: Patent trial would be efficient.
2. Proof: EC of trial = EC of EV settlement.
3. Brand likely to do *better* than EV in negotiations; no justification for RPs.

Solution: *Per Se* illegal.

Ban on RPs.

- Low ECs → RPs increase ECs.
- Low TCs → easy to administer.

Per Se Legal?

Allow (Almost?) All RPs.

- High ECs → RPs increase ECs.
- Low TCs → easy to administer.

Judicial Assessment of RPs

Two Options :

1. Resolve patent dispute?
2. Gauge settlement dynamics?

High ECs: Inaccurate.

High TCs: Expensive.

Example

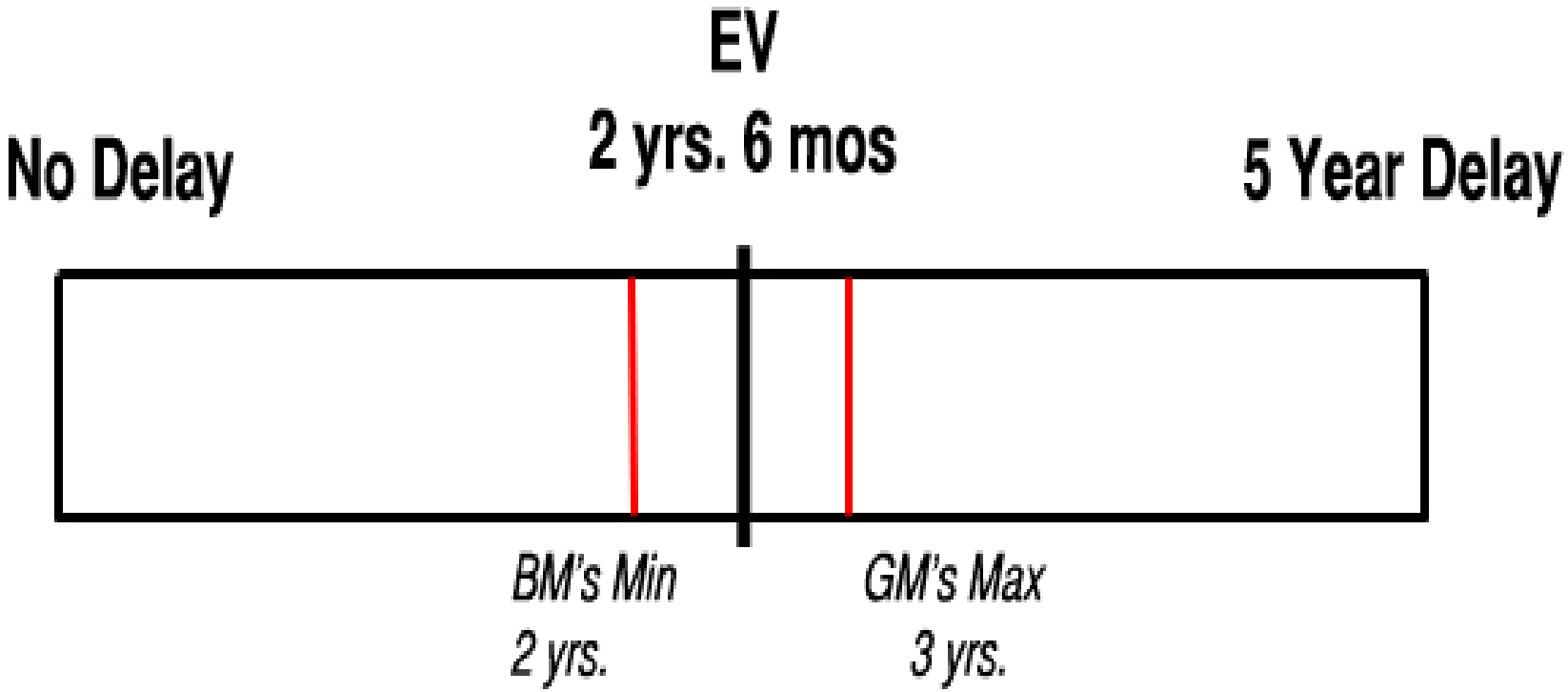
- Brand (B) v. Generic (G): infringement?

- 50% B will win: 5 years till entry.
- 50% G will win: 0 years till entry.
- Litigation costs: $2 mm each.

EV: 50% of 5 years = 2 years, 6 mos.

EC of Trial = EC if Settle for EV Entry Date.

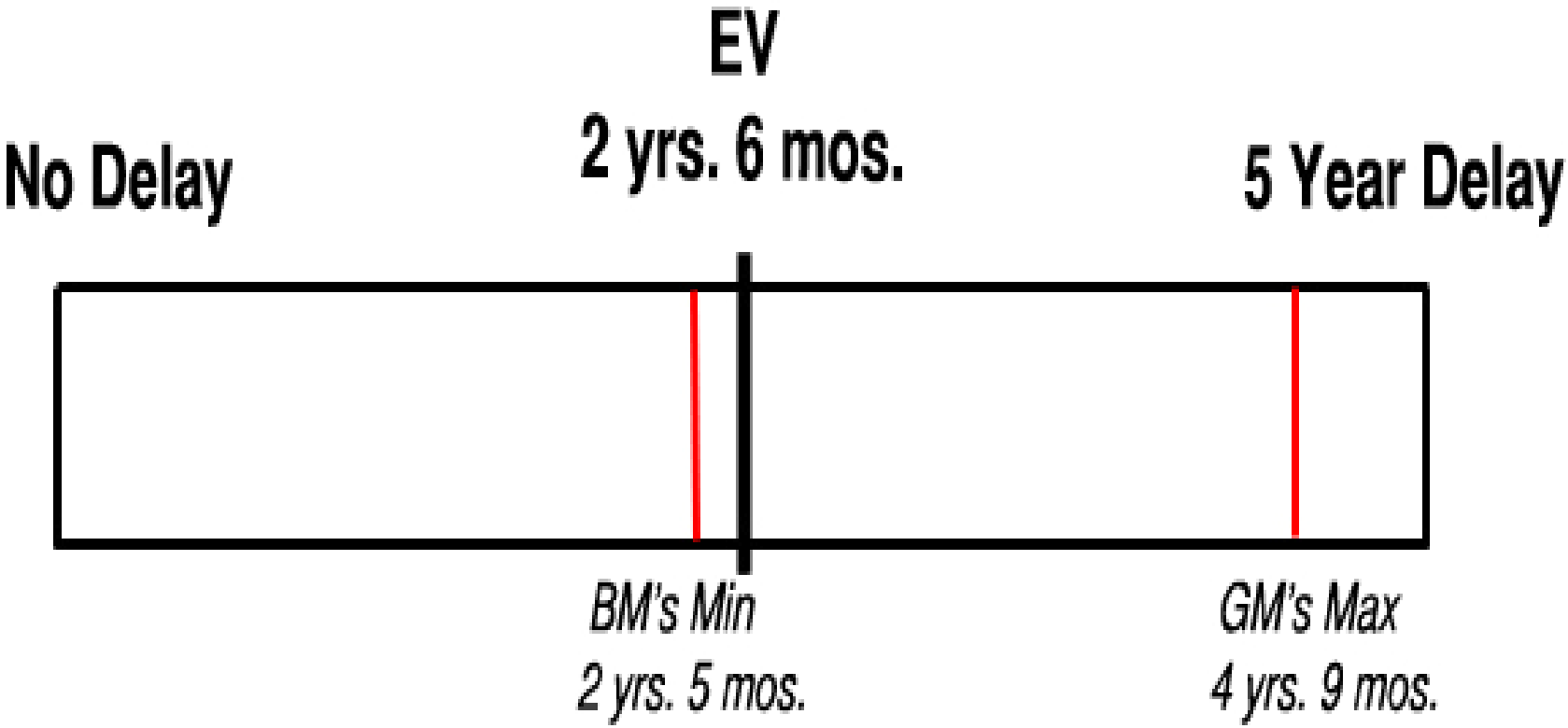
EV: 50% of 5 Year Delay



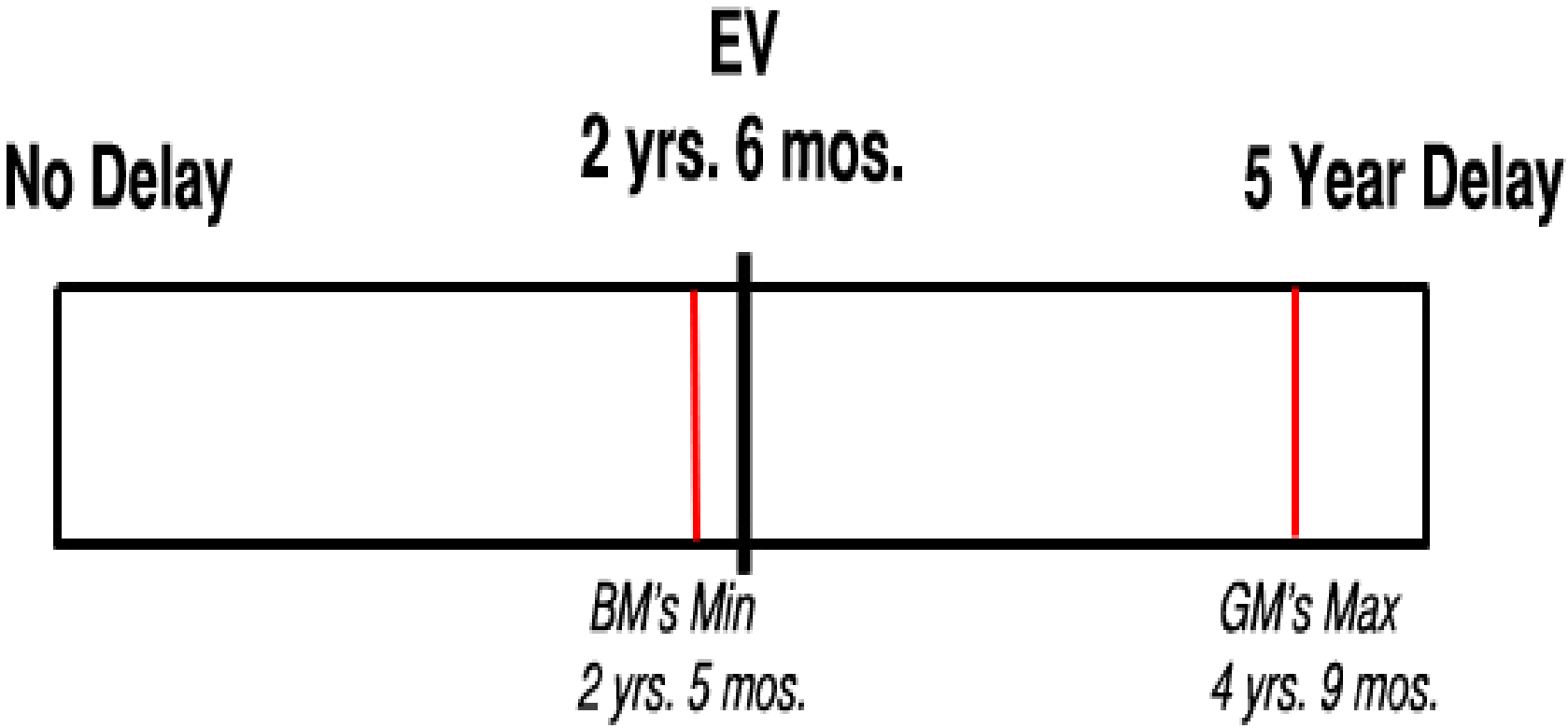
Settlement: EV?

- Possibly.
- Parties may vary from EV because of. . .
  - Litigation Costs.
  - Risk Aversion.
  - Imperfect Information.
  - Strategic Behavior.
  - Psychological Dynamics.

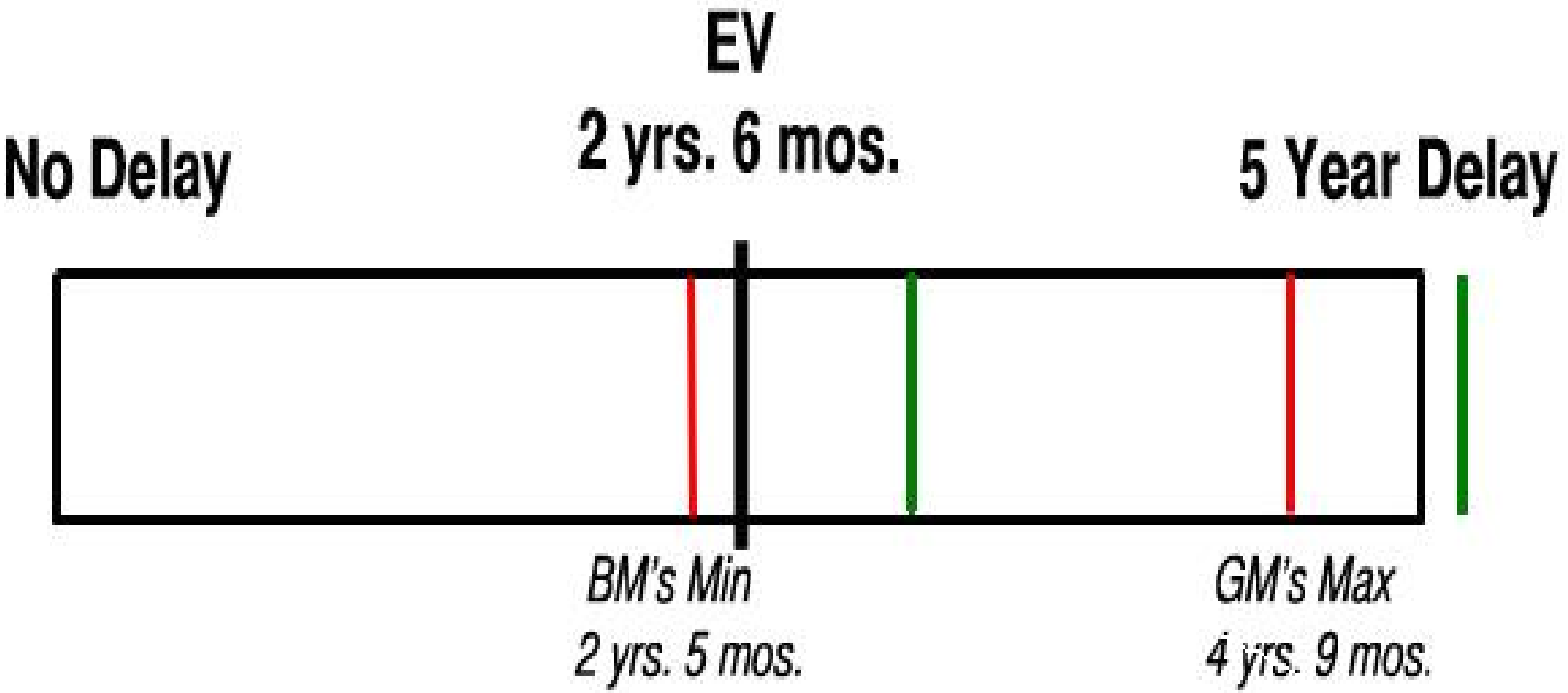
Effect of Stay & Exclusivity: Expand/Shift Settlement Range



Effect of RP: Expand/Shift Settlement Range



Combined Effect



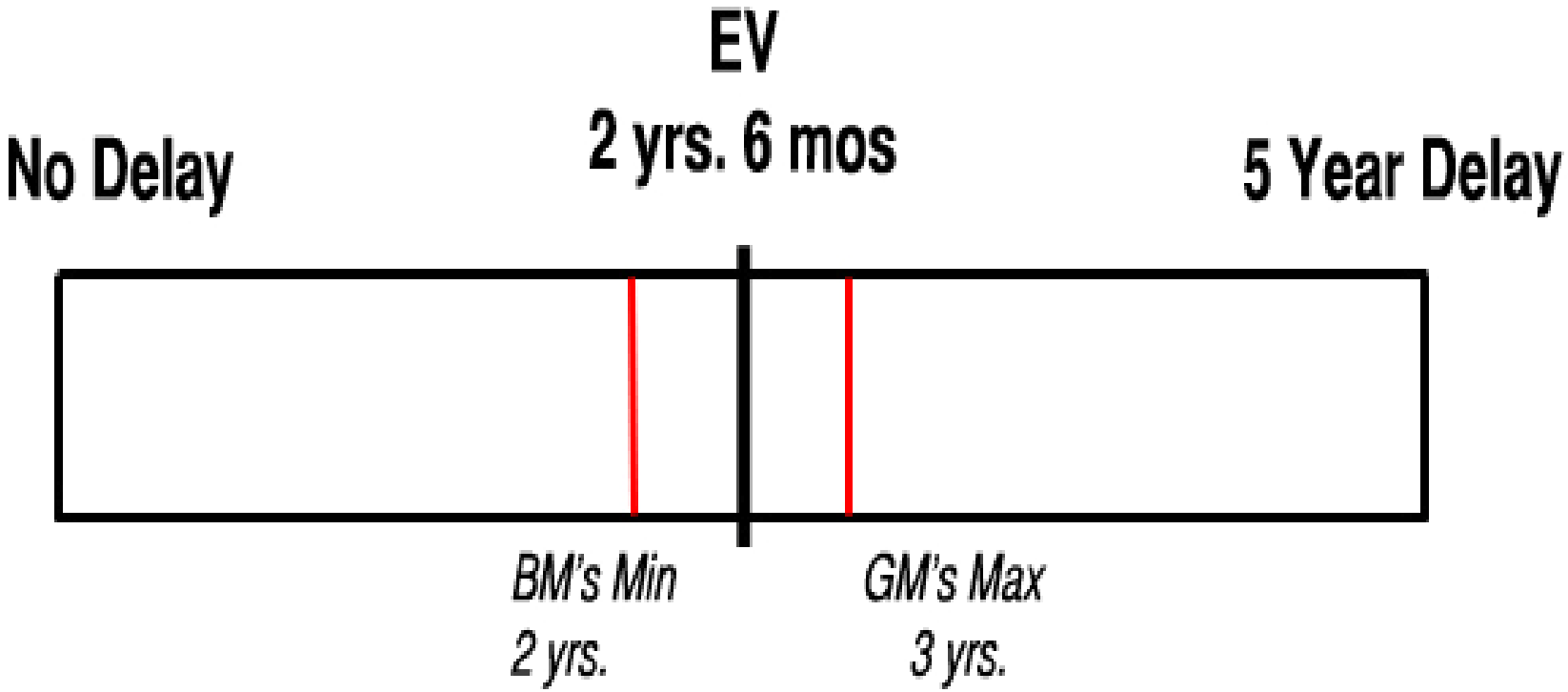
Options for RP Cases

1. *Per Se* Illegality.
2. *Per Se* Legality.
3. Allow Some RPs:
   a. If “procompetitive” > “anticompetitive;”
   b. If approximate litigation costs.

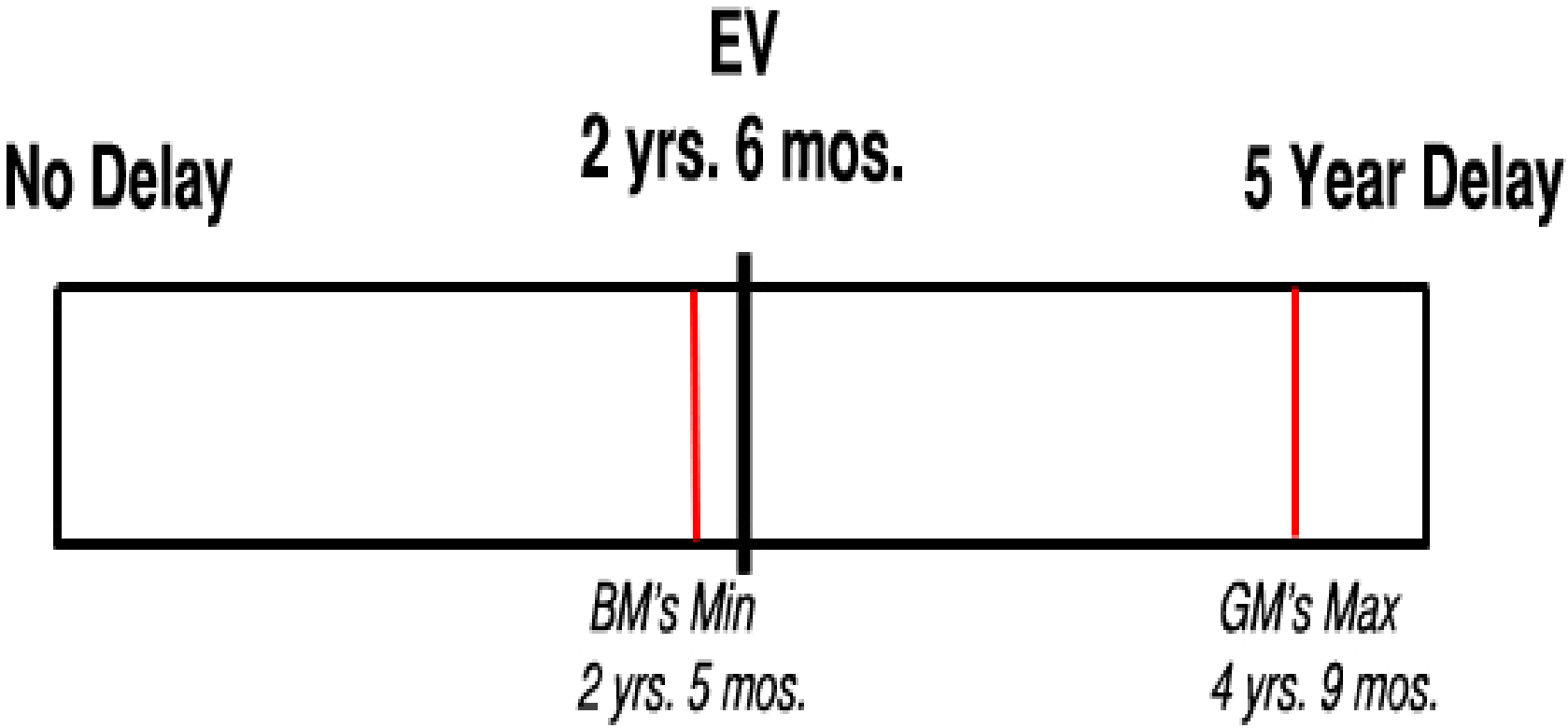
Per Se Illegality

- Error Costs: low.
  - Settlement approximates EV of trial.
  - Brands still do better than EV?
- Transaction Costs: relatively low.
  - Relatively easy to detect RPs.

EV: 50% of 5 Year Delay



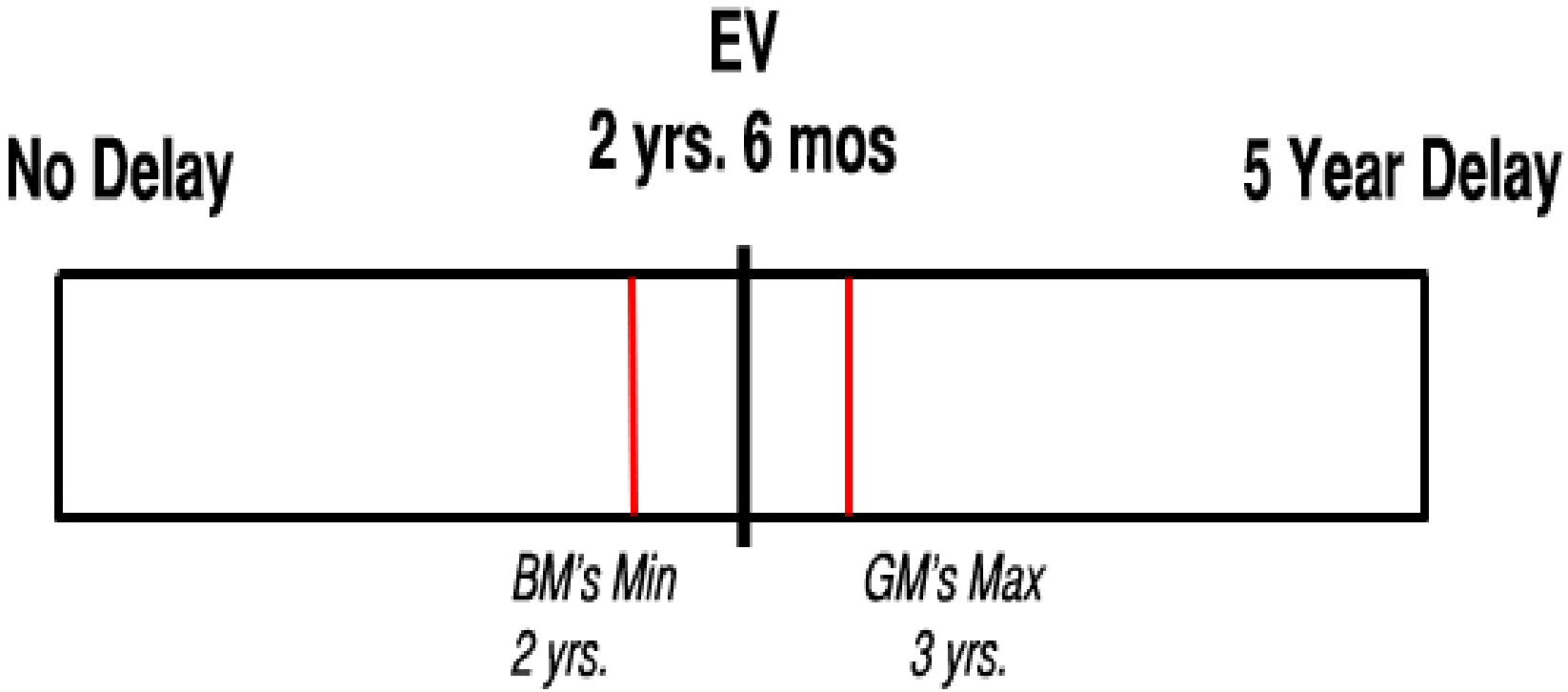
Effect of Stay & Exclusivity: Expand & Shift Settlement Range



Per Se Legality

- Error Costs: very high.
  - Enforce settlement even if invalid or non-infringed patent.
- Transaction Costs: low.
  - Few lawsuits → Drug purchasers will (almost) always lose.

EV: 50% of 5 Year Delay



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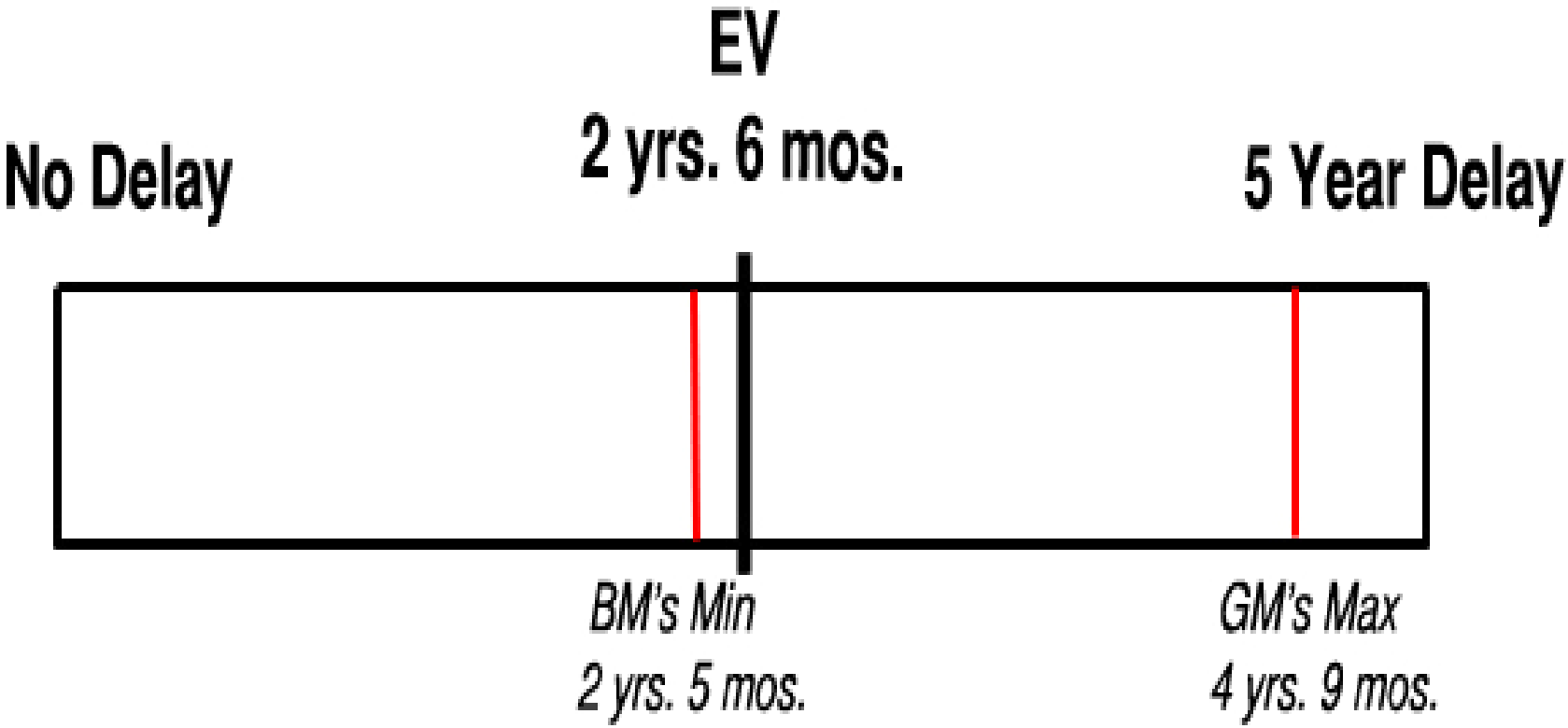
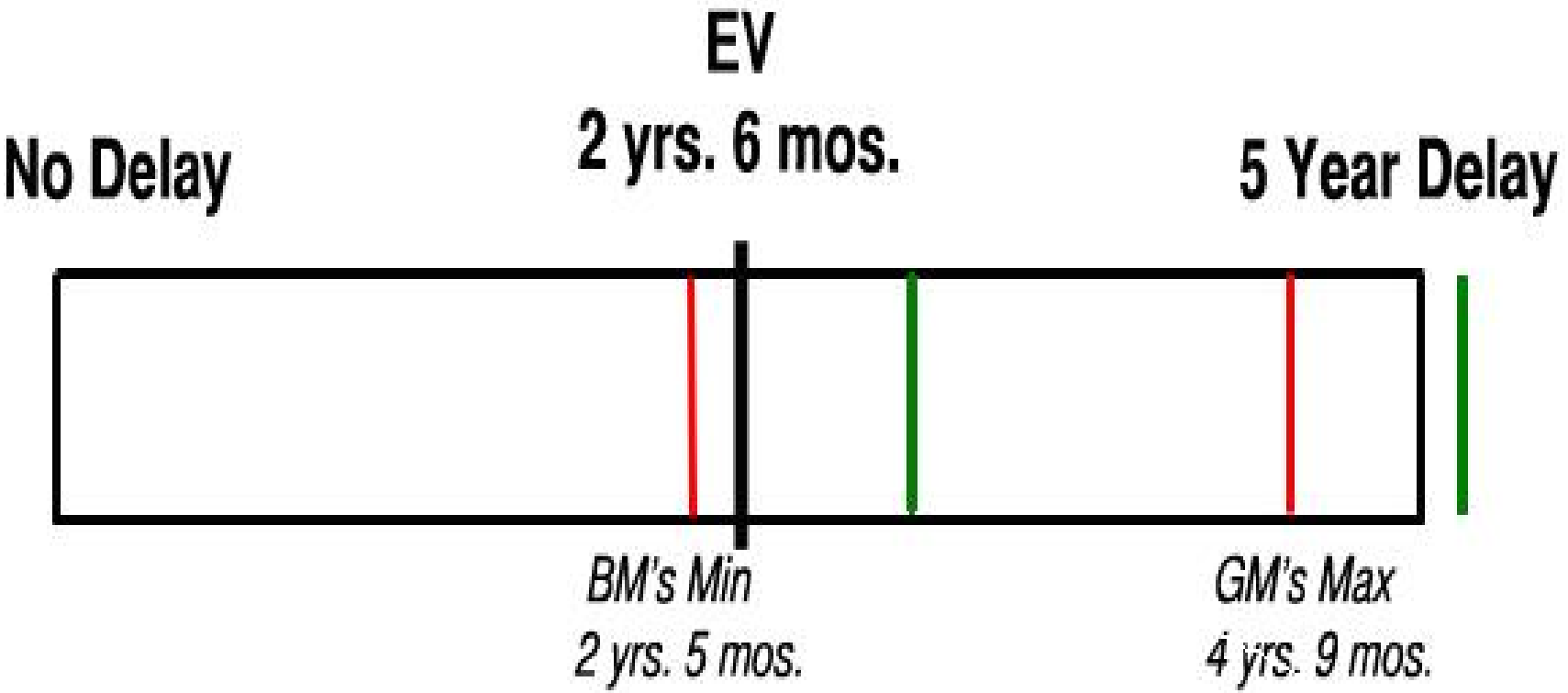


Combined Effect



S. 369: 1/2 Loaf? More? Less?

- Ds: CCE → Procomp > Anticomp.
- Various Factors.
- Allows Up to $7.5 mm of Litig. Costs.

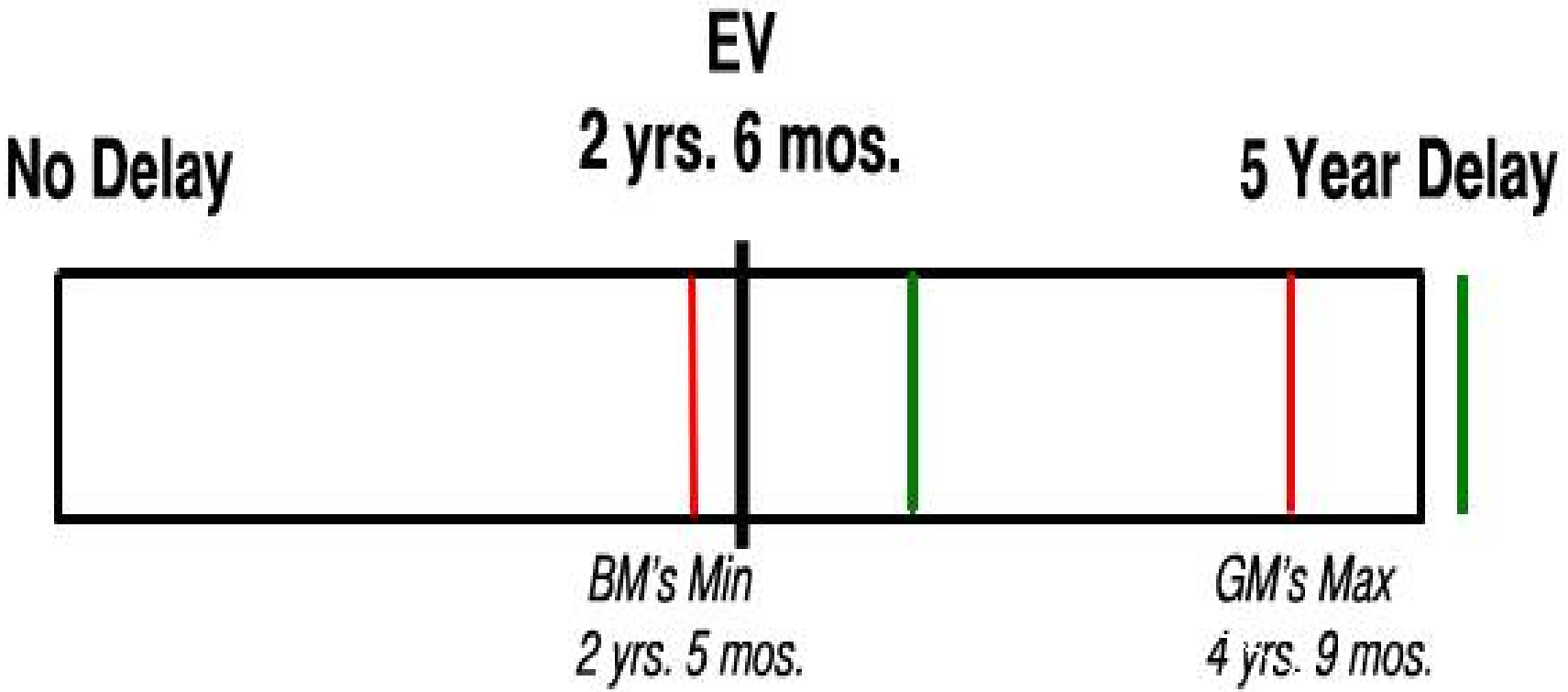
S. 369: Factors → Pro > Anti?

(1) Patent Life v. Generic Entry Date.
(2) Benefit to Consumers of Generic Entry.
(3) Compensation to Generic.
(4) Gain to Generic If Won Patent Litig.
(5) Loss to Brand If Lost Patent Litig.
(6) Timing of $s to Generic & Settlement.
(7) Other Factors Fact Finder (Jury?) Wants.

Concerns about S. 369

- How Balance Pro v. Anti?
  - EV of Patent Litigation?
  - Alternative Balancing of Incommensurables?
- High ECs and TCs:
  - Resolve Underlying Patent Dispute?
  - Address Settlement Dynamics?
- Why Allow Litigation Costs?

Combined Effect



2 Possible Interpretations

1. EV as Benchmark: Ds Never Win.
   - Why include factors?
   - Why allow payment of litigation costs?
2. Alt. → Undefined Approach?
   - How else explain factors?
   - Why else allow litigation costs?

H.L.A. Hart v. Lon Fuller

- Hart → postivism: judges can say what the law is without saying what it should be.
- Fuller (& Dworkin) → "purposivism": judges cannot interpret law without considering underlying purposes.

S. 369: Support for Fuller?

Conclusion

Right Framework:

1. Minimize ECs: settlement → EV of trial.
2. Minimize TC: easy rule to apply.

Right Rule: A Ban on RPs.

Right Bill: H.R. 1706, not S. 369.

Proof: Same EC for Trial and EV (Assumes Adjudication Correct)

- The proof assumes the following definitions:
- P = the odds the plaintiff will win, which are the odds the plaintiff is correct.
- O = the outcome if the plaintiff should win.
- Assume also that there are two possible outcomes: the plaintiff loses or recovers O.
- The expected error costs from use of an expected value outcome are as follows:
- In EVA, the plaintiff will receive P x O.
- The odds are P that the plaintiff should win, but will receive only P x O, for expected error costs of P x (O – (P x O)).
- The odds are (1 – P) that the plaintiff should lose, but will receive P x O, for expected (1 – P) x (P x O).
- The expected error costs, then, are P x (O – (P x O)) + (1 – P) x (P x O) = P x O – P2 x O + P x O – P2 x O = 2 x P x O – 2 x (P2 x O).
- The expected error costs in winner-take-all adjudication are:
- The odds are P x (1 – P) that the plaintiff should win but will not win, in which case the expected error costs are P x (1 – P) x (O – 0),
- The odds are (1 – P) x (P) the plaintiff should lose but will win, in which case the expected error costs are (1 – P) x P x (O – 0).
- The expected error costs, then, are P x (1 – P) x O + (1 – P) x P x O = 2 x P x O – 2 x (P2 x O).
- The expected error costs are the same for EVA and trial.

Proof: Same EC for Trial and EV (Recognizes Adjudicative Error)

- The expected error costs under EVA and trial are the same, assuming the following definitions:
- P = the likelihood the plaintiff is correct.
- J = the likelihood the jury will apply the preponderance of evidence standard correctly.
- O = the outcome if the plaintiff wins, with the only other possibility that she gets nothing.
- In expected value arbitration, if the plaintiff can carry the burden of persuasion, the plaintiff will recover the outcome (O) multiplied by the likelihood the jury will decide correctly (J). The odds are P that the plaintiff is correct, in which case the error is the difference between O and the amount awarded (O x J), and the odds are 1 - P that the plaintiff is incorrect, in which case the error is the amount awarded (O x J).
- In mathematical terms, if P > .5, P(O - OJ) + (1 - P) (OJ) = PO + JO - 2PJO.
-
- In expected value arbitration, if the plaintiff cannot carry the burden of persuasion, the plaintiff will recover the outcome (O) multiplied by the likelihood that the jury will err (1 - J). The odds are P that the plaintiff is correct, in which case the error is the difference between O and the amount awarded (O x (1 - J)), and the odds are 1 - P that the plaintiff is incorrect, in which case the error is the amount awarded (O x (1 - J)).
- In mathematical terms, if P <= .5, P(O - O(1 - J)) + (1 - P)(O(1 - J)) = 2PJO - PO - JO + O.
- In winner-take-all adjudication, if P should win under the preponderance of evidence standard, then the plaintiff's recovery should be O. Two possibilities then exist. First, with a likelihood of P, the plaintiff will win when it should lose for an expected error of (1 - P) x O, plus the jury may err causing the plaintiff to lose, even though the plaintiff should win, for an expected error of (1 - J) x O. Second, with a likelihood of 1 - P, the plaintiff will win when it should lose for an expected error of (1 - P) x O, except when jury error cause the plaintiff to lose when it *should* lose, for a decrease in error of (1 - J) x O.
- In mathematical terms, if P > .5, the expected error is P((1 - P)O + (1 - J)O) + (1 - P)(((1 - P)O - (1 - J)O) = PO + JO - 2PJO.
-
- In winner-take-all adjudication, if P should lose under the preponderance of evidence standard, there should be no recovery. Two possibilities again exist. First, with a likelihood of P, the plaintiff will lose when it should win for an expected error of P x O, less the possibility of jury error causing the plaintiff to win when it should win, or (1 - J) x O. Second, with a likelihood of 1 - P, the plaintiff will lose when it should win for an expected error of P x O, plus jury error will cause the plaintiff to win when it *should* lose for an additional expected error of (1 - J) x O.
- In mathematical terms, if P <= .5, the expected error is P(PO - (1 - J)O) + (1 - P)(PO + (1 - J)O) = 2PJO - PO - JO +O.