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Federal Trade Commission Finds Trademark Settlement Agreement Search Ad Restrictions “Inherently Suspect” in 1-800 Contacts Decision

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On November 7, 2018, the Federal Trade Commission issued a 3-1 decision holding that 1-800 Contacts, the nation’s largest online seller of contact lenses, had violated Section 5 of the FTC Act by entering into a series of trademark infringement settlement agreements that required its rivals to limit their Internet search keyword bidding and advertising.¹ The Commission found that the settlement agreements harmed consumers and competition for the online sale of contact lenses by limiting the availability of truthful Internet advertising in response to keyword searches, thus restricting the ability of consumers to price-comparison shop between competing suppliers of contact lenses. The Commission concluded that the settlement agreements at issue were “inherently suspect” and thus employed a truncated mode of analysis in finding liability. The Commission’s cease-and-desist order prohibits 1-800 Contacts from enforcing the unlawful provisions of the settlements and bars it from entering similar agreements in the future. 1-800 Contacts has announced that it will appeal the Commission decision.²

Background

Consumers buy contact lenses through a variety of channels—from eye care practitioners, optical retail

chains, mass merchant and club stores, and from “pure play” online sellers. 1-800 Contacts is by far the largest online seller, accounting for over 60 percent of online sales and more than four times the sales of the second largest online seller. Though online sellers typically offer the lowest prices of all sales channels, 1-800 Contacts’ prices are higher than other online sellers and above the price of mass merchants and club stores.³

Other online sellers bought Internet advertisements by bidding on search terms that included the key words “1-800 Contacts,” and thus those other sellers’ ads would appear in search engine results associated with the 1-800 Contacts name. The name is trademarked and 1-800 Contacts filed a series of federal trademark infringement suits against its rivals based on this advertising. Between 2004 and 2013, 1-800 Contacts entered into settlement agreements to resolve 13 of the 15 litigations it had filed.⁴ The settlements included provisions prohibiting each party from bidding on search advertising keywords that included the other party’s trademarked terms. The settlements also required each party to employ “negative” keywords to prevent its ads from displaying whenever a search included the other party’s trademarks—even if the party did not bid on the other party’s actual trademark.⁵

One of the cases that was not settled was decided against 1-800 Contacts when the court granted summary judgment to the defendant, finding no infringement where the rival advertisements were generated in response to a search for “1-800 Contacts” but did not actually use the 1-800 Contacts mark in the text of the advertisement.⁶ That portion of the decision was upheld on appeal.⁷

The FTC issued an administrative complaint against 1-800 Contacts in August 2016. After an evidentiary hearing in April and May 2017, the Administrative Law Judge issued a decision in October 2017 finding that the settlement agreements violated Section 5 of the FTC Act. The ALJ applied the traditional “rule of reason” analysis and found that the FTC had established actual

anticompetitive effects in a relevant market for online sale of contact lenses in the United States.⁸ Under FTC rules, the ALJ's decision was subject to review by the full Commission.

The Commission Decision

The Commission agreed that the settlement agreements violated Section 5 of the FTC Act, but reached its conclusion using two distinct modes of analysis: (1) the “inherently suspect” framework; and (2) assessing “direct evidence” of anticompetitive effects. The Commission held that “[e]ach mode of analysis provides an independent basis for finding...liability.”⁹ The Commission did not undertake a full-blown rule of reason analysis by defining a market and assessing market power to evaluate the competitive effects of the agreements.

“Inherently Suspect” Analysis

The FTC applies the “inherently suspect” framework when it finds that the conduct at issue has a “likely tendency to suppress competition,” such that “an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect....”¹⁰ Under this framework, the defendant can avoid summary condemnation only by advancing a plausible justification for the conduct; if it does so, the plaintiff (here, the FTC complaint counsel) must make a “more detailed showing that the restraints at issue are indeed likely, in the particular context, to harm competition.”¹¹ No proof of actual anticompetitive effects is required.

In this case, the Commission noted that it has “repeatedly found that advertising restrictions harm competition and consumers.”¹² The Commission noted that not all advertising restrictions are inherently suspect but concluded that the settlement agreements were inherently suspect, in part because they prevented consumers from “see[ing] a competitor’s ad in the first place.”¹³ Consequently, the settlements “prohibit[ed] the display of ads that would enable consumers to learn about alternative sellers of contact lenses and give them the opportunity to make price comparisons at the time they are likely to make a purchase.”¹⁴ The Commission noted also that the “suppressed ads often emphasize lower prices.”¹⁵

The Commission found that 1-800 Contacts had offered two plausible justifications for its conduct—avoidance of litigation costs and protection of its trademark—and thus had shifted the burden to plaintiff to make a more detailed showing of likely competitive harm. The Commission found that the FTC complaint counsel met

that burden, pointing to the broad scope of the agreements (which covered 14 different rival sellers constituting 79% of online contact lens sales) and the fact that the rival ads had been effective in reducing 1-800 Contacts sales.¹⁶

The Commission then assessed 1-800 Contacts’ proffered justifications more closely and declined to credit them. The Commission found no evidence that litigation cost savings would be passed through to consumers or would otherwise benefit competition in a way that would offset the anticompetitive effects of the settlements. The Commission was more circumspect with respect to the trademark protection justification; it emphasized that its decision did not rely on re-litigating the merits of the underlying trademark litigations. The Commission, however, did conclude that the agreements at issue “restrict[ed] a type of competitive advertising that has never been found to violate the trademark laws” and noted that 1-800 Contacts lost the one case it actually pursued to judgment.¹⁷ The Commission was even more skeptical of the proffered justification for requiring “negative” keywords in the settlement agreements. It found no support in the case law for a trademark infringement claim that would require such a restriction.¹⁸ The Commission also found that 1-800 Contacts could have protected its trademark against consumer confusion by a less restrictive alternative, such as requiring clear disclosure of the identity of the rival seller in search ads.¹⁹

“Direct Evidence” Analysis

The Commission also credited direct evidence of anticompetitive effects and found 1-800 Contacts liable under this alternative analytical framework. This direct evidence came in two forms: (1) restriction of truthful advertising and (2) an increase in prices of contact lenses sold online. The Commission relied on expert econometric analysis that 114 million competitor ads would have been displayed between January 2010 and June 2015 but for the settlement agreements. It also found that those ads would have increased competitors’ sales by 12.3%, and that those competitors were charging lower prices than 1-800 Contacts.²⁰ The Commission concluded that the settlement agreements “insulate[d] 1-800 Contacts from normal competitive forces and divert[ed] sales from low-priced sellers to a high-priced seller,” which was “direct evidence of an increase in price.”²¹

In addition to harm to consumers, the Commission found direct evidence of actual harm to search engines from the reduced price paid by the auction winners, which reduced revenue to the search engines and reduced the quality of the search engines’ results.²²

Commissioner Phillips’ Dissent

Commissioner Phillips authored a lengthy dissent, which mainly took issue with the majority’s use of the “inherently suspect” framework. The dissent argued that existing “inherently suspect” jurisprudence on advertising restraints involved either complete advertising bans or limitations on the content of advertisements—neither of which was present here.²³

The dissent also contended that the majority opinion did not give sufficient deference to the intellectual property interest of 1-800 Contacts and that the Commission, despite its claims to the contrary, actually premised its opinion on the belief that the trademark claims at the heart of the underlying litigations were weak.²⁴ The dissent argued that the Commission opinion “overstate[d] the clarity of trademark law” at the time of the settlements and noted that until 2004, Google had a policy prohibiting advertisers from bidding on third-party trademarks.²⁵

The dissent also criticized the Commission for failing to acknowledge the importance of the 1-800 Contacts brand and recognize the company’s interest in protecting it. The dissent asserted that searches using “1-800 Contacts” as a term were a “critical battleground” for competition “precisely—and only—because of 1-800 Contacts’ brand investment.”²⁶ For that reason, the dissent claimed that assigning antitrust liability for 1-800 Contacts’ conduct will “chill brand investment” and the “very competition the majority seeks to protect.”²⁷

Commissioner Phillips also disagreed with the majority’s “direct evidence” analysis. The dissent argued that restrictions on advertising, by themselves, are insufficient to show anticompetitive harm and also that the evidence of direct price effects was insufficient. The dissent asserted that 1-800 Contacts’ prices were higher than its competitors’ even before the settlements and that there was no evidence that the price differential had increased after the settlements or quantification of what the price would have been absent the settlements, and thus no evidence that the settlements caused observable price effects.²⁸

Conclusion

The Commission’s decision in 1-800 Contacts provides guidance regarding its views on Internet search advertising restrictions and the application of the “inherently suspect” framework, but is more interesting for what it may say about the Commission’s views on how to strike the balance when antitrust principles and intellectual property protections may be in conflict. The Commission makes clear that it will not defer to trademark rights when assessing conduct it views as likely to harm competition—even though the trademark settlements at issue were arguably within the scope of the exclusionary potential of 1-800 Contacts’ trademarks.

In that sense, the Commission majority’s approach seems in keeping with its approach in reverse payment cases—where the Commission has taken an aggressive role in policing patent settlement agreements that it believes may restrict generic drug competition. Indeed, the Commission majority cites *Actavis* for the proposition that antitrust liability is possible for a settlement of nonsham patent litigation even if the anticompetitive effects of the settlement lie within the “scope of the patent.”²⁹ In contrast, the dissent emphasizes the brand investment made by 1-800 Contacts and the importance of trademark rights in protecting that investment, and in turn cites *Actavis* for the proposition that the Commission should not be in the business of re-litigating fact intensive, nonsham intellectual property disputes.³⁰

Though the Commission’s decision seems to reflect the majority’s view of the weakness of the underlying trademark infringement claims (and the result may have been different had 1-800 Contacts won the one case it litigated to a verdict), the dispute between the majority and Commissioner Phillips also may signal an emerging split at the FTC on antitrust enforcement in cases that involve intellectual property rights. It may also reflect a difference between the Commission majority and the Antitrust Division, which has adopted an enforcement posture more deferential to intellectual property rights.³¹ 1-800 Contacts has announced that it will appeal the FTC decision and will likely focus on trademark protection and the prevention of “free riding” on its brand as a key part of that appeal.³² The decision in this case may be an important factor in determining the approach that prevails at the agencies in cases involving intellectual property rights.

1. *In re* 1-800 Contacts, Inc., FTC Docket No. 9372, Opinion of the Commission (Nov. 7, 2018) {hereinafter “Opinion”}. The Commission issued its final decision and order on November 14, 2018.

2. 15 U.S.C. § 45(c) provides for review of a Commission order in a federal appeals court if a petition is filed in an appropriate circuit court within 60 days.

3. Opinion at 4.

4. *Id.* at 8. One case ended in a default judgment for 1-800 Contacts. Another case went to summary judgment. *See infra* discussion at 2.

5. *Id.* at 9. 1-800 Contacts also entered a sourcing and services agreement with another contact lens seller that contained restrictions on search advertising similar to those included in the thirteen settlement agreements. *Id.* at 10.

6. *Id.* at 8 (citing *1-800 Contacts, Inc. v. Lens.com, Inc.*, 755 F. Supp. 2d 1151, 1181 (D. Utah 2010)).

7. *Id.* (citing *1-800 Contacts, Inc. v. Lens.com, Inc.*, 722 F.3d 1229 (10th Cir. 2013)).

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8. *Id.* at 11.
 9. *Id.* at 18.
 10. *Id.* (quoting *Polygram Holding, Inc.*, 136 F.T.C. 310, 344 (2003) and *California Dental Ass'n v. FTC*, 526 U.S. 756, 770 (1999)).
 11. *Id.* at 18-19 (quoting *Polygram Holding, Inc.*, 136 F.T.C. at 344-49).
 12. *Id.* at 21.
 13. *Id.* at 22.
 14. *Id.*
 15. *Id.*
 16. *Id.* at 32-33.
 17. *Id.* at 39-40.
 18. *Id.* at 41.
 19. *Id.* at 27-30.
 20. *Id.* at 42-46.
 21. *Id.* at 47.
 22. *Id.* at 50-53.
 23. *In re* 1-800 Contacts, Inc., FTC Docket No. 9372, Dissenting Statement of Commissioner Noah Joshua Phillips at 11 (Nov. 7, 2018) [hereinafter "Dissent"].
 24. Dissent at 22.
 25. *Id.* at 6, 24. The dissent also noted that even after Google changed its policy Google suggested that 1-800 Contacts require the use of "negative" keywords by rivals as way to prevent trademark infringement. *Id.* at 6.
 26. *Id.* at 27.
 27. *Id.* at 28.
 28. *Id.* at 30-32. The dissent also concluded that the majority had failed to show competitive harm to search engines. *Id.* at 38-40.
 29. Opinion at 15.
 30. Dissent at 23.
 31. Sonia Kuester Pfaffenroth & Peter J. Levitas, *Antitrust Agency Insights: Developments at the US Antitrust Enforcement Agencies*, Oct. 2018, available at <https://www.arnoldporter.com/en/perspectives/publications/2018/10/antitrust-agency-insights>.
 32. 1-800 Contacts Statement on FTC Ruling on Trademark Settlement Agreements, Nov. 14, 2018, available at <https://hvt-prod-media.s3.amazonaws.com/files/1-800-contacts-statement-on-ftc-ruling-on-trademark-settlement-agreements-nov2018-1542388475.pdf> ("We have the legal right to stop others from unlawfully using our trademarks that protect our brand name and from free-riding on our investment... The settlement agreements were a standard way to resolve such trademark claims and were not a means to hinder competition for contact lenses.").

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