REDACTED PUBLIC VERSION

18-3848-ag

United States Court of Appeals

for the

Second Circuit

1-800 CONTACTS,

Petitioner,

– v. –

FEDERAL TRADE COMMISSION,

Respondent.

ON APPEAL FROM THE FEDERAL TRADE COMMISSION

CONFIDENTIAL PAGE PROOF BRIEF FOR PETITIONER (FILED UNDER SEAL)

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, the undersigned counsel for Petitioner 1-800 Contacts, Inc. certifies that its parent corporations are CNT Holdings I Corp., a Delaware corporation, CNT Holdings II Corp., a Delaware corporation, and CNT Holdings III, a Delaware corporation. Petitioner is wholly owned by CNT Holdings III Corp., which is in turn wholly owned by CNT Holdings II Corp., which is in turn wholly owned by CNT Holdings I Corp. None of these parent corporations is publicly held and no publicly held company has more than a ten percent interest in CNT Holdings I Corp.

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1-800 Contacts, Inc. ("1-800 Contacts") petitions this Court to review the decision of the Federal Trade Commission (the "Commission") finding thirteen trademark infringement settlement agreements and one vertical sourcing agreement to be unlawful restraints of trade under Section 5 of the Federal Trade Commission Act and barring the enforcement of certain provisions.

PRELIMINARY STATEMENT

To understand this case, it is necessary to go back almost two decades, when the Commission began its regulatory assault on settlements of intellectual property ("IP") claims. The Commission started with "reverse-payment" patent settlements. These "unusual" settlements arose within a "unique" regulatory structure under the Hatch-Waxman Act—a structure that (unintentionally) produces "incentives for collusion." *FTC v. Actavis, Inc.*, 570 U.S. 136, 147, 156-57 (2013) (citation omitted). In this context, patent holding-plaintiffs paid millions of dollars to allegedly infringing defendants (a reverse payment) to stay out of the market to settle the infringement claims. *Id.* at 144-46. To the Commission, these were no ordinary IP settlements: they were illegal agreements not to compete.

Even as to these exclusionary patent settlements, this Court and others refused to condemn them under antitrust law, fearing that antitrust second-guessing would deter settlements and undermine patent policy, and that courts applying antitrust principles had no good way to conduct an after-the-fact analysis of the patent claim.

See, e.g., *In re Tamoxifen Citrate Antitrust Litig.*, 466 F.3d 187, 203 (2d Cir. 2006). A majority of the Supreme Court recognized these concerns, but narrowly (and reluctantly) agreed with the Commission that there "are sound reasons to treat reverse-payment settlements differently" than other settlements. Br. for Pet. at 16, *FTC v. Watson Pharms. Inc. (Actavis*), No. 12-416 (S. Ct. Jan. 22, 2013) (hereinafter "FTC *Actavis* Br."). As the majority explained, these settlements go to the core concern of antitrust—*complete exclusion from the market*—and where there is a "large and unjustified" reverse payment, antitrust law should play some role to prevent what looks like a splitting of monopoly profits. *Actavis*, 570 U.S. at 158.

At the same time, the majority was careful to cabin its holding. Indeed, the majority mollified the dissenters (and business community) by disclaiming any extension of antitrust to ordinary IP settlements: "Insofar as the dissent urges that settlements taking these commonplace forms [*i.e.*, without a reverse payment] have not been thought for that reason alone subject to antitrust liability, we agree and do not intend to alter that understanding." *Id.* at 152. But the dissenters considered this cold comfort, "fear[ing] the Court's attempt to limit its holding to the context of patent settlements under Hatch-Waxman will not last long." *Id.* at 170. That leads us to this case.

1-800 Contacts is a shining example of trademark policy at work. 1-800 Contacts started from literally nothing in a college dorm room. Through ingenuity, massive investments in its brand, and superior customer service, it was able to disrupt doctors' stranglehold on the market for retail sale of contact lenses. Rather than investing in their own brands, 1-800 Contacts' competitors tried to improperly divert sales by paying search engines to show their ads when consumers searched for 1-800 Contacts' federally-protected trademarks.

Thus, as numerous other companies did as part of a common trademark protection strategy, 1-800 Contacts prosecuted and settled a series of trademark infringement claims aimed at halting this type of infringing conduct: bidding on trademarked terms in auctions for paid search advertisements (ads search engines display in response to user searches). The Commission *concedes* that (1) these trademark claims were legitimate—*i.e.*, not shams; (2) the principal relief in the trademark settlements (no bidding on trademarked terms in search advertising auctions) appeared in other settlements and was ordered by courts; and (3) the settlements did not limit *other* forms of advertising, only the infringing advertising. Nevertheless, in a split decision, a majority of the Commission blew through *Actavis* and its careful distinctions—holding that 1-800 Contacts' commonplace, non-exclusionary trademark settlements were not only subject to antitrust second-guessing, but they were *presumptively unlawful*. Although the majority refused to admit it, the import of this ruling is that a plaintiff can state a plausible antitrust claim, exposing a trademark owner to expensive and potentially ruinous antitrust litigation, simply by pointing to any trademark settlement that requires an alleged infringer to stop running an infringing advertisement.

As Commissioner Noah Phillips' 46-page dissent (hereinafter "Dissent") explains, this "drastic" decision goes well beyond *Actavis*, will deter legitimate settlements, and "foster uncertainty and undermine trademark policy." Dissent 1, 10. Commissioner Phillips is not alone in that assessment. Former Commissioner Joshua Wright, academics, and others have likewise bemoaned the decision because it "dismisses . . . the intellectual property interest at stake," reflects "exceedingly weak" economic analysis, and "has the potential to chill procompetitive behavior." Manne, Singer & Wright, *Antitrust Out of Focus: The FTC's Myopic Pursuit of 1-800 Contacts' Trademark Settlements*, 18 THE ANTITRUST SOURCE, no. 5, Apr. 2019, at 3, 11, 16 ("Wright Article").

To restore a proper balance between IP and antitrust policy, this Court, consistent with *Actavis*, should reject the Commission's decision and hold the trademark settlements here are not subject to antitrust second-guessing. Unlike patents, "trademarks are by their nature non-exclusionary," and, thus, trademark settlements are "favored in the law." *Clorox Co. v. Sterling Winthrop, Inc.*, 117 F.3d 50, 55-56, 60 (2d Cir. 1997). Moreover, there is no "reverse-payment"—much less the type of "large and unjustified" reverse payment that *Actavis* indicated might fall within the antitrust construct. *See Actavis*, 570 U.S. at 157 (size of reverse payment indicator of "market power"); *id.* at 157-58 (antitrust claim more feasible because "the size of the unexplained reverse payment can provide a workable surrogate for the patent's weakness"). Instead, nothing more is afoot here than settlements of non-sham trademark claims that prohibit the infringing conduct in the same way that courts and parties routinely did. *Actavis* does not permit the Commission to assert antitrust primacy in this everyday situation, deterring valid settlements and undermining trademark policy in the process.

Even if antitrust should play some role, this Court should reject the Commission's "drastic step" (Dissent 10) of deeming the trademark settlements *presumptively unlawful* so that it could satisfy its burden without ever "prov[ing] actual anticompetitive effects." Opinion of the Commission ("Op.") 24. Incredibly, the Commission adopted this evidentiary shortcut even after *Actavis* rejected it in much more extreme circumstances. *Actavis*, 570 U.S. at 159. In so doing, the *Actavis* Court cited *California Dental Ass'n v. FTC*, 526 U.S. 756 (1999)—yet *another* Supreme Court case rejecting the Commission's attempt to use inherently suspect analysis in a case involving advertising restrictions on price discounts and quality. As Commissioner Phillips explained: "Given that the *California Dental* Court applied the traditional rule of reason to analyze restraints with a more obvious anticompetitive impact, *a fortiori*, the restraints here should not be analyzed under a harsher standard." Dissent 12.

Once the "presumptively unlawful" moniker falls away—and the Commission is forced to face the traditional rule of reason—there is no way its claim can succeed. The Commission claims that, even without its presumptively unlawful shortcut, there is "direct evidence" of anticompetitive effects. This is a high burden that requires the Commission to prove that 1-800 Contacts' agreements "significantly harm competition as a whole." *Clorox*, 117 F.3d at 57; *accord United States v. Am. Express Co.*, 838 F.3d 179, 194 (2d Cir. 2016), *aff'd*, *Ohio v. Am. Express Co.*, 138 S. Ct. 2274 (2018). The Commission cannot meet that burden when it does not contend 1-800 Contacts' agreements restricted the output of contacts lenses, offers no evidence of a market-price effect or of 1-800 Contacts' margins (much less that 1-800 Contacts maintained "abnormally high" margins, *Am. Express*, 838 F.3d at 205), and acknowledges that the market has grown consistently over the relevant period.

Indeed, the Commission's so-called "direct evidence" shows why it felt the need to invoke the presumptively unlawful shortcut in the first place. *First*, the Commission claims there were fewer search ads displayed in response to 1-800 Contacts' trademarks. But, as *California Dental* explained, the "question is not whether the universe of possible advertisements has been limited (as assuredly it has), but whether the limitation on advertisements obviously tends to limit" output of the underlying good or service. 526 U.S. at 776. But far from limiting output, competition here *flourished* and sales dramatically *increased* during the time of the challenged trademark agreements.

Second, the Commission points to the fact that 1-800 Contacts generally had higher prices than some online competitors. However, in a case about the importance of 1-800 Contacts' brand, the Commission remarkably does not examine whether the higher prices could be caused by consumers' preference for a strong brand, as opposed to a reduction in advertising (assuming such a reduction exists). Indeed, perhaps afraid of the results they would get, the Commission's experts did not do any empirical analysis of prices at all, demonstrating the same "'aversion to empirical evidence' in favor of burden-shifting" that got the Ninth Circuit reversed after affirming the Commission in *California Dental*, 224 F.3d 942, 947 (9th Cir. 2000).

Because the Commission cannot prove significant harm to competition as a whole—the threshold question under the rule of reason—that should be the end of this case. But the Commission also erred when it discounted 1-800 Contacts' procompetitive justifications (protection of trademarks and efficiency of litigation settlements) and held the settlements should have been structured according to *its* preferences. Specifically, over a decade after its first trademark settlement, the Commission told 1-800 Contacts that it should have settled with "disclosures," instead of the "non-use" provisions that the parties to the agreements chose and that courts regularly employed. Op. 27. As this Court said in the trademark context, "the parties are in the best position to determine what protections are needed and how to resolve" their disagreements, and, thus, it is "usually unwise for courts to second-guess them." *Clorox*, 117 F.3d at 60. Here, the Commission second-guessed the parties' settlement structure even though it could not cite a *single example* of parties ever settling a trademark dispute the way it preferred. This, too, requires reversal.

The Commission's process for assigning antitrust liability was deeply flawed at every step and threatens to transform ordinary and competition-enhancing business practices into presumptive antitrust violations. Trademark policy, like antitrust policy, aims to promote interbrand competition. *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 52 n.19 (1977) ("Interbrand competition . . . is the primary concern of antitrust law"); *Clorox*, 117 F.3d at 61 ("Efforts to protect trademarks, even aggressive ones, serve the competitive purpose of furthering trademark policies."). The Commission's short-sighted antitrust decision will undermine trademark policy and, in the long run, competition itself. It should be reversed.

JURISDICTIONAL STATEMENT

On August 8, 2016, the Commission filed a complaint in its administrative court pursuant to 16 C.F.R. § 3.11. The Commission issued its opinion and a Final Order on November 7, 2018, and 1-800 Contacts filed a timely petition for review with this Court on December 28, 2018. This Court has jurisdiction under 15 U.S.C. § 45(c).

STATEMENT OF THE ISSUES

1. Whether the Commission committed legal error by using antitrust law to second-guess and condemn non-exclusionary trademark settlements that arose from non-sham trademark claims and included the same relief that district courts order for such claims.

2. Whether the Commission committed legal error by deeming non-exclusionary trademark agreements "inherently suspect"—thus, avoiding the need to prove anticompetitive effects in the market as a whole—despite the Supreme Court's repeated rejection of this evidentiary shortcut.

3. Whether the Commission committed legal error by misapplying the "direct evidence" method to find anticompetitive effects where the "evidence" it offered is consistent with the lawful, competition-enhancing exercise of trademark rights.

4. Whether the Commission erred in finding that the 1-800 Contacts' trademark agreements harmed search engines by failing to offer any evidence of harm to competition as a whole to sell advertising.

5. Whether the Commission committed legal error in rejecting 1-800 Contacts' procompetitive justifications by (a) requiring proof that saved litigation costs

from settlements were "passed on" to consumers and (b) inventing a "not good enough" standard to discount 1-800 Contacts' asserted trademark claims.

6. Whether the Commission committed legal error in its "less anticompetitive means" analysis by failing to give "substantial weight" to the parties' chosen settlement terms and, instead, insisting on a "disclosure" provision that (according to the Commission's evidence) has never been used in any trademark settlement.

7. Whether the Commission committed legal error by failing to analyze the Luxottica agreement as a vertical sourcing agreement and finding that it violated the antitrust laws without considering its unique competition-enhancing benefits.

8. Whether the Commission's Final Order, which interjects the Commission into all of 1-800 Contacts' trademark enforcement efforts regardless of their context, is flawed and overly broad when the Commission's theory of harm is directed to trademark enforcement in the specific context of paid search advertising.

STATEMENT OF THE CASE

On August 8, 2016, over a decade after 1-800 Contacts entered into its first trademark settlement, the Commission filed a complaint in its administrative court against 1-800 Contacts pursuant to 16 C.F.R. § 3.11. The Complaint alleged the provisions related to search advertising in several of 1-800 Contacts' settlements and the Luxottica agreement (together, the "Challenged Agreements") violated Section 5 of the Federal Trade Commission Act.

The Commission's claim against 1-800 Contacts was tried before Administrative Law Judge D. Michael Chappell (the "ALJ") in an administrative trial beginning on April 11, 2017. On October 20, 2017, the ALJ issued a decision finding that the Challenged Agreements violate Section 5 (interpreted coextensively with Section 1 of the Sherman Act) and entered a remedial order.

On October 27, 2017, 1-800 Contacts timely appealed to the full Commission. On November 7, 2018, the Commission (in a three to one decision, with Commissioner Wilson not participating) affirmed the ALJ's conclusion, but on different grounds. On December 28, 2018, 1-800 Contacts timely filed a petition for review with this Court.

STATEMENT OF FACTS

It is hard to imagine a *worse* case for using antitrust law to condemn a valid exercise of trademark rights. For many years, the market for contact lenses was dominated by eye-care professionals ("ECPs") who, because of the lack of competition, charged high prices and had poor service. 1-800 Contacts cracked their stranglehold by investing hundreds of millions of dollars to build a powerful brand and an entirely new distribution channel. As the dissent put it, "[t]his massive endeavor—the kind of conduct trademark law is intended to foster—did more than benefit 1-800 Contacts: it pioneered the mail-order contact lens business and then the online contact lens business to the direct benefit of consumers in the form of reduced prices and increased convenience and choice." Dissent 4.

A. Key Features of the Contact Lens Industry.

Contact lenses are "medical devices" that effectively "are sold only pursuant to prescription." Initial Decision Findings of Fact ("IDF") 8-9.[1] A consumer who wants to wear contact lenses must visit an ECP to obtain a prescription. IDF 10. There are approximately 58,000 ECPs in the United States. IDF 74. In all but seven states, contact lens prescriptions expire in one year. IDF 18. This means that contact lens wearers must visit an ECP at least once a year (or every two years in a few states). IDF 19. ECPs use this mandated face-to-face interaction to their great advantage. Even today, ECPs sell over 80 percent of initial contact lens orders under a new prescription and over 50 percent of refill orders. IDF 404.

For many years, ECPs were not required to provide customers a copy of their prescription. *See* IDF 17. During this period, unless the ECP voluntarily provided a customer with a prescription, customers had no practical choice but to purchase contact lenses from the ECP. In 2003, in part at 1-800 Contacts' urging, Congress

[1] For ease of reference, IDF citations are to the ALJ's numbered findings of fact as opposed to page numbers.

passed the Fairness to Contact Lens Consumers Act, 15 U.S.C. § 7601, which requires that ECPs automatically provide such prescriptions. IDF 17. Once a customer has a copy of the prescription, he or she can purchase the prescribed contact lenses from any retailer. IDF 24-25. Today, contact lenses are sold by independent ECPs, optical retail chains, mass merchandisers (*e.g.*, Walmart, Target), club stores (*e.g.*, Costco, Sam's Club), purely online retailers, and other companies that sell through multiple channels. IDF 73.

In general, independent ECPs and optical retail chains (which themselves are often ECP-owned) charge the highest prices for contact lenses. IDF 83, 431. Consistent with its market-disruption strategy, 1-800 Contacts has long priced at a discount to these market leaders. IDF 433-34. Other purely online retailers—which have *not* made the same brand investment as 1-800 Contacts—generally price at a discount to 1-800 Contacts. IDF 442-44. Club stores generally charge the lowest prices in the industry. IDF 89, 448.

Even with increased prescription portability and the fact that a large portion of ECPs charge the highest prices in the industry, ECPs continue to dominate the sale of contact lenses. Independent ECPs and optical retail chains command approximately 60 percent of contact lens sales in the United States, and when combined with mass merchandisers and club stores, account for 83 percent of contact lens sales in the United States.[2] IDF 491. Online retailers, including 1-800 Contacts, account for the remaining 17 percent. IDF 491. Between 2003 and 2015, the total sales of contact lenses at retail grew at four to five percent annually, reaching $4.7 billion in 2015. IDF 4-5.

B. 1-800 Contacts Pioneered the Sale of Contact Lenses Online.

In 1992, Jonathan Coon visited an ECP to purchase his contact lenses. IDF 31. He found the process inconvenient, the service not very good, and the prices high. IDF 31. To Mr. Coon, this was not just a problem—it was an opportunity. From his college dorm room, Mr. Coon started the business that would become 1-800 Contacts. IDF 30. Over the next decade—through risk-taking, massive brand-building efforts, and a relentless focus on customer service—1-800 Contacts fundamentally changed the formerly stagnant retail market for contact lenses.

In the beginning, Mr. Coon's company carried only four products, and it sold exclusively to college students living on campus. IDF 33. In 1995, Mr. Coon cobbled together the money to acquire the phone number "1-800 Contacts" and changed the name of the company to match the newly-acquired phone number. IDF 36. 1-800 Contacts' sales more than doubled the first month after activating this phone number. IDF 37. Once 1-800 Contacts began advertising its new name and

[2] Many mass merchandisers and club stores that sell contact lenses have ECPs in-store (IDF 89) and are therefore included in this higher market share calculation.

phone number, its customer acquisition and retention rates jumped by 20 to 25 percent. IDF 51. In 1996, 1-800 Contacts launched its website as one of the first companies (if not the first) to sell contact lenses online, and quickly became the pioneer of this new sales channel. IDF 38.

Advertising is central to 1-800 Contacts' brand and value proposition. 1-800 Contacts' advertising spans a variety of media, including print, radio, television, and online. In a little over a decade, 1-800 Contacts invested over $400 million in advertising across these platforms, which dwarfs the advertising spend of any of its online competitors. IDF 582. The goal of 1-800 Contacts' advertising, as well as its customer service investments described below, is to "persuad[e] consumers to purchase a medical device like contact lenses from someone other than their ECP." IDF 56.

1-800 Contacts has achieved this objective, and did so primarily through forms of advertising *other* than paid search advertising. For example, between 2002 and 2014, 1-800 Contacts spent [redacted] on television advertising alone, which is more [redacted] the amount it spent on online advertising generally [redacted]. IDF 64-66. Over the same time period, 1-800 Contacts' spend on paid search advertising made up just a fraction of its total online advertising spend [redacted]. IDF 66. One reason 1-800 Contacts' advertising spend is split this way is that 1-800 Contacts has found television advertising drives customers to search for its website online. IDF 63.

1-800 Contacts' massive advertising investments have paid off. Despite the ECPs' natural advantage, 1-800 Contacts has earned the business of millions of customers, drawing them away from these expensive retailers to a lower-priced alternative (online sales) and an improved customer experience. 1-800 Contacts also has built the highest unaided brand awareness of any online retailer of contact lenses. IDF 581-82. According to one analysis from 2015, 1-800 Contacts has 20 times the unaided brand recognition of its next largest online competitor. IDF 414.

1-800 Contacts has not stopped there. It also has invested hundreds of millions of dollars maintaining superior customer service to further build its brand and ensure its customers will come back. For example, 1-800 Contacts continuously invests in website design to make its site simple and efficient. Returning customers can place an order with as few as two clicks on 1-800 Contacts' website. IDF 39. 1-800 Contacts also developed a mobile application that, among other features, enables customers to submit prescription information by photo. IDF 41-42. To this day, calls to 1-800 Contacts are answered by a live person, usually by the third ring, and emails are answered within 10 minutes. IDF 45.

1-800 Contacts maintains—at great expense—the largest inventory stock of any contact lens retailer. IDF 44. This inventory enables 1-800 Contacts to fill 98 percent of orders with inventory on hand rather than specially ordering contact lenses from manufacturers. IDF 44. 1-800 Contacts also offers free replacement lenses if a customer tears a lens. IDF 46. These customer service efforts have led to numerous customer service awards. IDF 47.

After almost three decades in business, 1-800 Contacts sells about 10 percent of the contact lenses in the country and provides a credible alternative to purchasing contact lenses from an ECP. IDF 492.

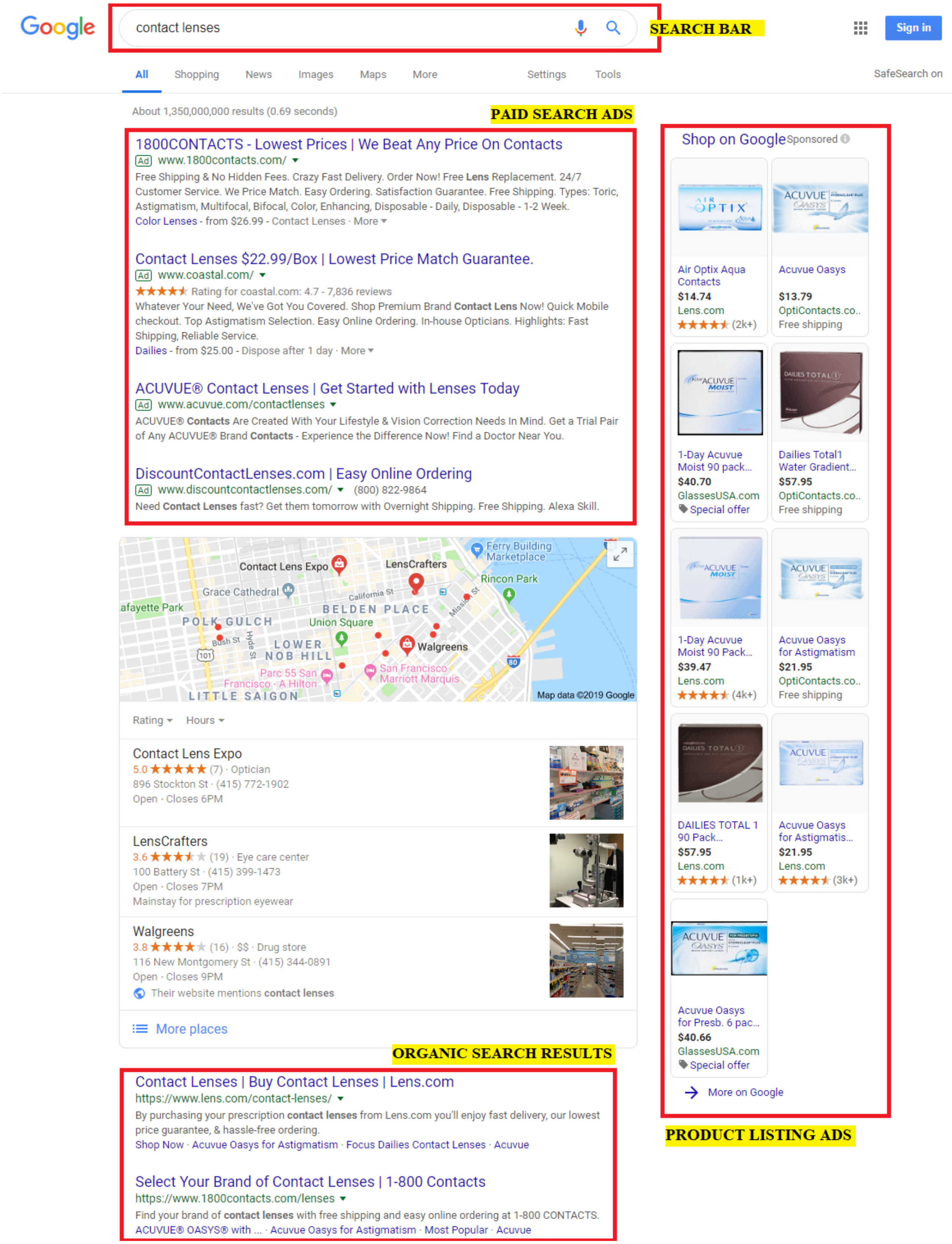
C. Paid Search Advertising Mechanics.

This case is about one form of online advertising: paid search advertising. As background, when a user enters a query into a search engine's search bar, such as on Google, the search engine displays two sets of search results: organic search results and paid search advertisements. IDF 141. Organic search results are displayed solely based on the search engine's assessment of relevance to the user's query. IDF 143. Advertisers do not (and cannot) pay the search engine when a user clicks on an organic search result. IDF 144.

In contrast, the ranking and positioning of paid search ads largely depends on payments from advertisers to the search engines. IDF 187. To engage in paid search advertising, advertisers bid on specific "keywords" in "auctions." IDF 158-59. In these auctions, an advertiser bids the highest amount that it is willing to pay if a user searches for a specific word or phrase and then clicks on the advertiser's ad that the search engine displays. IDF 186.

Search engines do not display paid search ads solely based on bids, however. IDF 184-85. The number and positioning of paid search ads displayed in response to any given user query depends on a combination of advertiser bids and several other factors evaluated by the search engine. IDF 202. At present on Google, paid search ads appear immediately under the search bar and are marked with a small box that says "Ad." IDF 150. The organic results appear below the paid search ads and, depending on the search, below a map. Search engines may also display "product listing ads" (which are not generated in response to keyword bids). IDF 271-74.

Figure 1


Google
contact lenses
SEARCH BAR
Sign in
All
Shopping
News
Images
Maps
More
Settings
Tools
SafeSearch on
About 1,350,000,000 results (0.69 seconds)
PAID SEARCH ADS
1800CONTACTS - Lowest Prices | We Beat Any Price On Contacts
Ad www.1800contacts.com/
Free Shipping & No Hidden Fees. Crazy Fast Delivery. Order Now! Free Lens Replacement. 24/7 Customer Service. We Price Match. Easy Ordering. Satisfaction Guarantee. Free Shipping. Types: Toric, Astigmatism, Multifocal, Bifocal, Color, Enhancing, Disposable - Daily, Disposable - 1-2 Week.
Color Lenses - from $26.99 - Contact Lenses · More
Contact Lenses $22.99/Box | Lowest Price Match Guarantee.
Ad www.coastal.com/
Rating for coastal.com: 4.7 - 7,836 reviews
Whatever Your Need, We've Got You Covered. Shop Premium Brand Contact Lens Now! Quick Mobile checkout. Top Astigmatism Selection. Easy Online Ordering. In-house Opticians. Highlights: Fast Shipping, Reliable Service.
Dailies - from $25.00 - Dispose after 1 day · More
ACUVUE® Contact Lenses | Get Started with Lenses Today
Ad www.acuvue.com/contactlenses
ACUVUE® Contacts Are Created With Your Lifestyle & Vision Correction Needs In Mind. Get a Trial Pair of Any ACUVUE® Brand Contacts - Experience the Difference Now! Find a Doctor Near You.
DiscountContactLenses.com | Easy Online Ordering
Ad www.discountcontactlenses.com/ (800) 822-9864
Need Contact Lenses fast? Get them tomorrow with Overnight Shipping. Free Shipping. Alexa Skill.
Contact Lens Expo
LensCrafters
Ferry Building Marketplace
Grace Cathedral
Rincon Park
afayette Park
POLK GULCH
BELDEN PLACE
Union Square
LOWER NOB HILL
Walgreens
Parc 55 San Francisco - A Hilton
San Francisco Marriott Marquis
LITTLE SAIGON
Map data ©2019 Google
Rating
Hours
Contact Lens Expo
5.0 (7) · Optician
896 Stockton St · (415) 772-1902
Open · Closes 6PM
LensCrafters
3.6 (19) · Eye care center
100 Battery St · (415) 399-1473
Open · Closes 7PM
Mainstay for prescription eyewear
Walgreens
3.8 (16) · $$ · Drug store
116 New Montgomery St · (415) 344-0891
Open · Closes 9PM
Their website mentions contact lenses
More places
ORGANIC SEARCH RESULTS
Contact Lenses | Buy Contact Lenses | Lens.com
https://www.lens.com/contact-lenses/
By purchasing your prescription contact lenses from Lens.com you'll enjoy fast delivery, our lowest price guarantee, & hassle-free ordering.
Shop Now · Acuvue Oasys for Astigmatism · Focus Dailies Contact Lenses · Acuvue
Select Your Brand of Contact Lenses | 1-800 Contacts
https://www.1800contacts.com/lenses
Find your brand of contact lenses with free shipping and easy online ordering at 1-800 CONTACTS.
ACUVUE® OASYS® with ... · Acuvue Oasys for Astigmatism · Most Popular · Acuvue
Shop on Google Sponsored
Air Optix Aqua Contacts
$14.74
Lens.com
(2k+)
Acuvue Oasys
$13.79
OptiContacts.co..
Free shipping
1-Day Acuvue Moist 90 pack...
$40.70
GlassesUSA.com
Special offer
Dailies Total1 Water Gradient...
$57.95
OptiContacts.co..
Free shipping
1-Day Acuvue Moist 90 Pack...
$39.47
Lens.com
(4k+)
Acuvue Oasys for Astigmatism
$21.95
OptiContacts.co..
Free shipping
DAILIES TOTAL 1 90 Pack...
$57.95
Lens.com
(1k+)
Acuvue Oasys for Astigmatis...
$21.95
Lens.com
(3k+)
Acuvue Oasys for Presb. 6 pac...
$40.66
GlassesUSA.com
Special offer
More on Google
PRODUCT LISTING ADS

In addition to bids on keywords, advertisers choose the type of "matching" they want the search engine to use when determining whether to display an ad. If the advertiser chooses "exact match," the search engine displays an ad only if the user searches for the word or phrase on which the advertiser bid. IDF 173. For example, if an advertiser bid on "tennis shoes," its ad would not be displayed when a user searches for "red tennis shoes." IDF 174.

If an advertiser selects "broad match," the search engine will seek to determine the meaning of the user's search and display ads that it believes are relevant to the user's intent. IDF 167-68. For example, if an advertiser bid on the keyword "low-carb diet plan," a search engine might display an ad in response to searches for "carb-free foods." IDF 168.[3] Search engines provide advertisers with the option to implement "negative keywords" to prevent ads from being displayed in response to searches for specific keywords. IDF 175. For example, an advertiser that sells eyeglasses could implement the negative keyword "wine glasses" to prevent its ads from being displayed when users search for "wine glasses." IDF 175.

[3] Search engines have other types of matching that fall between "exact match" and "broad match." IDF 169-72.

D. 1-800 Contacts' Valuable Brand Was a Target for Trademark Infringement.

Because 1-800 Contacts has an extremely valuable brand, some of its competitors have infringed on its trademarks to reap the benefits of brand investment without themselves investing. *See* IDF 301-02. One way they have done so is by bidding on the trademarked term "1-800 Contacts" (and similar variants) in search advertising auctions so that their ads appear when a customer searches for "1-800 Contacts." *See* IDF 302. This practice was "directly correlated with" 1-800 Contacts' television advertising spend. IDF 722. In other words, the more 1-800 Contacts spent on television ads to drive customers to its website, the more its free-riding competitors bid on "1-800 Contacts" in search advertising auctions.

Prior to 2004, this type of infringement was easy for 1-800 Contacts to resolve. Google had a policy under which it would restrict, at a brand owner's request, advertisers' ability to bid on trademarked keywords. IDF 287. Google changed this policy in April 2004. Google recognized that this policy change would lead to trademark infringement disputes, but nevertheless stated that it was "not in a position to arbitrate trademark disputes between advertisers and trademark owners." IDF 293. Google advised "trademark owners to resolve their disputes directly with advertisers." IDF 293.

This policy change sparked an outcry among brand owners across industries, many of which spilled into litigation with competitors and Google itself. *See, e.g.*, *Rescuecom Corp. v. Google, Inc.*, 562 F.3d 123 (2d Cir. 2009); *Rosetta Stone Ltd. v. Google, Inc.*, 676 F.3d 144 (4th Cir. 2012). To try to lessen this outrage, Google met with brand owners, including 1-800 Contacts, to discuss how they could resolve these disputes going forward. CX9031-010. Google suggested to 1-800 Contacts that it could resolve trademark disputes arising from this new policy by having alleged infringers implement 1-800 Contacts' trademarks as negative keywords. CX9031-010 to 11.

Bing followed a similar path as Google. Bing initially did not permit advertisers to bid on trademarks as keywords, but changed its policy in 2011 to allow the practice. IDF 296-98.

E. 1-800 Contacts Settled a Series of Legitimate Trademark Infringement Lawsuits with Settlement Agreements that Prohibited the Infringing Conduct.

The search engines' policy changes drove 1-800 Contacts and many other brand owners to litigate (or threaten litigation) with advertisers to resolve claims of trademark infringement based on trademark keyword bidding. *See* IDF 301-16, 325, 328-54; RX0734-096. Between 2004 and 2013, 1-800 Contacts brought, or threatened to bring, several of these actions, 13 of which settled. IDF 343. The Commission concedes that every one of them was legitimate—*i.e.*, not a sham. Op. 23. Ultimately, instead of spending millions of dollars to litigate, 1-800 Contacts and the alleged infringers chose to settle these lawsuits based on the same relief courts ordered for such claims—namely, "non-use" of the trademark terms in paid search advertising. IDF 343, 359-70. These settlements (the "Challenged Settlements") are the purported antitrust sin giving rise to the Commission's claims here.

Trademark Infringement Claims. In the aftermath of Google's 2004 policy change, and the flood of lawsuits that followed, courts began to grapple with legal issues surrounding trademark infringement lawsuits in this context. One threshold question percolating through the courts was whether bidding on a trademarked keywords in search advertising was a "use in commerce" under the Lanham Act—with most courts answering "yes."[4] IDF 333. While this issue was working through the courts, between 2004 and 2008, 1-800 Contacts entered into three trademark settlements where its competitors agreed to stop engaging in the infringing conduct. IDF 307, 315, 344.

These trademark infringement claims were strengthened in April 2009, when this Court issued a decision confirming that bidding on trademarked keywords is a "use in commerce." *Rescuecom*, 562 F.3d at 123; *see also* IDF 333. Courts across

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[4] *See, e.g.*, *Australian Gold, Inc. v. Hatfield*, 436 F.3d 1228, 1239 (10th Cir. 2006); *J.G. Wentworth S.S.C. Ltd. P'ship v. Settlement Funding LLC*, No. 06-0597, 2007 WL 30115, at *6 (E.D. Pa. Jan. 4, 2007); *Gov't Emps. Ins. Co. v. Google, Inc.*, 330 F. Supp. 2d 700, 702-03 (E.D. Va. 2004).

the country adopted *Rescuecom*'s holding.[5] IDF 333. After *Rescuecom*, the focus of these trademark infringement cases shifted from the use of the trademarks to the likelihood of consumer confusion. IDF 333. Likelihood-of-confusion cases are fact-intensive, expensive to litigate, and often require a judge or jury to resolve disputed facts, in part, because assessing likelihood of confusion involves detailed, multi-factor tests. IDF 334.

Rescuecom considerably increased the risk that an alleged infringer would be found liable for infringement when bidding on a trademarked keyword because the prospects of dismissal on a threshold issue vanished. IDF 333-34. Most of the Challenged Settlements (9 of 13) occurred in the wake of *Rescuecom*, as the alleged infringers faced heightened liability and both sides faced the expense and burden of litigating the "confusion" question. IDF 348. In fact, only one month after *Rescuecom*, Judge George B. Daniels of the Southern District of New York memorialized one of 1-800 Contacts' settlements as a permanent injunction. CX0316.

As their own testimony makes plain, the alleged infringers settled because of the potential for liability and the costs of litigation outweighed any benefit from

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[5] *See, e.g.*, *Network Automation, Inc. v. Advanced Sys. Concept, Inc.*, 638 F.3d 1137, 1144 (9th Cir. 2011); *1-800 Contacts, Inc. v. Mem'l Eye, P.A.*, No. 2:08-CV-983, 2010 WL 988524, at *6 (D. Utah Mar. 15, 2010).

continuing the allegedly infringing conduct. IDF 352-54. For example, Web Eye Care settled after *Rescuecom* because of the risks of losing the litigation and because the litigation costs were "not worth it." IDF 353. Similarly, Memorial Eye agreed to settle in 2013 because of the legal uncertainty around the "broad matching issue," and it knew "the Lens.com/1-800 Contacts case was still going on and they had spent $2 million."[6] IDF 349-50. Everyone (including the Commission's economist) agrees that parties act rationally when settling litigation. IDF 356.

Settlement Terms. While the terms of the Challenged Settlements are not identical, in general, the settlements prohibited the alleged infringer from bidding on a specifically-listed set of 1-800 Contacts' trademark terms (and similar variants, including misspellings) in search advertising auctions. *See, e.g.*, IDF 363.[7] Most of the Challenged Settlements also adopted Google's suggestion: they required the parties to implement negative keywords to prevent their ads from appearing in response to searches for the other party's trademarked keywords, as those ads might be displayed under the search engines' "broad match" instructions. IDF 364.

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6 In the *Lens.com* case, after six years of litigation and millions of dollars in legal expense, the Tenth Circuit affirmed the district court's grant of summary judgment to Lens.com on 1-800 Contacts' direct trademark infringement claims, while finding 1-800 Contacts had presented sufficient evidence on contributory infringement. *1-800 Contacts, Inc. v. Lens.com, Inc.*, 722 F.3d 1229, 1256-57 (10th Cir. 2013).

7 1-800 Contacts also agreed not to bid on a specifically-listed set of the alleged infringers' trademarks. IDF 363.

Trademark non-use settlements are common in trademark infringement cases, including those involving infringement based on keyword bidding. RX0734-107 to 09 (collecting keyword infringement cases that settled with similar non-use provisions). Search engines themselves settled cases with these same terms. *See, e.g.*, RX0732-0232 (settlement in which Yahoo agreed to block search ads that would be displayed in response to searches for American Airlines' trademarks). That is not surprising, as many courts have entered injunctions based on the *exact same relief*—*i.e.*, prohibiting alleged infringers from bidding on trademarked keywords in search advertising auctions and requiring negative keywords. RX0734-063-064, 099-107, 117-19 (collecting cases); *see infra* at 27-29 (chart of settlements and cases).

Notably, the trademark settlements did not reach further than the infringement. They targeted just one form of advertising—paid search advertising aimed at specific *trademark terms*. Indeed, as one of the Commission's experts admitted, "generic" terms—such as "contact," "contact lenses," or "discount contacts"—are more widely searched than trademark terms, and the Challenged Agreements did not touch these or other terms. IDF 367; CX8007-028 [redacted] of searches were for generic terms, [redacted] of searches were for 1-800 Contacts' trademarks). Nor did the agreements foreclose any other form of online advertising (*e.g.*, internet display advertising, social media advertising) or offline advertising (*e.g.*, television, print, and radio). *See* IDF 359-70.

About half of the settlements required the alleged infringer to make a small monetary payment to 1-800 Contacts. *See* CX0311; CX0313; CX0314; CX0315; CX0323; CX0324. None required 1-800 Contacts to pay the alleged infringer—*i.e.*, there was no reverse payment.

Summary. Starting fifteen years ago, 1-800 Contacts—like many other trademark owners—settled unquestionably legitimate trademark infringement claims using the same "non-use" provisions that courts were ordering as relief. The following chart presents a timeline of the settlements and contemporaneous case law.

1-800 Contacts' Settlements	Contemporaneous Cases
2004: • First Vision Direct Settlement • Coastal Contacts Settlement	• *Playboy Enters., Inc. v. Netscape Commc'ns Corp.*, 354 F.3d 1020, 1031 (9th Cir. 2004) (reversing summary judgment and finding that issue of keyword bidding infringement was for the jury, with a majority of the likelihood-of-confusion factors favoring brand owner) • *Google Inc. v. Am. Blind & Wallpaper Factory, Inc.*, No. C 03-05340 JE, 2005 WL 832398 (N.D. Cal. Mar. 30, 2005) (denying Google's motion to dismiss claims of trademark infringement pertaining to search advertising)

1-800 Contacts' Settlements	Contemporaneous Cases
	• *Gov't Emps. Ins. Co.*, 330 F. Supp. 2d at 702-03(same)
2008: • EZ Contacts Settlement	• *Australian Gold*, 436 F.3d 1228 (10th Cir. 2006) (affirming jury verdict concluding that keyword purchases constituted infringement) • *Soilworks, LLC v. Midwest Indus. Supply, Inc.*, 575 F. Supp. 2d 1118, 1132-33 (D. Ariz. 2008) (granting summary judgment in favor of brand owner over claims of keyword bidding infringement) • *Rhino Sports, Inc. v. Sport Court, Inc.*, No. CV-02-1815, 2007 WL 1302745 (D. Ariz. May 2, 2007) (refusing to amend injunction barring competitor from bidding on trademarks in search advertising auctions)
2009 – 2011: • Second Vision Direct Settlement • Lensfast Settlement • AC Lens Settlement • Lenses for Less Settlement • Contact Lens King Settlement • Empire Vision Settlement • Tram Data Settlement • Walgreens Settlement • Web Eye Care Settlement • Standard Optical Settlement	• *Rescuecom*, 562 F.3d at 123 (this Court's seminal holding that bidding on keywords constitutes "use in commerce") • *CJ Prods. LLC v. Snuggly Plushez LLC*, 809 F. Supp. 2d 127 (E.D.N.Y. Aug. 22, 2011) (Mauskopf, J.) (granting preliminary injunction barring trademark keyword bidding) • *Transamerica Corp. v. Moniker Online Servs, LLC*, No. 09-60973-CIV, 2010 WL 1416979, at *7 (S.D. Fla. Apr. 7 2010) (ordering defendant to implement negative keywords)

1-800 Contacts' Settlements	Contemporaneous Cases
	• *Quidgeon v. Olsen*, No. 10-cv-1168, 2011 WL 1480537 (C.D. Ill. Apr. 19, 2011) (injunction barring trademark keyword bidding) • *Binder v. Disability Grp., Inc.*, 772 F. Supp. 2d 1172 (C.D. Cal. 2011) (bench trial finding liability for bidding on trademarked keywords)
2013: • Memorial Eye Settlement	• *Rosetta Stone*, 676 F.3d 144 (4th Cir. 2012) (reversing grant of summary judgment in Google's favor related to allegations of trademark infringement in search advertising) • Consent Decree & Final J., *Greenberg Smoked Turkeys, Inc. v. Tsavo Media, Inc.*, No. 11-cv-00037 (Dkt. 29) (E.D. Tex. Jan. 23, 2012), ECF No. 29, (settlement prohibiting bidding on trademarked keywords) • J. & Permanent Inj., *Partners for Health & Home v. Yang*, 2:09-cv-07849-RZ (C.D. Cal. June 21, 2012), ECF No. 146, (permanent injunction barring trademark keyword bidding)

F. 1-800 Contacts and Luxottica Included a Keyword Bidding Regulation in a Vertical Sourcing Agreement.

In December 2013, 1-800 Contacts and Luxottica (an operator of various brick-and-mortar ECP chains) entered into a sourcing and services agreement. IDF 393. Under this agreement, 1-800 Contacts provides Luxottica with fulfillment services, including shipping contact lenses to Luxottica's customers and retail stores, and other services, such as sourcing contact lenses from the major contact lens manufacturers. IDF 394. Because of this sourcing agreement, [redacted]. IDF 395. Among the many terms in this collaborative agreement, 1-800 Contacts and Luxottica agreed to terms similar to those contained in the Challenged Settlements. That is, 1-800 Contacts and Luxottica agreed not to bid on one another's trademarks in search advertising auctions and to implement negative keywords. IDF 396.

G. Over the Period that 1-800 Contacts Entered the Challenged Agreements, Competition to Sell Contact Lenses Dramatically Increased and [redacted]

Under the Commission's theory that the Challenged Agreements enacted oppressive advertising restrictions, one would expect to see stagnating growth in the contact lens market and reduced competition to sell contact lenses. The opposite occurred. Since the first trademark settlement in 2004, the contact lens market grew by four to five percent annually. *See, e.g.*, IDF 4-5. More online contact lens sellers were founded. *See, e.g.*, IDF 106, 111, 117. More brick-and-mortar retailers expanded their online offerings. IDF 90-97. And even today, new companies frequently come into the market. IDF 123-34.

In fact, the Commission does not (and cannot) make any claim that the Challenged Agreements restricted output or harmed the quality of contact lenses.

Nor does the Commission suggest 1-800 Contacts has been able to grow its margins due to the Challenged Agreements. To the contrary, the undisputed evidence is that [redacted] even before any of the Challenged Agreements existed. RX0739-064, 107; Dissent 34.

None of this is surprising because, despite the Commission's effort to inflate the importance of paid search advertising using trademarked terms, that is just one of many forms of advertising. To be sure, 1-800 Contacts' competitors may have appreciated advertising using the brand that 1-800 Contacts spent hundreds of millions of dollars building. But the record does not support (and the Commission does not contend) that 1-800 Contacts' competitors were unable to compete without being able to use 1-800 Contacts' trademarks in a potentially infringing way.

H. The ALJ and Commission Opinions.

ALJ Opinion. On October 20, 2017, the ALJ issued an Initial Decision ("ID") finding that the Challenged Agreements violate Section 5 of the Federal Trade Commission Act. *See* ID at 190. The ALJ applied the traditional three-part burden-shifting framework under the rule of reason. ID at 123-189. As to anticompetitive effects, the ALJ arbitrarily limited the "market" to only online retailers (excluding sellers that make up to 83 percent of contacts lens sales from this "market") and found at "least some consumers" in this "market" paid higher prices due to the

Challenged Agreements. ID at 152-53. The ALJ found that the procompetitive benefits offered by 1-800 Contacts did not outweigh those "effects." ID at 190.

Commission Majority Opinion. On November 7, 2018, a Commission majority affirmed the ALJ's finding of liability, but went much further—adopting virtually every argument its staff put forward and creating new (and dangerous) antitrust rules.

First, the Commission held that *Actavis* did not forbid second-guessing of these settlements. Op. 15. Indeed, according to the Commission, it was not bound by the "*Actavis* considerations" at all. Op. 15.

Second, unlike the ALJ, the Commission applied the rarely-used "inherently suspect" standard to analyze the Challenged Agreements. Op. 18. Under this truncated analysis, the Commission can discharge its initial burden by showing that the "nature of the restraints" is anticompetitive and recognized as such by economic theory. Op. 19-20. Without citing a single source addressing trademarks, settlements, or search advertising, the Commission claimed that the inherently suspect standard applies to any agreement that regulates "the display of ads that would enable consumers to learn about alternative sellers . . . and give them the opportunity to make price comparisons at the time they are likely to make a purchase." Op. 22.

It then recognized that 1-800 Contacts had offered plausible and cognizable competition-enhancing justifications for the Challenged Agreements: saved litigation costs and trademark protection.[8] Op. 22-24. Yet, instead of reverting to a full rule of reason analysis (as Second Circuit law requires), it used an analysis under which it "still need not prove actual anticompetitive effects." Op. 24. (citation omitted). In the Commission's view, it wins under the inherently suspect standard after any procompetitive justification has been identified by merely "(i) identifying a theoretical basis for the alleged anticompetitive effects and showing that these effects are likely in this particular setting or (ii) explaining how [1-800 Contacts] could have minimized the anticompetitive effects of its conduct or accomplished its procompetitive justifications through less restrictive alternatives." Op. 24-25. The Commission held that it made both showings.

Third, in the alternative to its "inherently suspect" analysis, the Commission purported to find "direct evidence" of anticompetitive effects. Op. 42. The Commission found two forms of "direct evidence": (1) the Challenged Agreements reduced the number of ads displayed in response to queries on search engines for 1-800 Contacts' trademarks; and (2) absent the Challenged Agreements, some

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8 The majority later determined that these procompetitive justifications were not "valid." Op. 36.

consumers searching for "1-800 Contacts" might have seen additional ads and purchased at a lower price. Op. 42-47.

Fourth, the Commission held that the search engines—Google and Microsoft—were victims of the Challenged Agreements, and that harm to them was also "direct evidence" of anticompetitive effects. Op. 50-54.

Commissioner Phillips' Dissent. Commissioner Phillips issued a blistering 46-page dissent—one of the longest in Commission history.

He criticized the majority for not adhering to this Court's *Clorox* decision—a case "on all fours" with this one. Dissent 18. That case, as Commissioner Phillips explained, rejected an antitrust challenge to trademark settlement agreements because "trademarks are by their nature non-exclusionary" and "efforts to protect trademarks, even aggressive ones, serve the competitive purpose of furthering trademark policies." Dissent 16-20 (quoting *Clorox*, 117 F.3d at 55-56, 61).

Commissioner Phillips also excoriated the majority's "drastic" decision to apply an inherently suspect standard to effectively any restriction on advertising. As he explained, that is fundamentally inconsistent with *Actavis*, *Clorox*, *California Dental*, and other case law, and it also is profoundly bad policy. Dissent 10-21 (decision will "create uncertainty, dilute trademark rights, and dampen inter-brand competition").

Commissioner Phillips was equally critical of the Commission's purported "direct evidence" of anticompetitive effects. Dissent 29-35. With respect to the Commission's first piece of evidence—a reduction in the number of ads displayed in response to searches for 1-800 Contacts' trademarks—Commissioner Phillips explained that the relevant output for this purpose is not the amount of advertising in the world, but of the underlying good sold. Dissent 30-31 (citing *Cal. Dental*, 526 U.S. at 776). And here, the Commission does not contend that the output of contact lenses was restricted. ID at 153 n.36.

As to the second piece of evidence, Commissioner Phillips explained that the majority's analysis "rests almost entirely on the unremarkable fact that 1-800 Contacts' prices were higher than some of its competitors' prices." Dissent 32. Commissioner Phillips faulted the majority for failing to account for the fact (1) that this price gap pre-dated any of the Challenged Agreements and (2) that 1-800 Contacts' [redacted] regardless of the number of Challenged Agreements in place. Dissent 32-33. Moreover, he noted that the majority did not even consider that consumer preference for an established company with a strong brand could account for the price differential. Dissent 33 & n.44.[9]

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[9] For similar reasons, Commissioner Phillips criticized the Commission's holding that the Challenged Agreements harmed search engines. Dissent at 38-42.

SUMMARY OF ARGUMENT

The Commission's decision to apply antitrust scrutiny and its antitrust analysis are rife with legal errors requiring reversal.

First, the Commission erred in holding that the Challenged Settlements are subject to antitrust scrutiny. *Actavis* narrowly permitted antitrust second-guessing of "unusual" reverse-payment patent settlements that completely excluded competitors from the market, while exempting commonplace settlements based on traditional settlement considerations. *Actavis*, 570 U.S. at 152, 156. The settlements in this case should not be subject to antitrust scrutiny, as they are non-exclusionary trademark settlements that contain no reverse payment or other "unusual" structure and instead employ the same relief courts commonly granted in adjudicating the same claims.

Second, the Commission erred in applying the "inherently suspect" standard. The Commission's reasoning means that virtually any restriction on advertising is inherently suspect. But the Supreme Court rejected that rule 20 years ago in *California Dental* and, more recently, rejected application of the inherently suspect standard to exclusionary, reverse-payment settlements in *Actavis*. The Commission's third attempt to avoid the ordinary rule of reason, in a case presenting no threat to competition, should not be the proverbial charm.

Third, to show anticompetitive effects under the *correct* legal analysis, the Commission was required to prove "higher prices, reduced output, or lower quality in the market as a whole." *MacDermid Printing Sols. LLC v. Cortron Corp.*, 833 F.3d 172, 182 (2d Cir. 2016). The Commission failed to prove any of this. It does not claim that the Challenged Agreements reduced output of contact lenses, offered no evidence that the Challenged Agreements caused the quality of contact lenses to decrease, and failed to prove any relevant price effect because, among other things, it offered no evidence about 1-800 Contacts' margins, let alone evidence that its margins were "abnormally high." *Am. Express*, 838 F.3d at 205.

In place of proof of harm to competition, the Commission offered two pieces of "direct evidence" that are indistinguishable from the competition-enhancing exercise of 1-800 Contacts' trademark rights. As a matter of law, a mere reduction in advertising (the first piece of "evidence") is not an anticompetitive effect where there is no proven output effect *in the underlying market*. *Cal. Dental*, 526 U.S. at 776. Moreover, as a matter of fact, the Commission offered no proof that the Challenged Agreements reduced the amount of advertising, or even search advertising, for contact lenses.

The other form of direct evidence is essentially that 1-800 Contacts maintains higher prices than some online competitors. The Commission concedes that 1-800 Contacts has superior customer service, but claims that this superior service does not "fully account" for the difference. But in a case about 1-800 Contacts' strong brand, the Commission does not even consider that consumer preference for this strong brand (or any other factor) could account for the rest. The Commission's "evidence" that certain transactions were affected by 1-800 Contacts' exercise of its trademark rights does not come close to establishing harm to competition in the market as a whole.

Fourth, for similar reasons, the Commission failed to show harm to search engines. The Commission's finding of anticompetitive harm to the search engines is even more galling considering that the search engines told 1-800 Contacts to enter the Challenged Agreements to resolve the disputes they caused and disclaimed knowledge that the Challenged Agreements harmed them.

Fifth, beyond its failure to prove anticompetitive effects, the Commission erred in (1) discounting 1-800 Contacts' procompetitive justifications and (2) demanding that parties only use *its* proposed settlement term ("disclosures") under the guise of "less anticompetitive means." *Clorox* demands that the *parties*' choice of settlement terms be given "substantial weight," but the Commission gave their choice no weight—even though it could not identify any trademark settlement using its preferred settlement structure in the real world.

STANDARD OF REVIEW

The Commission's conclusions of law and application of law to facts are reviewed *de novo*. *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 454 (1986). The Commission's findings of fact are conclusive if supported by substantial evidence. *Schering-Plough Corp. v. FTC*, 402 F.3d 1056, 1062 (11th Cir. 2005).

ARGUMENT

I. THE COMMISSION ERRED BY APPLYING ANTITRUST SCRUTINY TO COMMONPLACE TRADEMARK SETTLEMENTS.

Actavis does not support the Commission's new rule. Settling a trademark lawsuit to block a potentially infringing advertisement cannot be a plausible antitrust violation that is sufficient to survive a motion to dismiss and expose the settling party to potentially ruinous liability or, at minimum, notoriously expensive antitrust discovery. 15 U.S.C. § 15(a); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 558 (2007). If allowed to stand, this rule will deter efficient settlements and undermine trademark policy and brand investments. By doing so, it will thwart the very interbrand competition that antitrust and trademark law are supposed to promote.

A. *Actavis* Permits Antitrust Scrutiny of Non-Sham Settlements Only in Extremely Narrow Circumstances.

Almost two decades ago, the Commission began a controversial quest to condemn an "unusual" type of IP settlement—reverse-payment patent settlements—under antitrust law. *See In the Matter of Schering-Plough Corp.*, No. 9297, 2002 WL 1488085, at *87-88 (F.T.C. June 27, 2002). These settlements arose in the context of a "unique" "drug-regulatory framework established" by the Hatch-Waxman Act. *Actavis*, 570 U.S. at 142, 155-56.

Under this Act, the first generic drug manufacturer that files an abbreviated new drug application—and successfully challenges a pioneer's patent—is granted a "generic exclusivity" period in which to sell its generic product in competition with the pioneer. *Id.* at 144. This exclusivity is potentially worth "several hundred million" dollars in profits to the generic manufacturer; at the same time, the generic's entry threatens the pioneer's monopoly. *Id.* at 143-44. According to the Commission, this situation presented an opportunity for collusion: the patent-infringement *plaintiff* (the pioneer drug manufacturer) could pay the allegedly infringing *defendant* (the generic manufacturer) millions of dollars in a settlement so the generic would stay out the market, effectively permitting the parties to split the monopoly profits. *Id.* at 155-56 (citing 12 P. Areeda & H. Hovenkamp, Antitrust Law ¶ 2046 at 341 (3d ed. 2010) (Hatch-Waxman structure creates "special incentives for collusion"). These reverse-payment settlements became the battleground at the intersection of antitrust, IP, and settlement principles.

But many courts rejected the Commission's suggestion that antitrust was a valid tool to second-guess even these exclusionary, unusual settlements. *See, e.g.*, *Tamoxifen*, 466 F.3d at 202-03; *Schering-Plough*, 402 F.3d at 1065. For example, in *Tamoxifen*, this Court reiterated its "longstanding adherence to the principle that 'courts are bound to encourage' the settlement of litigation" and recognized that using antitrust to second-guess these settlements would not only discourage settlements generally—it also would undermine patent policy itself. *Tamoxifen*, 466 F.3d at 202 (citation omitted).

Moreover, as this Court explained, there is simply no way to "guess" how a patent infringement claim would have turned out absent the settlement and, thus, could not base an antitrust determination on the strength of the underlying patent claim. *Id.* at 204. For these reasons and others, this Court aligned itself with the Eleventh Circuit in holding that, so long as the exclusionary effects of the settlement did not "exceed the scope of the patent's protection," *id.* at 218, there is no antitrust claim absent other circumstances (like sham litigation or a patent procured by fraud). In other words, "[w]hatever damage is done to competition by settlement is done pursuant to the monopoly extended to the patent holder by patent law unless the terms of the settlement enlarge the scope of that monopoly." *Id.* at 212-13.

Unhappy with these adverse decisions, the Commission sought review by the Supreme Court, ultimately leading to *Actavis*. In briefing *Actavis*, the Commission assured the Supreme Court that it had no reason to fear an antitrust assault on IP settlements generally because it was narrowly focused on the heightened competition risks and problems associated with "unusual" reverse-payment patent settlements.

For example, the Commission emphasized that "it is well-established" that patent settlements "do not generally violate the antitrust laws," and, "while a Hatch-Waxman settlement without a reverse payment should ordinarily raise no antitrust concern, there are sound reasons to treat reverse-payment settlements differently." *See* FTC *Actavis* Br. at 16, 26. But reverse-payment settlements, according to the Commission, were nothing more than a payment to "stay out of the market"—normally a *per se* violation of antitrust law. *Id.* at 20. In these circumstances, the Commission advocated that antitrust scrutiny should not only be permitted, but the settlements should be deemed *presumptively unlawful*. *Id*. at 19-22.

A divided Supreme Court narrowly permitted antitrust scrutiny of these reverse-payment settlements, while rejecting the Commission's effort to apply a presumptively unlawful standard (more on this below). The majority recognized the "value of settlements" and the "patent litigation problem"—*i.e.*, that a hindsight analysis of fact-intensive claims is difficult and unreliable. *Actavis*, 570 U.S. at 153. But the Court determined those factors should not "determine the results *here*," and that unique "considerations lead us to conclude that the FTC should have been given the opportunity to prove its antitrust claim" in this context. *Id.* at 153 (emphasis added).

The foremost "consideration" was that these patent settlements went to the heart of antitrust's concern: *exclusion of competition from the market*. *Id.* at 153-

54 (noting a "payment in return for staying out of the market" keeps prices at monopoly levels); *see also id.* at 146 ("Patent holders have a lawful right to exclude others from the market; thus a patent conveys the right to cripple competition") (internal quotation marks and citations excluded). The other "considerations" flowed from the unique nature of reverse-payment settlements. *Id.* at 153-58 (citation omitted). For example, the majority noted that (1) a large, reverse payment is typically an indicator of "market power," and (2) the "size of the unexplained reverse payment can provide a workable surrogate for a patent's weakness, all without forcing a court to conclude a detailed exploration of the validity of the patent itself." *Id.* at 157-58. Thus, the majority believed an "antitrust action is likely to prove more feasible administratively" in that context. *Id.* at 157. Throughout its opinion, the majority noted that the need for antitrust scrutiny was driven by the Hatch-Waxman structure, which creates "special incentives for collusion" and effectively ensures that, if the first-to-file generics are paid off to stay out of the market, other generics will not have the same incentive to challenge the patent. *Id.* at 156.

But the majority did not intend to open the floodgates to allow antitrust attack of IP settlements generally. To the contrary, the majority was careful to cabin its extension of antitrust scrutiny to this type of "unusual" reverse-payment settlement to avoid implicating "commonplace" settlements that did not carry the same risks.

Id. at 147-48, 152. Thus, the majority made clear that settlements "reflecting traditional settlement considerations, such as avoided litigation costs" should not be subject to the same antitrust scrutiny. *Id.* at 156. And, the majority tried to comfort the dissenters by making unambiguous that, "[i]nsofar as the dissent urges that settlements taking these commonplace forms have not been thought for that reason alone subject to antitrust liability, we agree, and do not intend to alter that understanding." *Id.* at 152.

The dissenters, however, were deeply troubled by even this limited extension of antitrust law. They recognized that "there would be no incentive to settle if, immediately after settling, the parties would have to litigate the same issue—the question of patent validity—as part of a defense against an antitrust suit." *Id.* at 170. The dissenters famously wished district courts "good luck" in figuring out how to apply antitrust's amorphous standards to reverse-payment patent settlements in the future. *Id.* at 173. The resulting uncertainty from this "novel" application of antitrust law, the dissenters explained, "weakens the protections afforded to innovators by patents, frustrates the public policy in favor of settling, and likely undermines the very policy [the majority] seeks to promote . . . ." *Id.* at 176. Ominously, the dissenters then presaged this case, "fear[ing] the Court's attempt to limit its holding to the context of patent settlements . . . will not hold long." *Id.* at 170.

B. The Challenged Settlements Do Not Implicate any of the Concerns that Led the *Actavis* Court to Narrowly Extend Antitrust Scrutiny.

The dissenters were right, as the Commission (contrary to its briefing in *Actavis*) was not content to assert antitrust primacy over just exclusionary patent settlements based on a large, unjustified reverse-payments. Instead, in this case, the Commission upended *Actavis*'s limited holding in favor of a dangerous rule that permits limitless antitrust scrutiny of trademark, and perhaps all IP, settlements. In doing so, the Commission has gone way too far.

This case is, if anything, the *opposite* of *Actavis*. *First*, because "trademarks are by their nature non-exclusionary," *Clorox*, 117 F.3d at 56, trademark agreements do not create the same risk to competition as patent settlements that block competitors entirely from the market. Indeed, precisely because of their non-exclusionary nature, this Court held that trademark settlements are "favored in the law" and that it is "usually unwise for courts to second-guess" them. *Id.* at 60.

The Challenged Settlements here are no exception. Like most trademark agreements, the parties could "escape the clutches" of the Challenged Settlements through many other forms of advertising—including in paid search advertising so long as they used different words (as occurred over a billion times during the relevant period).[10] *Clorox*, 117 F.3d at 57 (internal citations omitted). Further, far from

[10] During the relevant period, Google alone displayed over [redacted] paid search ads related to contact lenses for the counterparties to the Challenged Agreements

excluding competition and preserving a monopoly, the market for selling contact lenses became *more competitive* during the time of the Challenged Agreements, as more online sellers penetrated the market and overall output increased. *See, e.g.*, IDF 4, 96, 106, 111, 117, 126, 127, 129, 133.

Second, the Challenged Settlements here do not involve a "large, unjustified reverse payment," or anything like it. *Actavis*, 570 U.S. at 158. The few settlements that have monetary terms require payments from the alleged infringer to 1-800 Contacts—payments in the opposite direction of the "unusual" structure in *Actavis*. *See* CX0311; CX0313; CX0314; CX0315; CX0323; CX0324. Moreover, it is undisputed that (1) the "non-use" provision at the heart of these settlements regularly appeared in trademark settlements resolving trademark search advertising claims; and (2) courts ordered "non-use" as a remedy for such claims. This is critical because, as the Commission itself recognized in *Actavis*, the "extraordinary and distinguishing feature" of the settlements there was that the "defendant generic manufacturers receive something—a substantial cash payment from the brand-name

(*i.e.*, not including ads for 1-800 Contacts). RX0739-0098. And Google displayed over [redacted] paid search ads for contact lenses for retailers that were not party to any trademark agreement. RX0739-0099.

manufacturer that holds a patent—that they could not hope to obtain even if they *prevailed* in litigation." FTC *Actavis* Br. at 30.[11]

In this everyday settlement context, any antitrust scrutiny is misguided. Without a "large and unjustified reverse payment," there is no basis to infer market power or that the Challenged Settlements accomplished an anticompetitive end. *Actavis*, 570 U.S. at 157. Nor is there any objective, reliable way to conduct a *post-hoc* assessment of the underlying trademark claims. *Id.* at 157-58. Indeed, as the Commission majority conceded, it was inappropriate to "decid[e] matters of trademark law in the antitrust analysis" here. Op. 40. But it then did exactly that, holding that 1-800 Contacts' trademark claims were an insufficient procompetitive justification *unless* they met "some minimal threshold of validity—more than merely surviving challenges as shams." Op. 40. The majority then spent multiple pages

[11] In light of this position in *Actavis*, it is disingenuous for the Commission majority to suggest here that a court's ability to order the same injunctive relief as reflected in 1-800 Contacts' settlements ("non-use" of trademarks) is "irrelevant" to the antitrust analysis. Op. 14. The Commission also claims the settlements were "unusual" and nefarious because they "effectively eliminat[ed] an entire channel of competitive advertising." Op. 14. That is plainly not true. At most, the Challenged Settlements regulate how the parties can use certain trademarked words in one narrow channel of competitive advertising. The parties were free to, and did, engage in competitive paid search advertising using countless other keywords, *supra* n.10, or other forms of advertising.

weaving through trademark case law to suggest 1-800 Contacts' trademark claims failed to meet this amorphous "not good enough" standard. Op. 38-41. The fact that the Commission felt the need to deny that it was deciding the trademark question, when it transparently did just that, only highlights the undeniable reality: unlike in the unusual *Actavis* context, there is no way to apply antitrust principles to commonplace trademark settlements without a *post-hoc* analysis of trademark claims. And, as everyone agrees, that is not something courts applying antitrust principles are well-situated to do. *Actavis*, 570 U.S at 153; Op. 16.

Third, in *Actavis*, the Court was concerned that the "unique regulatory framework" distorted the ordinary incentives of litigants, which otherwise are presumed to act rationally in litigating and settling. 570 U.S. at 155-56. Indeed, the regulatory framework of the Hatch-Waxman Act created incentives for the parties to do something "virtually unheard of" elsewhere: settle with a reverse payment (*i.e.*, a payment from the plaintiff to defendant), which is relief that courts could not provide in patent litigation. Moreover, the regulatory structure removed the incentive for subsequent parties to challenge the patent, ensuring that any agreement to split monopoly rents would remain safe. *Id.* at 155-56.

No such distortion is present here. There is no dispute that the parties negotiating the Challenged Settlements were acting rationally and in their own best interests. If advertising on 1-800 Contacts' trademarks was material to any of the counterparties' ability to compete, they would have continued litigating the trademark claims that 1-800 Contacts was pursuing (especially if the claims were as weak as the Commission contends), instead of settling by giving up that ability and sometimes paying 1-800 Contacts. But instead of continuing to litigate, the parties here indisputably weighed the normal settlement considerations (risk of liability and litigation expense) and reached a settlement based on a term that courts could—and did—order.

As the Commission itself recently made clear in its first post-*Actavis* case, it is the existence of a reverse payment that "triggers antitrust scrutiny." Op. of the Comm'n at 6, *In the Matter of Impax Labs., Inc.*, Docket No. 9373 (Mar. 28, 2019).[12] Here, there is no reverse payment (much less a "large and unjustified" one), no market exclusion, and no distorting regulatory structure. All that is at issue here is 1-800 Contacts' good-faith effort to protect its trademarks through commonplace settlements. At least where, as here, (1) every one of the trademark challenges

[12] This rule is consistent with the U.S. Department of Justice Antitrust Division's principles for IP licensing. Makan Delrahim, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, Remarks Prepared for Delivery at University of Pennsylvania Law School: The "New Madison" Approach to Antitrust and Intellectual Property Law (Mar. 16, 2018) at https://www.justice.gov/opa/speech/file/1044316/download. Those principles state that the unilateral refusal to license IP is *per se lawful*. *Id.* at 15-16. That would be a craven promise if an IP owner was exposed to antitrust liability because it settled a case to prevent infringement.

underlying the settlements was legitimate and not a sham; and (2) the "non-use" provisions reflect the same relief ordered by courts in trademark infringement cases and do not reach beyond the alleged infringement, the ordinary rule that antitrust must yield to procompetitive trademark policy should govern. *See*, *e.g.*, *Actavis*, 570 U.S. at 156; *Deere & Co. v. MTD Holdings, Inc.*, No. 00 CIV. 5936 (LMM), 2004 WL 1794507, at *3 (S.D.N.Y. Aug. 11, 2004) (aggressive, non-sham trademark enforcement efforts "simply do not amount to antitrust violations or misuse"); *Weber v. Nat'l Football League*, 112 F. Supp. 2d 667, 673 (N.D. Ohio 2000) ("The weight of the authority dictates that legal efforts to protect trademark rights simply do not constitute a restraint of trade in violation of antitrust laws."); *Letica Corp. v. Sweetheart Cup Co.*, 790 F. Supp. 702, 706 (E.D. Mich. 1992).

II. THE COMMISSION ERRED IN APPLYING THE "INHERENTLY SUSPECT" STANDARD TO VIRTUALLY ELIMINATE ITS EVIDENTIARY BURDEN.

Lacking the ability to *prove* that 1-800 Contacts' exercise of its trademark rights caused anticompetitive effects "in the market as a whole," *MacDermid*, 833 F.3d at 182, the Commission takes, in the words of Commissioner Phillips' dissent, the "[d]rastic [s]tep" of applying the rarely-used "inherently suspect" standard (synonymous with the "quick look" and "presumptively unlawful" standards). Dissent 10. By applying this standard, the Commission *presumed* the Challenged Agreements were unlawful and freed itself from its initial burden of proving that the

Challenged Agreements caused market-wide anticompetitive effects. This low standard accepts theories and suspicion in place of evidence and, therefore, could result in near-summary condemnation of competition-enhancing conduct. The Commission's stubborn insistence on using this standard, despite repeatedly being told by courts not to, should once again be rejected.

A. The Inherently Suspect Standard Does Not Apply Under *Actavis, Clorox*, and *California Dental*.

Because the inherently suspect standard truncates the antitrust analysis and can lead to near-summary condemnation, the Supreme Court has erected a high barrier to its application. As the Commission recognizes, only conduct akin to a *per se* illegal violation of antitrust law (like price-fixing) should be judged under this truncated standard. Op. 19. Indeed, the U.S. Department of Justice recently cautioned against courts applying this standard, explaining it is only for "*rare cases*." Corrected Statement of Interest, *Stigar v. Dough Dough, Inc.*, No. Case 2:18-cv-00244-SAB, at 17 (E.D. Wash. Mar. 8, 2019) (emphasis added).

The inherently suspect standard—and its presumption of anticompetitive effects—applies only where an arrangement is so obviously anticompetitive that "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets." *Cal. Dental*, 526 U.S. at 770. Before applying this standard, courts must ensure there is ample judicial experience and economic learning to confidently predict the arrangement's competition-destroying effects. *Actavis*, 570 U.S. at 159; *see Cal. Dental*, 526 U.S. at 770.

Trying to make things easier on itself, the Commission repeatedly has tried to trigger this presumption of illegality, and repeatedly failed. Just five years before the Commission's opinion here, the Supreme Court expressly rejected the Commission's attempt to apply this truncated standard to the much more extreme facts of *Actavis*—a case involving a patent settlement that entirely blocked competitors from the market and had "unusual" terms that, in the Court's view, plausibly suggested weakness in the underlying patent. *Actavis*, 570 U.S. at 159-160. The Commission claims that *Actavis* does not completely foreclose the use of a presumption in evaluating an IP settlement, Op. 35, but even if true, *Actavis* "clearly does not support treating less egregious restrictions" in this case "as presumptively unlawful." Dissent 13; *see also* Wright Article at 6 ("We find it unlikely that an appellate court following *Actavis* closely would be willing to apply a truncated analysis to the settlement agreements at issue here."). Indeed, *Clorox*, a case involving a non-use trademark agreement between competitors, made clear that trademarks "are by their nature non-exclusionary" because "[a] trademark, unlike other intellectual property rights, does not confer a legal monopoly on any good or idea; it confers rights to a name only." 117 F.3d at 56; *see also* Dissent 18 (*Clorox* is "on all fours with this case"). A trademark settlement does not stop a competitor from producing or marketing products, and a party to a trademark agreement can "escape [its] clutches" simply by using a different name. *Clorox*, 117 F.3d at 57 (internal citations omitted); *accord* Dissent 21. Thus, far from suggesting the Commission can *presume* a trademark settlement is anticompetitive, *Clorox* holds that "it is difficult to show that an unfavorable trademark agreement raises antitrust concerns" at all. *Clorox*, 117 F.3d at 57. Only by showing "*actual* adverse effects on competition as a whole" is there is any possible antitrust concern. *Id.* at 56.

To adopt the Commission's inherently suspect standard, this Court would have to overrule *Clorox.* This case, however, proves the wisdom of *Clorox*'s teachings. The Challenged Agreements here do not prevent the parties from selling contact lenses or advertising those products—they simply prohibit one narrow form of advertising. *Id.* at 57. In fact, during the relevant period, contact lens sales increased at four to five percent annually, more online retailers of contact lens were founded, brick-and-mortar retailers expanded their online offerings, the parties to the Challenged Agreements engaged in advertising, including search advertising, and the market was (and is) characterized by vigorous competition. *See, e.g.*, IDF 4, 5, 96, 106, 111, 117, 124, 127, 129, 133. *Clorox* correctly recognizes that trademark agreements (like those here) present little risk to competition and derive from important trademark policies; thus, they should be respected—not presumptively condemned. *See Clorox*, 117 F.3d at 55 ("We begin with the fact that

Clorox challenges a trademark agreement. Such agreements are common, and favored, under the law.").

Ignoring the teachings of *Actavis* and *Clorox*, the Commission nevertheless announces a new rule that any limitation on the "display of ads that would enable consumers to learn about alternative sellers . . . and give them the opportunity to make price comparisons at the time they are likely to make a purchase" is inherently suspect. Op. 22. But that rule contradicts yet additional Supreme Court precedent, which the Commission also cavalierly disregards.

As the Supreme Court recently held, affirming this Court, there is "nothing inherently anticompetitive" about even broad restrictions on the ability of sellers to inform consumers about lower-priced options at the point of sale (*i.e.*, the time consumers are likely to make a purchase) where the restraints have the potential to increase interbrand competition and preserve investments. *Am. Express*, 138 S. Ct. at 2289; *see also Polk Bros., Inc. v. Forest City Ents., Inc.*, 776 F.2d 185, 190 (7th Cir. 1985) (applying the full rule of reason to a horizontal agreement not to compete that prevented the competitors from free riding off one another's advertising). Indeed, the Commission is simply reasserting the rule that it was unable to persuade the Supreme Court of 20 years ago in *California Dental*: that advertising regulations, as a category, are inherently suspect.

California Dental specifically rejected the Commission's attempt to apply the quick look standard to a broad advertising ban on price and quality implemented by a dentist association. *Cal. Dental*, 526 U.S. at 771. And, as Commissioner Phillips wrote, "[g]iven that the *California Dental* Court applied the traditional rule of reason to analyze restraints with a more obvious anticompetitive impact, *a fortiori*, the restraints here should not be analyzed under a harsher standard." Dissent 12. The Commission claims that *California Dental* stands for the proposition that evidentiary shortcuts are inappropriate where "the normal linkage between advertising restrictions and price/output effects in the underlying product market [is] attenuated." Op. 42. Yet it fails to consider that the limited nature of the Challenged Agreements and their roots in trademark law and good-faith litigation settlements sever this linkage.[13] Indeed, the Commission does not contend that the Challenged Agreements reduced the output of contact lenses, which would be the ordinary result if the Challenged Agreements were anticompetitive. ID at 153 n.36.

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[13] The Commission recognizes that search advertising is a "comparatively recent" phenomenon taking place within an "evolving marketplace economy." Op. 2. That recognition is fundamentally inconsistent with application of the inherently suspect standard, which only derives from extensive judicial and economic experience.

B. The Commission Failed to Cite a Single Case Dealing with Trademarks, Settlements, or Search Advertising in Support of Applying the Inherently Suspect Standard.

Even as it cast aside *Actavis*, *Clorox*, and *California Dental*, the Commission could not cite a *single* case or study that has anything to do with trademarks, settlements, or search advertising—the critical issues in this case. Instead, the cases the Commission relies upon to support its evidentiary shortcut involve broad advertising bans implemented by industry associations or advertising bans that support price fixing and other *per se* unlawful agreements.[14] *See* Dissent 14-15.

For example, in *In the Matter of Am. Med. Ass'n*, Docket No. 9604, 1979 WL 199033 (F.T.C. Oct. 12, 1979), the Commission held that the American Medical Association's and state medical societies' ethical rules prohibiting physicians from advertising were anticompetitive. *Id.* at *86. This unremarkable holding stems from the fact that the rules at issue completely eliminated price signals from reaching consumers who, in general, consumed the at-issue medical services locally (and in the 1970s would have to call each physician to compare pricing).[15] Similarly,

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[14] The Commission touts 21 studies to demonstrate the supposed robustness of its expert's conclusion that advertising restrictions are anticompetitive. Op. 20-21. But those studies analyze the same kinds of restraints at issue in the Commission's inapposite cases and do not involve trademarks, settlements, or search advertising. *See* Dissent at 15; CX8006-081-82.

[15] Broad advertising bans were also the subject of several other cases the Commission relies upon. *See In the Matter of Mass. Bd. of Registration in Optometry*, Docket No. 9195, 1988 WL 1025476, at *1-2 (F.T.C. 1988) (price advertising ban implemented by the sole licensing authority for optometrists in

Polygram Holding, Inc. v. FTC, 416 F.3d 29, 31-32 (D.C. Cir. 2005), involved an agreement between joint venturers to fix prices—*per se* illegal conduct—and an agreement to cease advertising in support of that price-fixing.

The Challenged Agreements are nothing like the general advertising bans and price-fixing reflected in these cases. *See* Dissent 10-11; Wright Article at 3 ("[T]he challenged agreements do not resemble—much less bear a 'close family resemblance' to—the general restrictions on advertising contemplated by the economic studies and case law" cited by the majority). In those cases, the problem was that no price signals, or only signals reflecting fixed prices, were advertised to the market. Here, that is simply not the case. If a consumer wanted to learn about her options for purchasing contact lenses, all she had to do is type "contact lenses," "contact lens retailers," "discount contacts," the name of a contact lens product, or any one of thousands of non-trademarked words into a search engine. *See* Dissent 9, 12; Wright Article at 4. In fact, search engines displayed [redacted] for contact lenses sold by retailers other than 1-800 Contacts during the relevant period,

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Massachusetts); *Bates v. State Bar of Ariz.*, 433 U.S. 350 (1977) (complete ban on attorney advertising in Arizona); *United States v. Gasoline Retailers Ass'n, Inc.*, 285 F.2d 688, 689 (7th Cir. 1961). The Commission also cites *Blackburn v. Sweeney*, 53 F.3d 825 (7th Cir. 1995), but that case involves a naked agreement between two law firms not to advertise in one another's territory. And *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374 (1992) is a case involving a state regulation banning price advertising.

not including the numerous other ads online (*e.g.*, social media ads, banner ads) and elsewhere (*e.g.*, television, radio, print). *See supra* n.10; *see also* Wright Article at 4-5.

Even more fundamentally, the Commission and the cases it cites do not account for the Challenged Agreements' roots in trademark law. With broad advertising bans, competitors have reduced incentive to invest in business improvements because they cannot advertise those differentiating features to attract customers. By contrast, trademarks create incentives for the parties to invest in business improvements, brand building, and advertising so that customers associate those differentiating features with the brand (or a competitor can choose to compete without a known brand, including by pure price cutting without brand or service investment). *See Park 'N Fly, Inc. v. Dollar Park & Fly, Inc.*, 469 U.S. 189, 198 (1985) ("National protection of trademarks is desirable, Congress concluded, because trademarks foster competition and the maintenance of quality by securing to the producer the benefits of good reputation."). Thus, trademarks promote interbrand competition, just like antitrust policy. *See GTE Sylvania*, 433 U.S. at 52 n.19; *Clorox*, 117 F.3d at 61.

As Commissioner Phillips explained, by applying the inherently suspect standard without regard to 1-800 Contacts' trademark rights, the Commission creates one of two rules: "either all advertising restrictions are inherently suspect, regardless of whether they protect intellectual property rights, or the level of scrutiny applied to a particular restraint will depend on the strength of the trademark holder's underlying infringement claim." Dissent 21. The Commission expressly disclaims the former, but by relying only on cases outside of the trademark context to invoke the inherently suspect standard, creates precisely that rule—a dangerous rule that would result in near-summary condemnation of any trademark enforcement effort. Dissent 21; *see supra* § I.B.

The latter rule—requiring re-litigation of the underlying trademark infringement lawsuit—is equally dangerous because it permits a years- or even decades-later second-guessing of a fact-intensive legal claim with no reliable way to predict what would have happened. Dissent 23-24 (collecting cases and stating "*Actavis* makes it clear that the Commission should not be in the business of evaluating the underlying infringement case when deciding an antitrust challenge"); *Clorox*, 117 F.3d at 60 ("[I]t is usually unwise for courts to second-guess [private resolutions of trademark disputes]."). As the Dissent explained, a "rule requiring the *post hoc* evaluation of intellectual property infringement claims will be difficult for us to apply, but also, and more importantly, for private parties to self-administer. What level of infringement confidence is required? Are plaintiffs only allowed to settle trademark infringement claims that they know they are going to win? That certainly can't be the standard." Dissent 29.

Ultimately, the Commission simply *assumes* that 1-800 Contacts' claims were invalid as a way to ignore its trademark rights. Dissent 22 (listing ways the Commission's analysis assumes the invalidity of 1-800 Contacts' trademark claims). The Commission points to no law or policy to justify this assumption, and it leads to a rule that enables any plaintiff who takes a different view of parties' trademark rights to expose those parties to near-summary condemnation under the inherently suspect standard. This would represent a dramatic intrusion into trademark policy and chill enforcement efforts and investment for fear of antitrust liability—ultimately reducing the interbrand competition that both trademark and antitrust policy aim to promote.

For all these reasons, the Commission never should have applied an inherently suspect analysis. But even where this standard applies, this Court holds that, "[o]nce [the defendant] has shown a procompetitive justification for the conduct," the plaintiff is required to "abandon [the inherently suspect analysis] and proceed to a full-blown rule of reason analysis." *Madison Square Garden, L.P. v. Nat'l Hockey League*, 270 F. App'x 56, 58 (summary order) (2d Cir. 2008) (quoting *Bogan v. Hodgkins*, 166 F.3d 509, 514 n.6 (2d Cir. 1999)); *Deutscher Tennis Bund v. ATP Tour, Inc.*, 610 F.3d 820, 831 (3d Cir. 2010). Because 1-800 Contacts identified pro-competitive justifications (saved litigation costs and protection of trademark rights), the Commission was bound to apply the full rule of reason even under its own favored standard. Either way, if antitrust scrutiny applies at all in this case, it must be performed under the rule of reason.

C. The Commission's Inherently Suspect Analysis Dramatically Departs from the Default Rule of Reason Analysis.

Contrary to the majority's suggestion, the inherently suspect standard marks a dramatic departure from the default rule of reason. Under rule of reason analysis, a plaintiff must prove as a threshold matter that the challenged restraint adversely affects "competition in the market as a whole." *MacDermid*, 833 F.3d at 185. This is a heavy burden, and plaintiffs often fail to offer such proof for a variety of reasons—*e.g.*, they do not properly define the relevant market, they fail to show reduced output or increased prices, or they do not isolate the observed market behavior to the challenged restraint. *See, e.g.*, *Am. Express*, 138 S. Ct. at 2285; *MacDermid*, 833 F.3d at 184-85.

"If the plaintiff carries its burden [on anticompetitive effects], then the burden shifts to the defendant to show a procompetitive rationale for the restraint. If the defendant makes this showing, then the burden shifts back to the plaintiff to demonstrate that the procompetitive efficiencies could be reasonably achieved through less anticompetitive means." *Am. Express*, 138 S. Ct. at 2284 (internal citations omitted).

Unlike in the default rule-of-reason analysis, the inherently suspect standard eliminates the threshold and often most difficult element of the antitrust claim—

proof of harm to "competition in the market as a whole." *MacDermid*, 833 F.3d at 185. Instead, it allows a plaintiff like the Commission here to *presume* market-wide harm, shifting the initial burden to the defendant (here, 1-800 Contacts) to offer plausible procompetitive justifications. Op. 18. Indeed, according to the Commission's analysis, even after 1-800 Contacts made this pro-competitive showing, it "still need not prove actual anticompetitive effects" to meet its burden. Op. 21 (citation omitted). Rather, the Commission only found it necessary to show (a) a "theoretical basis" for the alleged effects with some evidence that the effects are "likely," which is an extremely low bar, or (b) that the procompetitive justifications can be achieved in a less restrictive way, which is the *third* step in the ordinary rule-of-reason analysis and, thus, comes into play only *after* the plaintiff has satisfied its threshold burden of proving market-wide effects (and after the defendant has offered proof of procompetitive benefits). Op. 21; *see K.M.B. Warehouse, Inc. v. Walker Mfg. Co.*, 61 F.3d 123, 127 (2d Cir. 1995); *Clorox*, 117 F.3d at 57.

In *California Dental*, the Supreme Court recognized the danger of the lenient, theoretical approach reflected in the inherently suspect standard. Rejecting the Ninth Circuit's decision to apply the inherently suspect standard to the broad advertising restriction there, the Supreme Court admonished the Ninth Circuit for doing exactly what the Commission did here: relying on platitudes like "price advertising is fundamental to price competition" and substituting "*a priori* analysis" where "empirical" answers were possible. *Cal. Dental*, 526 U.S. at 773-74. Indeed, the Court criticized the Ninth Circuit for apparently thinking, as the Commission did here, that it was "justified without further analysis to shift a burden to [the defendant] to adduce hard evidence of the procompetitive nature of its policy; the court's aversion to empirical evidence at the moment of this implicit burden shifting underscores the leniency of its enquiry into evidence of the restrictions' anticompetitive effects." *Id.* at 776.

Here, too, the Commission relied on the same sort of platitudes and studiously avoided hard proof in presuming that "theoretical" effects were "likely." Op. 24. For example, the Commission said "[e]conomics and prior cases counsel that the challenged advertising restrictions prevent consumers from obtaining information that would permit price and service comparisons." Op. 34. The Commission then touted the supposed "significance" of the advertising at issue, the unremarkable fact that some rivals price lower than 1-800 Contacts, and that 1-800 Contacts lost some marginal amount of sales when competitors advertised using its trademarks. *Id.* at 33-34. Even if true, however, this is simply not the type of evidence that can show *an adverse effect on competition in the market as a whole*. *MacDermid*, F.3d at 182; *Clorox*, 117 F.3d at 59 ("The antitrust laws do not guarantee competitors the right to compete free of encumbrances, however, so long as competition as a whole is not significantly affected.”). The Commission’s application of this shortcut to avoid its burden was an error.

III. THE COMMISSION FAILED TO PROVE ANTICOMPETITIVE EFFECTS IN THE MARKET AS A WHOLE.

To leave the impression that it was not relying solely on the inherently suspect standard, the Commission found that it had offered “direct evidence” that the Challenged Agreements caused anticompetitive harm to contact lens purchasers and to search engines. Op. 42-47, 50-54. But the Commission’s supposed evidence does not come close to showing anticompetitive effects “in the market as a whole.” *MacDermid*, 833 F.3d at 182; *see also Am. Express*, 838 F.3d at 205 (when proceeding under the direct evidence method, plaintiff must show the restraint made “*all* . . . consumers [in the market] worse off overall.”).

The Commission offers no empirical evidence of prices, offers no evidence of 1-800 Contacts’ profit margins, and has never contended that output was restrained or that the quality of contact lenses was reduced. Instead, the Commission simply rebrands the competition-enhancing effect of trademark enforcement and settlement as “direct evidence” of anticompetitive harm. Indeed, the Commission primarily relies on two experts whose analyses come to the unremarkable conclusion that, without the Challenged Agreements, there would have been more potentially infringing search ads displayed and some people who saw those ads might have purchased from a retailer other than 1-800 Contacts at a lower price. But to accept the Commission's (and its experts') position that this constitutes direct evidence of anticompetitive harm is to accept that exercising trademark (or other IP) rights to stop infringement is an antitrust violation.

A. The Commission Has Not Proven "Direct Evidence" of Harm to Consumers.

The Commission points to two types of "direct evidence": (1) a reduction in the number of search ads displayed in response to searches for 1-800 Contacts' trademarks; and (2) that "at least some consumers" would have purchased from a lower-priced competitor if more paid search ads had been displayed. Op. 42-47. These are not "direct evidence" sufficient to carry the Commission's burden.

Alleged Reduction in Advertising. The Commission treats advertising as if it is a goal unto itself and not a means to an end—*i.e.*, to increase sales—in contending that a reduction in advertising with no accompanying output effect is nevertheless direct evidence of an anticompetitive effect. Op. 43-44. The Supreme Court, in a case involving the Commission, rejected this rule. *Cal. Dental*, 526 U.S. at 776. In reversing the Ninth Circuit, the Court in *California Dental* held that a restriction on advertising is not, standing alone, an anticompetitive harm. The relevant question for evaluating advertising restraints, the Court held, "is not whether the universe of possible advertisements has been limited (as assuredly it has), but whether the limitation on advertisements obviously tends to limit the total delivery of dental services." *Id*.

Consistent with this holding, *Clorox* recognized that trademark agreements necessarily impose "encumbrances" on competitors, and prevent them from "competing as effectively as they otherwise might" by limiting their ability to advertise or market their products. *Clorox*, 117 F.3d at 59. But that does not implicate any antitrust issue unless "competition as a whole" in the sale of the underlying products is "significantly affected." *Id.* at 59-60. In that case, where "numerous" companies could compete to sell the product at issue despite the trademark agreements, and those agreements did not restrict competitors' ability "to enter these alleged markets," there was no antitrust issue. *Id.* at 59-60. *Clorox* thus confirms that the focus is not advertising as such, it is the competitiveness of the markets in which the advertising occurs.

The Commission ignores this holding from *Clorox* and tries to confine *California Dental* to the professional service context because, in the Commission's view, the Court's holding was based on its finding that consumers experienced difficulty making price comparisons of professional services. Op. 42-43. In fact, courts apply *California Dental* well outside the professional services context. *See* Dissent at 13-14 (collecting cases). More fundamentally, the Commission failed to recognize that the reason the Court found consumers' difficultly in comparing prices to be important was that a reduction in advertising might not have an effect on output of dental services. *Cal. Dental*, 526 U.S. at 773-778; *see also* Dissent 30. At all points, the Court was focused on the effect in the underlying market and not on the number of ads available, which the Court acknowledged were reduced.

This case, in which the Commission does not contend that the Challenged Agreement affected the output of contact lenses, presents no reason for abandoning this focus. Indeed, it is particularly illogical to deem a reduction in ads to be direct evidence of anticompetitive harm when the very issue in the trademark litigations underlying the agreements was whether those ads infringed 1-800 Contacts' trademarks.[16] As a result, a reduction in advertising could just as well be a competition-enhancing result of trademark policy. *See Clorox*, 117 F.3d at 57 (trademark agreements promote competition even where they "only marginally advance[ ] trademark polic[y]."). The Commission's rule is effectively a rule against good-faith trademark enforcement unless litigated to final verdict.

In any event, the Commission failed to prove as a matter of fact that the Challenged Agreements caused a reduction in advertising, or even paid search advertising. Dissent 41-42. The Commission provides no evidence of the

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[16] Perhaps recognizing the shaky foundation on which its advertising-as-a-harm theory rests, the Commission pivots to a rule that reductions of "truthful information" constitute an anticompetitive harm. Op. 43. Neither of the cases the Commission cites in support of this rule—*Ind. Fed'n*, 476 U.S. 447 and *In the Matter of Realcomp II Ltd.*, Docket No. 9320, 2007 WL 6936319 (F.T.C. Oct. 30, 2007)—involve restraints on information. Instead, they address reductions in output of the underlying services (dental x-rays and real estate listings). Dissent at 30-31.

Challenged Agreement counterparties' advertising spend or how those counterparties adjusted it after the Challenged Agreements.[17] Dissent 40. As a result, the Commission did not present evidence to show that the number of ads or the amount of truthful information was actually reduced, even if those were cognizable forms of "direct evidence" in this context.

Alleged Price Effect. The Commission's finding of "direct evidence of a price effect" is even more lacking. The fact that one competitor charges higher prices than another is not direct evidence of an anticompetitive effect, particularly when IP rights are at stake. *See, Actavis*, 570 U.S. at 147 (acknowledging a patent owner may be able to charge high prices); *see also Leegin Creative Leather Prods. v. PSKS, Inc.*, 551 U.S. 877, 896-97 (2007); *Am. Express*, 838 F.3d at 204-05. To prove an anticompetitive price effect, a plaintiff must provide a rigorous analysis of prices, margins, and causal connection to the at-issue agreements. *See Am. Express*, 833 F.3d at 205-06. And it must show an effect that permeates the market *as a*

[17] The Commission claims that some counterparties to the Challenged Agreements chose keywords based on return on investment, as opposed to maintaining a fixed advertising budget, although it does no analysis to verify this. Op. 44 n.46. According to the Commission, because some counterparties found 1-800 Contacts' trademarks to be more profitable than others, the counterparties may not have switched to other keywords. The Commission cites nothing to support its necessary thesis that competitors must have access to their top advertising choices even where those choices infringe a trademark. This lack of citation is unsurprising; that is not the law. *Clorox*, 117 F.3d at 59 (no anticompetitive harm even where infringement might be more effective).

whole. *Id.* at 205; *MacDermid*, 833 F.3d at 186-87 (no showing of anticompetitive effects even assuming some consumers purchased from the defendant instead of another option); *CDC Techs., Inc. v. IDEXX Labs., Inc.*, 186 F.3d 74, 80-81 (2d Cir. 1999).

The Commission does not even try to show a price effect in this way. Instead, the Commission's so-called price effect is really just a prediction that "at least some consumers" who searched for 1-800 Contacts' trademarks on a search engine after 2004 (when the first Challenged Agreement went into effect) would have purchased from a lower-priced competitor if they had seen additional search advertising.[18] Op. 46-47. Of course, the fact that "at least some consumers" did not see the infringing advertisements is a function of 1-800 Contacts validly exercising its trademark rights. That cannot be "anticompetitive." Putting that aside, however, the notion that "at least some consumers" might have paid more for contact lenses because they did not see a competitive advertisement is not proof of *harm to competition as a whole*. *See Am. Express*, 838 F.3d at 205.

[18] The Commission's analysis of direct price effects also is flawed because it is based on the assumption that the market is limited to the sale of contact lenses online. *E.g.*, Op. 48-49 (referring to 1-800 Contacts' as the "incumbent online seller, with a dominant share of online sales."). But the Commission has not proven any relevant market and, thus, cannot rely on inferences flowing from the market being limited in that way. *See Geneva Pharms. v. Barr Labs.*, 386 F.3d 485, 500 (2d Cir. 2004).

To the extent the Commission speculates the Challenged Agreements enabled 1-800 Contacts to maintain "supracompetitive" prices generally, there is no evidence to support that theory. Indeed, the Commission specifically chose to *avoid* empirical evidence of pricing, and the empirical and other record evidence that does exist refutes any such price effect.

First, it is undisputed that 1-800 Contacts has charged generally higher prices than its purely online competitors (though lower than 60 percent of the market) before any of the Challenged Agreements existed. Dissent 32; *see also Am. Express*, 138 S. Ct. at 2288 (rejecting a finding of anticompetitive effects and noting "Amex has historically charged higher merchant fees than these competitors").

Second, the Commission offered no evidence at all on profit margins. Dissent 33-34. This is critical because this Court and the Supreme Court have repeatedly focused not just on prices in the abstract, but rather on *margins*, in antitrust cases to determine whether a given price is supracompetitive. *See Am. Express*, 838 F.3d at 205 (requiring proof of "abnormally high" profit margins), *aff'd,* 138 S.Ct. at 2288 (noting the failure of the Government to offer any measure of profit margins); *see also Geneva Pharm.*, 386 F.3d at 500. The only evidence on margins was offered by 1-800 Contacts, [redacted]. RX0739-0063 to 65. The Commission tries to nullify that evidence by making an unsupported claim that calculating margins "in an economically meaningful manner is difficult" (ignoring that the margins were calculated by one of the country's leading economists).[19] Op. 49. That criticism, even if supported, is meaningless because the Commission has the burden to prove supracompetitive pricing by offering evidence of "abnormally high" margins, but it did not. Dissent 33.

Third, the Commission failed to account for obvious factors that could have caused the price differential. Incredibly, in a case about the strength of 1-800 Contacts' brand, the Commission did not even consider that consumer preference for 1-800 Contacts' stronger brand (or any other factor) could explain a pricing differential.[20] *See* Dissent 32-33 & n.44; Wright Article at 7 ("As the leader among online lens retailers with widespread brand-name recognition—attributable to its first-mover advantage in online contact lens sales and its significant marketing expenditures to drive brand awareness—1-800 Contacts commands a pricing premium relative to lesser-known online rivals."). And although the Commission repeatedly has recognized in other cases that branded products often command a pricing premium relative to lesser-known competitors, it simply ignored that reality

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[19] [redacted] Op. 49. The Commission presented no evidence on rising costs, so this amounts to conjecture.

[20] The Commission apparently concedes that 1-800 Contacts' superior customer service accounts for at least some of the price difference. Op. 48.

here. *See, e.g.*, Complaint at 7, *In re J.M. Smucker Co. & Conagra Brands, Inc.*, Docket No. 9381 (F.T.C. Mar. 5, 2018); Analysis of the Agreement Containing Consent Orders to Aid Public Comment at 2, *In the Matter of McCormick & Co.*, Docket No. C-4225 (F.T.C. July 30, 2008).

Finally, the Commission's complete failure to even attempt to quantify *any* price effect—or empirically test 1-800 Contacts' prices at all—bears emphasis. Dissent 33; *Cal. Dental*, 224 F.3d at 947 (reversal by Supreme Court driven in part by an "'aversion to empirical evidence' in favor of burden shifting"). The Commission contends that it does not need to provide a "precise competitive price" to show direct evidence that 1-800 Contacts' prices were supracompetitive. Op. 49. This is not a matter of precision: the Commission made no effort at any quantification. *See K.M.B. Warehouse*, 61 F.3d at 128 (citation omitted) (requiring an "empirical demonstration" of adverse effects). Instead, it says that "some consumers" paid a price higher than they would have without the Challenged Agreements. But that position has no limiting principle. Without any quantification of a price effect, there is no way to know whether any given price is the product of a competitive market or not, and a plaintiff could meet its initial burden by showing that even one person paid a higher price—effectively eliminating any burden of proof under the rule of reason.

Ultimately, the Commission's "direct evidence" of price effects supposedly caused by the Challenged Agreements is a mere theory offered by its experts that 1-800 Contacts might have lowered its prices if there was more advertising (or infringement of its trademarks). Op. 49; *see also* Dissent 33. Under the direct evidence method, however, a theory cannot substitute for facts, and it is beyond dispute that the Commission has not provided any facts showing that the Challenged Agreements caused a relevant price effect.

B. The Commission Did Not Prove that the Challenged Agreements Harmed Search Engines.

The Commission also claims that it has offered direct evidence of harm to search engines in the form of (1) a reduction in the price paid in auctions involving 1-800 Contacts' trademarks; and (2) a reduction in the quality of search engine results pages due to a reduction in the number of ads. This is yet another "novel" theory. Dissent 38. Like the Commission's flawed attempts to show direct evidence of harm to consumers, the Commission conflates the intended effect of trademark policy with anticompetitive harm to search engines, and, in any event, none of it constitutes evidence of harm to the market as a whole.[21] *MacDermid*, 833 F.3d at 184; *accord Clorox*, 117 F.3d at 59. This holding is all the more egregious

[21] The Commission argues that the Commission could also find harm to search engines using the inherently suspect standard. Op. 50-51 n.54. As explained in *Actavis*, 570 U.S. at 159-60, the inherently suspect standard is not appropriate in these novel and complex circumstances. *See supra* § II.

considering that Google affirmatively instructed 1-800 Contacts (and other brand owners) to settle trademark disputes related to keyword bidding in exactly the way that 1-800 Contacts did. *See* CX9031-010 to 011. In other words, the Commission apparently believes that Google set up an antitrust conspiracy against itself. And Microsoft, for its part, declared that it was "[redacted]" RX0704-0007.

The Commission contends that there is "direct evidence" of anticompetitive effects because search engines received less money from advertisers when a person clicked on an ad displayed in response to searches for 1-800 Contacts' trademarks. Op. 51-53. But any price reduction on an infinitesimal percentage of search engines' sales is not "direct evidence" that the Challenged Agreements "significantly affect[ed] competition as a whole" in any relevant advertising market.[22] *Clorox*, 117 F.3d at 59. Without proof of effects on *competition*, a reduction in the prices of *certain sales* does not constitute direct evidence.

[22] The Commission does not attempt to define a "market" for search engine advertising, and courts have rejected such a narrow market definition. *See, e.g.*, *Lasoff v. Amazon.com Inc.*, No. C16-151, 2017 WL 832941, at *4 (W.D. Wash. Jan. 26, 2017) (rejecting a "search engine advertising" market as too narrow). Thus, the relevant question is whether the Challenged Agreements, which relate to bidding on certain trademarked terms of certain competitors of one product (contact lenses) in one form of advertising (paid search advertising), impact a broader market for *advertising generally*. Plainly, they do not.

Moreover, the Commission proffered no evidence that the parties to the Challenged Agreements reduced their advertising budgets or spends. This is important because, even if the parties to the Challenged Agreements were unable to bid on certain trademarked terms, they could have shifted their advertising spend elsewhere—whether online or to another advertising channel. For example, 1-800 Contacts could have spent the money it saved on its trademarked keywords to engage in additional advertising, online or elsewhere, to build its brand or drive consumers online. *See* IDF 63 (1-800 Contacts' television advertising drives online sales). Moreover, retailers that were *not* parties to a Challenged Agreement could have purchased more advertising by bidding on 1-800 Contacts' trademarks as keywords, bidding on other keywords, or spending more money in other advertising channels. Numerous other permutations exist under which the Challenged Agreements would have a revenue-neutral or revenue-increasing effect for sellers of advertising. Although ruling these possibilities out would be only the first of many steps in directly proving harm to competition to sell advertising, the Commission did not even get that far because it myopically focused on sales of search ads related to 1-800 Contacts' trademarks to only a handful of contact lens retailers.[23]

[23] Instead of examining advertising budgets and spend, the Commission majority cited testimony of certain counterparties to the Challenged Agreements that they bid on keywords based on expected return on investment. Op. 54. The Commission assumes that, once these counterparties were forbidden from bidding on their "first-choice of keywords" (1-800 Contacts), they would not

Given all of the ways that retailers may have shifted their purchases, it is no wonder that Microsoft [redacted] RX0704-0007. And it defies common sense to suggest that Google would have advised 1-800 Contacts to settle trademark disputes on exactly the terms in the Challenged Agreements if those agreements would harm its ability to compete in any advertising market. CX9031-010 to 011.

The Commission also claims that the Challenged Agreements harmed the quality of the search engines' results pages by reducing the number of ads shown in response to searches for 1-800 Contacts' trademarks. Op. 52-53. This is merely a rehashing of the Commission's legally-flawed argument that a reduction in the number of ads is direct evidence of harm to consumers. *See supra* § III.A. And the Commission provides no reason to believe that the number of ads shown by a search engine equates to the quality of the results page. Indeed, that theory is refuted by the evidence. Both Google and Microsoft, by telling brand owners to settle trademark disputes related to keyword bidding on their own, IDF 293, 297, evidently decided that whatever reduction in search advertising that might occur was worth it

have replaced those bids with other keywords or advertising generally. *Id.* As the Dissent recognized, while that might be one plausible hypothesis, it "equally plausible they would have bought other advertisements, with no harm going to the owners of the search engines." Dissent 41. It was the Commission's burden to *prove* competitive harm in an advertising market, not to pile up assumptions and *declare* it.

in exchange for extracting themselves from the time and expense of mediating trademark disputes, or themselves being party to lawsuits.

IV. THE COMMISSION ERRED IN REJECTING 1-800 CONTACTS' EVIDENCE OF PROCOMPETITIVE EFFECTS.

The Commission's failure to prove anticompetitive effects alone should be the end of this case. However, it botched the rest of the elements of the rule of reason analysis, too, including with respect to 1-800 Contacts' procompetitive justifications. In particular, though the Commission acknowledges that the Challenged Agreements actually saved millions in litigation costs and were designed to protect 1-800 Contacts' brand, it sets the value of those recognized benefits at zero based on new rules invented to eliminate them from the antitrust analysis. Op. 37-41.

As to the millions in saved litigation costs, the Commission claims that they do not count because 1-800 Contacts did not provide evidence that those saved litigation costs were passed on to consumers in the form of cost savings. Op. 37. The Commission cites no authority that litigation costs must be "passed on."

In fact, *Actavis* specifically recognized saved litigation costs as a procompetitive benefit, without suggesting that such savings count only if they are passed on to consumers. *Actavis*, 570 U.S. at 156-57. Given that *Actavis* arose in the context of a market-blocking patent, it is particularly unlikely that such litigation costs would be passed on to consumers where the patentee monopolist would have no incentive to do so. And, while not in the litigation savings context, just last year the Supreme Court rejected the notion that there needs to be proof of pass on. *Am. Express*, 138 S. Ct. 2288-89. Moreover, as the Dissent correctly observes, because saved litigation costs do not impact marginal costs, there is no practical way to show that such cost savings were passed on to consumers. Dissent 36. Thus, while the Commission acknowledges that saved litigation costs are a procompetitive benefit, it has created a rule where they never count.

As to the protection of trademarks, the Commission deems this justification invalid because 1-800 Contacts' infringement claims allegedly did not meet some "minimum threshold of validity—more than merely surviving challenges as shams." Op. 40. In other words, to the Commission, the trademark claims were not a sham, but they also were "not good enough" for antitrust purposes.

The Commission cites no authority for this "not good enough" rule. Nor does it offer any explanation of what it means or how parties trying to settle cases would have any idea how to apply it. But, whatever threshold the Commission is trying to employ, it is met in this case. As discussed above, trademark infringement cases involving keyword bidding frequently survive dispositive motions, judges and juries have found liability for this type of conduct, and courts—including as to 1-800

Contacts' claims—have entered injunctions preventing this type of conduct.[24] *See supra* 27-29.

The reason the Commission had to contort the rules is obvious. Under the rule of reason, the Commission would have to balance anticompetitive harms against procompetitive benefits. *Am. Express*, 838 F.3d at 195. The Commission's "proof" of anticompetitive effects is that the Challenged Agreements reduced the number of paid search ads displayed in response to searches for 1-800 Contacts' trademarks and that reduction allegedly affected prices paid by "at least some consumers." *See supra* § III.A. Even accepting for the sake of argument that these were valid anticompetitive effects, the Commission would have to balance that undefined competitive effect against the millions of dollars in concrete cost savings and 1-800 Contacts' undeniable right to protect its brand. There simply is no credible way that, with this proof, the Challenged Agreements could be, on balance, anticompetitive,

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[24] The Commission cites several dismissals or denials of preliminary injunctions in cases involving allegations of trademark infringement related to search advertising. Op. 39 n.43. Virtually all of these cases post-date the Challenged Agreements and therefore are irrelevant to 1-800 Contacts' trademark claims or the antitrust analysis of the Challenged Agreements, which "are to be judged at the time the agreements were entered into." *In re Ciprofloxacin Hydrochloride Antitrust Litig.*, 363 F. Supp. 2d 514, 530 (E.D.N.Y. 2005) (quoting *Valley Drug Co. v. Geneva Pharms., Inc.*, 344 F.3d 1294, 1306 (11th Cir. 2003)); *see also SCM Corp. v. Xerox Corp.*, 645 F.2d 1195, 1207 (2d Cir. 1981). As the Dissent correctly observes, trademark law at the time of the Challenged Agreements supported 1-800 Contacts' claims, which is why even the majority agrees they were not shams. Dissent at 24-26.

which is why the Commission invented rules that allowed it to ignore 1-800 Contacts' proof of procompetitive effects.

V. THE COMMISSION HAS NOT SHOWN A LESS RESTRICTIVE ALTERNATIVE.

Under the rule of reason, courts do not consider whether a less restrictive alternative exists until after the plaintiff proves market-wide anticompetitive effects and the defendant proves procompetitive benefits. *K.M.B. Warehouse*, 61 F.3d at 127. In the Commission's inherently suspect analysis, however, it tried to substitute a proffered less restrictive alternative for anticompetitive effects. *See supra* 38. But regardless of where it is placed in the analysis, the Commission has not shown a less restrictive alternative.

Under this Court's precedent, "absent exceptional circumstances . . . the parties' determination of the scope of needed trademark protections is entitled to substantial weight." *Clorox*, 117 F.3d at 60. Far from giving "substantial weight" to 1-800 Contacts' and the counterparties' determinations as to the scope of the Challenged Agreements, the Commission gave *no weight* to the parties' views. The less restrictive alternative the Commission touts—"disclosure" of affiliation when bidding on trademarks—is conjured from the Commission's imagination. Op. 27. By its own admission, the Commission has no evidence that anyone has settled these types of infringement cases using such disclosures.[25] Op. 29. And it rejects without explanation 1-800 Contacts' trademark practitioner expert's unchallenged testimony that parties involved in infringement litigation involving this type of conduct settle the cases with non-use provisions because of the ease of monitoring and certainty that such settlements provide. RX0734-0119 to 23.

The Commission tries to prop up its imagined solution for resolving trademark infringement by pointing to its regulatory authority to remedy *unilateral* false advertising and other deceptive practices, which sometimes involves disclosures. Op. 28-30. This misses the point of *Clorox*. The parties' determinations as to whether and how to resolve trademark infringement are entitled to "substantial weight" because the parties are the best advocates for their interests and, thus, "are in the best position" to achieve an optimal solution. 117 F.3d at 60. In this case, if the counterparties thought that the ability to display ads in response to searches for 1-800 Contacts' trademarks was critical (or even material) to their competitive success, they would not have agreed to stop this advertising (and sometimes pay 1-800 Contacts) and instead continued to litigate. Instead of doing that, however, they

[25] The Commission tries to explain away its lack of evidence by claiming that many of these settlements are confidential. Op. 29. This should not be permitted as an excuse, as the Commission has subpoena power it could have used to gain access to these confidential settlements.

rationally agreed to settle with "non-use" provisions—a decision that *Clorox* holds should not be "second-guess[ed]." *Id.*

What the Commission has done here, therefore, is to overrule the parties' judgment about their own best interests and effectively dictate that the *only way* that *anyone* can settle these types of infringement claims is through use of disclosures. The Commission's fiat cannot be squared with *Clorox*'s deference to parties' rational judgments as to how best resolve trademark disputes.

VI. THE COMMISSION ERRED BY LUMPING THE LUXOTTICA AGREEMENT TOGETHER WITH THE CHALLENGED SETTLEMENTS.

As part of the Commission's presumption-driven condemnation of the Challenged Agreements, the Commission sweeps in the Luxottica sourcing and services agreement—a vertical collaboration with unique benefits among the Challenged Agreements. Under this agreement, 1-800 Contacts provides back-end services that make Luxottica (the owner of several brick-and-mortar retail stores) and 1-800 Contacts stronger competitors. IDF 394-95 [redacted].

These are well-recognized competition-enhancing benefits that the Commission ignores in applying the inherently suspect standard (and the "direct evidence" method) to the Luxottica agreement. Dissent 43-45. In fact, the only time the Commission mentions the Luxottica agreement separately from the Challenged Settlements is to say that it is not a settlement. That's the point: the unique benefits of the Luxottica agreement should have been analyzed on their own, rather than discarded without consideration. Dissent 45.

The Commission's decision to ignore these benefits highlights the errors throughout its opinion. In the Commission's apparent view, the fact that the Luxottica agreement actually reduced contact lens prices and benefitted customers does not matter to the application of the inherently suspect standard. This is plainly wrong because the inherently suspect standard applies only to arrangements that are obviously anticompetitive, not to arrangements with obvious competition-enhancing benefits. *See Cal. Dental*, 526 U.S. at 770. The failure to consider these benefits also undermines its "direct evidence" analysis because the Commission failed to balance its unquantified and hypothetical anticompetitive harms against the recognized competition-enhancing benefits stemming from the Luxottica agreement. *See id.*

VII. THIS CASE SHOULD NOT BE REMANDED TO THE COMMISSION FOR FURTHER CONSIDERATION.

If this Court finds that the Commission has not proven its case under the truncated standards described above, it should not remand this case to the Commission for further consideration. *Cal. Dental*, 224 F.3d at 959 (remanding only to dismiss). The Commission had every opportunity to decide whether the

ALJ's traditional rule of reason analysis was valid or not, and its tactical decision to abandon that analysis should not give it a "second bite at the apple" on appeal. *See id.* In any event, the Commission cannot prove its case under the full rule of reason, so a remand would be futile.

First, the Commission has no evidence of harm to competition in the market as a whole, and the evidence that *does* exist flatly refutes it. The Commission chose a strategy under which it and its experts stated the obvious—that the Challenged Agreements prevented certain competitors from running potentially infringing ads in response to 1-800 Contacts' trademarks, and 1-800 Contacts accordingly preserved some amount of sales that might have been diverted by those ads. This is simply another way of restating that 1-800 Contacts validly exercised its trademark rights, which cannot be anticompetitive "on balance" under any analysis. Moreover, the Commission did not even try to show that the Challenged Agreements increased market prices, increased 1-800 Contacts' margins, decreased output, or impacted quality. Without evidence of these types of effects, the Commission cannot prove its case on remand.[26]

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[26] The Commission also committed another error that cannot be resolved on remand: it treated all of the Challenged Agreements as if they are a single agreement. This aggregation is impermissible unless the Commission can establish a "rim" connecting each of the counterparties to the Challenged Agreements. *See, e.g.*, *In re Nexium (Esomeprazole) Antitrust Litig.*, 842 F.3d 34, 56-58 (1st Cir. 2016). Here, the Commission has not shown that the counterparties knew about one another's agreements, much less that each of their

Second, the crux of a full rule of reason analysis is whether the Challenged Agreements facilitated or enhanced the exercise of market power. *See K.M.B. Warehouse*, 61 F.3d at 129. The Supreme Court recently defined market power as "the ability to raise price profitably *by restricting output*." *Am. Express*, 138 S. Ct. at 2288. The Commission cannot make this critical showing because it does not contend that the Challenged Agreements restricted output of contact lenses. ID at 153 n.36.

Third, the Commission cannot prevail if it must consider 1-800 Contacts' proof of procompetitive effects. The Commission concedes that the Challenged Settlements saved millions of dollars in litigation costs and were driven by legitimate (non-sham) claims. These are compelling procompetitive justifications that the Commission was only able to discount through new and unfounded legal rules. Moreover, the Commission cannot show that there are "less restrictive alternatives." This Court requires that "substantial weight" be given to the parties' judgment on how to structure their settlements, and rejects any attempt by the Commission to second-guess that judgment with its own preferences. For all these reasons, the

decisions to enter into an agreement depended on all others entering a similar agreement. *Id.* On remand, the Commission would have to show that *each* agreement caused anticompetitive effects on competition as a whole, a showing that the Commission cannot make on this record.

Commission simply cannot—on this record—meet its burden under the full rule of reason analysis.

VIII. THE COMMISSION'S ORDER IS OVERLY BROAD AND SHOULD BE NARROWED.

If the Court decides in the Commission's favor, it should still modify the Final Order to tailor it to the conduct at issue in this case. The Commission's theory in this case is that 1-800 Contacts' trademark enforcement methods generated harm because of the mechanics of paid search advertising, and it purports not to disturb the general principle that trademark enforcement is procompetitive. Nevertheless, the Commission's Final Order interjects the Commission into *all* of 1-800 Contacts' trademark enforcement efforts regardless of whether they have anything to do with search advertising, and effectively leaves 1-800 Contacts with no practical way to settle infringement claims. This weakens 1-800 Contacts' ability to enforce its trademarks.[27]

[27] The Commission is not strictly limited to enjoining just the challenged conduct if its decision is upheld. But this is not a limitless authority. The enjoined conduct must be an alternate "road[] to the prohibited goal." *FTC v. Ruberoid Co.*, 343 U.S. 470, 473 (1952). The Commission has not articulated a theory, let alone a factual basis, to conclude that 1-800 Contacts' general trademark enforcement provides a way to circumvent the Commission's order. *See ITT Cont'l Baking Co. v. FTC*, 532 F.2d 207, 222 (2d Cir. 1976) (striking sections of the Commission's order directed at conduct lacking a "reasonable relationship" to conduct found illegal and finding them "too broad to be sustained").

In particular, the Court should reject Section II.C of the Final Order. This provision precludes 1-800 Contacts from entering into any agreement with a seller of contact lenses that places any limitation on "truthful, non-deceptive, and non-infringing advertising or promotion" whether or not related to search advertising. Order § II.C. This leaves 1-800 Contacts with no reasonable way to settle trademark infringement lawsuits in any advertising context because the very question at issue in those cases is whether the advertising is infringing. Dissent 45-46.

In addition, the Court should strike Section IV.B.1-2. These provisions require 1-800 Contacts to report to the Commission every time it communicates with anyone about their suspected trademark infringement in any context. Order § IV.B.1. And, 1-800 Contacts at the time of such communication has to send the suspected infringer a letter noting that 1-800 Contacts' trademarks are under supervision by the Commission. Order § IV.B.2. This increases enforcement costs, which itself will decrease 1-800 Contacts' enforcement efforts, and makes it less likely that suspected infringers will cease the infringement.

At a minimum, the Final Order should be narrowed to tailor it to the purported harms at issue in this case.

CONCLUSION

For the foregoing reasons, the Commission's decision should be vacated and remanded to the Commission with instructions to dismiss.

Dated: June 7, 2019

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CERTIFICATE OF COMPLIANCE PURSUANT TO FED. R. APP. P. 32(a)(7)(C)

Pursuant to Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedure, I certify under penalty of perjury that the foregoing Brief of Petitioner 1-800 Contacts, Inc. is prepared in a proportionally spaced typeface (14-point Times New Roman) and contains 19,815 words, as calculated by the Microsoft Word program and excluding the parts of the Brief exempted by Rule 32(a)(7)(B)(iii). Accordingly, it complies with the Court's order, dated May 20, 2019, granting Petitioner leave to file an oversized principal brief of up to 20,000 words.

Dated: June 7, 2019

/s/ Stephen Fishbein
Stephen Fishbein

STATE OF NEW YORK	)		
	)	ss.:	**AFFIDAVIT OF SERVICE BY OVERNIGHT EXPRESS MAIL**
COUNTY OF NEW YORK	)		

I, Tyrone Heath, being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age and resides at the address shown above or at 2179 Washington Avenue, #19 Bronx, New York 10457.

On June 7, 2019

deponent served the within: **Confidential Page Proof Brief for Petitioner (Filed Under Seal)**

upon:

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the address(es) designated by said attorney(s) for that purpose by depositing **2** true copy(ies) of same, enclosed in a postpaid properly addressed wrapper in a Post Office Official Overnight Express Mail Depository, under the exclusive custody and care of the United States Postal Service, within the State of New York.

Sworn to before me on June 7, 2019

s/ Maria Maisonet
MARIA MAISONET
Notary Public State of New York
No. 01MA6204360
Qualified in Queens County
Commission Expires Apr. 20, 2021

s/Tyrone Heath

Job# 288874