Antitrust Out of Focus: The FTC’s Myopic Pursuit of 1-800 Contacts’ Trademark Settlements

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On November 14, 2018, the Federal Trade Commission issued an opinion condemning as an antitrust violation trademark settlement agreements between 1-800 Contacts and 14 online sellers of contact lenses. The settlement agreements arise from trademark infringement claims brought by 1-800 Contacts against these online rivals. The agreements require the parties to: (1) refrain from bidding on each other's trademark terms (e.g., “1-800 Contacts”) in search-based keyword advertising, and (2) employ “negative” keywords to prevent its ads from displaying when a consumer searches online for the other party's trademarks. The settlement agreements do not limit either party's ability to advertise through other media (e.g., print, television, radio, or other forms of online advertising) or even through paid search advertising generally (e.g., “contact lens”), as long as advertisements are not displayed in response to a search for the other party’s trademark. Most of the settlement agreements explicitly exempted non-infringing uses, including comparative advertising.

FTC Chairman Joseph Simons, a Republican, authored the Commission’s opinion and was joined by the two Democratic Commissioners, Rohit Chopra and Rebecca Slaughter. The Commission majority—based upon its determination that the agreements were “inherently suspect”—concluded that a truncated rule of reason analysis was sufficient to evaluate the settlement agreements and, on this basis concluded that the settlement agreements violated Section 1 of the Sherman Act. Notably, Republican Commissioner Noah Phillips dissented from both the application of a truncated analysis, as well as the majority’s condemnation of the challenged agreements.

In finding that the settlement agreements violated Section 1 of the Sherman Act, Chairman Simons and the majority commit two critical errors—one legal, the other economic—that render the Commission opinion, in our view, highly vulnerable to reversal upon appeal. First, the Commission improperly applies the Polygram “inherently suspect” framework to substantiate its truncated rule of reason analysis, which is reserved for agreements between rivals that are well established—whether through judicial learning or economic evidence—of having anticompetitive effects. As Judge Douglas Ginsburg wrote in Polygram, the approach is reserved for agreements that “have a close family resemblance to those already convicted in the court of consumer welfare." Yet we are not...
aware of any economic articles or studies, nor of any judicial decisions, that document any harm flowing from agreements with a “close family resemblance” to the agreements challenged here.

The second error is the majority's use of an economic analysis that, in contrast to the challenged agreements, is inherently suspect. The FTC analyzed contact lens prices as the appropriate metric of antitrust injury. The Commission deploys that economic analysis and evidence of 1-800 Contacts’ pricing premium among online contact lens retailers to claim that the agreements have anticompetitive effects. Yet evidence of 1-800 Contacts’ price premium relative to smaller online rivals—how the alleged anticompetitive harm manifests itself according to the Commission—is unrelated to the trademark settlements and falls woefully short of evidence of consumer injury. Indeed, 1-800 Contacts commanded the same premium prior to the challenged conduct. And although the Commission marshals significant analytical tools to demonstrate how Google allegedly lost millions of ads due to the settlements, harm to an online platform does not by itself constitute harm to consumers. That the alleged restraint may have caused some transactions to occur at 1-800 Contacts’ relatively higher price cannot by itself constitute anticompetitive conduct; such a rule would condemn any commercial arrangement that commanded a price premium, regardless of whether output was restricted.

Commissioner Phillips’ dissent identifies each of these errors, and we believe that his dissent clearly and correctly lays out the factual and legal inconsistencies in the Commission opinion. Moreover, Commissioner Phillips correctly focuses upon an important aspect of the case that the majority largely dismisses: the intellectual property interest at stake.

In addition, as Commissioner Phillips recognizes, the Commission’s analysis falls short of the standard set forth by the Supreme Court. The Supreme Court rejected the FTC’s plea to apply a quick look approach in *Actavis* and *California Dental*, two cases involving agreements that, on their face, appear far more suspect than the challenged agreements in this case. *Actavis* remains the Supreme Court’s latest word on the application of Section 1 of the Sherman Act to settlement agreements involving intellectual property rights (such as the trademark settlements here), and the Court applied the rule of reason in that case. Further, *Actavis* rejected truncated analysis for intellectual property settlements in evaluating conduct that included splitting monopoly rents—conduct that is far more likely to harm competition than the conduct alleged here. Reviewing 1-800 Contacts’ trademark settlement agreements under the inherently suspect framework is unlikely to withstand scrutiny from the Second Circuit, to which 1-800 Contacts has appealed the Commission’s decision.6

**The Trademark Settlement Agreements Are Not Inherently Suspect**

Chairman Simons’ opinion relies heavily upon quotes from and citations to *Polygram*. The Commission’s analysis begins by outlining the definition of inherently suspect conduct as stated in the FTC and D.C. Circuit opinions:

> Inherently suspect conduct “ordinarily encompasses behavior that past judicial experience and current economic learning have shown to warrant summary condemnation.” Consequently, our analysis considers whether there is a “close family resemblance between the suspect practice and another

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practice that already stands convicted in the court of consumer welfare.” The determination is based on the conduct’s “likely tendency to suppress competition.”

The Commission finds that the challenged settlement agreements constitute a type of advertising restriction that is likely to harm competition because they withhold from consumers truthful information to compare and evaluate prices among online sellers at the “crucial moment” when sales are about to be made. The Commission then concludes that “[e]conomic theory indicates that restrictions on this type of advertising are likely to harm competition.”

Invocation of the inherently suspect framework is reserved for evaluation of agreements where there is substantial evidence—from judicial experience or economic learning—that the agreements at issue are known to have anticompetitive effects. Given the necessity of closely tethering summary condemnation of a particular restraint to rigorous economic evidence, one expects to see somewhere in the Commission opinion citations to studies demonstrating that restrictions that bear the “close family resemblance” to those embedded into the trademark settlements at issue here harmed competition. Yet the Commission presents no such evidence.

Indeed, a careful reading of the Commission opinion reveals that the Commission only cites studies of the effects of advertising restrictions in unrelated contexts. Not one citation appears relevant to evaluating the competitive effects of a settlement of non-sham trademark infringement claims, least of all in the context of paid search keyword auctions. The Commission’s conclusion that the settlement agreements are inherently suspect also cannot be reconciled logically with the admission that search-based keyword advertising is “relatively new” and that e-commerce is a “comparatively recent” phenomenon.

The Supreme Court has repeatedly affirmed that a truncated rule of reason analysis is “appropriate only where ‘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.” As Commissioner Phillips explains, the 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 that Chairman Simons cites in support of characterizing the settlement agreements as inherently suspect. Thus, without anything to rely upon to find the agreements inherently suspect, the Commission’s conclusion is unsustainable.

This conflation of general restrictions on advertising and the settlement agreements at issue in the case appears to reflect a crucial factual error that pervades the Commission opinion. Chairman Simons states that the settlement agreements “effectively shut off an entire—and very

7 Commission opinion, supra note 1, at 19 (quoting Polygram, 416 F.3d at 37; 136 F.T.C. at 344–45).
8 Id. at 20–21 (“Thus, even when the Court did not affirm liability in California Dental, it recognized that in ordinary commercial markets, bans on truthful advertising normally are likely to cause competitive harm.”).
9 Id. at 20 (emphasis added).
10 Polygram, 136 F.T.C. at 344–45.
11 The Commission concedes that “[t]he trademark litigation underlying the settlement agreements was not sham.” See Commission opinion, supra note 1, at 23.
12 Id. at 1, 28.
14 See Phillips dissent, supra note 2, at 10–11 (“The Trademark Settlements do not approximate conduct that the Commission or courts have previously found to be inherently suspect, much less per se illegal. Those precedents make abundantly clear that the Commission should not treat the Trademark Settlements as presumptively unlawful. That is especially so given the trademark rights involved, an issue that none of the cases on which the majority rely even consider.”).
important—channel of advertising.” 15 This assertion is highly relevant to whether the Commission is able to invoke a presumption of anticompetitive harm based upon truncated analysis or, instead, has to prove its case with economic evidence.

Commissioner Phillips’ dissent correctly emphasizes that the challenged agreements restrict only a narrow subset of advertising: paid search advertising triggered when a user searched for the settlement parties’ trademarked terms. That is, the agreements did not restrict any form of advertising per se, but only the placement of a settlement party’s paid search ads on certain search results pages. The settlement agreements did not prevent or restrict either party’s ability to engage in advertising through print, television, radio, internet display advertising, affiliate marketing, social media advertising, or search engine optimization. 16 And the settling parties were entitled to, and in fact did, engage in paid search advertising responsive to generic terms and phrases and, of course, their own trademarks. 17

The Commission thus conflates the effect of the settlement agreements on a specific mechanism by which paid search advertising is purchased with online search generally—a lapse that then leads the majority to find—incorrectly—that the agreements “effectively eliminat[e] an entire channel of competitive advertising.” 18 Online search may very well be “one of the key methods by which consumers discover vendors and compare products and services.” 19 But prohibiting a company from bidding on certain trademarked terms as keywords to trigger paid search advertising does not “impede” consumers’ ability to compare prices “at the critical time when they are about to make a purchase.” 20 Indeed, as Commissioner Phillips notes, the settlement agreements specifically permit “comparative advertising . . . and similar non-infringing uses.” 21 Consumers searching online would still be presented with organic results, likely including links to websites discussing and comparing online sellers of contact lenses, even if a consumer performs a purely navigational search of “1-800 Contacts” and especially if a user searching “at the critical time when they are about to make a purchase” includes search terms in the search query indicating a desire to compare online contact sellers (e.g., “1-800 Contacts cheaper”).

Accordingly, Commissioner Phillips also points out that none of the cases cited in the Commission opinion support the Commission’s analytical approach based upon the facts of this case:

Critically, none involve intellectual property. And all involve advertising restrictions that bear no resemblance to the Trademark Settlements because the restraints at issue were: (1) complete bans on advertising; (2) restrictions on the content of advertisements (i.e., limitations or bans on the ability to advertise price or quality); or (3) restrictions akin to per se violations of the Sherman Act. The distinction between the restrictions at issue in those cases and the Trademark Settlements is significant, because it is obvious how a complete ban on advertising (without implicating intellectual property rights) and these other types of restrictions could be anticompetitive. Far less obvious is how some consumers not seeing advertisements in response to searches for certain trademarked terms has the

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15 Id. at 14.
16 Id. at 9.
17 Id.
18 Id.
19 Commission opinion, supra note 1, at 14.
20 Id. at 20.
21 Phillips dissent, supra note 2, at 9.
same effect. That is precisely the line drawn in *California Dental*, and there should be no doubt on which side the Trademark Settlements fall.\textsuperscript{22}

The settlement agreements at issue here do not entail a complete ban on advertising, nor do they limit the parties’ ability to advertise lower prices compared to 1-800 Contacts. Yet by failing to recognize this fundamental distinction, the Commission opinion ends up citing as support cases that are inapposite.

1-800 Contacts offered two procompetitive justifications for the settlement agreements: avoidance of litigation costs through settlement and trademark protection. The Commission finds those justifications to be cognizable and facially plausible, but ultimately rejects them as having no basis in fact.\textsuperscript{23} Specifically, the Commission opinion holds that to prove its justifications were valid, 1-800 Contacts would have had to demonstrate that litigation cost savings would be passed through to consumers and that the underlying trademark litigations had more merit than merely surviving challenges as shams.\textsuperscript{24} Yet those positions are not supported by case law or economic theory, as Commissioner Phillips emphasizes in his dissent.\textsuperscript{25} Avoidance of litigation costs is a well-recognized procompetitive justification, even under *Actavis*,\textsuperscript{26} as is the protection of intellectual property rights.\textsuperscript{27}

The Commission asserted that limitations on truthful advertising on the basis of trademark protection must be narrowly tailored, and that the non-use restrictions render the challenged agreements unreasonably overbroad.\textsuperscript{28} Commissioner Phillips’ dissent points out that non-use restrictions are the most common means of settling trademark infringement litigation.\textsuperscript{29} The Commission opinion dismisses that fact, holding that such restrictions “cut off an important channel of truthful price advertising” in a situation where company names are not alleged to cause confusion.\textsuperscript{30}

A lack of confusion appears to be key to the Commission’s decision to discredit 1-800 Contacts’ justification of trademark protection. The Commission opinion states that

apart from a single district court summary judgment decision from over ten years ago, no court has found bidding on trademark keywords to constitute trademark infringement, absent some additional factor, such as a misleading use of the trademark in the ad text that confuses consumers as to the advertisement’s source, sponsorship, or affiliation.\textsuperscript{31}

\textsuperscript{22} Id. at 14.

\textsuperscript{23} Commission opinion, supra note 1, at 23, 36.

\textsuperscript{24} Id. at 37, 40.

\textsuperscript{25} Phillips dissent, supra note 2, at 35–37.


\textsuperscript{27} See Commission opinion, supra note 1, at 23 (citing *Actavis*, 570 U.S. at 153; Schering-Plough I, 136 F.T.C. 956, 1003 (2003); *In re Tamoxifen Citrate Antitrust Litig.*, 466 F.3d 187, 202 (2d Cir. 2006)); see also Phillips dissent, supra note 2, at 27 (“The procompetitive benefits of trademarks are precisely why courts like the Second Circuit have encouraged zealous trademark enforcement, and declined to impose upon mark owners the fear of treble antitrust damages.”).

\textsuperscript{28} Commission opinion, supra note 1, at 25.

\textsuperscript{29} Phillips dissent, supra note 2, at 28.

\textsuperscript{30} Commission opinion, supra note 1, at 26.

\textsuperscript{31} Id. at 38.
Commissioner Phillips aptly criticized the majority for evaluating 1-800 Contact’s inherently fact-intensive infringement claims and rejecting the trademark-related justification for the challenged agreements: “the Commission should not be in the business of litigating (or re-litigating) the underlying trademark infringement claim.”

The Supreme Court explicitly rejected as inappropriate the Commission’s invitation to adopt a truncated analysis for reverse payment settlements of claimed patent infringements in Actavis, a case in which the “alleged conduct at issue was far more harmful to competition than anything at issue here, as well-established economic evidence demonstrated,” as Commissioner Phillips points out. 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. The challenged agreements are not inherently suspect and should have been analyzed under the full rule of reason framework.

The Commission’s Economic Analysis Is Unsound

Not only is the Commission Opinion on shaky legal ground, but also the economic analysis endorsed by Chairman Simons and Commissioners Chopra and Slaughter is exceedingly weak. The antitrust laws require any antitrust plaintiff, including the government, to connect the conduct being challenged with an antitrust injury. Common forms of injury include elevated prices, reduced output, and reduced quality of service attributable to the challenged conduct. To satisfy its prima facie burden of demonstrating that the challenged agreements violate Section 1 of the Sherman Act, an antitrust plaintiff must establish the causal relationship between conduct and anticompetitive effect. This is typically, but not exclusively, made via a regression model, which controls for other factors that also might affect prices. Love it or hate it, the consumer welfare standard is fairly exacting.

To satisfy its burden, the FTC points to contact lens prices as the appropriate metric of antitrust injury. But rather than connecting 1-800 Contacts’ higher lens prices to the allegedly anticompetitive trademark settlements, the agency rests its case on 1-800 Contacts’ pricing premium among online lens retailers—a premium that predated the challenged conduct. Given its small footprint in the overall contact lens business, 1-800 Contacts does not necessarily enjoy pricing power. According to the FTC, online retailers (not including brick-and-mortar retailers like Walmart and Target, which also sell online) collectively account for only 17 percent of total lens sales in the United States. To the extent that 1-800 Contacts accounts for 50 to 60 percent of such online

32 Phillips dissent, supra note 2, at 22, 26.
33 FTC v. Actavis, 570 U.S. 136, 158–59 (2013) (“The FTC urges us to hold that reverse payment settlement agreements are presumptively unlawful and that courts reviewing such agreements should proceed via a ‘quick look’ approach, rather than applying a ‘rule of reason.’ We decline to do so.”); Phillips dissent, supra note 2, at 13.
35 Commission opinion, supra note 1, at 4.
sales, as the record suggests,\textsuperscript{36} it follows that the company accounts for only about 8 to 10 percent of total U.S. contact lens sales.\textsuperscript{37} Indeed, 1-800 Contacts positions itself as a pricing maverick, aiming for consumers who would otherwise purchase a more expensive lens from an eyecare practitioner or a brick-and-mortar store.\textsuperscript{38}

As the leader among online lens retailers with widespread brand-name recognition—attributable to its first-mover advantage in online contact lens sales and to its significant marketing expenditures to drive brand awareness—1-800 Contacts commands a pricing premium relative to lesser-known online rivals.\textsuperscript{39} The relevant question from an economic perspective—and the question a plaintiff must answer to prevail—is whether and to what extent any portion of 1-800 Contacts’ premium can be attributed to the allegedly anticompetitive trademark settlements. Put differently, in the absence of the settlements, by how much would 1-800 Contacts have been forced to cut its prices to fend off the threat of customer substitution towards lesser-known rivals? Although there was some record evidence that 1-800 Contacts’ weekly sales were positively correlated with the elimination of a rival’s ads using the 1-800 Contacts search term, the FTC’s proof of antitrust injury did not establish that 1-800 Contacts’ prices were artificially inflated due to the settlements. Thus, there is no demonstrated connection between the challenged conduct and antitrust injury, and no proof of anticompetitive effects.

The FTC’s expert economists did offer up a regression model. However, they focused not on 1-800 Contacts’ prices, but instead at a target largely disconnected from consumer welfare: Google’s ad sales for the keyword “1-800 Contacts.” According to David Evans, one of the two FTC expert economic witnesses, absent the trademark settlements, Google would have sold 114 million additional ads for rival online retailers in response to queries containing the phrase “1-800 Contacts.” This may be bad news for Google, but the link between Google’s ad sales and consumer welfare overall—whether through lower prices or higher quality search results—is tenuous at best.

As the Commission opinion acknowledges, contact lenses are “commodity products,” and thus “consumers can comparison shop” across all corners of the internet—not just Google’s search pages. Indeed, online shopping for any product, including, presumably, lenses, has for several years been more likely to originate on non-Google shopping platforms, such as Amazon or Walmart.\textsuperscript{40} Even if Google’s platform was somehow deemed an essential input for 1-800 Contacts’ rivals to compete effectively online, the trademark settlements did not bar those rivals from buying lens-related keywords on Google’s site; instead, the agreements merely barred those rivals from buying the phrase “1-800 Contacts” and required rivals to employ negative keywords to ensure their ads did not appear in response to a search for 1-800 Contacts’ trademarked terms. The FTC’s proof of anticompetitive effects failed to show that consumers paid higher prices or that output was reduced due to the challenged settlement agreements.

\textsuperscript{36} See Complaint ¶ 14, 1-800 Contacts, Inc., FTC Docket No. 9372 (Aug. 8, 2016) (asserting that 1-800 Contacts’ sales “represent[] approximately 50 percent of the online retail sales of contact lenses”); Commission opinion, supra note 1 (citing 1-800 Contacts’ CEO testimony that its sales “constituted more than 60 percent of the online contact lens market”).

\textsuperscript{37} The FTC also asserted quality degradation in search results, but it used search engine harm as a proxy for consumer harm, a fatal flaw we address below.

\textsuperscript{38} Commission opinion, supra note 1, at 4.

\textsuperscript{39} Phillips dissent, supra note 2, at 3–4.

**Conclusion**

The Commission took an aggressive approach in this case, which could have important implications for parties seeking to settle legitimate trademark infringement claims, as well as for parties seeking to protect intellectual property rights more broadly. Commissioner Phillips raises legitimate concerns about the Commission’s remedy, including a reduced incentive to settle trademark infringement disputes, which may materialize as either less trademark enforcement or more costly litigation. Public policy counsels against both of those outcomes, but they are no doubt more likely, absent a reversal of the Commission’s decision.

As noted, 1-800 Contacts is appealing the Commission’s decision.\(^41\) We believe that the legal and economic errors discussed above each independently requires reversal. The Second Circuit will also have the benefit of Commissioner Phillips’ dissent, which thoroughly repudiates the majority opinion’s approach in favor of adherence to legal precedent and application of rigorous economic analysis.

The direction of antitrust enforcement under the Trump administration has no doubt been a hot topic among the antitrust bar.\(^42\) The unusual lineup in this case—a majority party Chairman joined by two minority Commissioners, without support from another Commissioner of his own party—has rarely occurred in the Commission’s history; indeed, to our knowledge no case has been decided along these lines since 1990.\(^43\) While the unusual lineup is certainly not dispositive of the direction the Commission will take in the future, it does raise some interesting questions about the Commission’s future enforcement priorities.

Chairman Simons’ position in this case also suggests a potential divergence from his Republican colleagues, as well as the DOJ Antitrust Division, on the approach to antitrust analysis of intellectual property rights. Striking the appropriate balance between protecting intellectual property rights and enforcing the antitrust laws is a complicated but important task. Imposing antitrust liability where a legitimate intellectual property interest is at stake has the potential to chill procompetitive behavior. Doing so is fully appropriate where the economic evidence indicates harm to consumers (and not just to rivals) or where harm can properly be inferred from economic learning. Neither is the case here.

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\(^41\) See Petition for Review of Agency Order, supra note 6.


\(^43\) Voting data was collected by the authors from FTC records, Fed. Trade Comm’n, Cases and Proceedings, https://www.ftc.gov/enforcement/cases-proceedings (data on file with authors).