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Second Circuit Overturns FTC's 1-800 Contacts Antitrust Verdict

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In a surprising move, the US Court of Appeals for the Second Circuit reversed an earlier decision by the Federal Trade Commission (FTC) that the country's largest online retailer of contact lenses – 1-800 Contacts – violated antitrust laws for using trademark agreements with rivals to manipulate the market.

Passing decision in *1-800 Contacts v Federal Trade Commission (FTC)* last week, Circuit Judges Lynch and Menashi ruled that a 2015 FTC verdict that 1-800 Contacts used trademark agreements with rivals to manipulate ads and inflate prices was biased on evidence that was "theoretical and anecdotal."

Holding that the Commission "incorrectly concluded that the agreements are an unfair method of competition" under the FTC Act, the judges said that the Commission's conclusion that differences between 1-800 Contacts' prices and those of its competitors constitute direct evidence of anticompetitive effects "is not supported by substantial evidence."

The judges explained, "While trademark agreements limit competitors from competing as effectively as they otherwise might, we owe significant deference to arm's length use agreements negotiated by parties to those agreements.

"Doing so may give rise to collateral harm in a relevant market. But forcing companies to be less aggressive in enforcing their trademarks is antithetical to the procompetitive goals of trademark policy… And without considering the downstream effects of requiring less aggressive enforcement, the government has failed to show that the proffered alternatives achieve the same legitimate procompetitive benefits as those advanced by the petitioner."

The judges added, "In this case, where the restrictions that arise are born of typical trademark settlement agreements, we cannot overlook the challenged agreements' procompetitive goal of promoting trademark policy.

"in light of the strong procompetitive justification of protecting petitioner's trademarks, we conclude the challenged agreements 'merely regulates and perhaps thereby promotes competition,' … They do not constitute a violation of the Sherman Act, and therefore an asserted violation of the FTC Act fails of necessity."

Subsequently, the courts granted a petition for review, vacated the final order of the Commission and remanded the case to the Commission with orders to dismiss the administrative complaint.

McKool Smith's Nicolas Matich commented that the Second Circuit's decision is a "big win for brand owners, but really also a big win for anyone looking to settle IP claims."

He explained, "The FTC's case had a number of flaws. Most importantly, it rested on second-guessing settlements for claims that were indisputably brought in good faith, in a developing area of the law, and on the basis of disputed facts. Subjecting parties to antitrust scrutiny years after the fact for settling in the face of genuine legal uncertainty would have set a terrible precedent.

Settlements are supposed to achieve peace, but, had the FTC prevailed, settling parties might end up trading present IP litigation for future antitrust litigation. That likely would have prevented rational settlements and forced unnecessary litigation. Fortunately, the Second Circuit rejected the FTC's arguments and adhered to the traditional view that good faith arm's length settlements are generally pro-competitive."

Matich added, “The FTC position seemed to be that the types of trademark claims 1-800-Contacts brought were per se illegitimate, because there could never be evidence of consumer confusion in any internet search case—a strange claim given that consumer confusion is heavily dependent on context and that context is always changing on the internet.

“Most courts have held that it is a question of fact whether consumer confusion results from search engine advertising. Not surprisingly, the 1-800-Contacts panel didn’t buy the FTC’s argument.”

Background

The FTC alleged in August 2016 that the 1-800 Contacts unlawfully “orchestrated and now maintains a web of anti-competitive agreements” that harms competition in online search advertising auctions.

The suit stems from cease-and-desist letters 1-800 Contacts sent to rival online sellers of contact lenses in 2004, whose search advertisements appeared in response to user queries containing the term ‘1-800 contacts’ (or variations thereof). As such, 1-800 Contacts accused its rivals of infringing its trademarks.

“1-800 Contacts claimed – inaccurately – that the mere fact that a rival’s advertisement appeared on the results page in response to a query containing a 1-800 Contacts trademark constituted infringement. 1-800 Contacts threatened to sue its rivals that did not agree to cease participating in these search advertising auctions,” the FTC asserted.

It claimed that at the heart of this case are at least 14 written bidding agreements that 1-800 Contacts entered with its most significant online rivals, who collectively account for some 80% of all contact lenses sold online, the commission alleges.

Through these deals, the defendant “effectively shut down” its significant rivals’ search advertising against 1-800 Contacts’ trademarks, blocking relevant, valuable advertising that would have been displayed to consumers absent these agreements.

1-800 Contacts stated that it “strongly disagrees with the agency’s contention that settlement agreements designed to protect its trademark hinder competition.”

It added, “1-800 Contacts is confident in its legal position and will vigorously defend its IP rights in response to the administrative complaint filed today by the FTC.”

In November 2017, the FTC’s Chief Administrative Law Judge (ALJ) Michael Chappell ruled that 1-800 Contacts “unlawfully harmed” competition in online search advertising auctions.

ALJ Chappell held the deals made with rival companies by the Utah-headquartered seller “unreasonably restrain” trade in violation of Section 5 of the FTC Act.

He added that the subsequent agreements “disrupted the ordinary give and take of the marketplace” by restricting competing advertisements from appearing in response to an internet search for the trademark terms of the parties to the deals.