

## "The Second Circuit Got It Right": FTC Decision Reversed in Trademark Agreements Dispute

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- In 2018 the FTC found 14 keywords agreements to have restrained competition
- Second Circuit reverses, highlights pro-competitive nature of trademark agreements
- Notes that agreements to protect trademark interests are favoured under the law

The Second Circuit has reversed a Federal Trade Commission (FTC) decision which held that a series of trademark agreements between online contact lens company 1-800 Contacts and its competitors focusing on keyword advertising restrained competition. The court found that the FTC had improperly considered the agreements to be "inherently suspect" and had incorrectly concluded that they were a violation of the FTC Act under the "rule of reason" – expanding on the pro-competitive nature of trademark agreements. A legal expert told *WTR*: "The Second Circuit got it right."

In 2002, 1-800 Contacts began filing complaints and sending cease and desist letters to a number of competitors, claiming trademark infringement in relation to their online advertisements. The agreements subsequently entered into contained provisions restricting specific terms on which the parties could bid. Although bidding on keywords such as 'contacts' or 'contact lenses' was not prohibited, the agreements included language that prohibited the parties from using each other's trademarks (and variations) as keywords, while also requiring them to employ negative keywords. The issue before the FTC was whether the agreements "restrained competition" and "constituted unfair methods of competition in or affecting commerce". As analysed [previously](#) on *WTR*, on 17 November 2018 the FTC (in a 3-1-1 vote) held that the settlement agreements were indeed anti-competitive and in violation of Section 5 of the FTC Act.

The FTC majority – using an abbreviated form of antitrust analysis – stated that the 1-800 Contacts settlements restricted advertisements that would otherwise give consumers the opportunity to learn about competitors. In response to the argument that 1-800 Contacts was merely trying to enforce its trademark rights, the majority concluded that the negative consequences of restricting keyword advertising outweighed any purported trademark enforcement benefit. Further, it stated that no court has found bidding on trademark keywords to constitute infringement, absent some aggravating factor.

1-800 Contacts appealed and on Friday, in *1-800 Contacts v FTC* (18-3848), the Court of Appeals for the Second Circuit had its say. First, it rejected the contention that trademark settlement agreements are immune from antitrust scrutiny.

In its decision, the FTC applied an abbreviated form of antitrust analysis and an "inherently suspect" framework, under which neither direct evidence of harm nor proof of market power is needed to show the anticompetitive effect of the restraint because the "likely tendency to suppress competition" posed by the challenged conduct makes it "inherently suspect". However, the court found that the agreements could not be classified as inherently suspect and that the restraints at issue "could plausibly be thought to have a net procompetitive effect because they are derived from trademark settlement agreements".

Turning to the FTC's application of the 'rule of reason' approach, it noted that the commission bears the burden of establishing a *prima facie* case of anticompetitive effect. In this case, the FTC had contended that it satisfied its burden by adducing evidence of increased contact lens prices and a reduction in the quantity of advertisements. However, the appeals court noted that the government had not conducted an empirical analysis of the agreements' effect on the price of contact lenses in the online market, characterising its evidence as theoretical and anecdotal rather than direct.

The court also ruled that "the protection of [the] petitioner's trademark interests constitutes a valid procompetitive justification for the challenged agreements", adding that – as established in *Clorox v Sterling*

*Winthrop* (117 F3d 50, 1997) – “trademarks are by their nature non-exclusionary, and agreements to protect trademark interests are common, and favoured, under the law”.

The court expanded: “That does not mean that every trademark agreement has a legitimate procompetitive justification. If the ‘provisions relating to trademark protection are auxiliary to an underlying illegal agreement between competitors’, or if there were other exceptional circumstances, we would think twice before concluding the challenged conduct has a procompetitive justification. As in *Clorox*, however, there is a lack of evidence here that the challenged agreements are the ‘product of anything other than hard-nosed trademark negotiations’.”

Further, it noted that, as the petitioner had carried its burden of identifying a pro-competitive justification, the government must show that a less restrictive alternative exists that achieves the same legitimate competitive benefits. However, the court found that the FTC had failed to do so and concluded: “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 regulate and perhaps thereby promote competition’. They do not constitute a violation of the Sherman Act, and therefore an asserted violation of the FTC Act fails of necessity.”

Reacting to the decision, [Nicholas Matich](#), principal in McKool Smith’s IP practice group, tells *WTR*: “This decision is very good for parties to trademark disputes and should provide clarity for settlement negotiations. The FTC clearly disagreed with the merits of 1-800 Contacts’ claims in the litigation it settled, but the claims were brought in good faith and settled in an area of law that was, and still is, developing. Particularly strange was the FTC’s seeming desire to lay down a *per se* rule about consumer confusion in internet advertising, an area that is usually fairly fact-specific. Subjecting parties that settle reasonable disagreements in the face of legal and factual uncertainty to later antitrust scrutiny would have deterred settlements and prolonged litigation unnecessarily. The Second Circuit got it right.”

[Erin E Connors](#), associate at Sunstein, concurs that the decision “makes a good deal of sense”, expanding: “As the Second Circuit indicated, public policy strongly favours settlement agreements like the ones 1-800 Contacts entered into. While such agreements may limit fully effective competition, as the court stated, ‘we owe significant deference to arm’s length use agreements negotiated by parties to those agreements’. Forcing companies to be less aggressive in enforcing trademark rights would be “antithetical to the pro-competitive goals of trademark policy”.

However, this may not be the end of the dispute. Connors notes: “The FTC has already indicated it is considering its options for proceeding, so this still may not be the last we’ve seen of this keyword controversy.”