PUBLIC RECORD

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

COMMISSIONERS: **Maureen K. Ohlhausen, Chairwoman**
Terrell McSweeny

In the Matter of **1-800 Contacts, Inc.,** **a corporation,** **Respondent.**	**Docket No. 9372**

RESPONDENT'S BRIEF ON APPEAL

REFERENCES

References are made using the following citation forms and abbreviations:

F. — ALJ Findings of Fact

ID — Initial Decision

RFF # — Respondent Proposed Finding of Fact

RCL — Respondent Proposed Conclusion of Law

Name of Witness, Tr. XX — Trial Testimony

CX # (Name of Witness, Dep. at XX) — Deposition Testimony

CX — Complaint Counsel Exhibit

RX — Respondent Exhibit

Cmplt. ¶ X — Complaint

{bold} — In Camera Material

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I. STATEMENT OF THE CASE

A. SUMMARY OF ARGUMENT

Well-settled precedent and public policy strongly favor settlements. The Commission gave deference to this important public policy in persuading the Supreme Court that reverse payment settlements of patent litigation should be subject to antitrust scrutiny. The Commission prevailed by acknowledging that not all settlements pose antitrust concerns and by distinguishing, as the Court itself did, between unusual settlements that require antitrust scrutiny and traditional settlements that do not.

In this case, however, Complaint Counsel ask the Commission to change course — to subject run-of-the-mill settlements to a full rule of reason analysis and to condemn them on the ground that 1-800 Contacts would not or should not have prevailed on the claims that were settled. Complaint Counsel thus would have the Commission allow, for the first time, an antitrust challenge to a settlement premised on the notion that a party would not have won the claims it settled, even when the claims were not sham. The Commission should reject this invitation to significantly expand the antitrust laws' scope, for "[a]n after-the-fact inquiry by the Commission into the merits of the underlying litigation is not only unlikely to be particularly helpful, but also likely to be unreliable." *In re Schering-Plough*, 136 F.T.C. 956, 997 (2003). And it "could have a chilling effect on [trademark] settlements down the road, and thus make it harder for parties to enjoy the advantages of certainty." *Id*. at 998. Here, it is undisputed that the challenged settlements were products of uncertainty — about the applicable legal standards, about what the evidence would show, and about the costs of litigation.

1-800 Contacts sells contact lenses. For a number of years, it did so by having customers dial 1-8-0-0-C-O-N-T-A-C-T-S, its trademark. Today, however, 1-800 Contacts sells most of its contacts at its website, 1800contacts.com. And consumers find the company not by dialing its name but by typing it into a search engine. But unlike the phone company, a search engine does not send a consumer who searches for the trademarked term "1800contacts" to 1800Contacts.com. It sends the consumer to a "search results page," which has links to that website and to other websites that other sellers have paid to have listed there.

Starting in 2004, 1-800 Contacts, like many companies at the time, claimed that companies that paid search engines to show these ads were violating its trademark rights and taking unfair advantage of its goodwill in violation of federal and state laws. 1-800 Contacts sued fourteen such companies for trademark infringement, trademark dilution, state and common law unfair competition, and unjust enrichment. At the time, the scope of trademark infringement liability for paid search advertising was highly unsettled. So too was the law regarding dilution and the state law claims, which the ALJ did not address. Some aspects of trademark law remain entirely unexplored even today. All that was clear at the time of the settlements was that determining whether the challenged advertisements were likely to confuse consumers would involve a highly fact-intensive inquiry in unsettled areas of law with an unpredictable outcome.

With one exception, the parties to these disputes made the wholly unexceptional decision to settle these uncertain claims in order to avoid the costs of litigation and the risks of losing on the merits. Specifically, the defendants agreed that they would not cause search engines to display their ads in response to searches for 1-800 Contacts' trademarks. 1-800 Contacts did not pay the settling parties anything.

There is no ground for debate that this form of settlement was traditional and commonplace. Complaint Counsel have conceded that the settlements provided for relief that 1-800 Contacts could have obtained if it successfully litigated its claims to judgment.

Numerous court injunctions, decrees and settlements both in the public docket and in the record take the same form as the challenged settlements. Complaint Counsel have not proffered a single settlement involving paid search advertising that does not contain the challenged provisions. And unrebutted testimony by 1-800 Contacts' trademark practitioner expert places beyond doubt that the settlements are commonplace.

The Supreme Court in *Actavis*, adopting the Commission's own position, held that such settlements are not subject to antitrust scrutiny: "commonplace forms have not been thought for that reason alone subject to antitrust liability." *FTC v. Actavis, Inc.*, 133 S. Ct. 2223, 2233 (2013). And the ALJ's application of the rule of reason to those settlements illustrates why.

The ALJ concluded that the settlements harm competition because they restrict one way that firms can compete with the trademark holder. Of course they did; that is the point of trademark protection. But the ALJ then forced 1-800 Contacts to justify that protection by proving that it would have prevailed on the claims that were settled — the very inquiry that the Commission has found unreliable and problematic. Antitrust scrutiny of settlements that include only relief that the claimant could have won if it had prevailed leads quickly to a regime that presumptively condemns intellectual property settlements, turning on its head a century of precedent instructing courts to uphold settlements "whenever possible." *Am. Sec. Vanlines, Inc. v. Gallagher*, 782 F.2d 1056, 1060 (D.C. Cir. 1986). The Commission should reject that highly problematic rule of law and hold that, under *Actavis*, the challenged settlements were not subject to antitrust scrutiny.

If the Commission's claim does warrant antitrust scrutiny, it nonetheless fails.

First, Complaint Counsel failed to prove that the settlement agreements had any anticompetitive effects. Complaint Counsel's experts conceded that they did not proffer any evidence that the challenged settlements resulted in lower output or supracompetitive prices for contact lenses. That is fatal, for "[i]mpressionistic assessments of harm should not drive major interventions in the market. Rather, empiricism should control." Maureen K. Ohlhausen, *The FTC's Path Ahead*, Feb. 3, 2017, at 2.[1]

Second, Complaint Counsel failed to prove that 1-800 Contacts has market power even if, as the ALJ incorrectly found, the market consists of just online sales of contact lenses, because Complaint Counsel failed to prove that there were any barriers to entry or expansion in the supposed "online market." If the market is *correctly* defined as the market for retail sales of contact lenses, 1-800 Contacts lacks market power for the foregoing reasons *and* because it accounts for only 10% of contact lens sales in the United States.

Third, Complaint Counsel failed to prove that 1-800 Contacts' settlements were not reasonably necessary to obtain the procompetitive benefits of settling litigation and protecting trademarks because they did not prove that 1-800 Contacts had any other practical way to settle while also protecting its trademark rights. Complaint Counsel did not identify a single real-world settlement taking the form they imagined in hindsight. Condemning the trademark settlements would thus effectively force 1-800 Contacts to share its trademark rights, which is not permitted under the antitrust laws absent naked abuse of intellectual property rights such as price-fixing or patent pooling wholly missing here.

Finally, the ALJ's order is unconstitutional. It invades Article III courts' inherent power to supervise the existing settlements and retroactively deprives 1-800 Contacts of the ability to enforce its trademark rights in violation of the Fifth Amendment.

[1] https://www.ftc.gov/system/files/documents/public_statements/1070123/gcr_the-ftc_path_ahead.pdf.

B. STATEMENT OF FACTS

1. The Contact Lens Industry

Contact lenses are regulated medical devices that require a prescription from an "eye care professional" ("ECP") — an optometrist or ophthalmologist. F. 8-12; RFF 1-10. ECPs historically withheld prescriptions from their patients, which "limited the consumer's ability to shop for the best price and . . . impacted competition." H.R. REP. 108-318, 4, 2004 U.S.C.C.A.N. 1759, 1759. But the Fairness to Contact Lens Consumers Act, 15 U.S.C. § 7601, *et seq*., and the Commission's Contact Lens Rule, 16 C.F.R. § 315, *et seq*., gave consumers the "automatic right to copies of their own prescriptions." F. 17, 20-22. This "increase[d] competition in the sale of contact lenses," and there is now "a myriad of competitive options to fill contact lens prescriptions from the optometrist's office, to third party sellers like pharmacies, department stores, and Internet or mail order outlets." H.R. REP. 108-318, 5, 2004 U.S.C.C.A.N. 1759, 1760.

The 16,000 independent ECPs in the U.S., F. 79, RFF 370-392, still account for 40% of contact lens sales. F. 431, 491. Optical retail chains such as LensCrafters, Pearle Vision, Visionworks and America's Best account for 20% of contact lens sales in the United States. F. 82-88, 491; RFF 393-398. Mass merchants such as Walmart, Target, Sears and JC Penny, and club stores such as Costco, BJ's and Sam's Club, account for another 23% of contact lens sales. F. 89-97, 491; RFF 399-420. And so-called "pure play" online retailers without any physical locations account for the remaining 17% of contact lens sales. F. 491.

Although these retailers sell identical products, they compete on service, price, and convenience. RFF 73, 110-143, 1975. They offer a range of prices commensurate with their varying levels of service and convenience; on average, club stores have the lowest retail prices for contact lenses, followed by online retailers, mass merchants such as Walmart, optical chains and independent ECPs. F. 431-432, 441-442.

ECPs and retailers in every category, not just "pure play" online retailers, sell online. RFF 372, 393-420; F. 82-97. Given that there are virtually no barriers to entry to selling contacts online, RFF 621-661, online retailers continue to enter the market (*e.g.*, Hubble) and offline retailers continue to expand into online sales (*e.g.*, Costco). F. 123-134; RFF 372, 375-386, 397, 401-402, 403, 463-487.

2. 1-800 Contacts' Business Model

To distinguish itself among the diverse crowd of contact lens sellers, 1-800 Contacts adopted a business model of providing premium service and competitive prices, rather than the lowest possible prices. RFF 110-123, 216-219; F. 43-45, 50-66. 1-800 Contacts' "strategy has been to lure customers away from traditional physical retailers," ID 126, and has "focused on offering consumers a better alternative to buying contact lenses from their ECP[s]." F. 55; RFF 27-65. 1-800 Contacts generally set its prices at a discount to ECPs' and optical chains' prices. F. 433-434; RFF 216-233. ECPs remain the company's principal competitors and largest source of new customers. RFF 63-109.

To reach consumers, build its brand, and enhance its reputation, 1-800 Contacts has made enormous investments in advertising and customer service. It has spent more than $500 million over the last three decades — much of it on television — to inform consumers of the advantages of buying online rather than from their ECPs. RFF 248-292; F. 50-66. And it has been recognized for providing some of the best customer service in the entire economy — earning higher scores than Amazon and Apple. F.47; RFF 124-186.

As a result of these significant investments in advertising and service, "1-800 Contacts" has become a very well-known and respected brand. RFF 274-279.

3. The Challenged Trademark Settlements

Other online contact lens retailers who have not invested in broadscale advertising or service, RFF 187-205, 280-285, tried to use 1-800 Contacts' brand to win sales. Specifically, some online retailers paid search engines Google and Bing to display ads for their websites when consumers search for 1-800 Contacts' trademarks.

To protect its trademarks and brand, 1-800 Contacts — like numerous other companies — asserted claims against some of these online retailers for trademark infringement, trademark dilution, and other causes of action. F. 301-342; RFF 1014-1075. There is no dispute that those claims were *bona fide*. Two courts have so held, RFF 1151, and Complaint Counsel conceded as much. RFF 1152, 1326.

Between 2004 and 2014, thirteen contact lens retailers settled 1-800 Contacts' claims. It is undisputed "that the settlements are the result of the parties on each side taking into account their best assessments of the probabilities and outcomes as well as their expected costs of litigation," RFF 1394; *see also* F. 343-358; RFF 1385-1423, and that "from the settling parties' perspective, the settlements were economically rational." F.357. Several involved payments by other online retailers (then defendants) to 1-800 Contacts (then the plaintiff). RFF 1262-1267. None involved a payment *from* 1-800 Contacts. RFF 1257-1259, 1406.

The settlements were narrowly tailored. F. 359-370; RFF 1154-1185. The settlements only "prohibit each party from causing advertisements to appear in response to an internet search for the other party's trademarks." F. 361. To accomplish this end, the agreements require the use of so-called "negative keywords," which prevent ads from appearing inadvertently in response to a search for 1-800 Contacts' trademarks. RFF 1186-1191. But the settlements "do not restrict the purchase or appearance of advertisements in response to searches for generic terms, such as 'contacts,' 'contact lens,' and 'contact lenses,'" which represent the vast majority of contacts-related searches. F. 367; RFF 1156-1185. Nor do they restrict advertising in response to comparative searches such as "cheaper than 1-800 Contacts." RFF 1238. And they do not restrict advertising through traditional media (television, radio, print ads, *etc*.) or other Internet means (display advertising, email marketing, social media, *etc*.). RFF 1951-1955. What the settlements do prevent is a retailer from presenting its ads in response to a consumer's internet search for "1800 contacts" or another of 1-800 Contacts' trademarks.

4. The Settlements Did Not Affect Competition or Consumers

These narrowly drawn settlements did not affect market-wide competition and did not harm consumers. Even focusing on the limited world of paid search advertising, only 2% of all contacts-related searches were for 1-800 Contacts' trademarks. RFF 1946. There is no evidence the settlements caused a decline in the share of paid search ads shown by 1-800 Contacts' competitors, which remained **{**[redacted]**}** from 2002 through 2016 as the settlements went into effect. RFF 1894-1896; Order on Non-Parties' Motions for *In Camera* Treatment (Apr. 4, 2017), at 6-7; Order on *In Camera* Treatment of Google Exhibits (Apr. 12, 2017). Between 2004 and 2016, Google displayed more than **{**[redacted]**}** paid search ads for contact lens retailers other than 1-800 Contacts, including nearly **{**[redacted]**}** by retailers that entered into the settlements. *Id.*; RFF 1893, 1923-1928. Information about the settling retailers (in forms other than advertising) also continued to be displayed to consumers in response to searches for 1-800 Contacts. RFF 717-750.

Complaint Counsel proffered no empirical evidence of decreased contact lens output or increased market prices. They do not even contend that the settlements "reduced the output of contact lenses." ID 153; *see also* RFF 2039-2040. In fact, inputting Google data into Complaint Counsel's expert's model yields the result that the settlements actually *increased* online sales of contact lenses. RFF 1861-1876.[2] Moreover, Complaint Counsel eschewed any empirical analysis of whether the settlements resulted in prices above competitive levels. RFF 2048-2058. And it is undisputed that 1-800 Contacts' profit margins **{**[redacted]**}** despite the settlement agreements. RFF 2041-2042; Order on Respondent's Motion for *In Camera* Treatment (Apr. 4, 2017) ("Respondent *In Camera* Order"), at 2; RX1131.

II. QUESTIONS PRESENTED

1. Are the challenged settlement agreements subject to antitrust scrutiny when Complaint Counsel presented no evidence that they were unusual?

2. Did Complaint Counsel sustain their burden under the Rule of Reason to prove anticompetitive effects when they did not present any evidence that the settlements resulted in reduced output of contact lenses or prices above competitive levels?

3. Did Complaint Counsel sustain their burden under the Rule of Reason to prove that 1-800 Contacts had market power, when they introduced no evidence of any barriers to entry or to expansion in the relevant market?

4. Could Complaint Counsel prove a relevant market limited to online sales of contact lenses without any economic proof about cross-elasticity of demand or that offline sellers did not constrain 1-800 Contacts from raising prices?

5. To justify the settlements, did 1-800 Contacts have the burden to prove that it would have prevailed on the underlying claims that it settled?

6. Could Complaint Counsel sustain their burden under the Rule of Reason to prove a reasonably less restrictive alternative to the challenged settlements without introducing any real-world examples of such alternative settlements?

7. Does the Constitution permit an administrative agency to apply a new rule of law retroactively to dissolve a settlement of *bona fide* claims filed in an Article III court that a respondent may no longer be able to pursue? Do other Constitutional concerns require dismissal?

[2] The result was that, in the absence of the settlements, some consumers who searched for 1-800 Contacts would not succeed in buying online. Even if (as the ALJ posited) those consumers would not abandon contact lens purchases altogether, ID 189, they would buy from offline retailers, which the ALJ concluded were outside the relevant market.

III. ARGUMENT

A. Complaint Counsel Failed To Satisfy *Actavis'* Threshold Requirements

Complaint Counsel's challenge to 1-800 Contacts' trademark settlements should be dismissed under *FTC v. Actavis, Inc.*, 133 S. Ct. 2223 (2013). All settlements of intellectual property claims restrain competition. But prior to *Actavis*, courts concluded that if "there is nothing suspicious about the circumstances of a patent settlement, then to prevent a cloud from being cast over the settlement process a third party should not be permitted to haul the parties to the settlement over the hot coals of antitrust litigation." *Asahi Glass Co. v. Pentech Pharms., Inc.*, 289 F. Supp. 2d 986, 992 (N.D. Ill. 2003); *accord In re Tamoxifen Citrate Antitrust Litig.*, 466 F.3d 187, 205, 208 (2d Cir. 2006). *Actavis* reaffirmed this principle when it "exempted 'commonplace forms' of settlement from scrutiny," *In re Lipitor Antitrust Litig.*, 868 F.3d 231, 250 (3d Cir. 2017), and held that a party challenging a settlement must show that the settlement's "form" is "unusual." *Actavis*, 133 S. Ct. at 2231.

That central holding in *Actavis* tracked the Commission's own position that antitrust concerns do not arise when "an agreement . . . fits comfortably within traditional understandings of the way in which private litigation is generally settled." *FTC v. Watson Pharm, Inc.*, No. 12-416, Br. for Pet'r, 2013 WL 267027 (U.S. Jan. 22, 2013) ("*Actavis* Br."), at *27. The Supreme Court agreed with the Commission, holding that antitrust scrutiny does not apply where settlements take traditional or "commonplace forms." 133 S. Ct. at 2233. As discussed below, Complaint Counsel did not prove that 1-800 Contacts' settlement agreements were "unusual" within the meaning of *Actavis*, which requires dismissal. *Id*.

1. Complaint Counsel Did Not Prove That the Settlement Agreements At Issue Were "Unusual"

Complaint Counsel's case fails at the outset because they did not prove that the settlement agreements at issue took an "unusual" form, as required by *Actavis*.

A settlement's form is critical because it is the only fixed point of reference for a reviewing court to consider where, as here, the merits of the settled claims were (and are still) uncertain and the antitrust challenge comes so many years after the parties settled. As explained more fully in Section IIIB(4), *infra*, the reason for this uncertainty is easy to understand: trademark infringement is an inherently fact-intensive question that is analyzed under a multi-factor test, and the parties could not know when they settled what that test would yield. F.334; ID 170; *Rosetta Stone Ltd. v. Google, Inc.*, 676 F.3d 144, 153 (4th Cir. 2012). In addition, there were and are several open legal questions regarding what constitutes infringement in the ever-evolving paid search advertising context. RFF 1076-1077.

However, the "form" that 1-800 Contacts' settlements took *is* certain, and the record is clear and undisputed that the challenged settlement "form" is "commonplace" on every dimension identified by the Court in *Actavis* and by the Commission.

First, the settlements here "fit[] comfortably within traditional understandings of the way in which private litigation is generally settled." *Actavis* Br., 2013 WL 267027 at *27. Each settlement was a standard non-use agreement whereby a party agreed not to use another's trademark, which is "the order of the day" in trademark infringement actions. *SunAmerica Corp. v. Sun Life Assurance Co. of Canada*, 77 F.3d 1325, 1336 (11th Cir. 1996); 3 McCarthy on Trademarks and Unfair Competition § 18:82 (5th Ed. 2017); Trademark Settlement Agreement and Release § 1, Practical Law Standard (Westlaw 2017). As public dockets make clear, parties routinely use this form of settlement in connection with the use of trademarks in paid search advertising. RFF 1296-1355; RCL 13. And *Actavis*' *only* example of a "commonplace" settlement form that it did not intend to displace was an agreement in which a party agreed to pay damages to a trademark holder, to not use a registered trademark, and to abandon a pending application for its competing trademark. *See* 133 S. Ct. at 2233 (citing *Metro-Goldwyn Mayer, Inc. v. 007 Safety Prods., Inc.*, 183 F.3d 10 (1st Cir. 1999)). That agreement is materially indistinguishable from the challenged settlements.

Second, while the outcome of the settled claims was uncertain, the challenged settlements provided for relief that a court could have ordered if 1-800 Contacts had prevailed. The principal reason why *Actavis* found settlements with "reverse payments" to be unusual is that such payments exceed the relief that a judge or jury could have provided under the patent statutes because a Hatch-Waxman defendant has no infringement claim for damages against the plaintiff. 133 S. Ct. at 2233. Again, that followed the Commission's position that "[t]he extraordinary and distinguishing feature of reverse-payment agreements" is that the defendants "receive something . . . *that they could not hope to obtain even if they prevailed in the litigation*." *Actavis* Br., 2013 WL 267027 at *30 (emphasis added). The Commission reiterated the importance of the available relief just two months after *Actavis*. *See In re Effexor XR Antitrust Litig.*, No. 3:11-cv-05479-PGS-LHG (D.N.J.), Br. of FTC as *Amicus Curiae*, Dkt. No. 236-2 (Sept. 13, 2013), 2013 WL 5183029, at *7 (settlement that "includes something that the alleged infringer could not get even if it prevailed in the patent litigation . . . may raise antitrust concerns") (citing *Actavis*, 133 S. Ct. at 2233)).

Here, however, 1-800 Contacts could have received the same relief if it prevailed in its trademark litigation as it did in its settlement agreements. Indeed, a court entered an injunction in 1-800 Contacts' favor that parallels the terms of the settlements it reached with other retailers. RFF 1109, 1198, 1263; F. 345-347. And courts across the country have issued similar injunctions. *See* RFF 1325, 1328-1348; Post-Trial Br. at 22 n.1 (citing cases). Complaint Counsel therefore rightly conceded that "the obligations of 1-800 Contacts' counterparties to the Challenged Settlement Agreements under those Agreements was comparable to relief that a court of competent and appropriate jurisdiction would have had the legal authority to order if merited in an appropriate case." RX0679A at 5.

Complaint Counsel attempt to evade this concession by characterizing the settlements as "overbroad" vis-à-vis 1-800 Contacts' trademark rights. But those arguments focus on the wrong issue. Whether 1-800 Contacts would have prevailed on its federal or state claims in the underlying lawsuits is uncertain. So the proper analysis must "focus on the state of the world as it was perceived by the parties at the time that they entered into the settlement agreement, when they could not be sure how the litigation would turn out." *In re Schering-Plough*, 136 F.T.C. at 995. *Cf. Windsurfing Int'l Inc. v. AMF, Inc.*, 782 F.2d 995, 1002 (Fed. Cir. 1986) (license of trademarks later found generic was not unenforceable for misuse). The touchstone is what relief a court could have ordered if 1-800 Contacts did win.

Third, 1-800 Contacts' unrebutted evidence demonstrated that "[p]racticing lawyers would have no difficulty recognizing" that the form of the challenged settlements "is regularly used to settle litigation." *FTC v. Actavis, Inc.*, No. 12-416, Reply Br. for Pet'r, 2013 WL 1099171 (U.S. Mar. 18, 2013), at *11 n.3. Based on his own extensive experience in trademark litigation (including cases involving paid search advertising), the challenged settlements themselves, and numerous other settlements, 1-800 Contacts' expert Howard Hogan testified that the "form of the settlement agreements at issue is very typical," Hogan, Tr. 3274, and that "these agreements are very commonplace in terms of the settlement agreements that are used to resolve these kinds of disputes." Hogan, Tr. 3248, 3246. *See* RFF 1275-1289; 1296-1366.

By contrast, Complaint Counsel's only evidence regarding whether the settlement agreements took an "unusual" form came from their rebuttal expert, Professor Rebecca Tushnet. Unlike Mr. Hogan, Professor Tushnet has never settled a trademark case, could not point to any settlement involving paid search advertising taking a form different from the challenged agreements, *and did not even read* the challenged agreements. *See* RFF 1290-1295. These deficiencies eviscerate Professor Tushnet's reliability and Complaint Counsel's case.

Rather than address Complaint Counsel's failure to prove that the settlements were "unusual," the ALJ erroneously concluded that Complaint Counsel had no burden to do so. Citing the Court's statement in *Actavis* that its "precedents make clear that patent-related settlement agreements can sometimes violate the antitrust laws," the ALJ concluded that "Respondent's interpretation of *Actavis* as providing immunity for commonplace settlement agreements is overly broad and contrary to the authorities cited with approval by the *Actavis* court." ID 122. That was error.

1-800 Contacts does not dispute that *some* settlement agreements — like those involving large reverse payments, price fixing, or patent pooling — can potentially violate the antitrust laws. But the question in *this* case is whether antitrust scrutiny of the challenged settlements is permitted. *Actavis* established a two-part test for answering that question. The Court expressly contrasted an "unusual" reverse payment settlement with settlements taking "traditional" forms, where "a party with a claim (or counterclaim) for damages receives a sum equal to or less than the value of its claim." 133 S. Ct. at 2233. The Court concluded that "settlements taking these *commonplace forms* have not been thought for that reason alone subject to antitrust liability." *Id*. (emphasis added). And it underscored that it did not "intend to alter that understanding" by applying antitrust scrutiny only to "unusual" reverse payment settlements. *Id.*

Accordingly, the courts have uniformly held that *Actavis* "exempted 'commonplace forms' of settlement from scrutiny." *In re Lipitor Antitrust Litig.*, 868 F.3d at 250. *See In re Loestrin 24 Fe Antitrust Litig.*, 814 F.3d 538, 544 n.4 (1st Cir. 2016) ("The court noted that it did not intend to disturb commonplace settlement forms"); *King Drug Company of Florence, Inc. v. Smithkline Beecham Corporation*, 791 F.3d 388, 402 (3d Cir. 2015) (*Actavis* "should not be read to subject to antitrust scrutiny 'commonplace forms' of settlement"). That these cases "analyzed reverse payment settlements of patent disputes" (ID 122) and did not find them "commonplace" does not alter the fact that the cases uniformly distinguished unusual settlements, which give rise to antitrust scrutiny, from commonplace settlements, which do not.

The ALJ's reliance on *Actavis*' discussion of *United States v. Singer Manufacturing Co.*, 374 U.S. 174 (1963), *United States v. New Wrinkle, Inc.*, 342 U.S. 371, 378 (1952), and *Standard Oil Co. (Indiana) v. United States*, 283 U.S. 163 (1931), is misplaced. Indeed, those earlier cases *highlight* the distinction between "unusual" and "commonplace" settlements. They involved, respectively, agreements by patentees to assign intellectual property rights to the party in the best position to enforce the rights against mutual competitors; to fix the prices of licensed products; and to create a patent pool among dominant competitors. Courts do not and cannot order such relief at the end of a lawsuit.

The challenged non-use trademark settlement agreements are a far cry from such naked anticompetitive conduct. They provide for traditional relief that is fully contemplated by the Lanham Act, is well within a court's power to order and is regularly part of trademark settlements agreed to in practice. Such settlements are not "unusual" and therefore cannot give rise to antitrust liability.

2. Complaint Counsel Did Not Identify Any Considerations Favoring Antitrust Scrutiny and Outweighing the Strong Policy in Favor of Settlements

Even if Complaint Counsel had satisfied their burden to prove that the settlements were "unusual," dismissal would still be required under *Actavis*. The *Actavis* Court did not stop after concluding that the reverse payment settlements before it were unusual. Rather, it extensively analyzed whether five "considerations, taken together, outweigh the single strong consideration—the desirability of settlements—that led the Eleventh Circuit to provide near-automatic antitrust immunity to reverse payment settlements." 133 S. Ct. at 2234-37. The ALJ erred when he ignored the relevant considerations, stating instead in a footnote that he did not need to determine "whether or not the evidence proves the five factors that the Supreme Court cited as justifying antitrust scrutiny." ID 122 n.18.

While the *Actavis* Court's discussion of the five considerations naturally was tailored to the reverse payment settlements before it, Complaint Counsel have not proven that *any* of these considerations favors antitrust scrutiny of the challenged trademark settlements here, let alone that those considerations taken together outweigh the law's strong policy in favor of settlement.[3]

The first three considerations that the *Actavis* Court identified relate to whether a challenged settlement poses a significant risk of unjustified anticompetitive harm, including whether a firm that can engage in such a settlement has market power to bring about such harm.

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[3] To be clear, *Actavis* holds that the five considerations *only* need to be analyzed *if* the plaintiff has demonstrated that the challenged settlement is "unusual."

133 S. Ct. at 2234-36. The trademark settlements here pose no such risk. The "opportunity for effective antitrust misuse of a trademark . . . is so limited that it poses a far less serious threat to the economic health of the nation." *Clorox Co. v. Sterling Winthrop, Inc.*, 117 F.3d 50, 57 (2d Cir. 1997) (quotation marks omitted); 6 McCarthy on Trademarks and Unfair Competition § 31:96 (5th ed.) ("because the economic exclusivity of a trademark is far less than that of a patent, there is far less opportunity for a trademark to play an integral role in violations of the antitrust laws"). That is particularly true where the challenged settlements affected advertising by only some companies in only one medium in response to only a small fraction of Internet searches related to contacts. F. 359-370; RFF 1154-1185.

Further, nothing indicates that the settlements would not be justified. The legal and factual uncertainty surrounding the settlements at issue in this case demonstrates that they were "supported by traditional settlement considerations." 133 S. Ct. at 2235. Indeed, it is undisputed "that the settlements are the result of the parties on each side taking into account their best assessments of the probabilities and outcomes as well as their expected costs of litigation." RFF 1394; *see also* F. 343-358; RFF 1385-1423.

There is no reason to think that 1-800 Contacts was "using its monopoly profits to avoid the risk of . . . a finding of noninfringement." 133 S. Ct. at 2236. Since there were no reverse payments, there is no evidence that the settlements were a means to "induce the defendants to "abandon [their] claim with a share of its monopoly profits that would otherwise be lost in the competitive market." *Id.* at 2235. In fact, there were no monopoly profits to share, for "[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." *Clorox*, 117 F.3d at 56.

But even if such narrow trademark settlements posed a risk of competitive harm, the settlements do not suggest that a trademark holder "likely possesses the power to bring that harm about in practice." 133 S. Ct. at 2236. Again, trademarks, unlike patents, do not pose a risk of monopoly power. *Mozart Co. v. Mercedes-Benz of N. Am., Inc.*, 833 F.2d 1342, 1346 (9th Cir. 1987). Certainly non-use trademark settlements without substantial monetary payments, RFF 1257-1267, cannot support an inference of market power. RFF 1422-1423.

There also would be "legitimate justifications" for any harm to competition that might result from such settlements. *Actavis*, 133 S. Ct. at 2236. "Trademarks encourage competition, promote economic growth and can raise the standard of living of an entire nation." S. REP. 100-515, 4, 1988 U.S.C.C.A.N. 5577, 5580. As such, "trademarks desirably promote competition and the maintenance of product quality." *Park 'N Fly, Inc. v. Dollar Park & Fly, Inc.*, 469 U.S. 189, 193 (1985); *Ty Inc. v. Perryman*, 306 F.3d 509, 510 (7th Cir. 2002). Complaint Counsel's expert testified that "[p]rotecting trademark rights encourages investment in this sort of brand-building activity, which in turn generates valuable market information, promotes competition and ultimately benefits consumers." RFF 1448. Clearly, "[t]he assertion of trademark rights can have procompetitive effects. . . ." *Windsurfing Int'l Inc.*, 782 F.2d at 1002.

The fourth *Actavis* consideration addresses whether an antitrust challenge to a particular settlement is "feasible administratively." 133 S. Ct. at 2236. The Commission itself recognized that an antitrust challenge to a settlement that requires re-litigating the merits is not feasible, noting the "the disadvantages of effectively retrying the patent case inside the subsequent antitrust action." *Actavis* Br., 2013 WL 267027 at *54. The Court in *Actavis* held that was not an issue for "reverse payment" settlements because "the size of the unexplained reverse payment can provide a workable surrogate for a patent's weakness, all without forcing a court to conduct a detailed exploration of the validity of the patent itself." 133 S. Ct. at 2234, 2236-37.

No shortcut is available here, as the trial made clear. The ALJ acknowledged that accounting for 1-800 Contacts' trademark rights in the antitrust analysis "would necessarily involve an inquiry into the merits" of the underlying trademark actions, ID 171, while Complaint Counsel sought to introduce extensive testimony from a trademark law professor as well as a consumer survey of the kind that would be introduced in a trademark case. They also devoted large portions of their briefing to their positions on trademark law.

The Commission has recognized that imposing antitrust liability in such a situation is unfair and unwise. A trademark holder should not be forced to re-litigate trademark claims in order to avoid antitrust liability because "[a]n after-the-fact inquiry by the Commission into the merits of the underlying litigation is not only unlikely to be particularly helpful, but also likely to be unreliable." *Schering-Plough*, 136 F.T.C. at 997. *See also* ID 171 (acknowledging that such an "after the fact" inquiry "would require unacceptable speculation"). And forcing parties to choose between litigating trademark claims now, and litigating them later on pain of antitrust liability, "could have a chilling effect on [trademark] settlements down the road, and thus make it harder for parties to enjoy the advantages of certainty." *Id.* at 998; *see also Actavis* Br., 2013 WL 267027 at *54 (retrying underlying claims creates "powerful disincentive to settlement"). Moreover, condemning settlements based on the merits of the settled claims would lead to the strange result that cases where the law is uncertain would become the riskiest cases to settle, for the very lack of precedent that generally leads parties to settle would make it difficult to defend their settlement.

Finally, the fifth *Actavis* consideration about whether to permit antitrust scrutiny of settlement agreements is whether the parties could settle similar disputes "'in other ways.'" 133 S. Ct. at 2237. No alternatives exist here. As explained in Section IIIB(4), *infra*, Complaint Counsel introduced no evidence of a feasible alternative way to settle trademark disputes related to paid search advertising. The record does not contain even one real-world trademark settlement embodying Complaint Counsel's speculative alternatives. RFF 1367-1384.

This is yet another consideration weighing against antitrust scrutiny. Essentially, Complaint Counsel's position is that a trademark owner can incur antitrust liability if it settles claims on terms that prohibit some ads that are potentially actionable but may not ultimately be proven infringing. But if that is the only meaningful way to settle a trademark case, subjecting such settlements to antitrust scrutiny will raise the costs of trademark enforcement. RFF 1478-1481. Enforcing trademarks will require either the full costs of litigation through trial or the potential costs of antitrust litigation in a challenge to a settlement. It is obvious that trademark owners will be less willing to assert their rights in that situation, which will reduce the value of trademark rights and the associated procompetitive incentives. *Four Corners Nephrology Assocs., P.C. v. Mercy Med. Ctr. of Durango*, 582 F.3d 1216, 1221 (10th Cir. 2009) (Gorsuch, J.) ("Without some confidence that they can control access to their own property, real or intellectual, how many firms would be deterred from undertaking the risks associated with, say, a significant new endeavor or facility?").

In short, the considerations that the Supreme Court identified in *Actavis* weigh strongly in favor of recognizing that the "general legal policy favoring the settlement of disputes," 133 S. Ct. at 2234, protects the challenged settlements.

B. <u>Complaint Counsel Failed To Meet Their Burden Under The Rule Of Reason To Prove That The Settlement Agreements Were Anticompetitive</u>

Even if the Commission were to find that the settlement agreements are subject to antitrust scrutiny, Complaint Counsel failed to prove their antitrust claim. Complaint Counsel failed to prove the agreements caused anticompetitive effects and failed to identify less restrictive alternatives that would have protected 1-800 Contacts' legitimate trademark rights.

1. Complaint Counsel Failed to Prove that the Challenged Settlement Agreements Had Anticompetitive Effects

(a) Complaint Counsel Proffered No Evidence of Reduced Output or Supracompetitive Prices

"Without a showing of actual adverse effect on competition, [a plaintiff] cannot make out a case under the antitrust laws." *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 31 (1984). Complaint Counsel therefore had "the initial burden of showing that the challenged action has had an *actual* adverse effect on competition as a whole in the relevant market." *Capital Imaging Assocs., P.C. v. Mohawk Valley Med. Assocs., Inc*., 996 F.2d 537, 543 (2d Cir. 1993). Anticompetitive effects are "ordinarily measured by reduced output in a properly defined market." 7 P. Areeda & H. Hovenkamp, *Antitrust Law* (4th ed. 2017), at ¶ 1504b, p. 415; *see also Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 19–20 (1979); RFF 2034. In some cases, because "[s]upracompetitive pricing entails a restriction in output," *Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 233 (1993), an antitrust plaintiff can prove anticompetitive effects by proving that the defendant raised prices above competitive levels.

Complaint Counsel did not proffer any direct evidence of reduced output or supracompetitive prices. In fact, "Complaint Counsel do[] not contend that the Challenged Agreements reduced the output of contact lenses." ID 153; *see also* RFF 2039-2040

(Complaint Counsel's experts conceded they offered no opinions on reduced output). Complaint Counsel's economic experts also disclaimed any proof that the settlement agreements resulted in supracompetitive prices. RFF 2048-2058. And Complaint Counsel did not adduce any proof regarding 1-800 Contacts' margins, as required to prove supracompetitive prices. *See Mylan Pharm. Inc. v. Warner Chilcott Pub. Ltd. Co.*, 838 F.3d 421, 434 (3d Cir. 2016); *FTC v. Lundbeck, Inc.*, 650 F.3d 1236, 1242 (8th Cir. 2011); *Geneva Pharm. Tech. Corp. v. Barr Labs., Inc.*, 386 F.3d 485, 500 (2d Cir. 2004). In fact, it is undisputed that 1-800 Contacts' margins **{**[redacted]**}** from 2002 through 2016. RFF 2041-2042; Respondent *In Camera* Order, at 2; RX1131.

Complaint Counsel's lack of "evidence that tends to prove that output was restricted or prices were above a competitive level" is fatal. *Brooke Group*, 509 U.S. at 237; *Jacobs v. Tempur-Pedic Int'l, Inc.*, 626 F.3d 1327, 1339-40 (11th Cir. 2010); *Okskanen v. Page Mem'l Hosp.*, 945 F.2d 696, 709 (4th Cir. 1991).

(b) Evidence of a Restriction on Advertising is Insufficient to Prove Actual Adverse Effects As a Matter of Law

Instead of demanding evidence of restricted output or increased prices, the ALJ held that "restricting advertising can constitute a consumer harm and form the basis for a finding of anticompetitive effects, and it is not necessary to also prove that prices increased and/or that output decreased." ID 152-53 (citation omitted). This was error.

First, the Supreme Court has made clear that in a rule of reason case, evidence of a reduction in advertising is insufficient to show actual adverse effects. As the Court explained, the relevant question for antitrust purposes 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 [the product being advertised]."

California Dental Ass'n v. FTC, 526 U.S. 756, 776 (1999); *see also id.* ("The relevant output for antitrust purposes here is presumably not information or advertising, but dental services themselves.").

This principle is especially critical here because virtually *every* restriction on the use of a trademark is a restriction on advertising. Accordingly, if proof that the settlements "restrict[ed] competing advertisements from appearing" and "were effective in restricting advertisements" sufficed to prove anticompetitive effects, ID 154, every settlement of a trademark case would be anticompetitive. That conclusion is untenable given "the general legal policy favoring the settlement of disputes," *Actavis*, 133 S. Ct. at 2234, and the principle that trademark settlements are "favored in the law" and "presume[d]" to be "pro-competitive." *Clorox Co.*, 117 F.3d at 60. The Initial Decision thus portends "the risk of chilling procompetitive behavior with too lax a liability standard." *Weyerhauser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*, 549 U.S. 312, 325 (2007).

Second, in light of this, the ALJ's reliance on *FTC v. Indiana Federation of Dentists*, 476 U.S. 447 (1986) ("*IFD*"), for the proposition that a restriction on advertising is sufficient to show actual adverse effects is misplaced. That case involved a "refusal to compete with respect to the package of services offered to customers," for which the defendants offered "[n]o credible argument" of any procompetitive justification. *Id.* at 459. There was a horizontal conspiracy to withhold "a particular service that [customers] desire—the forwarding of x rays to insurance companies along with claim forms." *Id*. In other words, the case involved an express restriction on output.

IFD thus involved "what has come to be called abbreviated or 'quick-look' analysis under the rule of reason." *California Dental Ass'n*, 526 U.S. at 770. As such, the case is inapplicable to trademark settlements that say nothing about output and which are presumptively procompetitive. *Clorox Co.*, 117 F.3d at 60. The courts have rejected the proposition that *IFD* "entitles [a plaintiff] to prove actual effects with predictive notions" and "have continued to require some empirical evidence of actual effects following [*IFD*]." *Procaps S.A. v. Patheon, Inc.*, 845 F.3d 1072, 1086 (11th Cir. 2016). Supposed evidence of a reduction in advertising is no substitute for evidence of an effect on output or prices. *See California Dental Ass'n v. FTC*, 224 F.3d 942, 957 (9th Cir. 2000) (reversing Commission where "the FTC has never quantified any increase in price or reduction in output of dental services resulting from [advertising] restrictions"); *K.M.B. Warehouse Distribs., Inc. v. Walker Mfg. Co.*, 61 F.3d 123, 127-28 (2d Cir. 1995) (no proof of harm to competition absent "empirical demonstration concerning the adverse effect of the defendants' arrangement on price or quality") (internal quotation marks and alterations omitted).

Third, the ALJ could not rely on the testimony of Complaint Counsel's experts regarding the theoretical effects of an advertising restriction as direct evidence of adverse effects. *See Procaps S.A.*, 845 F.3d at 1085 (testimony by expert that "relied only on inferences drawn from his abstract understanding of market conditions rather than from pointing to any particular data" and did not "determine any actual impact" did not prove anticompetitive effects); *Military Servs. Realty, Inc. v. Realty Consultants of Va., Ltd.*, 823 F.2d 829, 832 (4th Cir. 1987); David S. Evans, *Dodging the Consumer Harm Inquiry: A Brief Survey of Recent Government Antitrust Cases*, 75 St. John's L. Rev. 545, 545-46 (Fall 2001) ("Theory alone usually cannot answer those questions. . . . [T]here must be empirical evidence.").

(c) Evidence of Increased Purchases From 1-800 Contacts is Insufficient to Prove Actual Adverse Effects As a Matter of Law

The ALJ also erred in holding that the challenged settlements had anticompetitive effects because they supposedly "resulted in consumers purchasing from 1-800 Contacts at higher prices than they would have paid to lower-priced competitors." ID 156. A factfinder "may not infer competitive injury from price and output data absent some evidence that tends to prove that output was restricted or prices were above a competitive level." *Brooke Grp. Ltd.*, 509 U.S. at 237; *see also Jacobs*, 626 F.3d at 1339-40; *Rebel Oil Co. v. Atl. Richfield Co.*, 51 F.3d 1421, 1433 (9th Cir. 1995). But Complaint Counsel did not introduce any evidence of the competitive price. And evidence that 1-800 Contacts sometimes charges more than some other online retailers does not support any inference of supracompetitive pricing.

1-800 Contacts' ability to charge more is entirely consistent with high demand for 1-800 Contacts' superior service and well-known brand. "Generally you must pay more for higher quality." *Blue Cross & Blue Shield United of Wisc. v. Marshfield Clinic*, 65 F.3d 1406, 1412 (7th Cir. 1995) (Posner, J.); *see also Leegin Creative Leather Prod., Inc. v. PSKS, Inc.*, 551 U.S. 877, 897 (2007) ("The manufacturer strives to improve its product quality or to promote its brand because it believes this conduct will lead to increased demand despite higher prices."); RFF 2060-2062. Indeed, "[a] consumer may rationally pay more for a trademarked product than for its physically identical substitute merely for the greater assurance of quality that a trademark conveys." *In re Brand Name Prescription Drugs Antitrust Litig.*, 186 F.3d 781, 788 (7th Cir. 1999) (Posner, J.); *see also Borden, Inc.; Proposed Order Modification With Statement To Aid Public Comment*, 48 FR 9023-02, 1983 WL 169978, at 9025-26 (Mar. 3, 1983) (fact that "consumers [are] willing to pay a premium price in reliance upon [a] familiar and successfully advertised trademark . . . . reflect[s] a marketplace judgment about interbrand competition"); RFF 1437-1444, 2063-2064.

Complaint Counsel offered no evidence that 1-800 Contacts' prices were higher than other firms' prices after adjusting for differences in quality or brand equity.[4] Their expert Dr. Athey was unqualified and did not undertake any study to answer that question. RFF 2059-2071. Accordingly, there is no reason to doubt that 1-800 Contacts' customers paid more because they got more than if they purchased from one of the settling parties and therefore no basis in the record to conclude that they were harmed by doing so. RFF 1861-1863, 2035-2037.

Further, if 1-800 Contacts was using the settlement to raise prices without spending money to provide higher value, one would have expected 1-800 Contacts' margins to increase as the settlements went into effect. **{**[redacted]**}** RFF 2041-2042; Respondent *In Camera* Order, at 2; RX1131. In such circumstances, proof that 1-800 Contacts provides a premium brand while other firms charge less is just proof of interbrand competition. In other words, retailers are competing on more than just price. That is not "evidence that tends to prove that output was restricted or prices were *above a competitive level*." *Brooke Grp. Ltd.*, 509 U.S. at 237 (emphasis added).

2. Complaint Counsel Failed to Prove Market Power Even in a Supposed Online-Only Market

Complaint Counsel also failed to prove that 1-800 Contacts and/or any of the other settling parties had market power because Complaint Counsel failed to prove barriers to entry.

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[4] Prices vary widely among both online and offline retailers. F. 431-432, 434, 441-442, 692-693; CX. This can only be explained by differences in service quality and reputation. RFF 2059-2066. The ALJ's findings that consumers were unaware of these differences, F. 694-698, were erroneous. RFF 1970-1984.

"The first requirement in every suit based on the Rule of Reason is market power, without which the practice cannot cause those injuries (lower output and the associated welfare losses) that matter under the federal antitrust laws." *Menasha Corp. v. News Am. Mktg. In-Store, Inc.*, 354 F.3d 661, 663 (7th Cir. 2004); *see also E. Food Servs., Inc. v. Pontifical Catholic Univ. Servs. Ass'n*, 357 F.3d 1, 5 (1st Cir. 2004); *California Dental*, 526 U.S. at 782 (Breyer, J., concurring in part and dissenting in part) (defendant must have "sufficient market power to make a difference"); *Okskanen*, 945 F.2d at 709. "Proof of market power, then, for many courts is a critical first step, or 'screen,' or 'filter,' which is often dispositive of the case." *SCFC ILC, Inc. v. Visa USA, Inc.*, 36 F.3d 958, 965 (10th Cir. 1994).

Market power is "the ability of a single seller to raise price and restrict output, for reduced output is the almost inevitable result of higher prices." *Fortner Enters. v. U.S. Steel Corp.*, 394 U.S. 495, 503 (1969). There can be no market power absent barriers to entry, "for any attempt to raise prices above the competitive level will lure into the market new competitors able and willing to offer their commercial goods or personal services for less." *United States v. Syufy Enterprises*, 903 F.2d 659, 664 (9th Cir. 1990); *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 119 n.15 (1986) ("without barriers to entry it would presumably be impossible to maintain supracompetitive prices for an extended time.") (quotation marks omitted). Even firms with significant market share cannot raise prices in the absence of barriers to entry. *Syufy Enterprises*, 903 F.2d at 664 n. 6; *E. Food Servs., Inc.*, 357 F.3d at 6; *United States v. Waste Mgmt., Inc.*, 743 F.2d 976, 983 (2d Cir. 1984) (reversing finding of market power where defendant had 50% market share but entry was easy).

Complaint Counsel failed to "show that there are significant barriers to entry *and* show that existing *competitors lack* the capacity to increase their output in the short run." *Rebel Oil*

Co., 51 F.3d at 1434 (emphasis added); *see also United States v. Microsoft Corp.*, 253 F.3d 34, 82 (D.C. Cir. 2001) (government "ha[d] the burden of establishing barriers to entry into a properly defined relevant market" and proving "that those barriers are 'significant'"); RFF 628-633. They did not prove any features of that business "that prevent new rivals from timely responding to an increase in price above the competitive level." *Microsoft Corp.*, 253 F.3d at 51; *see also* RFF 621-661. In fact, Complaint Counsel's expert testified that "for online firms, the capital requirements tend not to be substantial" (CX 9042 (Evans, Dep. at 137)), and that the only barriers are "getting noticed online" and "making yourself known to the customers." RFF 642-643. Nothing indicates that Walmart or Costco could not fill the void if 1-800 Contacts cut output to try to raise prices. New firms are entering and offline firms are expanding online. F. 123-134; RFF 372, 375-386, 397, 401-402, 403, 463-487.

Complaint Counsel's failure to prove entry barriers necessary to demonstrate market power is fatal to their claim. "Unless the defendants possess market power, it is unnecessary to ask whether their conduct may be beneficial to consumers. Firms without power bear no burden of justification." *Ball Mem'l Hosp., Inc. v. Mutual Hosp. Ins., Inc.*, 784 F.2d 1325, 1334-35 (7th Cir. 1986).

3. Complaint Counsel Failed to Prove a Relevant Antitrust Market Limited to Online Sales of Contact Lenses

Complaint Counsel also failed to prove a relevant antitrust market limited to online sales. *See Southeast Mo. Hosp. v. C.R. Bard, Inc.*, 642 F.3d 608, 613 (8th Cir. 2011) ("Without a well-defined relevant market, a court cannot determine the effect that an allegedly illegal act has on competition."); *Worldwide Basketball & Sport Tours, Inc. v. NCAA*, 388 F.3d 955, 962 (6th Cir. 2004); *Reifert v. S. Cent. Wisc. MLS Corp.*, 450 F.3d 312, 320 (7th Cir. 2006). This is fatal to Complaint Counsel's case because only 20% of all sales of contact lenses are made online, which is "woefully short under any metric from which to infer market power." *Cohlmia v. St. John Med. Ctr*., 693 F.3d 1269, 1283 (10th Cir. 2012); *Valley Liquors, Inc. v. Renfield Importers, Ltd.*, 822 F.2d 656, 666 (7th Cir. 1987).

(a) Offline Firms Constrain 1-800 Contacts From Charging Supracompetitive Prices

"The goal in defining the relevant market is to identify the market participants and competitive pressures that restrain an individual firm's ability to raise prices or restrict output." *Geneva Pharm. Tech. Corp.*, 386 F.3d at 496; *see also Satellite Television & Associated Res., Inc. v. Cont'l Cablevision of Va., Inc*., 714 F.2d 351, 356 (4th Cir. 1983).

"Because the ability of consumers to turn to other suppliers restrains a firm from raising prices above the competitive level, the definition of the 'relevant market' rests on a determination of available substitutes." *Rothery Storage & Van Co. v. Atlas Van Lines, Inc*., 792 F.2d 210, 218 (D.C. Cir. 1986) (Bork, J.). This inquiry generally begins with identifying products that are "reasonably interchangeable by consumers for the same purposes." *United States v. E.I. du Pont de Nemours & Co*., 351 U.S. 377, 395 (1956). "'Interchangeability' implies that one product is roughly equivalent to another for the use to which it is put; while there might be some degree of preference for the one over the other, either would work effectively." *Allen-Myland, Inc. v. Int'l Bus. Machs. Corp.*, 33 F.3d 194, 206 (3d Cir. 1994).

The evidence is overwhelming that contact lenses sold offline are substitutes for and constrain the price of contact lenses sold online, and thus are part of the market. *See AD/SAT, Div. of Skylight, Inc. v. Associated Press*, 181 F.3d 216, 228 (2d Cir. 1999). For example:

1. Consumer surveys show that consumers switch from buying contact lenses offline to buying them online. RFF 527, 536.

2. 1-800 Contacts' core business model is persuading ECP customers (who generally buy offline) to buy contact lenses online and 1-800 Contacts historically has set prices at a discount to ECPs' prices. RFF 509-520; F. 55-58, 433.

3. Complaint Counsel's expert, Dr. Evans, testified that offline firms constrain 1-800 Contacts' ability to raise prices above competitive levels. He did not disagree "that ECPs and mass merchants play some role in constraining prices at online sellers." RFF 521. He also admitted that if (as is the case) the prices of Costco, Walmart or mass merchandise chains were lower than 1-800 Contacts' prices (RFF 528-533; F. 441-442, 448) it would make economic sense for 1-800 Contacts to consider how many customers it would lose to Costco or Walmart if it raised prices. RFF 534. He further testified that it would make economic sense for 1-800 Contacts to consider how raising prices would affect the relationship between its prices and ECPs' prices. RFF 526.

4. Walmart considers all retailers to be its competitors and ECPs to be its largest competitors, and it prices contact lenses the same in stores and online. RFF 406-413.

5. **{**[redacted]**}** RFF 243-247; Respondent *In Camera* Order at 2; CX1334.

6. Congress intended the Fairness to Contact Lens Consumers Act to facilitate "a myriad of *competitive options*" other than ECPs, including "Internet or mail order outlets." *See* H.R. REP 108-318, 4, 2004 U.S.C.C.A.N. 1759, 1760 (emphasis added).

7. The Commission itself found that competition from other retailers "will constrain an ECP's pricing for contact lenses." RFF 547-550. And the Commission adopted

the Contact Lens Rule, 16 C.F.R. § 315, *et seq*., to facilitate consumers' ability to shop for contact lenses, from both online and offline sellers. RFF 551-554, 556.

8. The contact lens manufacturers' Uniform Pricing Policies ("UPPs") requiring online firms to maintain prices charged by ECPs only make sense if there is some relationship between offline and online prices. RFF 557-560; F. 478 (purpose of UPP "was to help ECPs be more competitive against non-ECP retailers by increasing the prices of the online retailers and other contact lens discounters to the level of prices charged by ECPs"); *Leegin Creative Leather Prod., Inc.*, 551 U.S. at 890 (resale price maintenance assumes, and seeks to reduce, "competition among retailers selling the same brand").

(b) Complaint Counsel Have No Empirical Economic Proof Supporting a Market Limited to Online Sales

In order to prove a market limited to online sales of contact lenses, Complaint Counsel had to introduce empirical evidence that offline firms do not affect 1-800 Contacts' ability to raise prices. *See Reifert*, 450 F.3d at 318 ("Actual data and a reasonable analysis are necessary to demonstrate that a product or service is a good substitute for another."); *U.S. Anchor Mfg., Inc. v. Rule Indus., Inc*., 7 F.3d 986, 998 (11th Cir. 1993) ("a submarket must be supported by demonstrable empirical evidence"); *H.J., Inc. v. Int'l Tel. & Tel. Corp*., 867 F.2d 1531, 1540 (8th Cir. 1989) ("This court has been insistent upon market data or similar hard evidence in identifying the relevant market.") (quotation marks omitted).

Complaint Counsel did not introduce any such evidence. They did proffer a critical loss analysis from Dr. Evans. But the ALJ correctly found it inconclusive because the consumer switching "data relied upon by Dr. Evans did not convey what consumers would do in response to a price increase." ID 133-136; *see also* RFF 576-594. Indeed, data on switching in general "is not an actual measure of diversion, because it is not limited to switching caused by price changes." Joseph Simons & Malcolm Coate, United States v. H&R Block: *An Illustration of the DOJ's New But Controversial Approach to Market Definition*, 10 J. of Competition L. & Economics, 543, 577 (2014); *see also FTC v. Sysco Corp.*, 113 F. Supp. 3d 1, 36-37 (D.D.C. 2015) (criticizing FTC expert's critical loss analysis based on data that did not "describe[e] whether [defendants] lost a customer for a price-based reason or some reason having nothing to do with price"); *United States v. H & R Block, Inc*., 833 F. Supp. 2d 36, 69-71 (D.D.C. 2011) (same for analysis based on switching in general, "not diversion based solely on a price change"). That different parts of the same survey found different switching rates that "can confirm multiple relevant markets," ID 136; RFF 565-575, underscores that Dr. Evans' analysis was unreliable. *H & R Block, Inc*., 833 F. Supp. 2d at 64.[5]

Further, "the candidate market tested by [Dr. Evans'] UPP natural experiment included club stores" and "did not allow the exclusion of club stores from the relevant market." ID 138; F. 487; *see also* RFF 595-604. The ALJ nevertheless excluded club stores from the market because "1-800 Contacts excludes club stores from its price matching." ID 138 n. 24 (citing F. 450). But if 1-800 Contacts' price matching policy alone could determine which firms are in the relevant market, all offline retailers other than club stores would be part of the market because 1-800 Contacts will match all of their prices. RFF 234-247; F. 438.

[5] No evidence supports the notion that switching to ECPs does not reflect "an appropriate diversion ratio" because such customers "cycle between buying from ECPs when they require a new prescription and buying from 1-800 Contacts when they need a refill." ID 136; F. 465. At any rate, what matters is not whether consumers switch forever, but whether they are sufficiently willing to switch to constrain price increases.

(c) The ALJ Erred in Applying *Brown Shoe*

Despite a dearth of empirical proof, the ALJ found a relevant market limited to online sales of contact lenses based on the so-called "practical indicia" that the Supreme Court recognized in *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962). That was error.

The *Brown Shoe* factors "were never intended to exclude economic analysis altogether." *Reifert*, 450 F.3d at 320. They "are practical aids for identifying the areas of actual or potential competition" and "their presence or absence does not decide automatically the submarket issue." *Thurman Indus., Inc. v. Pay 'N Pak Stores, Inc.*, 875 F.2d 1369, 1375 (9th Cir. 1989); *see also U.S. Horticultural Supply v. Scotts Co*., 367 F. App'x 305, 311 (3d Cir. 2010) ("failure to present evidence that [defendant's] pricing decisions are constrained cannot be overcome by [] 'practical indicia' evidence"). The ALJ was wrong to define a relevant market limited to online sales based on the *Brown Shoe* factors without hard economic evidence.

The ALJ also erred by applying the *Brown Shoe* factors without regard for whether they identify the firms that constrain the defendants from increasing prices by restricting output. *See Int'l Tel. & Tel. Corp. v. Gen. Tel. & Elecs. Corp.,* 518 F.2d 913, 932 (9th Cir. 1975) ("factors which distinguish one purported submarket from another" must be "economically significant"); *see also Rothery Storage & Van Co.*, 792 F.2d at 219 ("When submarket indicia are viewed as proxies for cross-elasticities they assist in predicting a firm's ability to restrict output and hence to harm consumers."). While the ALJ mechanically credited Complaint Counsel's assertions that online firms differ in some ways from offline firms, "more is required than a showing that a product differs from others." *Bogan v. Hodgkins*, 166 F.3d 509, 516 (2d Cir. 1999); *see also Menasha Corp.*, 354 F.3d at 664.

Industry Recognition. The ALJ did not address Congress' and the Commission's recognition of competition among all sellers of contact lenses, relying instead on a radio interview and occasional references to an "online contact lens market" in documents. ID 133. Such "casual remarks" making "general comments were not evidence of anything, and, in particular, they were certainly not evidence that the industry recognized some specific submarket as a 'separate economic entity.'" *Rothery Storage & Van Co.*, 792 F.2d at 219; *see also H.J., Inc.*, 867 F.2d at 1540 ("casual statements, not made as part of a serious market analysis" were "not sufficient for the jury to infer the technical conclusion" about relevant market); *Nobel Sci. Indus., Inc. v. Beckman Instruments, Inc.*, 670 F. Supp. 1313, 1318-19 (D. Md. 1986).

Further, the ALJ's conclusion that "[o]nline retailers uniformly identify other online retailers as their closest competitors," ID 127, ignores abundant evidence that 1-800 Contacts, an online retailer, has structured its entire business model to compete with offline sellers and that Walmart considers ECPs and 1-800 Contacts to be among its largest competitors and considers offline and online firms' prices in setting its own. RFF 406-413. *See Balaklaw v. Lovell*, 14 F.3d 793, 799 (2d Cir. 1994) ("market definition must encompass the realities of competition") (internal quotation marks omitted); *Eastman Kodak Co. v. Image Tech. Servs., Inc.*, 504 U.S. 451, 482 (1992).

<u>Peculiar Characteristics / Distinct Customers</u>. The ALJ did not cite any evidence from any online retailer that "[o]nline retailers typically compete only for [a] 'refill' portion of the market." ID 128. Nor did the ALJ cite any evidence from any consumers in finding that "[o]nline purchasing is more convenient than purchasing from brick and mortar sites." *Id.*; RFF 605-607. And the ALJ did not explain how offline firms' different vision insurance policies or search advertising strategies (ID 128-29) affect their ability to constrain 1-800 Contacts' prices. *See Thurman Indus., Inc.*, 875 F.2d at 1376 ("Without a showing of the role that industry and public perception, distinct customers, or specialized vendors play in motivating and shaping consumer decisions, the demarcation of a submarket from within the pool of producers and sellers who supply economic substitutes cannot be justified.”).

Even if these findings were supported by the record, they would merely demonstrate that some consumers prefer some features of buying contact lenses online, which cannot define a market as a matter of law. *See Newcal Indus., Inc. v. Ikon Office Solution*, 513 F.3d 1038, 1045 (9th Cir. 2008) (“The consumers do not define the boundaries of the market; the products or producers do.”); *Menasha*, 354 F.3d at 665 (fact that “vanilla is people’s favorite flavor of ice cream” could not define a market). The “convenience, cost savings and better service” of one distribution method over another alone do not define a relevant antitrust market. *Westman Comm’n Co. v. Hobart Int’l, Inc.*, 796 F.2d 1216, 1220 (10th Cir. 1986); *see also PSKS, Inc. v. Leegin Creative Leather Prods., Inc.*, 615 F.3d 412, 418 (5th Cir. 2010) (“the relevant market definition must focus on the product rather than the distribution level.”).

<u>Distinct Prices</u>. The ALJ’s reasoning that “distinct customers paying distinct prices may constitute a cognisable submarket under *Brown Shoe*” revives “the discredited fuzzy analysis from the 1960s.” Joseph Simons, *et al*., *Recent DC Circuit Decisions in Whole Foods Leave Standard for Future Mergers Unsettled*, 5 Competition L. Int’l 12, 20 (2009). The “Supreme Court has repeatedly held that a price differential alone is insufficient to infer two separate product markets.” *HDC Med., Inc. v. Minntech Corp.*, 474 F.3d 543, 547 (8th Cir. 2007). *See United States v. Cont’l Can Co.*, 378 U.S. 441, 455 (1964) (“[P]rice is only one factor in a user’s choice between one [product] or the other” and is “not determinative of the product market issue.”); *see also FTC v. Tenet Health Care Corp.*, 186 F.3d 1045, 1054 (8th Cir. 1999); *AD/SAT, Div. of Skylight, Inc.*, 181 F.3d at 228.

Moreover, it makes no sense to consider online and offline prices distinct when retailers such as Costco and Walmart charge the same prices in stores and online. RFF 406, 419. Limiting the market to online sales inexplicably splits these contact lens businesses in two, RFF 564, which makes no sense.

Specialized Vendors. The ALJ also relied on evidence that "[o]nline retailers must invest in unique assets that differ significantly from those of physical retailers," such as large inventory and prescription verification systems. ID 130-131. That was inexplicable because the Commission's Contact Lens Rule mandates verification for every "seller" of contact lenses, not just online sellers. 16 C.F.R. § 315.5. Regardless, the ALJ did not analyze why inventory or prescription verification systems made any difference to whether offline retailers constrain online retailers' ability to increase prices. *See Thurman Indus., Inc*., 875 F.2d at 1376.

Many products "differ not only in brand name but also in performance, physical appearance, size, capacity, cost, price, reliability, ease of use, service, customer support, and other features. Nevertheless, they generally compete with one another sufficiently that the price of one brand is greatly constrained by the price of others." 2B Areeda, *Antitrust Law* ¶ 563a, at pp. 407-08; *see also United States v. E. I. du Pont de Nemours & Co.*, 351 U.S. 377, 399 (1956) (cellophane in same market as other wrapping because "despite cellophane's advantages it has to meet competition from other materials in every one of its uses"). Just so for online and offline sales of contact lenses.

4. Complaint Counsel Failed to Prove Any Less Restrictive Alternatives

(a) Trademark Settlements Have Procompetitive Benefits

Even if Complaint Counsel had shown that the settlements were subject to antitrust scrutiny and sustained their threshold burdens to prove market power and anticompetitive effects, the burden merely would have shifted to 1-800 Contacts to prove that the settlement agreements had procompetitive benefits. *See Craftsmen Limousine, Inc. v. Ford Motor Co.*, 491 F.3d 380, 388 (8th Cir. 2007); ID 120. 1-800 Contacts clearly did so.

"Procompetitive effects include efficiency gains, the development or improvement of products, and other benefits to consumers and society." *California ex rel. Harris v. Safeway, Inc.*, 651 F.3d 1118, 1160 (9th Cir. 2011); *see also Broadcast Music Inc.*, 441 U.S. at 19-20 (procompetitive agreements "increase economic efficiency"). The parties' "expert witnesses agreed that settlements that reduce the cost of litigation are generally economically efficient." ID 168 (citing F.357-358). The ALJ found that "[s]ettling lawsuits is generally efficient." F. 355; *see also* RFF 1385-1423. And the reasons why the settlements are not subject to antitrust scrutiny (Part I, *supra*) show, at a minimum, that they are procompetitive. The ALJ wrongly rejected avoiding litigation costs through settlement as a procompetitive justification. ID 169.

The ALJ also erred in holding that "protecting [1-800 Contacts'] trademark rights" was not a procompetitive justification. ID 172. As explained above, settlements of trademark litigation are "favored in the law" and "it is reasonable to presume" that they "are pro-competitive." *Clorox Co.*, 117 F.3d at 60. The ALJ rejected 1-800 Contacts' trademark protection justification "because it *assumes* that displaying an ad in response to a search for 1-800 Contacts' brand name is, in fact, trademark infringement." ID 170. This misconstrued the parties' burdens with respect to the merits of 1-800 Contacts' claims.

It was not 1-800 Contacts' burden to prove that it *would* have won the claims it settled. As the Commission and the ALJ recognized, that outcome cannot be reconstructed. Rather, it was *Complaint Counsel*'s burden to prove the challenged settlements did not reasonably protect 1-800 Contacts' trademark and other rights because 1-800 Contacts *could not* have won the claims it settled. After all, Complaint Counsel's position is that "we accommodate trademark law by asking whether an agreement between horizontal competitors is *reasonably necessary* to protect the trademark rights of one of those competitors." (Closing Arg. Tr. 10:6-10 (emphasis added); *id.* at 165:7-12 ("the way that this Court gives credence to public policy that favors litigation settlements is to ask whether the restraint is *reasonably necessary* in order to achieve the protection of their intellectual property rights.") (emphasis added)). And it is *Complaint Counsel* who "must prove that the challenged conduct is not reasonably necessary to achieve the legitimate objectives or that those objectives can be achieved in a substantially less restrictive manner." *In the Matter of Polygram Holding, Inc.*, 136 F.T.C. 310, 476 (2003); *see also* ID 120.

Complaint Counsel contended that 1-800 Contacts could not have won the claims it settled because the challenged ads did not have its trademark in the text and some appeared only due to the search engine's "broad matching" with the trademark. But contemporaneous decisions held that "[w]hether Defendants' sponsored advertisements actually include [the plaintiff's] trademarks in the text is not determinative of whether there has been any infringement." *Fair Isaac Corp. v. Experian Info. Sols. Inc.*, 645 F. Supp. 2d 734, 760–61 (D. Minn. 2009); s*ee also Hearts on Fire Co., LLC v. Blue Nile, Inc*., 603 F. Supp. 2d 274, 288 (D. Mass. 2009) ("While these advertisements may not have displayed the mark itself, the surrounding context supplies a sufficient basis to support allegations of consumer confusion at this early stage of the litigation."). Moreover, the law remains entirely unsettled as to whether "broad matching," *i.e.*, causing an ad to appear in response to a search for a trademark without bidding on the trademark itself, is a "use" of a trademark subject to the Lanham Act. F. 167-

168, 336; RFF 1186-1209. And Complaint Counsel hardly addressed, let alone disproved, the merits of 1-800 Contacts' dilution and state law claims.

Indeed, Complaint Counsel's position that the law was clearly against 1-800 Contacts is difficult to square with the settlements themselves. For example, if Walgreens was certain to win and broad matching in response to searches for 1-800 Contacts' trademark was competitively critical, as Complaint Counsel contend, why did Walgreens settle? There is no evidence that Walgreens was cash-constrained, and even if there were, avoiding the costs of litigation is a "traditional settlement consideration[]." *Actavis*, 133 S. Ct. at 2236.

Finally, even if 1-800 Contacts had the burden to do more than prove that its claims were cognizable, 1-800 Contacts did so by proffering Dr. Ronald Goodstein's testimony regarding consumer behavior and the consumer survey conducted by Dr. Kent Van Liere. The ALJ declined to rely on this evidence, but he did not hold that it was so unreliable that it could not have been presented to a jury at trial. Nor could the ALJ have done so given that the Fourth Circuit held it was error to exclude a survey in which Dr. Van Liere used the same methodology he used here. *Rosetta Stone Ltd.*, 676 F.3d at 159. If the relevant question was whether 1-800 Contacts could have won its claims, and Dr. Goodstein's testimony and Dr. Van Liere's survey would have been admissible evidence supporting those claims, the ALJ erred by giving them no procompetitive weight.

(b) Complaint Counsel Failed to Prove 1-800 Contacts Had Reasonable and Practical Alternatives to Protect Its Trademark Rights

The Supreme Court has recognized a "general legal policy favoring the settlement of disputes." *Actavis*, 133 S. Ct. at 2234. Antitrust liability can displace that policy only if Complaint Counsel proved that the parties could "settle in other ways." *Id.* at 2237. Put differently, where, as here, a plaintiff challenges an agreement of a type that the Supreme Court has recognized advances important policy goals, the plaintiff "must make a strong evidentiary showing that its alternatives are viable here." *O'Bannon v. NCAA*, 802 F.3d 1049, 1074 (9th Cir. 2015).

Complaint Counsel failed to do so. "Proffered less restrictive alternatives should either be based on actual experience in analogous situations elsewhere or else be fairly obvious." 11 P. Areeda & H. Hovenkamp, *Antitrust Law*, at ¶ 1913b, pp. 375-376 (3d ed. 2006)); *see also id.*, at ¶ 1822b, p. 218 ("alternative is practicable only if it is used by similarly situated firms in the same or a very similar industry"); *M & H Tire Co. v. Hoosier Racing Tire Corp.*, 733 F.2d 973, 987 (1st Cir. 1984) (rejecting "possible less restrictive alternatives [that] are more hypothetical than practical"). The record, however, does not contain even one real-world trademark settlement embodying Complaint Counsel's alternative terms. RFF 1367-1369. Thus, Complaint Counsel's proposed alternatives were "merely theoretical." DOJ/FTC, Horizontal Merger Guidelines, §10, at 30 (2010). And as the Commission has recognized, "the Agencies consider only alternatives that are practical in the business situation faced by the participants; the Agencies do not search for a theoretically less restrictive alternative that is not realistic given business realities." DOJ/FTC, Guidelines for Competitor Collaborations, § 3.36(b) (2000).

The "business realities" make clear that Complaint Counsel's proposed alternative approaches are unworkable. *First*, Complaint Counsel's alternative of requiring "clear and conspicuous disclosure" would likely generate future litigation and therefore would not be "virtually as effective in serving the legitimate objective without significantly increased cost." *Cty. of Tuolumne v. Sonora Cmty. Hosp.*, 236 F.3d 1148, 1159 (9th Cir. 2001); RFF 1370-1384. That is why courts have rejected trademark relief premised on amorphous standards about what is clear or confusing. *See Harley-Davidson, Inc. v. Morris*, 19 F.3d 142, 146 (3d Cir. 1994); *Calvin Klein Cosmetics Corp. v. Parfums de Coeur, Ltd.*, 824 F.2d 665, 667 & 669 (8th Cir. 1987); *John H. Harland Co. v. Clarke Checks, Inc.*, 711 F.2d 966, 984-5 (11th Cir. 1983); 5 McCarthy on Trademarks and Unfair Competition § 30:13.

Moreover, Complaint Counsel did not introduce any evidence that any labeling would reduce confusion, let alone sustain their "heavy burden" to prove that altering the allegedly infringing materials "would significantly reduce the likelihood of consumer confusion." *Australian Gold, Inc. v. Hatfield*, 436 F.3d 1228, 1243 (10th Cir. 2006); *see also Weight Watchers Int'l, Inc. v. Luigino's, Inc.*, 423 F.3d 137, 143–44 (2d Cir. 2005) (proponent of disclaimer "must establish the disclaimer's effectiveness").

Second, Complaint Counsel's alternative of prohibiting only advertisements that use a trademark in ad text would not be as effective in protecting 1-800 Contacts' trademark rights because, again, "[w]hether Defendants' sponsored advertisements actually include [the plaintiff's] trademarks in the text *is not determinative* of whether there has been any infringement." *Fair Isaac Corp.*, 645 F. Supp. 2d at 760–61 (emphasis added); *see also Hearts on Fire Co., LLC*, 603 F. Supp. 2d at 288; *LBF Travel, Inc. v. Fareportal, Inc.*, No. 13 CIV. 9143 LAK GWG, 2014 WL 5671853, at *9 (S.D.N.Y. Nov. 5, 2014).

Unable to identify any reasonable and practical alternative for 1-800 Contacts to protect its trademark rights, Complaint Counsel's claim simply reflects the "imaginations of lawyers" trying to "conjure up some method of achieving the business purpose in question that would result in a somewhat lesser restriction of trade." *Am. Motor Inns, Inc. v. Holiday Inns, Inc.*, 521 F.2d 1230, 1249–50 (3d Cir. 1975). But "it is usually unwise for courts to second-guess" trademark settlements. *Clorox*, 117 F.3d at 60; *see Am. Motor Inns, Inc.*, 521 F.2d at 1249 (rejecting rule under which "courts would be placed in the position of second-guessing business judgments"). The Commission should reject Complaint Counsel's proposal to do so here.

C. The Commission Should Order Only Prospective Relief Because The Initial Remedial Order Is Unconstitutional

For the foregoing reasons, Complaint Counsel failed to satisfy their burden to prove a violation of Section 5 of the FTC Act. Accordingly, the Commission need not consider the ALJ's flawed remedial Order. However, if the Commission concludes that 1-800 Contacts "restricted competition beyond 'the scope of any property right that 1-800 Contacts may have in its trademarks,'" Opinion and Order of the Commission at 4 (quoting Cmplt. ¶ 32), *and* if it decides that some form of remedy is appropriate, it must modify the ALJ's Order to allow continued judicial enforcement of the existing settlement agreements, while only barring 1-800 Contacts from entering similar agreements in the future without judicial approval.

Courts have the "inherent power to recognize, encourage, and when necessary enforce settlement agreements reached by the parties." *Bell v. Schexnayder*, 36 F.3d 447, 449 (5th Cir. 1994). An order from the Commission barring Article III courts from approving or enforcing settlements would encroach upon these core judicial powers and would constitute an unconstitutional "encroachment or aggrandizement of one branch at the expense of the other." *Buckley v. Valeo*, 424 U.S. 1, 122 (1976) (*per curiam*).

These principles led the ALJ to modify Complaint Counsel's proposed order to permit 1-800 Contacts to settle in the future on terms approved by a court at the conclusion of contested litigation. ID 193 (modifying proposed Order "to preserve the prerogatives of a court overseeing litigation."). But the ALJ inexplicably denied 1-800 Contacts' requests to delete Paragraph III and modify Paragraph II of that proposed Order to permit 1-800 Contacts to enforce "any settlement agreements already entered into prior to the initiation of the

Commission's complaint in this matter." ID 196-97 & 193 n.48. Article III courts not only have inherent powers to facilitate settlement, but also "the inherent power to enforce and to consider challenges to settlements entered in cases originally filed therein." *Ballato v. General Elec.*, 147 F.R.D. 95, 97 (E.D. Pa. 1993). This power to enforce settlements "has as its foundation the policy favoring the amicable adjustment of disputes and the avoidance of costly and time-consuming litigation." *Id*.; *see TNT Mktg., Inc. v. Agresti*, 796 F.2d 276, 278 (9th Cir. 1986) ("The district court ha[s] inherent power to enforce the agreement in settlement of litigation before it"). The Commission cannot interfere with Article III courts' power to do so with respect to the challenged settlements.

The ALJ's Order also violates 1-800 Contacts' Fifth Amendment rights. If 1-800 Contacts expected this Commission to extinguish its settlement agreements, it would have continued litigating its infringement issues to the point where a federal district court issued a final order — including after trial on the merits or through a default judgment. But 1-800 Contacts cannot travel back in time to re-litigate its suits if a new order dissolves its settlement agreements. Expired statutes of limitations, dismissals with prejudice, lost evidence, and a host of other practical realities would make such re-litigation difficult, if not impossible. *See generally SEC v. Chenery Corp*., 332 U.S. 194, 203 (1947) (agency must "balance[ ]" the "ill effect[s]" associated with new rule's retroactive application against "the mischief of producing a result which is contrary to a statutory design or to legal and equitable principles"). These practical realities led the ALJ to doubt the efficacy of assessing 1-800 Contacts' trademark and other rights in hindsight. ID 171. As such, condemning settlements that protect 1-800 Contacts' trademark and other rights would retroactively deprive it of the ability to enforce its rights in violation of the Due Process and Takings Clauses. *See Landgraf v. USI Film Prods.,* *Inc.*, 511 U.S. 244, 265 (1994); *Downs v. Dir., Office of Workers Comp. Programs*, 803 F.2d 193, 198-99 (5th Cir. 1986) (upholding due process challenge to retrospective challenge to existing settlement agreement).

Courts must carefully scrutinize "whether a new rule developed in adjudication should be given retroactive effect." *Local 900, Int'l Union of Elec. Workers v. NLRB*, 727 F.2d 1184, 1994 (D.C. Cir. 1984). "Unless the burden of imposing the new standard is *de minimis*, or the newly discovered statutory design compels its retroactive application, the principles which underlie the very notion of an ordered society, in which authoritatively established rules of conduct may fairly be relied upon, must preclude its retroactive effect." *Retail, Wholesale & Dep't Store Union v. NLRB*, 466 F.2d 380, 392 (D.C. Cir. 1972).

The ALJ rejected this retroactivity principle on the ground that "horizontal agreements to restrict advertising can constitute an unreasonable restraint of trade is scarcely a new rule," nor is "balancing asserted procompetitive effects against anticompetitive effects." ID 193. That analysis is doubly flawed.

First, if the fact that a case involved general antitrust principles sufficed to defeat protections against retroactivity, there would never be "new rules." *See Gray v. Netherland*, 518 U.S. 152, 168-70 (1996) ("[T]he new rule doctrine 'would be meaningless if applied at this level of generality'") (citation omitted). *Second*, the "new rule" at issue is not an antitrust rule but a trademark rule. To sustain the remedial Order, the Commission must hold, at a minimum, that 1-800 Contacts "restricted competition beyond 'the scope of any property right that 1-800 Contacts may have in its trademarks,'" Opinion and Order of the Commission at 4 (quoting Cmplt. ¶ 32). Although the ALJ expressly declined to so find with respect to the thirteen settlements at issue, *see* ID 170, its adverse decision necessarily offers a "new rule" regarding a trademark holder's rights in the paid search advertising context.

Prior to this decision, *no court* held that trademark rights do not include the ability to settle infringement cases with commonplace non-use agreements. To the contrary, a federal district court specifically approved 1-800 Contacts' settlement agreement with Vision Direct; that settlement mirrors the other settlements that the ALJ's order would retroactively undo; and those 13 settlements were based on professional legal advice. RFF 1105-1106. *See Retail, Wholesale & Dep't Store Union*, 466 F.2d at 391.

For all of these reasons, and for those stated in 1-800 Contacts' post-trial reply brief (at 133-145), a decision in Complaint Counsel's favor will unavoidably establish a new *trademark law* rule, and its retroactive application to 1-800 Contacts' settled lawsuits is both inequitable and legally impermissible. *See Chenery Corp.*, 332 U.S. at 203. Accordingly, if the Commission rules against 1-800 Contacts on the merits, it should craft a prospective-only remedy leaving existing settlements in place.

D. <u>This Administrative Proceeding Is Unconstitutional</u>

This administrative proceeding is unconstitutional because it was conducted by an ALJ, an "inferior Officer[]" of the United States, U.S. Const. Art. II, § 2, Cl. 2, that Congress has improperly insulated from control by the executive branch by making Commissioners removable only for cause, 15 U.S.C. § 41, and authorizing them to remove ALJs only for cause, 5 U.S.C. § 7521(a)-(b). *See Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 492-98 (2010); *Freytag v. Commissioner*, 501 U.S. 868 (1991); *Bandimere v. SEC*, 844 F.3d 1168 (10th Cir. 2016); *Burgess* v. *FDIC*, 871 F.3d 297 (5th Cir. 2017). *Cf. Lucia v. SEC*, No. 17-130 (U.S.), Br. for United States as Respondent (Nov. 2017).

Further, the Commission lacks a quorum, *FTC v. Flotill Prod., Inc.*, 389 U.S. 179, 183 (1967), and lacks power to permit two commissioners to constitute one, 16 C.F.R. § 4.14(b). *New Process Steel, L.P. v. N.L.R.B.*, 560 U.S. 674, 688 (2010) (invalidating action by agency lacking authority to delegate powers to two members). *Cf. In the Matter of Children's Advertising*, 93 F.T.C. 323, 1979 WL 199198, at *1 (Mar. 7, 1979) (it is "in the public interest that Commission decisions of significance . . . be taken with the participation of no fewer than three Commissioners").

IV. CONCLUSION

The Commission should dismiss the complaint.

Dated: December 6, 2017

Respectfully submitted,

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PROPOSED ORDER

Upon consideration of the briefs submitted by Respondent and Complaint Counsel, the arguments of counsel for the parties before this Commission in Open Session, and the record in this matter, IT IS HEREBY ORDERED that:

1. The Administrative Law Judge's Initial Decision is based on erroneous findings of fact and conclusions of law and therefore is vacated.

2. The Complaint is dismissed.

ORDERED:

____

The Commission

___________, 2018

CERTIFICATE OF SERVICE

I hereby certify that on December 11, 2017, I filed **RESPONDENT'S BRIEF ON APPEAL** using the FTC's E-Filing System, which will send notification of such filing to all counsel of record as well as the following:

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The Honorable D. Michael Chappell
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DATED: December 11, 2017

By: *<u>/s/ Eunice Ikemoto</u>*
Eunice Ikemoto

CERTIFICATE FOR ELECTRONIC FILING

I hereby certify that the electronic copy sent to the Secretary of the Commission is a true and correct copy of the paper original and that I possess a paper original of the signed document that is available for review by the parties and the adjudicator.

DATED: December 11, 2017

By: *<u>/s/ Steven M. Perry</u>*
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Notice of Electronic Service

I hereby certify that on December 11, 2017, I filed an electronic copy of the foregoing Respondent's Brief on Appeal, with:

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