UNITED STATES OF AMERICA

BEFORE THE FEDERAL TRADE COMMISSION

COMMISSIONERS: Joseph J. Simons, Chairman
Maureen K. Ohlhausen
Noah Joshua Phillips
Rohit Chopra
Rebecca Kelly Slaughter

In the Matter of:	)	
1-800 CONTACTS, INC.,	)	
a corporation,	)	Docket No. 9372
Respondent.	)	
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ORAL ARGUMENT

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P R O C E E D I N G S

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CHAIRMAN SIMONS: Good afternoon everyone and welcome.

The commission is meeting today in open session to hear oral argument in the matter of 1-800 Contacts, Inc., Docket Number 9372, on appeal of the respondent from the initial decision issued by the administrative law judge.

The respondent is represented by Mr. Gregory Stone.

Hello, Mr. Stone, welcome.

Would you like to introduce the people at your table?

MR. STONE: Yes.

Justin Raphael, Sean Gates, and Phil Nickels, who will operate the AV to the extent that's necessary.

CHAIRMAN SIMONS: Terrific. Welcome.

Counsel supporting the complaint is represented by Mr. Daniel Matheson.

Welcome, Mr. Matheson.

Would you like to introduce the people at your table?

MR. MATHESON: Thank you, Mr. Chairman.

We have Barbara Blank, the deputy assistant director of anticompetitive practices, Chuck Loughlin, our chief trial counsel, and our impressive paralegal, Terri Martin.

CHAIRMAN SIMONS: Thank you and welcome.

During this proceeding, each side will have 45 minutes to present their arguments.

Counsel for the respondent will make the first presentation and will be permitted to reserve time for rebuttal.

Counsel supporting the complaint will then make his presentation.

Counsel for the respondent may conclude the argument with a rebuttal presentation.

Mr. Stone, I understand that you want to take some time for rebuttal?

MR. STONE: Yes, I do, Mr. Chairman. I'd like to reserve ten minutes.

CHAIRMAN SIMONS: Terrific. Thank you.

MR. STONE: Thank you.

CHAIRMAN SIMONS: So we're all set up for that.

Mr. Stone, you may begin.

MR. STONE: Thank you.

Mr. Chairman, Commissioners, good afternoon.

The challenged settlement agreements, the settlement agreements at issue in this case, restricted certain of 1-800 Contacts' competitors from displaying paid advertising in response to a subset of contact lens-related Internet searches, and that subset was defined as the trademarks of 1-800 Contacts.

So a search, for example, for the name "1-800 Contacts" was one that the settlement agreements said the corresponding settling parties should not display their ad in response to such a search.

The settlement agreements did not restrict advertising from being displayed in response to any other contact lens-related searches.

Two percent of the searches were for 1-800 Contacts' trademarks. Ninety-eight percent, according to complaint counsel's expert Dr. Evans, were unrelated and not restricted.

In addition to not restricting these searches, this 98 percent, there were no restrictions in the settlement agreements on other forms of Internet advertising.

For example, display and banner ads, retargeting, PLAs or product comparison ads were not in

any way restricted.

Moreover, the organic search results, which are determined by the search engines, Bing, Google and Yahoo, were in no way affected by these settlement agreements.

Other forms of advertising were also unaffected, TV, newspaper, radio, e-mail, social media, brochures, pamphlets, fliers, all unaffected.

The way in which these settlement agreements implemented or the parties implemented the restrictions in the settlement agreements was twofold. And this is both -- in both instances consistent with exactly the recommendation and advice that Google had provided: Don't bid on a keyword that is a trademark term, and use negative keywords to ensure that when the algorithm is matching your ads to other searches, it doesn't match your ad to a trademark search even if you had bid on some other terms other than the trademark terms themselves.

So two things: Don't bid on trademark keywords, and use negative keywords to prevent your ad from appearing if the algorithm otherwise would have displayed it.

Given the limited scope of the restrictions at issue in this case, it's not surprising that

complaint counsel were unable to present any quantitative or empirical evidence that would show that there was any actual restriction on output of contact lenses or that there were any supracompetitive prices being charged.

Both of complaint counsel's --

CHAIRMAN SIMONS: Mr. Stone, can I interrupt you for a second.

MR. STONE: Yes.

CHAIRMAN SIMONS: When you say no evidence of supracompetitive prices being charged, would that also include no evidence that the prices were higher than they otherwise would have been?

MR. STONE: No. There was clearly evidence that 1-800 Contacts, given the bundle of attributes it offers to its customers, had prices higher than some of the other online sellers who did not offer those same attributes of large inventory, convenience, better customer service, faster, more reliable shipping, and so on.

So yes, the prices were different, but to determine if the prices were supracompetitive, what complaint counsel could have done, and didn't do, would be to compare the margins that 1-800 Contacts obtained on its sales before the settlement agreements

and then the margins it obtained after the agreements to see whether it had been able to raise its prices as a result of the settlement agreements. They did not present that evidence.

We did present some evidence on margins. It's in camera, so I won't address it, but I urge the commission to consider Professor Murphy's testimony about what that evidence showed and the conclusions you can draw from it.

COMMISSIONER PHILLIPS: Counsel, I'm Interested, along similar lines, to know how that showing – or that lack of showing – bears on whether we get into a market power test. Do we have direct effects? Don't we? What is the test?

MR. STONE: You do not have direct effects.

And our position is look at Jefferson Parish as an example, for example, that without evidence of direct effects, you should not have to get into market power.

The Amex decision from yesterday, very helpful I think to our position in many respects, suggests that in a context of horizontal agreements maybe you want to look to see separately or as opposed to direct effects whether there's also market power and, in addition, some actual effect on competition, but you

don't have to show the same direct effects perhaps. They've put that in a footnote and suggest maybe that's the test.

We submit under Jefferson Parish no, that you should be required to show direct effects, which were not shown here.

And I think there's no dispute that there was no evidence of restrictions on output or supracompetitive prices.

With respect to the other two issues, market power, the ALJ, at the urging of complaint counsel, defined the market as a market for online contact lenses. That market definition, for purposes of this case, we contend was incorrect. This commission should correct that error and find that the appropriate market definition is the sale of contact lenses in the United States.

In addition, we think this commission should find that there was no evidence of direct anticompetitive effects and for either of those two reasons should reverse the ALJ and should dismiss the complaint.

Before turning, though, to those issues of market power and anticompetitive effects, let me pause for a moment and talk about the impact of Actavis, if

I might, on this case. I know that's a decision that is well-known to the commission.

We've read your briefs, and your briefs set out the commission's position quite clearly as to when you think settlement agreements should or should not be subject to either antitrust scrutiny -- but I don't want to use a sometimes loaded term -- when they should give rise to antitrust liability.

This case should not give rise to antitrust liability.

In the first instance, the settlement agreements here are commonplace. There's nothing like the reverse payments that were at issue in Actavis in this case. There's nothing to distort the bargaining position of the parties to the case. Here, the parties looked at what's my legal risk and legal uncertainty, what are the facts in this case.

We all understand that trademark cases and the corresponding state law claims in this case of unfair competition and unjust enrichment are fact-intensive cases. These kinds of cases go to trial.

That was the case in Hearts on Fire. That was the case in Fair Isaac. In another case, Soilworks, the court entered summary judgment in favor of the plaintiff, the trademark holder, on issues of liability

and set it for trial only on damages. But all of these are fact-intensive cases.

So the parties looked at those risks and they evaluated them, and they decided whether it made more sense to settle or proceed to trial. They of course took into account the costs of litigation.

There was nothing here to suggest that the agreement resulted from anything extraneous, such as a payment of a substantial amount of money from the plaintiff.

COMMISSIONER OHLHAUSEN: Counsel, let me jump in and --

MR. STONE: Yes, Commissioner.

COMMISSIONER OHLHAUSEN: -- ask you about the settlement agreements with a substantial number of other competitors in the marketplace --

MR. STONE: Yes.

COMMISSIONER OHLHAUSEN: -- which I think distinguishes this in some ways as well.

The settlement agreements were effectively an agreement among rivals not to advertise in certain ways, and so my question for you is, why don't we view this case as more akin to for example, the commission's decision in Polygram, about agreements among competitors not to advertise?

MR. STONE: Yes. To be clear, I think this is a series of bilateral agreements. There were no agreements except between 1-800 Contacts and 13 other companies. One of those agreements has since expired, so we're really down to 12 agreements.

And they are bilateral agreements that have -- don't have a prohibition on all advertising for a fixed period of time, as in Polygram, but rather have a restriction on the nature of the advertising that can be done. And here, there's a procompetitive benefit that is easily shown because, here, the procompetitive benefit is the benefits that flow from trademark protection.

COMMISSIONER OHLHAUSEN: let me ask you a question about that, because trademark, unlike patents, it has to deal with preventing confusion, right, preventing consumer confusion about who's producing this good.

And so what evidence is there that these agreements were in response to consumer confusion arising from using the trademark terms in search, particularly because those trademark terms maybe didn't appear at all in the ads that were displayed?

MR. STONE: Yes.

So let me just be clear. I think -- and I'll

get right to your question. I think there's at least two fundamental purposes of trademark law. One is to avoid consumer confusion. The other is to encourage brand differentiation and promote the benefits of interbrand competition that flow from people having valuable trademarks that allow consumers to identify the source, not just to avoid confusion.

With respect to the settlement agreements in this case, there was evidence presented at the hearing below, both current evidence by both Dr. Van Liere and Dr. Goodstein, that consumers would be confused by these ads.

If you go back in time, there was evidence that 1-800 Contacts experienced instances when it believed consumers were calling it to follow up on an order they had placed, but the order had been placed with one of the competitors, so they had actual percipient evidence that their consumers were being confused. They thought they purchased from 1-800 Contacts and instead purchased from someone else. That is source confusion.

Initial interest confusion is harder to identify in terms of your actual conduct, but they prepared a survey in the Lens.com case, which was presented to the court there. The court decided there

were some problems with overall the reliability of the survey. I understand surveys are often challenged, but they had survey evidence in that case that there was actual confusion.

In this case, what we did is we used a different expert, and we replicated the methodology that the Fourth Circuit had approved in Rosetta Stone. Dr. Van Liere presented that survey. That survey established that consumers would experience initial interest confusion as a result of searching for 1-800 Contacts, which we know -- what do you expect when you search for a company's name?

COMMISSIONER OHLHAUSEN: Actually, let me --

MR. STONE: Sure.

COMMISSIONER OHLHAUSEN: -- just cut you off on that.

The next part of my question is, how should we think about the subsequent decisions saying that using a trademark search term for a keyword is not a violation of the trademark?

MR. STONE: Well, there is no case that says using a search term that is a trademark as a keyword is not an anti- -- is not a trademark violation that is more recent than the cases that we have cited where

they found that it potentially was, subject to the factual presentation about confusion being likely.

So if you can show the likelihood of confusion, purchasing a keyword that is a trademark term is a use and will be a violation of the law, the trademark --

COMMISSIONER OHLHAUSEN: It may be a violation of use, but it isn't necessarily one that's causing confusion.

MR. STONE: Well, it may or may not cause confusion. You don't know until you hear the evidence.

What we know is that in Fair Isaac and in Hearts on Fire, the courts said we're denying the motions to dismiss by the defendant, we're denying summary judgment, this case is going to go to trial on that issue.

What we know in Soilworks, a 2008 decision from the District of Arizona, is that in that case the court found liability, that is, confusion and infringement, on summary judgment in favor of the plaintiff, set the case for trial on damages, and the case then settled.

So I don't have a case that I can point you to where it went all the way through to trial and appeal

on this issue. But we do know that as a matter of legal theory and legal principles, the court in Rescuecom, for example, in the Second Circuit, said that that constitutes a use which, if you can show likelihood of confusion, you would have a violation of the trademark statute.

COMMISSIONER OHLHAUSEN: Thank you.

CHAIRMAN SIMONS: So the real issue here, though, is relief, isn't it?

So even assuming that there was confusion and there's a violation of the Lanham Act, right, the real question here is relief, isn't it, and the question is why wouldn't some type of disclosure that says "We're not 1-800 Contacts" be sufficient?

MR. STONE: Well, I think that's exactly the question that complaint counsel put or the argument they made, which is, we think the relief should be something other than a nonuse agreement.

Why is a nonuse agreement appropriate. McCarthy's trademark treatise in volume 3 at 18:82 says: Nonuse agreements are the standard way that trademark infringement cases are settled, not by additional disclaimers.

In addition, we have Mr. Hogan's testimony. He's been practicing in the area of trademark law for

two decades or more. His testimony was clear: The common way to settle these is through nonuse agreements, and it is not practicable to try to settle them through the use of some disclaimer, as complaint counsel urged.

And my third point -- and I realize you have another question there -- my third point is, complaint counsel did not present a single settlement agreement in which disclaimers were used as opposed to the nonuse agreements that Mr. Hogan testified to at length.

So it would just be this commission would be saying it might be nice to do it some other way that would be perhaps less restrictive, but there's no showing in the record and no reason to think that other ways of trying to resolve these cases would have achieved the same procompetitive benefits and the same efficiency of enforcement that are achieved by utilizing the nonuse agreements that were used here.

CHAIRMAN SIMONS: I mean, I can imagine that, you know, your argument would be stronger if this was a single instance, a single settlement, but this is, whatever the numbers are, 12 or 13 of them with a significant percentage of the online sellers; right? Does that change the analysis any?

MR. STONE: It does not change the analysis. If you have multiple people infringing your patent, what should the patentee do? Would you say to the patentee, you can enforce it against the first three infringers, but you have to let the rest infringe because any more than three would be too many? I think not.

And here, there were separate cases. They were brought over a period of time from 2004 all the way to 2013, so this is conduct that occurred at different points in time that led to the same harm to 1-800 Contacts that led it to initiate this litigation.

CHAIRMAN SIMONS: So one of the things at least I'm thinking of is that when you're in situations like this that there's some kind of a balance that the court needs to do or that we need to do with respect to, on the one hand, intellectual property policies and, on the other hand, the antitrust -- antitrust policies. And maybe when it's only one agreement with a competitor who's not terribly significant in the marketplace, then the intellectual property balance is further on that side of the scale, but when you have something like this, I'm nervous that maybe the antitrust policy considerations are more

weighty.

MR. STONE: Let me step back from that for a moment.

If we think about this in terms of market power and impact on consumers, imagine the situation in which Samsung were to settle with Apple and agree that Samsung would not sell certain products thought to be infringing because they violated Apple's patents. The impact of a settlement between just those two companies would be much greater in terms of market share or impact on consumers than the settlements here.

Remember, only 17 percent of contact lenses are sold by online sellers, pure-play online sellers.

CHAIRMAN SIMONS: No. Let's just put that to the side for now --

MR. STONE: Okay.

CHAIRMAN SIMONS: -- and assume with me for a minute that this is a substantial part of the relevant market.

MR. STONE: Okay. I think then it doesn't matter whether there's three or four or five players in the market. A settlement with the next largest player will have much greater impact than the settlements here, so I don't think the multiple, the

number of settlements makes a difference.

I think what we have to ask ourselves is, is there any reason to think that the procompetitive benefits of settlement, which are, avoid the courts from being bogged down with cases, the efficiency, the saving of resources that would otherwise be devoted by the parties and the court to resolving the cases, the elimination of uncertainty, any reason to think that those procompetitive benefits were not what motivated the settlements here. And there's no evidence of that.

Complaint counsel do point to the fact that there's a reciprocal provision -- and I don't want to not address that. It may be of concern to some of you -- there's the fact that 1-800 Contacts also agreed it wouldn't put its ads up in response to a search for the competitors' trademarks, is that the equivalent of a reverse payment. Well, we submit not, for three reasons.

First, nobody was doing it. 1-800 Contacts wasn't doing it. There was no value exchanged. They weren't agreeing to stop doing something they were doing, and there was no indication they had any intention of doing it. To the contrary, their policy was not to do it.

COMMISSIONER PHILLIPS: Counsel, before we go on --

MR. STONE: Yes.

COMMISSIONER PHILLIPS: -- I'll just ask you this point.

Let's assume we're in the rule of reason world. Where does the IP come in? Does it come in as a threshold matter? Is it part, like in Clorox, of looking at whether there is anticompetitive harm in the first instance? Is it just something we weigh at the end of the day?

MR. STONE: I think when you read Actavis in the context of the decisions that came before it particularly and when you read the briefs the commission filed in that case, it's clear that the fact that there is IP is a threshold consideration.

If there is IP involved, if the relief that is obtained through settlement is relief that could have been obtained through successful litigation, and if there's no reason to think there's anything external that would otherwise distort the economic interests of the parties, then that should be the end of the inquiry. And I think that's what the Actavis court says.

CHAIRMAN SIMONS: That's what the dissent

says.

MR. STONE: No. The dissent went further I think. I think Justice Breyer said, upon consideration of the IP interests, giving weight to those and looking at the five factors that he went through, he says, when we take all these together, we find here that we will override the strong benefits of settlement, the procompetitive benefits identified by the Eleventh Circuit. It's only after looking at the IP and the five factors.

Those five factors, none of them are present here, and here we have a situation in which the IP then predominates in the analysis, and we should not go any further.

If we did go further, from a policy perspective, think of the consequences. Every settlement in an IP case would be subject to an antitrust challenge and not just perhaps by the Federal Trade Commission or by state AGs, but it would be subject to class actions brought on behalf of consumers, which is exactly what has happened to 1-800 Contacts. There's now MDL cases brought against it as a result of this action initiated here.

COMMISSIONER SLAUGHTER: Let me ask you a question related to whether the situation that

1-800 Contacts is facing is unique, and it's a little bit related to what Chairman Simons was asking.

Is the practice of bidding on a competitor's trademarks in search advertising one that is limited to the contact lens industry or does it extend beyond that to other Internet advertising?

MR. STONE: Well, obviously, Rosetta Stone was a case in which that happened. American Airlines was a case in which that happened. There's hotel cases in which that happened. Hearts on Fire was a jewelry case in which that happened. Fair Isaac was credit reporting in which that happened.

So I think the indication is that kind of trying to free-ride, if you will, on someone else's investment in their trademark and try to divert or confuse customers from going to that trademark holder's website and come instead to mine, I think that cuts across all of the industries as the proliferation of cases has shown.

And this all came about in 2004 when Google changed its policy and for the first time allowed competitors to bid on someone else's trademark. Until 2004, this really didn't happen, because of Google's policy and their large market share in the search engine industry, but beginning in 2004 you'll see a

proliferation of cases, which gave rise ultimately to the ones I've cited and a vast array of other ones that were testified to by Mr. Hogan, among others, during the course of the trial.

COMMISSIONER OHLHAUSEN: Counsel, you raised the free riding issue, and I wanted to draw your attention back to Polygram, where the commission talked about that and then basically said, well, that's not free riding, that's competition, that's the essence of competition.

MR. STONE: Yes.

COMMISSIONER OHLHAUSEN: So why would we consider it free riding and anticompetitive -- or procompetitive to prevent it, whereas Polygram considered that anticompetitive --

MR. STONE: Sure. I hesitated a bit to use the "free riding" term because I didn't want to get off necessarily into this, but I think it's a really important question to address.

The biggest difference was, here, they're free-riding on someone's congressionally protected right in their trademark. Right? Here, they're free-riding on your IP right. This is no different --

COMMISSIONER OHLHAUSEN: But this isn't a patent right, going back to the scope of the trademark

right is -- the line is confusion, right, consumer confusion. And I guess my concern is, these agreements seem to go beyond what that trademark right actually grants.

MR. STONE: I think -- okay. So I think there's several parts to your question. If I don't forget them, I want to address each of them.

I think trademark doesn't just guard against confusion. It ensures the value of brand differentiation and promotes investment in the brand. That's why companies sometimes have to bring trademark infringement actions, even in the absence of confusion, if they think people are misusing their trademark in a way they need to protect it so they don't lose it.

With respect to the free-riding distinction, here they're free-riding on the investments 1-800 Contacts had made in its trademark, which is an IP protected right, not nearly as economically powerful in an exclusionary sense as patents. That's for sure. But it is a right nonetheless that is intended to encourage companies to invest in their brand name.

And when someone comes along and says, I'm going to try to free-ride on your investment in your

brand name, it not only gives rise to trademark cases, but it gives rise to unjust enrichment cases, state law unfair competition and false advertising cases, which are among the different claims that were asserted by 1-800 Contacts.

Different than Polygram is there was no IP in Polygram, so yes, they raised the free-riding issue, but it wasn't free-riding on someone's statutorily protected intellectual property as it is here.

COMMISSIONER PHILLIPS: I thought, in Polygram, part of what influenced Judge Ginsburg was the fact that what the parties were doing looked a heckuva lot like price-fixing.

Wasn't that part of the court's decision?

MR. STONE: I think that was part of the court's decision. Here we have nothing that looks like price-fixing. There's nothing here that impacts the price that anyone charges in any fashion, and nobody has contended that it does, so I think there's a big difference here.

COMMISSIONER PHILLIPS: At the commission level, though, in that case, we also found that just the limitation on advertising was enough.

Were we wrong?

MR. STONE: Well, I think for guidance on the

advertising question we should look to Cal Dental. I think Cal Dental is the Supreme Court's exposition of how we should view advertising. I think the Supreme Court was clear there. They said limiting the amount of advertising is not in and of itself a sufficient competitive effect, we have to show that there was a reduction in the output of dental services, in that case, or supracompetitive prices, neither of which were shown. They applied the rule of reason in Cal Dental, and they said, under that analysis, just like we think under the appropriate analysis here, without a showing of direct effects, you should conclude that there is no antitrust liability that arises.

So I think Cal Dental is the key case in terms of how we should assess restrictions on advertising.

CHAIRMAN SIMONS: And in terms of Cal Dental, though, would you say that that holding was limited to professional associations and that, absent a professional association, there is precedent for the notion that restrictions on advertising are inherently suspect?

MR. STONE: I don't think I would agree with that. I think it's -- I don't think there's any reason to think that professional associations should

be held to a different standard. The court didn't seem to say that in its opinion.

And if you look at other cases, like Indiana Federation of Dentists, what we see is professional associations can sometimes act very much to protect the interests of some or all against others, and so you would have the same issue there where you have collective action, the potential for collective or collusive action, which is more I would say insidious than what we have in a series of bilateral agreements here where you have no reason to think anybody is acting to the detriment of any other party. They weren't acting to the detriment of consumers. This didn't involve all online sellers.

And if you look at the market power issues, which I want to touch on at least a bit, what you see is you have an extraordinary number of people who could enter this market or could expand into this market who are not bound in any way by any of the settlement agreements.

So here you have clearly no market power that we exercise because Walmart, who's not bound and who sells contact lenses both in the store and online and who sells them at the same price, could expand their capacity and just sell more contacts online if

1-800 Contacts was charging supracompetitive prices.

Similarly, Costco has the ability to expand its capacity.

CVS, which was not online at the time of the trial, could have expanded into the online market if it wanted, and to some extent it has today, subsequent to the conclusion of the evidence in the case.

So what you see is all of these unbound parties identified by Professor Athey in her report and her testimony could easily expand or enter the market if there was any anticompetitive conduct.

CHAIRMAN SIMONS: What share of the online contact lens market would those companies --

MR. STONE: Walmart is the second largest, today, online seller, behind 1-800 Contacts, so they're the second largest. Together, we see that the mass merchandisers --

CHAIRMAN SIMONS: So if we exclude Walmart, tell me what it is.

MR. STONE: We -- I don't know that we broke down the market share data by Costco, for example, independent.

We did look at mass merchandisers and wholesale stores as one group. They were larger than the online sellers. We did look at mass merchandisers as a group.

They were larger than the online sellers. And we did look at the eyecare professionals, and they were at 40 percent or a bit higher, far larger than anyone else --

CHAIRMAN SIMONS: So this is outside of the FTC's alleged market definition, is what you're talking about.

MR. STONE: Yeah. Within the online market -- well, it's interesting. Within the online market, for the period of time covered by the complaint, that comprised a market in which 1-800 Contacts was the largest seller, and the next largest was substantially smaller because less than half of the market was made up by a vast array of online sellers, some probably twenty or more sellers. Mr. Bethers identified in his testimony it was quite a long list.

Of those, some are more interesting than others. I don't want to -- I want to just make my point on Walmart. They sell in both of these supposedly distinct markets at the very same price, and I think that's important.

Okay. So that was hopefully responsive to that question.

Let me for a moment just turn to the issue of anticompetitive effects if I might, because I want to

just make sure that it's not just that -- well, let me say one more thing about market definition. I sort of got distracted.

In addition to the barriers in entry, none of which were identified at all by the ALJ in his initial decision -- and we think that's a finding that should have been made, and the finding would have been no barriers to entry and no barriers to expansion -- Dr. Evans did do a critical loss analysis or purported to.

And I know the commission is familiar with it. I know, Mr. Chairman, you're particularly familiar with that. And I want to talk about it for just a minute, because that's intended to measure the diversion ratio in the event there's a price increase.

And Dr. Evans did not have any data of what a diversion ratio would be in the event of a price increase. Instead, he looked to a survey of what 1-800 Contacts had done of what they call their deadfile, which is consumers who have not purchased from 1-800 Contacts for a substantial period of time.

And he looked at that, and he said, Well, I don't know how many people in this are really representative of 1-800 Contacts customers, I don't know if they're representative of the customers of

other online sellers, but they were asked a question, which was: If you were to buy contact lenses again, who would you purchase them from?

The vast majority said 1-800 Contacts.

Now, they were asked the question on a scale of 0 to 10, which is interesting, so he took 6 and above and said, I'll take those as ones who would go to 1-800 Contacts. He took 5, which happens to be right in the middle, and those below and said, I'm going to assume they'd go someplace else.

And then he looked and took the answers of the people who said, I might go someplace else. They were asked where would they go. Forty percent of those said, If I didn't go to 1-800 Contacts, I'd go to another online seller. He assumed that to be the diversion ratio.

That was a mistake in his methodology. The very next page of the survey shows that only 17 percent of the people who left 1-800 Contacts actually did go to other online sellers, 49 percent went to eyecare professionals, so he just picked one page.

COMMISSIONER SLAUGHTER: Does the data show whether that 49 percent were people who were going for a new prescription that they had to get in-house at

their eyecare professionals versus a refill prescription?

MR. STONE: It does not show that, which is why you shouldn't assume, as the ALJ did, that they all went because it was renewing their prescription, not because they were going back to purchase from there.

COMMISSIONER SLAUGHTER: So the data doesn't show which it was of those two categories.

MR. STONE: The data does not show.

But when we have a range of numbers from 17 percent to 40 percent for possible diversion ratios and when picking one or the other makes a difference in the outcome of your market definition analysis using critical loss, we should be very suspicious of the result, just like we should ask -- it's not a representative sample so far as anybody knows, no evidence on that. It's the deadfile, as it was referred to.

More importantly, Dr. Evans used the 40 percent number and said, I'm going to assume it's reciprocal. I'm going to assume if 1-800's customers 40 percent of the time when they went someplace else would go to other online sellers, I'm going to assume that 40 percent of the time, if the other online sellers

raised their prices, that those consumers would go to 1-800 Contacts.

Why would you think that? These are people who you might assume were really interested in low prices. Why wouldn't they, if their online seller raised its prices, decide I'm going to go to one of the club stores, because it only costs me a membership fee to Costco, for example, or Sam's Club, which I may have already, and now I can buy my contacts for even less than they were being -- charging me at my online seller. And guess what? Those club stores are now online as well, so if convenience matters, they'll ship them right to my house. I don't even have to pick them up on my visit to Costco once a month or whatever they might make.

So I think, in that sense, he used data incorrectly and inappropriately to try to come to a conclusion, and that conclusion should be disregarded.

Instead, we should look at things like the Fairness to Contact Lens Consumers Act and the Contact Lens Rule, which tell us that this commission and Congress thinks that if you make prescriptions available to consumers, that will encourage people to win away the business of eyecare professionals selling contacts and reduce the prices that they charge.

We also should look -- I see I just have a tiny bit of time left, and let me just use it on this one.

We also should look I think to the fact that output has increased. And that was important in the Amex case, to see an increase in output, and we should look here to the very same thing.

Mr. Bethers testified, since 2002 until the time of trial, that output had gone from, for the online sellers, 7.5 percent to 17.

And in recent studies submitted to the commission in March of this year in connection with the Contact Lens Rule what did we see, we saw the same thing, a 10 to 11 percent annual increase in sales online, indicating that output has been going up, has not been restricted as a result of these agreements or for any other reason.

CHAIRMAN SIMONS: But that's not a but-for analysis; right? They may have gone up that far in any event; right?

MR. STONE: It might have occurred in any event. It's not a but-for analysis. But it certainly supports our contention that the failure to show actual restrictions on output or actual evidence of supracompetitive prices is a significant failure of

proof that in this instance justifies reversing the initial decision and dismissing the complaint.

Let me just touch on the procompetitive justifications. I want to just make sure that we're clear that it is there are benefits, as was testified to by Professor Landes in his report and deposition, there are clear benefits to society from encouraging people to invest in their trademark.

CHAIRMAN SIMONS: Mr. Stone, do you want to run into your rebuttal time?

MR. STONE: For just one minute if I might, Mr. Chairman.

CHAIRMAN SIMONS: All right.

MR. STONE: I think what's clear from his testimony is that one of those benefits is to encourage the investment in that trademark that 1-800 Contacts made here, $500 million in TV advertising over the period of time that was covered by that. That's a huge investment. That's why consumers recognize it. That's why when they advertise, they're advertising on TV, buy from us, not your eyecare professional. They're not advertising against other online sellers.

It's important to protect that investment. And if other online sellers can take advantage or free-ride

on that investment -- and I don't mean to use a loaded term -- then that minimizes the value in the trademark, reduces the incentive to invest in the trademark in the future.

COMMISSIONER OHLHAUSEN: Counsel, ask -- I mean, IP has limits, whether it's patents have limits or trademarks have limits, I think you can only take that argument so far, that there's benefits to investing, but if you have an agreement that exceeds -- that's what Actavis was about; right? You had an agreement that gave the IP holder more protection than they could actually have gotten through just asserting the IP. And I think, the argument you outline eventually runs up against a barrier, that it's not limitless, that more protection is better.

MR. STONE: Your Honor, I would just respond, I think in our case they did not get any relief that they could not have gotten if they had won.

And in Actavis, indeed, the patent holder there didn't get any relief they couldn't have gotten if they had won at trial. They simply precluded a product from being on the market. Indeed, they allowed it to enter the market earlier than they might have if they won, but they paid money as part of the deal, which is what

made it I think suspicious in the eyes of the commission -- I don't mean to speak for the commission -- and suspicious in the eyes of the court as we read the opinion.

With that, I think I'll reserve the rest of my time.

Thank you very much.

CHAIRMAN SIMONS: Thank you, Mr. Stone.

Mr. Matheson?

MR. MATHESON: Thank you, Mr. Chairman, Commissioners.

May I begin?

CHAIRMAN SIMONS: Please.

MR. MATHESON: There are a number of factual points I'd like to respond to that were addressed with my colleague. But before we do that, I would like to address the analytical framework that applies to naked restraints between competitors that are not ancillary through any integration of resources.

Now, these naked restraints impacted the critical battleground in the online sale of contact lenses, which is the search engine results page. And we know how to deal with these, and it's not Jefferson Parish.

This commission made absolutely clear by

synthesizing decades of case law, first in Polygram and then again in Realcomp, the analytical framework that applies.

There are three methods through which complaint counsel can carry its prima facie case and shift to respondent the burden to come forward with a procompetitive justification.

Through either we can demonstrate these are inherently suspect or we can demonstrate there are direct effects, and we did so, which was the basis for the initial decision, or we can indirectly demonstrate anticompetitive effects by demonstrating market power.

And the other -- we actually respectfully request the commission make a finding on all three of these bases and, in addition, hold that these are bidding restraints. These were bidding restraints that prevented horizontal competitors from entering auctions.

Since National Society of Professional Engineers, it has been the law that a restraint between horizontal competitors that interferes with the price setting of the free market is illegal on its face. That's a direct quote from National Society of Professional Engineers.

Now, the analytical framework employed in

Realcomp and Polygram tells us we need to reach a confident conclusion about the principal tendency of the restraint. And there, they're quoting Cal Dental.

And Cal Dental is entirely consistent with the Mass Board, AMA, Polygram and Realcomp framework that sets forth the three related, although distinct, in the words of Realcomp, methods of carrying out our prima facie case.

The chairman asked whether advertising restraints are inherently suspect. While it may not always be the case, it has been the judicial experience of the commission that, quote, restraints on truthful advertising are inherently likely to produce anticompetitive effects. The nature or character of these restrictions is sufficient alone to establish their anticompetitive quality. That was a direct quote from the commission in Mass Board, which was in turn quoting AMA, which was handed down by the commission in 1979 and affirmed by the Supreme Court in 1982.

For 40 years, it has been the law of the commission that absent a procompetitive justification, for which we did not have one from respondent here, a restriction on advertising is, a quote from Realcomp, ample judicial and commission experience as to the

competitive impact of restraints on discounters' advertising.

COMMISSIONER PHILLIPS: Counsel, if I can just stop you there for just a second. One of the things that gives me a lot of pause is that the cases that you're citing, the sort of learned judicial experience having to do with restrictions to advertising, don't involve IP.

And you're asking us to declare a rule here, and I'd feel a lot more comfortable if you could point me to cases that also potentially involve a violation of IP, because where you have IP, I hope you would agree with me, it sort of changes our analysis.

MR. MATHESON: Your Honor, there is, as the initial decision found, nothing magical about a settlement agreement that resolves IP litigation that exempts it from the antitrust scrutiny, and the initial decision is quoting the Southern District of Florida in In re Terazosin.

There is nothing magical about an agreement between horizontal competitors that they will resolve their commercial dispute or litigation through a restriction on competition.

Now, Actavis cited with approval Singer, New Wrinkle, Standard Oil v. United States, and we've

added to that United States v. Masonite, where you had a series of settlements of patent litigations that were adjudged per se unlawful.

It is a canard that antitrust settlements or -- sorry -- that settlements of intellectual property are subject to a different analysis. They are subject to the same analysis now.

There may be procompetitive justifications that can be advanced. Here, we don't need to worry about that, because we can tell by looking at the face of this restraint it is overly broad. It prevents competitive advertising regardless of the content of the ad.

And unlike in Actavis, a trademark right does not provide the right to exclude all uses of intellectual property. A trademark right only provides the right to exclude a certain category of confusing uses.

COMMISSIONER PHILLIPS: In Actavis, in Clorox, substantial weight was given to the right, was it not?

MR. MATHESON: Your Honor, the analysis in Clorox was a standard rule of reason analysis that asked is there an anticompetitive effect that can be discerned from this agreement.

Now, that was a case about labeling. In that

case, "Pine-Sol" could not be used as a label on a can of a nonaerosol disinfectant spray, but any other label in the world could be used, and the Second Circuit noted that why didn't Clorox just go ahead and slap a "Clorox" label on it and no competition would be displaced.

So the analysis the Second Circuit went through was a standard rule of reason analysis in which the plaintiff failed to shift to the defendant any requirement to come forth with a procompetitive justification. That is the opposite of what we're dealing with here, but the rule of reason framework is the same.

I mean, here, we have established the obligation on the defendant to come forth with a procompetitive justification. They have not done so. In Clorox, the plaintiff failed to trigger the obligation to come forth with a procompetitive justification.

COMMISSIONER PHILLIPS: Wasn't part of that the fact that it was a trademark settlement? That was part of the anticompetitive effects analysis, was it not, in Clorox?

MR. MATHESON: It was not. The anticompetitive effects analysis, to the extent that

it was undertaken, simply said we cannot discern any anticompetitive effect arising from an agreement that would stop one advertiser from using one label on a bottle of spray. You can mark -- and actually, they -- it wasn't just a label. They could also market the spray as anything other than a nonaerosol disinfectant spray. Pine-Sol could market it as a cleaner. They just couldn't market it as a nonaerosol disinfectant, and in that case, there's no reason to believe that an anticompetitive effect would result.

Here, we have the established framework of Polygram and Realcomp, and we have established that an anticompetitive effect based on the commission's judicial experience and a mountain of academic learning has -- we have every reason to believe these will cause negative competitive consequences, and we demonstrated it through direct evidence.

CHAIRMAN SIMONS: So let me ask you this.

In terms of the "inherently suspect" approach, is your position that that approach can apply here, that this restraint is inherently suspect, and that there's no plausible efficiency justification even though there's a trademark lawsuit settlement?

MR. MATHESON: There was no plausible efficiency justification advanced.

Now, what the initial decision found and it is entirely possible that saving money through resolving a dispute instead of spending money in court is a cognizable justification.

And so in order for the justification to work, it has to be cognizable legally, plausible factually and reasonably related. The restraint has to be reasonably related to be conscience of that justification.

Here, the initial decision found that there was no connection between the supposed savings of money in litigation and the consumer benefit.

A better analysis might be, it is not cognizable to save money when you settle on terms that are vastly overbroad because they could have settled the litigation in any number of different ways.

The order we've asked the commission to enter provides all kinds of ways they can settle litigation. They can target confusing uses of names. They can require clear disclosure of sources. They can target false and deceptive advertising. They can settle litigation, instead of wasting money in court, in any number of ways that will not inevitably prevent all uses of a trademark even if those uses are not confusing.

COMMISSIONER CHOPRA: But isn't it inherently confusing when you search for someone's brand name and you see someone who's their exact competitor show up as the ad as well? Couldn't a consumer reasonably assume that these might be similar products that are owned by the same company?

MR. MATHESON: The Tenth Circuit in Lens.com called that a, quote, unnatural inference when there's clear disclosure of the source of the advertisement. And that's what we've asked 1-800 Contacts to do.

We also had a study by Dr. Jacoby. It was not dealt with in detail in the initial decision, but it is in complaint counsel's proposed findings of fact at paragraphs 1810 through 1822. Dr. Jacoby demonstrated that de minimis confusion resulted when 1-800 Contacts' competitors' ads were displayed.

And we have a host of trademark cases, including Toyota v. Tabari and others, that actually suggest the opposite. They suggest that consumers understand they were presented with competitive advertisements, and as long as they're clearly labeled, there is no reason to believe that they will experience confusion or consumer search costs.

COMMISSIONER SLAUGHTER: I believe you articulated three different theories under which

complaint counsel has made a prima facie case and asked us to reach all three of those theories even though the ALJ only addressed the direct anticompetitive effects.

Why do we need to address all three? Is one not sufficient?

MR. MATHESON: One is sufficient, Your Honor. In Polygram and Realcomp, all three were addressed. And complaint counsel respectfully suggests it would provide a more fulsome record in the event of an appeal and would clearly send a message to the private bar that trademark -- that settlements of this type -- and as the questions have indicated, these -- the comparative advertising -- triggering comparative advertising through the use of keywords may be fairly common -- that we should send a mention to the private bar that absent the justification, these are seriously suspect.

Now, if there are circumstances in which a justification can be brought forth, then that's a different story.

For example, if you actually had two companies with confusingly similar names so you would have a reason to believe that if you saw an ad for 1-800 Contacts and an ad for 1-8-0-0 Contacts, you

might reasonably be confused, well, that is something that the order we've asked the commission to enter addresses. It allows them to address confusingly similar names.

COMMISSIONER SLAUGHTER: So do the merits of the underlying trademark case matter in whether there would be procompetitive benefits to the settlements?

MR. MATHESON: They do not. It does not make a whit of difference whether 1-800 Contacts would have lost or won every single case it brought. The important thing is, on their face, these agreements prohibit or they prevent the display of advertising regardless of the content of the ad.

COMMISSIONER SLAUGHTER: So help me square that with the argument that you just made, that if there really was confusion resulting from the triggered ads then that would be a problem that needed addressing. That to me goes to the merits of the underlying trademark case, but you're telling us that the underlying trademark case isn't relevant to our decision about whether the restraints were more anticompetitive than procompetitive.

MR. MATHESON: Yes. Because, on their face, these do not address only those ads that are likely to be confusing or would be confusing.

And so if it was the case that one of the thirteen sued competitors had been running confusing ads and misusing 1-800 Contacts' trademark, 1-800 Contacts could have won that case and still could not have gotten the relief that it gave to itself with these horizontal agreements.

These companies settled -- and there's clear findings on this issue -- because the cost of litigation and because the benefit of advertising against 1-800 Contacts for these particular competitors wasn't that large, because they have low margins. These guys are deep discounters for the most part, so they don't make a lot of money every time they make a sale and take one away from 1-800 Contacts, but consumers benefit. And that was the direct evidence of harm the ALJ found.

CHAIRMAN SIMONS: Let me ask you a question.

Suppose that it turned out that the relief that they got in the settlement agreements was really easy to enforce and to monitor and, on the other hand, that the relief that you're suggesting turned out to be really expensive, costly and difficult to monitor, maybe prohibitively costly.

How would that -- would that affect your analysis at all?

MR. MATHESON: Your Honor, this commission's orders in Mass Board and American Medical Association put the onus on the horizontal agree-ers to distinguish the truthful from the false, the deceptive from the misleading, as the Supreme Court said in Shapero v. Kentucky Bar Association.

The fact that they can quickly agree that no confusion will result if no advertising is shown is neither here nor there. That is not a procompetitive efficiency because they are removing from the marketplace advertisements that are valuable for consumers.

It was also very easy in Polygram for the two sides to agree on how to make certain investments and the two sides to avoid certain disputes by forgoing procompetitive advertising. That is not a procompetitive efficiency. It is not cognizable under the antitrust laws.

CHAIRMAN SIMONS: Counsel --

COMMISSIONER OHLHAUSEN: May I?

CHAIRMAN SIMONS: Please.

COMMISSIONER OHLHAUSEN: Thank you.

So, Counsel, speaking generally and not necessarily about this case, if one shows a reduction in advertising, is that on its own enough to show an

anticompetitive harm, or do you have to show that there's an increase in price or a reduction in output? And what precedents support your answer?

MR. MATHESON: So in Indiana Federation of Dentists, they said -- and I quote -- "Proof of actual detrimental effects can obviate the need for an inquiry into market power, which is but a surrogate." And in Indiana Federation of Dentists, the output that was reduced was valuable information that would have been provided to insurance companies that would have assisted them in making efficient decisions.

Here, we have restricted valuable information that goes to consumers that the record demonstrates would have assisted them in finding lower-priced options for buying the precise same box of contact lenses because it's a commodity product.

So while there may be a circumstance in which advertising does not add anything to consumers' choice set and is simply valueless or noise or perhaps even overburdensome, that's certainly not a situation we're facing here.

So here we are facing the Realcomp situation, the Indiana Federation of Dentists situation and the Polygram situation where the advertisements are procompetitive and connected to consumer benefits.

And if there's some hypothetical world in which the advertising would have what we would normally expect to find in an ordinary competitive market, which is that advertising helps consumers find lower-priced goods and services and maximize utility, this situation clearly is one.

COMMISSIONER PHILLIPS: Can I just follow up just briefly on that.

So there's a line -- there's a couple of lines in California Dental that seem to run contrary to what you just said about Indiana Federation -- I'm quoting -- "The question is not whether the universe of possible advertisements has been limited, as assuredly it has, but whether the limitation on advertisements obviously tends to limit the total delivery of dental services."

And then there's another quote on the same page that sort of says the same thing.

Isn't that the Supreme Court telling us that it isn't just limiting the advertisements, there has to be a downstream effect?

MR. MATHESON: It is not, Your Honor.

California Dental is clearly limited to the professional context and to a context in which disclosures were required. In California Dental,

additional disclosures were required in the event that a dentist wanted to advertise to consumers that they were offering price discounts or that they were making certain comfort claims.

In the context of an additional disclosure in a market characterized by a vast asymmetry of information, what the Supreme Court held was it was not necessarily possible to take the same presumptions that apply in the market for ordinary goods and services.

Realcomp explains that Cal Dental is fully consistent with the Mass Board framework and provides -- I missed the precise word, but it provides guidance on how to apply Mass Board. And then Realcomp goes forth and holds that a reduction in the number of discount listings on multiple listing services was itself an anticompetitive harm, because the discount listings placed, quote, price pressure on the full-service brokerage listings.

And we have the same situation here. Dr. Athey held and the initial decision noted that, here, the lower-priced advertisements put pricing pressure on 1-800 Contacts.

So in a situation where it's a market for ordinary goods and services, we don't worry about

asymmetries of information, and we have a demonstration that pricing pressure is resulting in what Realcomp clearly controls, and Realcomp never questioned that Cal Dental is on all fours with all the precedents cited.

COMMISSIONER PHILLIPS: If I may, just one more.

At the very beginning of your argument, you referred to the SERP page as the critical battleground; right?

Why is that? Why is this particular SERP page or these particular SERP pages the critical battleground?

MR. MATHESON: So, in this industry, what the initial decision found is that retailers of contact lenses are advertising a commodity product, and many of them are start-ups who are either small businesses that are new to the industry or established brand names, Walgreens being the classic example.

It did not sell contact lenses online. It got into the business, and it wanted to stand shoulder to shoulder with 1-800 Contacts and tell people, We're selling the exact same box of contact lens for less, and we're a brand name you can trust.

So in this case, all of the evidence from not

just the experts but the folks who came into court and testified established that they benefited when they were able to put advertising next to 1-800 Contacts.

And we have direct evidence from the files of Memorial Eye and Lens Direct that show when they were able to put advertisements right next to 1-800's that they achieved sales at levels of investment that were profitable. They would have continued this course of activity but for the restraints in the case of Memorial Eye.

And let's keep in mind, when Memorial Eye was subject to these restraints, it left the market. It was expanding. It was successful. It wasn't even using 1-800 Contacts' trademark. It didn't place bids on 1-800 Contacts' trademark. All of the ads Memorial Eye ran next to 1-800 Contacts' trademark search were broad-matched in by Google because Google thought consumers would be interested.

Memorial Eye was doing great. They ran a couple of small optometry shops and they ran a successful online business, and when 1-800 Contacts brought the hammer down, and they were forced to accept the settlement to avoid $150,000 in expert fees in litigation, they folded up shop and went home.

That's direct evidence right there of the kinds

of effect these restraints had, because Dr. Evans testified and Memorial Eye testified that when they were able to advertise, consumers took advantage of their lower-priced services. They bought lower-priced contact lenses from Memorial Eye, and 1-800 Contacts noticed.

There are twenty- -- I mean, it appears -- apparently, there's a dispute about the direct evidence. There's 22 paragraphs of findings in the initial decision. Every week, 1-800 Contacts tracked the competitors showing up in response to searches for its trademark, and every single week, it connected successful good weeks with the elimination of rivals' ads, and it noted that when rivals' ads showed up 1-800 Contacts lost sales.

COMMISSIONER SLAUGHTER: So you just suggested that avoiding the $150,000 in expert fees and settling and agreeing not to compete in this way was -- is an anticompetitive effect of settlement, a consequence of settlement of litigation. Respondent has argued that settling litigation and eliminating -- and the efficiencies that come with it is actually a procompetitive benefit. Which -- how do you take that argument head on?

MR. MATHESON: Consumers are clearly worse off

because Memorial Eye left the market.

Now, if it's the case that money is saved on litigation and that money is used for other output-enhancing or price-cutting mechanisms, then it's conceivable that would be a cognizable procompetitive justification. But, again, in order to advance a cognizable justification that's based on saving money, 1-800 has to connect the restraints at issue with saving money.

The restraint at issue prevents all of Memorial Eye's ads whether or not they are confusing. It does not only prevent those ads which are likely to be confusing.

COMMISSIONER PHILLIPS: Do they have to do that for the valuable IP?

MR. MATHESON: I'm sorry. I'm not following that question.

COMMISSIONER PHILLIPS: So we're talking about procompetitive justifications, and the question is -- and you just gave your account of how we ought to treat the savings from settling litigation.

My question is -- and this really wasn't in the brief and it wasn't in the ALJ's opinion -- what kind of weight do we assign to the value of trademark, either this trademark or trademark generally?

MR. MATHESON: Well, what the initial decision found -- and this is at page 170 of the initial decision -- is that trademark protection standing alone was not a cognizable or plausible justification because it was entirely based on the premise that an advertisement displayed in response to a 1-800 Contacts search would be infringing, and so that is how the initial decision accepted and accommodated our overbreadth demonstration.

COMMISSIONER PHILLIPS: I'm having trouble -- I hear what you're saying. I'm having trouble squaring that with our job not being evaluating the merits of the trademark claim.

MR. MATHESON: And the reason that we don't need to evaluate the merits of the trademark claim, one of the best examples here is Hearts on Fire, which is a case that's cited frequently in respondent's papers.

Hearts on Fire clearly holds that diversion of sales without a demonstration of confusion is not actionable trademark infringement. And that's what we have here. And the example that the Hearts on Fire case provided is one that we like a lot.

When you go to a drugstore, they put the generic ibuprofen right next to the Advil. And that

benefits consumers. And nobody is confused about whether they're buying Advil or generic ibuprofen. And that's what we have here.

And the notion that the assertion that it's completely divorced from any empirical demonstration that people are confused about whether it's Advil or generic ibuprofen when it's got a clear label on the box that says this is generic, but it's cheaper, the notion that Advil wants to protect its trademark would not support a horizontal agreement to eliminate that consumer benefit.

CHAIRMAN SIMONS: Even if there was confusion, can you still win this case?

I mean, suppose there's confusion because the names are a little bit similar or the advertising that they actually perform, that they use, is a little bit -- is a little bit confusing, but that's just, okay, is there a violation. There's another question, which perhaps is more important, is what is the relief.

Is the relief to shut them out from advertising in this channel completely, or is the relief to require disclosure?

MR. MATHESON: And the order we've asked the commission to enter requires or allows 1-800 Contacts

to reach any settlements it wants with its competitors that would require disclosure or would address claims. That's precisely the reason we think we can win, Mr. Chairman.

And it is again because, regardless of whether or not any particular advertisement is confusing, we know that noninfringing ads are possible. Decades of trademark precedent tell us that. The Lens.com case told us that in the context of 1-800 Contacts, and we have a survey that tells us that.

So we know that it's entirely -- it's been demonstrated to be a truism, that the only -- that nonconfusing advertising is possible because the only litigated case tells us that, and so that's -- that's right.

And finally, to put it back in the antitrust framework, in order to be a procompetitive justification to eliminate confusion, the agreement has to be -- and we'll quote -- reasonably necessary to accomplish this.

Now, we don't need to get into a fine argument about burdens here, but the Hovenkamp citation that we've provided in our papers suggests we have come forward with multiple alternative routes that could have gotten 1-800 and anyone who was displaying

confusing advertising to a settlement that would have accomplished all of the procompetitive things that it's supposed to have accomplished through these agreements.

Now it's 1-800's burden to show that eliminating all advertising triggered by its trademarks is reasonably necessary as opposed to only addressing advertising that's confusing regarding source, affiliation or sponsorship.

COMMISSIONER CHOPRA: So there were two restraints actually in the settlement agreements, so one was they couldn't bid on the trademark keyword, and then there was also the negative keyword provision.

So should we be thinking about the two of them separately, together or should it not matter?

MR. MATHESON: It is a distinction of degree and not kind, so under our direct effects method of satisfying the -- our prima facie case, we obviously didn't make a demonstration of what the effect would have been had there been no negative keyword requirement.

The negative keyword requirement is, by implication, incredibly important because many of the ads, all of the Memorial Eye ads at issue, for example,

were triggered through broad matching, and thus, negative keywords is -- the implementation of those is what eliminated Memorial Eye from the search engine results page.

And one point on the negative keywords just to address a factual point, paragraph 364 of the initial decision findings of fact makes it clear that the negative keyword requirement requires the parties to these settlements to eliminate advertising from any search that, quote, includes 1-800 Contacts' trademarks.

So in their reply brief at page 4, they suggested that a consumer could run a search for "cheaper than 1-800 Contacts" that the initial decision broadly found is incorrect and it cites a number of the settlement agreements that quite clearly on their face say "includes."

COMMISSIONER OHLHAUSEN: Counsel,

Respondent had noted that California Dental said that the relevant antitrust question was not whether advertising had been limited but, rather, the limitation on advertising tended to limit total delivery of the product being advertised.

So does this raise questions for us about the

ALJ's finding of an actual anticompetitive effect based on the restricted advertising?

MR. MATHESON: It does not.

The direct evidence -- or the direct effects evidence is overwhelming. The direct effects evidence includes not only the ordinary-course documents of 1-800 that demonstrate the effect of removing its competitors' advertisements from the search engine results page and includes our expert's demonstrations that this impacted 114 million ads over a five-year period, 145,000 clicks over the first six months of 2015, and 12.3 percent of 1-800 Contacts' rivals sales in a six-month period were eliminated by these agreements.

Now, the reason that matters is they were all selling for lower prices than 1-800 Contacts, and so that is our direct evidence that consumers paid higher prices.

And moreover, the initial decision noted that price matching decreased. Now, price matching is a little down in the weeds, but it's an incredibly important feature of this case because 1-800 Contacts implemented its price-matching policy specifically to respond to the pricing pressure brought by the advertising of its online rivals it was not able to

eliminate, and this amounted to a tremendous, tremendous benefit to consumers.

It was up to 2 percent of 1-800 Contacts' sales were given back to consumers in the form of price matches when those consumers were able to understand that lower prices are available.

And direct effects, so, again, getting back to advertising, on paragraph 694 of the initial decision findings of fact, he finds -- and I quote -- or the initial decision finds, "Many consumers are not aware of the price discrepancy between 1-800 Contacts and its online competitors." This is based both on actual record evidence, 1-800 Contacts' own analysis of RX 1228 page 36, that says actual price variances are much more than consumers perceive, approximately. I don't want to quote it because it's in camera.

So there is a direct demonstration that consumers paid more, 1-800 Contacts discounted less. And we also showed that advertising was reduced, but either one of those under Polygram should be sufficient.

COMMISSIONER CHOPRA: So as a factual matter again, did the negative -- were you able to separate out the impact of bidding on the trademark keyword versus the negative keyword?

MR. MATHESON: We were not able to separate that because the data that Dr. Evans has doesn't actually tell you which keywords are bid on.

Now, this response to this 2 percent notion we've heard a couple times, the initial decision at paragraph 657 of the findings of fact completely debunks this notion that only 2 percent of searches were for 1-800 Contacts' trademarks. It specifically notes that the only data regarding the frequency of searches for 1-800 Contacts' trademarks was analyzed by Dr. Athey. It was at least 17 percent.

And that is as many as the, quote, big three, "contacts," "contact" and "contact lenses," which are vital to the success of any online competitor.

I'm sorry. Did I --

COMMISSIONER CHOPRA: Yes.

MR. MATHESON: Thank you. Before moving on.

So having demonstrated direct effects and having demonstrated the nature of the restraints, we carried our burden in two different ways, but we also demonstrated indirectly that this restraint is likely to lead to anticompetitive effects because it locks up 79 percent of the sales in the market for the online sale of contact lenses.

Now, there was some discussion of the critical

loss analysis, but that's way down the width of the evidence that we put forth on market definition. There is direct and reliable evidence that prices in the online space are inelastic and do not respond to prices in any other form of sales.

Paragraphs 443 to 447 of the findings of fact demonstrate, AC Lens came and testified, Lens Direct came and testified, Memorial Eye came and testified that they don't pay attention to any prices except online prices because those are the ones that they think that constrain their pricing.

Now, this is a far cry from some sort of vague industry recognition. This is direct evidence that prices are not responsive to price cutting in the club space, for example.

We also have the evidence regarding price match that 1-800 Contacts only took to respond to online competition.

So that direct evidence of inelasticity is confirmed by the uniform pricing policy, the UPP analysis.

So the UPP, that natural experiment, came about in approximately 2014 when the four major manufacturers of contact lenses all set minimum resale prices on certain types of contact lenses.

Now, the analysis demonstrates that that was very profitable for online sellers of contact lenses.

This natural experiment was criticized because all discounters, including club stores, had to raise their prices in response to this minimum pricing policy. But we can separate club stores from online contact lens sellers through any number of other ways.

There's direct evidence that 1-800 testified that because club stores charge a fee, they're not viewed by 1-800 Contacts customers as a part of the competitive set.

And the initial decision explicitly held -- and I quote -- club stores do not significantly constrain online contact lens retailers. That's the initial decision at page 138 footnote 24.

So that's the second method.

Now, we also -- I also heard Mr. Stone say there was not evidence on barriers to entry. That's paragraphs 418 to 429 of the initial decision's findings of fact.

The initial decision properly held that the online space requires sophisticated websites. It requires prescription verification, which is a barrier to entry that perhaps explains why Amazon.com does not sell contact lenses.

So we have -- so even when people have the ability to deliver products to your house, they still need to verify the prescriptions with the ECPs. That's another barrier to entry.

The distribution required to enter at scale and address the anticompetitive effects is massive.

1-800 Contacts has a 130,000 square foot distribution facility. They stock more than 60,000 SKUs. Walmart stocks 400, so we are talking about an order of magnitude difference. The next largest, AC Lens, which is the -- stocks 32,000.

And Walmart came up as one of the major online sellers. Walmart has never actually provided its own online delivery. From 2008 until the end of 2012, 1-800 Contacts ran Walmart's marketing and provided all of the fulfillment for home deliveries. Starting January 1, 2013, AC Lens took over.

So even large, sophisticated companies have struggled to enter the contact lens space, which further confirms the barriers to entry.

CHAIRMAN SIMONS: So was Walmart effectively running two separate businesses, a brick-and-mortar business and a completely separate and online business?

MR. MATHESON: Walmart has outsourced the

fulfillment function of its online business since 2008.

CHAIRMAN SIMONS: So they have their own warehouse basically for what they do in-store and then they contract out for the online distribution?

MR. MATHESON: Yes.

Now, they no longer contract out for their online marketing. That ended when the -- there was a long and tortured history between 1-800 Contacts and Walmart in which they actually cobranded for a while and they tried to integrate the store.

Walmart -- there's been testimony that they've struggled a bit in the online space because they do maintain the same prices in-store and online, and that doesn't work.

And that's why Memorial Eye charged a lot less online than they charged in their stores, because to be in the online space you have to offer a compelling value proposition because you're selling a commodity product, and consumers know they can order the same box of lenses from anybody.

And that's an important point. I'm not sure it comes across in the initial decision.

When you get a prescription from an eyecare professional, that prescription tells you the

characteristics of the lens, and it has a brand name on it.

So when you're prescribed Johnson & Johnson ACUVUE, the only contact lens anybody can legally sell you is a Johnson & Johnson ACUVUE contact lens with exactly the characteristics for the thickness and the right eye focus and the left eye focus that's written on that piece of paper. You have no ability to shop around, which is why it's such a -- which is why it's, by definition, a commodity product.

COMMISSIONER CHOPRA: So you're saying there's high barriers to entry, but then you're also raising Memorial Eye again, so it sounds like they didn't have a very rough time, did they?

MR. MATHESON: Well, I mean, they had some success until they were crunched by this restraint. But when we talk about barriers to entry, we should ask ourselves was it -- did it actually happen that any competitor was able to emerge and ameliorate the demonstrated anticompetitive effects, and the answer is no, because while these agreements were in place, 1-800 Contacts kept attacking new entrants with them.

So the theoretical ability of consumers to access information about contact lenses somewhere else was of no value to them. Every time a new player

entered the space, they were constrained, and the anticompetitive effect was not dissipated or ameliorated.

COMMISSIONER CHOPRA: I hear that. But the point is that if you have a brick-and-mortar chain, whether it's a few stores or hundreds of stores, is it really that hard to get into the online space?

MR. MATHESON: Memorial Eye testified in this court that they had to make enormous investments, not only in inventory and distribution but also in getting search advertising expertise, so there are barriers. And to demonstrate, no successful entry has occurred.

WebEyeCare is the entrant that 1-800 Contacts has touted. The precise number is in camera, but since they entered in 2009, they've obtained less than 2 percent of the online market, so growth in this space is not easy. Barriers to entry are not low.

And even if theoretically it was possible for somebody to enter at scale, we know that didn't happen. We know that did not address the fact that 79 percent of the online sales were locked up by these agreements.

So finally we come to critical loss and the Brown Shoe factors.

Now, critical loss analysis, Dr. -- Dr. Evans,

our expert, and their expert, Dr. Murphy, who is a renowned economist, they both agreed that critical loss was an appropriate way -- or critical loss and implementation of the hypothetical monopolist test was an appropriate way to gauge the market.

Now, the only thing they disagreed on was the right way to estimate the actual loss.

Dr. Evans won. Dr. Evans relied on -- our expert relied on more credible evidence. It wasn't simply just one presentation, CX 1113 we keep talking about. There was also other record evidence that demonstrates -- and I quote -- price-driven lapsers are more likely to move to another online player than elsewhere. That's CX 1449 at 96.

So Dr. Evans picked a 40 percent diversion as a reasonable average of all the various metrics that he could have picked.

Now, both Dr. Evans and Dr. Murphy agree, if the actual loss was 23 percent or more, then the online market for contact lenses would satisfy the hypothetical monopolist test.

And Dr. Murphy actually conceded, their own expert conceded in this courtroom, that the market for online contact lenses satisfies the hypothetical monopolist test under a range of assumptions except for

the one number we picked, the 17 percent.

The reason he said that didn't matter is he wanted to analyze competitive effects of restraint in a broader market, but he agreed with Dr. Evans' analysis and he agreed that the online market actually survives the hypothetical monopolist test.

So I'm not sure if there's anything left to say about Actavis.

COMMISSIONER PHILLIPS: Can I ask one follow-up question --

MR. MATHESON: Yes.

COMMISSIONER PHILLIPS: -- while you're figuring what you want to talk about.

So earlier I asked you about those lines in CDA talking about direct effects, and you told me that, well, that was in the context of professional services, right, CDA concerns.

There is a line from, you know, Antitrust Law, Areeda and Hovenkamp, that says direct proof -- I'll tell you when I'm quoting, but direct proof of anticompetitive effects requires, quote, "proof of the actual detrimental effects, such as a reduction of output," which sounds a lot like what the CDA court was saying but not in that same context.

MR. MATHESON: Well, such as a reduction in

output might provide one of many ways you could demonstrate it, but price increase economics tells us, when prices go up, consumers purchase less, output is reduced.

O'Bannon v. NCAA in the Ninth Circuit in 2015 explicitly says you don't need to demonstrate a reduction in output.

So I guess the question is, in CDA, what was the Supreme Court trying to grapple with. They were trying to grapple with the amount of factual demonstration that was necessary to take them from a restraint on dentists that required additional disclosure to a conclusion that consumers had suffered.

And what they said was that complaint counsel had to identify the, quote, theoretical basis for an anticompetitive effect before the burden shifted to respondent to come forth with an empirical demonstration of procompetitive effect.

That's judicial experience. That's economic theory. Judicial experience and economic theory in an area of professional services characterized by enormous asymmetry of information did not allow the Supreme Court to confidently conclude that the principal tenancy of the restraint would be to harm

consumers.

Here, we're in the opposite end of any sort of spectrum. It's a commodity product. Realcomp says that we have ample judicial experience with restrictions on discounter's advertising. That was in 2009. That is the analysis that should guide this commission.

It's the analysis that has guided the commission since Mass Board, footnote to Polygram. Footnote to Polygram, he walks through the evolution of horizontal restraints at the commission and he demonstrates that the commission has been roundly upheld by the Supreme Court even when questioned by courts of appeal.

Superior Court Trial Lawyers Association and IFT were both questioned by the court of appeals and resoundingly reinstated by the Supreme Court that the commission was right.

It's a pleasure to be part of the process, and that is the process that should guide the commission today, as was emphasized in Realcomp.

COMMISSIONER OHLHAUSEN: Counsel how should we think about timing.

So, for example, if 1-800 entered these

agreements at a time when the boundaries of their right were less clear, whether bidding on a trademark term for search advertising was a violation or not, should we look at just what the state of the law was and the state of the expectations were at the time the agreements were entered? If the law changed or it became more clear that it wasn't a violation, how should we consider that, if we can consider that at all?

MR. MATHESON: In this case we shouldn't consider it.

So the citation they provided was the FTC's opinion in Schering-Plough, which, let's remember, use that as a reason to apply the rule of reason.

What the commission said in Schering-Plough was, because of the need to honor the expectations of the parties at the time, we're going to apply the rule of reason rather than per se condemnation. That's exactly what we're asking the commission to do here.

Now, in terms of whether they would have won or lost any individual lawsuit, it should not matter to the commission that they would have won or lost based on some alleged ambiguity in the law or ambiguity on the facts.

The fact remains that looking at these

restraints now, we know they're overbroad on the face of the restraint.

It has never been the case and was not the case in 2004, it has never been the case since the Lanham Act was passed, that a trademark allows the holder to prevent uses of the mark that are noninfringing.

I would be pleased to address any other questions the commission has, but if there are none, I would like to leave with a final thought from Polygram.

The notion that 1-800 Contacts' competitors came in and somehow took advantage of its goodwill by placing advertisements on the Internet is not an actual form of trademark infringement, as Hearts on Fire shows.

Instead, what the commission said in Polygram is, quote, taking advantage of the interest in competing products that promotional efforts may induce is an essential part of the process of competition that occurs daily in our economy.

That's exactly what 1-800 Contacts' rivals are trying to do, and we hope the commission will allow them to continue to do so.

Thank you.

CHAIRMAN SIMONS: Thank you, Mr. Matheson.

Mr. Stone, you're up.

MR. STONE: Thank you, Mr. Chairman.

Complaint counsel told us that there were alternative ways by which they could shift the burden of establishing procompetitive benefits to 1-800 Contacts. One was to show direct evidence of anticompetitive effects.

Here, they failed. No restrictions on output. No supracompetitive prices. They had opportunities to do that, and they did not.

They also failed to show market power.

And the market definition point I want to touch on for a moment in a couple respects.

The first is with respect to the natural experiment of the UPP. What did the manufacturers intend by imposing resale price maintenance?

The evidence was clear. They intended to benefit their customers who prescribe the lenses, the eyecare professionals. The eyecare professionals were upset that their market share was dropping and they were facing price competition, so they said, We'll force everybody up closer to your level.

It didn't force 1-800 Contacts to move much, but it forced other online sellers, the Walmarts, and

the club stores to move their prices up.

Now, the reason was, they were all competing with the ECPs. That was the motivation behind the uniform pricing policies in the first instance.

And yes, it led to higher margins in the short term for some of those sellers, but as Mr. Clarkson testified from AC Lens, he said: In the long term, the UPP is a disaster for my business, because I'll never get any more customers from the eyecare professionals, and that means my customer base will continue to shrink and shrink and shrink.

So the natural experiment shows us that, indeed, all of these sellers are competing with the largest single seller in the market in terms of category, the eyecare professionals. That's what that natural experiment shows us, and it's important to keep that in mind.

With respect to the claim that there was barrier -- there are in fact barriers to entry, well, it's interesting to look at that.

Take WebEyeCare. It was an optometrist and her cousin decided to enter the online business, two people. They were able to do the prescription verification. As they admitted, as Dr. Evans admitted on the stand, it didn't cost much to buy the fax

machine that allowed them to start receiving the initial orders.

They didn't succeed to any huge extent, but only because they didn't make the investment in brand name and product for brand differentiation that 1-800 Contacts made. Beyond that, they were successful, and they overcame the barriers to entry.

Now, there's been other new entrants since then that Mr. Bethers testified to at trial. There were four that he pointed to in particular. They were Simple Contacts, Hubble Contacts, Sightbox, and Daysoft, all of which overcame whatever the supposed barriers to entry are and have succeeded today.

And indeed, there was testimony -- and the commission may have seen it themselves -- that Hubble advertises on TV now, advertising their alternative. They were the -- founded by two of the guys who founded one of the razor blade companies, because they offer a fixed fee and will supply you with a month's supply of contacts just like you get a month's supply of razor blades for a fixed fee.

So new entrants have succeeded in doing the prescription verification and stocking sufficient inventory.

With respect to Walmart, it may be useful to

note, in response to your question, Mr. Chairman, that during the time that 1-800 Contacts was in a venture with Walmart, it was supplying both the store, the in-store brick-and-mortar inventory and product and the online, and then Walmart took the brick-and-mortar part in-house and now uses AC Lens.

Other companies use others to provide their source of inventory, and whether they use them or don't use them for prescription verification is not a big issue.

So for those reasons, you should not ultimately shift the burden of showing procompetitive benefits to 1-800 Contacts. But if you do, there were four witnesses who acknowledged the benefits of settling trademark cases and protecting the investment in trademark.

Consistent with this commission's decision in Borden, there's value in product differentiation. Professor Landes, Professor Murphy testified to that.

We also had testimony from Mr. Hogan, who testified about why trademark holders find it so important to protect their trademarks.

And then Dr. Evans admitted on cross-examination that, yes, trademarks are very important and need to be protected, and there's value

to consumers in brand differentiation and product differentiation and encouraging investment as 1-800 Contacts did in building its brand name and reputation.

That takes me slight -- so there was all this evidence of procompetitive benefits, not to mention the benefits that it's better for everyone to settle a case than to litigate it through trial.

So I want to turn now --

COMMISSIONER SLAUGHTER: So -- I'm sorry --

MR. STONE: I don't want to turn yet.

Yes, Commissioner.

COMMISSIONER OHLHAUSEN: I would say, Counsel, the decision in Actavis would say it's not better for consumers necessarily.

MR. STONE: Oh, I think the decision in Actavis says -- I think the decision in Actavis acknowledges the procompetitive benefits of settlements, but it says it has to be a settlement where you were settling the issues that were in the litigation, not subject to some external pressure that somehow distorted the economic incentives the parties had. I think they gave great --

COMMISSIONER OHLHAUSEN: I'm not sure Actavis said that.

COMMISSIONER SLAUGHTER: Yeah. I would actually ask a similar question, which is that you can acknowledge -- one can acknowledge the benefits of settlement, public policy benefits of settlement, that are not the same as procompetitive benefits of settlements, so where in Actavis did they say that settlement is a procompetitive benefit rather than just a general public policy benefit?

MR. STONE: What they said, on page 2237, is: "In our view, these considerations" -- referring to the five factors -- "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."

So I think there they were acknowledging the Eleventh Circuit's reasoning, which, if we go back and look at that decision, talked about the procompetitive benefits and the efficiencies achieved through settlement.

COMMISSIONER SLAUGHTER: While we're on Actavis, can we talk about the argument that you advanced about Actavis' exclusion of what you describe

as commonplace settlements a little bit?

What the Actavis court said, what the majority said, was: "Insofar as the dissent urges that settlements taking these commonplace forms have not been thought for that reason alone subject to antitrust liability, we agree, and do not intend to alter that understanding."

What meaning do you give the words "for that reason alone"?

MR. STONE: I give it the same meaning that the First and Third Circuits gave it, and the First and Third Circuits in the Lipitor case and the Loestrin 24 case both said they understood that language to mean that commonplace settlement forms are ones that are not going to be give rise to antitrust liability. And that's how they interpreted the language.

I agree the language is not as clear as we might looking at it today wish it had been, but the First and Third Circuits interpreted it the way we did, and it is consistent with what the commission said in its briefs below in Actavis where they said that there are procompetitive benefits to settlements.

COMMISSIONER SLAUGHTER: But I don't think the First and Third Circuits looked at the particular

words "for that reason alone"; right? They looked at the concept of commonplace settlements as an exclusion potentially, but as I read that sentence, "settlements taking these commonplace forms have not been thought for that reason alone," for the reason of their form alone, "to be subject to antitrust scrutiny."

MR. STONE: No. I think --

COMMISSIONER SLAUGHTER: And so the question that I have here is, is your contention that the commission should not treat these trademark settlements by virtue of their form as subject to antitrust scrutiny or is it the substance that matters more?

MR. STONE: If Justice Breyer had meant the interpretation that I think you have suggested he might have meant, which is that the form alone won't give rise to liability, then his entire preceding discussion about what forms are usual and not unusual was unnecessary because all they needed to say was, consistent with that reading, all settlement agreements are going to be subject to antitrust scrutiny, we're not going to have any group of them that we're going to say are going to be generally not give rise to antitrust liability, and he didn't say that, so I think what he meant was there has to be more than a

commonplace form of the agreement in order for liability to arise.

CHAIRMAN SIMONS: Is another interpretation of what he's saying there that in light of the fact that it was so uncommon that -- you know, we do rule of reason on a spectrum, right, and for some -- some types of conduct we go more to the spectrum where it's inherently suspect and in some types of conduct we go more to the part of the spectrum where it's procompetitive. And in this case it looked like what he's saying is that because of this unusual situation, we're going to -- we're going to have these five things or whatever the factors were, the number of factors were, and those are the things we're going to focus on, we're not going to focus on the broader issues that you might see in a much more full-blown rule of reason analysis.

MR. STONE: Well, I think he was pretty clear that a rule of reason analysis was what was appropriate in Actavis. I mean, I think he said that quite clearly that we have to do a rule of reason analysis.

CHAIRMAN SIMONS: Right. But we also talk about the rule of reason being done on a spectrum, and it looks like what he's saying is, well, that rule of

reason analysis needs to be done on the spectrum that's really close to inherently suspect.

MR. STONE: I don't know that I would necessarily read it that way, but I understand, Mr. Chairman, your point in that regard.

If I can go to --

COMMISSIONER SLAUGHTER: Yeah, go ahead.

MR. STONE: No, no.

COMMISSIONER SLAUGHTER: I was going to ask, if we do accept that there is a sort of categorical exclusion under Actavis for commonplace settlements and that these trademark settlements would fit that, what would be the scope of that exclusion that you would advise? Is it all settlements of trademark litigation? Is it settlements of trademark litigation that contain nonuse forms -- terms?

MR. STONE: I think if you --

COMMISSIONER PHILLIPS: Can I add onto your question for a second, like what if your settlement included price-fixing?

MR. STONE: Yes. I think that's exactly the way to think about it. If there are the extraneous external factors that are not the kinds of things that you would expect if parties were settling just the claims before them, so you can look at -- you can look

at Line Materials, you can look at Singer, you can look at other cases where they do things beyond the relief they could have gotten in the context of the litigation itself or there's external consideration like a reverse payment, then I need to say, these may require scrutiny.

In other cases where the settlement -- and I do if I have -- can have a couple of minutes to touch on just why this isn't overbroad, because here the argument is, no, these go beyond the bounds because you've got more relief than you could have.

And complaint counsel says, We don't care a whit about whether they would have won or lost, so let's assume 1-800 Contacts would have won all the cases. Just for the sake of our thought experiment, let's assume they would have won them all. What would be the relief they would get?

Complaint counsel say they would not have gotten a nonuse order. Really?

In Fair Isaac, the court said whether defendant's sponsored advertisements actually include Fair Isaac's trademarks in the text is not determinative of whether there has been any infringement, so it doesn't matter whether you put the name in the text or not.

Indeed, were this commission to order people to put the name "I'm not 1-800 Contacts" in the ads, you would be ordering them to run ads that Google currently doesn't permit. Google doesn't allow, as we saw in the evidence in court in the hearing, doesn't allow ads to use another company's trademark in the text of the ad.

So it's not practicable what they're proposing. They're asking you to order something that Google wouldn't allow the ads to have.

Moreover, there is no case, no case that says a nonuse agreement with respect to somebody who has put an ad up that may -- that is likely to be confusing -- and that was the finding. Likely to be confusing was what Dr. Van Liere's survey found. Dr. Jacoby didn't dispute that.

And in any event, complaint counsel say we shouldn't get into the merits, so if we don't get into the merits, should this commission decide as a matter of law that nonuse agreements cannot be permitted, do we want the commission to take the position, send a message to all practitioners, and to Professor McCarthy your treatise is wrong, nonuse agreements are overbroad, you can't do that, you can only provide for disclaimers or other sorts of disclosures.

Interestingly, no evidence at the hearing that any one of the settling parties ever asked 1-800 Contacts, Could I have a, quote, less restrictive solution? Could you just make me use a disclaimer or maybe change the text in some fashion?

No one asked for that. No one thinks it's practicable or enforceable.

Mr. Hogan's testimony on this was definitive and clear, and the absence of any agreement consistent with what complaint counsel urges the commission to do is also consistent and clear.

The nonuse agreements that were entered here are appropriate.

And the -- with respect to the breadth of the negative keywords, I submit that if you look at Mr. Craven's testimony in the transcript at pages 643 through 650, he made clear that the settlement agreements themselves show that only an exact match negative keyword is all that's required, because on the list of restricted terms it said "1-800 Contact" singular and "1-800 Contacts" plural.

Only if you were using exact match would you need to do that. If you expected the negative keyword to be broad match, you'd only have to put in the singular, you wouldn't have to add the plural.

Giving weight to each term in the agreement, we see that it only required exact match, and that's exactly what the permanent injunction entered in the Southern District of New York required. I think that is Exhibit CX 144 --

CHAIRMAN SIMONS: Mr. Stone, can you wrap up? You're out of time.

COMMISSIONER CHOPRA: Let me just ask, if I may, on this negative keyword part, so complaint counsel said that -- I believe it was "cheaper than 1-800 Contacts."

MR. STONE: Yes.

COMMISSIONER CHOPRA: So my understanding is that you required in most of the settlement agreements "includes" and your list, so is "cheaper than 1-800 Contacts" allowed or not allowed?

MR. STONE: It is allowed. The testimony by the representatives of 1-800 Contacts was clear. It was allowed. There's never been any action challenging that.

I have to say there also was evidence at the hearing that there's never been anybody who did the search "cheaper than 1-800 Contacts" until the investigation started, and so I think if you could go back and figure out the IP addresses, it would all be

lawyers, but it is not prohibited.

COMMISSIONER CHOPRA: So did you include the -- let's call this the comparative exclusion. Did you include them in every settlement agreement or just some?

MR. STONE: They were in all -- I think they were in all the settlement agreements except perhaps Walgreens'. And if you look at the evidence, the negotiating history of exhibits submitted, they said this agreement is too complicated, we don't want all these carve-outs and everything else, we're just going to agree one, two, three, that's it, simple, done, we're fine.

COMMISSIONER CHOPRA: So if I put in "1-800 Contacts competitors" or "1-800 Contacts alternatives" --

MR. STONE: Yes. That would not be prohibited by the settlement agreements.

COMMISSIONER CHOPRA: And 1-800 Contacts would not have reached out to say you're infringing.

MR. STONE: Would not.

Mr. Coons' testimony, Mr. Bethers' testimony, the individuals who ran the search advertising for 1-800 were consistent in their testimony. They would not have construed the agreement in that fashion, and

they never did.

CHAIRMAN SIMONS: Okay.

MR. STONE: Thank you very much.

CHAIRMAN SIMONS: Thank you very much.

That concludes our oral argument in this matter. Thank you, both sides, for terrific presentations.

And we stand adjourned.

(Whereupon, the foregoing oral argument was concluded at 3:43 p.m.)

CERTIFICATE OF REPORTER

I, JOSETT F. WHALEN, do hereby certify that the foregoing proceedings were taken by me in stenotype and thereafter reduced to typewriting under my supervision; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and further, that I am not a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of the action.

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