GIBSON DUNN

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# SECOND CIRCUIT ISSUES IMPORTANT RULING ON TRADEMARK SETTLEMENTS AND ANTITRUST/IP INTERFACE

To Our Clients and Friends:

On June 11, 2021, the Second Circuit issued its decision in *1-800 Contacts, Inc. v. FTC*,[1] an appeal of an administrative litigation brought by the Federal Trade Commission against 1-800 Contacts. The decision—which rejected the FTC's claim that several trademark settlements by 1-800 Contacts violated the antitrust laws —found that the trademark settlement agreements at issue were "typical" and procompetitive, and provides crucial guidance for parties considering settling trademark disputes. The decision also has broader implications for antitrust claims involving the enforcement of intellectual property rights and will likely serve as an important precedent in such cases. From a substantive trademark perspective, the decision also confirms that the law over the use of another party's trademarks as search engine keywords remains "unsettled."

**The FTC's Case Against 1-800 Contacts**

The FTC's case challenged thirteen agreements that 1-800 Contacts had signed with competitors to settle trademark infringement claims where it alleged that those competitors' online advertisements infringed 1-800 Contacts' trademarks.[2] The settlements restricted competitors' use of search advertising by requiring them (1) to refrain from bidding on 1-800 Contacts' trademarks in search-engine auctions, and (2) to affirmatively bid on negative keywords that would prevent their ads from being displayed when a consumer searched for a 1-800 Contacts trademark. The FTC alleged that these agreements restricted competition in violation of Section 5 of the FTC Act because they "prevent[ed] [1-800 Contacts'] competitors from disseminating ads that would have informed consumers that the same contact lenses were available at a cheaper price from other online retailers," and reduced "price competition in search advertising auctions."[3] An Administrative Law Judge (ALJ) upheld the FTC's case, and the Commission affirmed the ALJ's decision, classifying the agreements in question as "inherently suspect" under the antitrust laws.[4]

**The Second Circuit's Decision**

1-800 Contacts appealed the Commission's decision to the Second Circuit, and the appeals court reversed. As an initial matter, the court agreed with the FTC that trademark settlements are not categorially immune from antitrust scrutiny.[5] Consistent with *FTC v. Actavis*,[6] the Second Circuit held that trademark settlements can, under certain circumstances, violate the antitrust laws. But the court rejected the Commission's characterization of the trademark settlements as "inherently suspect" and its application of a truncated rule of reason analysis.[7] Because trademark settlements have "cognizable procompetitive justifications" and have not "been widely condemned" by courts, the court found that application of the full rule of reason approach was required.[8]

The court found that 1-800 Contacts had shown that its settlements had procompetitive justifications. The court reasoned that the "[t]he protection of [1-800 Contacts'] trademark interests constitutes a valid procompetitive justification,"[9] that "agreements to protect trademark interests are 'common, and favored, under the law,'" and that courts "should 'presume' that trademark settlement agreements are procompetitive."[10] In response to the FTC's claim that these procompetitive justifications did not justify the restrictions in the settlements because those benefits could be achieved through a "less restrictive alternative," the court adopted a very narrow view of that doctrine. In language deferential to the settling parties, the court held that "what is 'reasonably necessary'" to achieve the procompetitive benefits of protecting a trademark interest "is likely to be determined by competitors during settlement negotiations."[11] The court then found that the FTC's proposed alternative—a "disclosure requirement"—was not shown to be a less restrictive alternative because, among other things, the FTC failed to address the practical difficulties with its proposal, e.g., how the disclosure requirement could be enforced.[12] As a result, the court found that the FTC's proposed alternative might not as be as effective in promoting the "parties' ability to protect and enforce their trademarks."[13] The court, accordingly, found that the FTC failed to show that the settlement agreements violated the antitrust laws and ordered the FTC's case dismissed.

**Practical Implications for Trademark Settlements**

The *1-800 Contacts* decision has numerous practical implications for parties seeking to settle trademark disputes and otherwise protect their trademark interests. The decision provides some very useful guidance on how companies may settle trademark disputes with minimal antitrust risk, but companies should continue to take care to consider antitrust concerns in crafting such settlements. While the court dismissed the FTC's case against 1-800 Contacts, it did find that trademark settlements can raise antitrust issues in certain circumstances. Overall, there are several key takeaways from the decision, including:

- The Second Circuit decision includes language that is deferential to the settling parties in trademark disputes. As a result, the FTC and private plaintiffs will face significant hurdles if they attempt to bringing new antitrust cases challenging trademark settlements. Notably, a respondent in an FTC administrative proceeding can appeal an adverse decision in any Circuit in which the respondent does business,[14] which means that the Second Circuit's decision will effectively set the legal standard for any future FTC administrative enforcement actions.

- While the Second Circuit did not expressly define the situations in which a trademark settlement might raise greater antitrust risk, it did mention an agreement entered "under duress" "between parties with unequal bargaining power" as a potential example of where a trademark settlement might be entitled to lesser deference in an antitrust challenge.[15]

- The court also left open the possibility that the requirement that competitors use negative keywords could be higher risk than agreements not to bid on each other's trademarks. The court stated that it had "no reason to consider" the issue of whether the requirement to use negative keywords went "beyond any legitimate claim of trademark infringement" because the FTC had not made a finding of anticompetitive effects specific to "this narrow aspect of the settlement agreements."[16]

- The court stated that the merits of the trademark claims that led to the settlement agreements in the *1-800 Contacts* case were "unsettled."[17] Although the court's overall holding implies that courts will be reluctant to second guess the merits of a claim that the parties have elected to settle, aggressive antitrust plaintiffs will likely continue to argue that a lower level of deference should apply if the trademark claims are extremely weak.

- The decision's reasoning also appears to extend to agreements between competitors that do not arise out of pending trademark infringement litigation. While the FTC had argued that one of the agreements was particularly suspect because the parties' agreement to limit their bidding on trademark terms was not based on an asserted infringement claim, the court found that the FTC had not offered "direct evidence differentiating" that agreement from the others and that the court did not need to do so in its decision because "protecting trademarks is a valid procompetitive justification for the restrictions."[18]

Given the risk that regulators or private plaintiffs will continue to pursue similar claims, it remains crucial for companies considering settling trademark disputes with restrictions on search advertising to analyze the antitrust risk of such arrangements.

**Broader Implications for Other Types of IP Enforcement and Settlements**

The decision also has important implications for non-trademark cases. The court found, as noted, that protecting one's intellectual property rights constitutes a legitimate business interest that can justify restrictions on an allegedly infringing party's conduct in a settlement agreement. Although the decision emphasizes the unique features of trademarks, its reasoning is likely to apply, at least to some extent, to antitrust claims challenging settlements of other types of IP disputes. For example, we expect that this decision will be cited by parties in antitrust cases based on alleged reverse-payment settlement agreements in the pharmaceutical industry. Similarly, the court's narrow interpretation of the "less restrictive alternative" doctrine is also likely applicable outside of the trademark context. For that doctrine to apply, the court required the plaintiff to do more than just speculate about potentially less restrictive alternatives: the plaintiff "needs to show more than the mere *possibility*" of a less restrictive alternative.[19] And the court also stated that not any proposed alternative will do—the proposed alternative must be practical to apply, as well as "substantially less restrictive" than the arrangement challenged.[20]

Finally, the decision in *1-800 Contacts* also serves as a reminder that, in an era in which commentators are encouraging more aggressive and novel antitrust enforcement, the federal judiciary remains the ultimate arbiter of federal antitrust policy. Enforcers seeking to expand the scope of U.S. antitrust law must do more than bring novel cases—they must also prove their cases with hard facts in a court of law.

** Gibson Dunn partner Howard S. Hogan served as an expert witness for 1-800 Contacts in this case, and offered the opinion that the settlement agreements at issue were standard trademark settlements, as courts continue to determine the bounds of trademark claims arising from the use of trademarks as search engine keywords.*

[1] — F.3d —, 2021 WL 2385274 (2d Cir. June 11, 2021).

[2] *Id.* at *2-3.

[3] *Id.* at *3.

[4] *Id.*

[5] *Id.* at *4.

[6] 570 U.S. 136 (2013).

[7] *1-800 Contacts*, 2021 WL 2385274, at *7. The "inherently suspect" framework is also known as the "abbreviated rule of reason analysis" or a "quick-look" approach. *Id.* at *6 (quoting *Cal. Dental Ass'n v. FTC*, 526 U.S. 756, 770 (1999)).

[8] *Id.* at *7.

[9] *Id.* at *9.

[10] *Id.* at *9 (first quoting *Clorox*, 117 F.3d at 55; and then quoting *id.* at 60).

[11] *Id.* at *10 (quoting *United States v. Brown Univ.*, 5 F.3d 658, 679 (3d Cir. 1993)).

[12] *Id.* at *11.

[13] *Id.* The panel also held that the FTC failed to offer "direct" evidence of anticompetitive effects. *Id.* at *8.

[14] 15 U.S.C. § 45(c).

[15] *1-800 Contacts*, 2021 WL 2385274, at *10 n.14.

[16] *Id.* at *11 n.17.

[17] *Id.* at *9 n.13.

[18] *Id.* at *9 n.12.

[19] *Id.* at *11 (emphasis added).

[20] *Id.* (quoting Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law: An Analysis of Antitrust Principles and Their Application ¶ 1502 (3rd & 4th eds., 2019 Cum. Supp. 2010-2018)).

*Gibson Dunn lawyers are available to assist in addressing any questions you may have regarding these developments. Please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Antitrust and Competition, Intellectual Property, Fashion, Retail and Consumer Products, or Media, Entertainment and Technology practice groups, or the authors:*

*Eric J. Stock – New York (+1 212-351-2301, estock@gibsondunn.com)*
*Howard S. Hogan – Washington, D.C. (+1 202-887-3640, hhogan@gibsondunn.com)*
*Stephen Weissman – Washington, D.C. (+1 202-955-8678, sweissman@gibsondunn.com)*
*Michael J. Perry – Washington, D.C. (+1 202-887-3558, mjperry@gibsondunn.com)*

*Please also feel free to contact the following U.S. practice leaders:*

***Antitrust and Competition Group:***
*Rachel S. Brass – San Francisco (+1 415-393-8293, rbrass@gibsondunn.com)*
*Stephen Weissman – Washington, D.C. (+1 202-955-8678, sweissman@gibsondunn.com)*

***Intellectual Property Group:***
*Kate Dominguez – New York (+1 212-351-2338, kdominguez@gibsondunn.com)*
*Y. Ernest Hsin – San Francisco (+1 415-393-8224, ehsin@gibsondunn.com)*
*Josh Krevitt – New York (+1 212-351-4000, jkrevitt@gibsondunn.com)*
*Jane M. Love, Ph.D. – New York (+1 212-351-3922, jlove@gibsondunn.com)*

***Fashion, Retail and Consumer Products Group:***
*Howard S. Hogan – Washington, D.C. (+1 202-887-3640, hhogan@gibsondunn.com)*

***Media, Entertainment and Technology Group:***
*Scott A. Edelman – Los Angeles (+1 310-557-8061, sedelman@gibsondunn.com)*
*Kevin Masuda – Los Angeles (+1 213-229-7872, kmasuda@gibsondunn.com)*
*Benyamin S. Ross – Los Angeles (+1 213-229-7048, bross@gibsondunn.com)*