

1 UNITED STATES OF AMERICA
2 BEFORE THE FEDERAL TRADE COMMISSION

3 COMMISSIONERS: Joseph J. Simons, Chairman
4 Maureen K. Ohlhausen
5 Noah Joshua Phillips
6 Rohit Chopra
7 Rebecca Kelly Slaughter

7 In the Matter of:)
8 1-800 CONTACTS, INC.,)
9 a corporation,) Docket No. 9372
10 Respondent.)
11 -----)

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13 June 26, 2018
14 2:00 p.m.
15 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.

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,

1 any way restricted.

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

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

9 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

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

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

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

15 MR. STONE: You do not have direct effects.

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

20 The Amex decision from yesterday, very helpful
21 I think to our position in many respects, suggests
22 that in a context of horizontal agreements maybe you
23 want to look to see separately or as opposed to direct
24 effects whether there's also market power and, in
25 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 the merits of

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

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

9 This case should not give rise to antitrust
10 liability.

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

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

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

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

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

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

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

13 MR. STONE: Yes, Commissioner.

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

17 MR. STONE: Yes.

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

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

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

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

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

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

24 MR. STONE: Yes.

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

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

7 COMMISSIONER OHLHAUSEN: Thank you.

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

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

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

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

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

1 weighty.

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

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

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

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

17 MR. STONE: Okay.

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

21 MR. STONE: Okay. I think then it doesn't
22 matter whether there's three or four or five players
23 in the market. A settlement with the next largest
24 player will have much greater impact than the
25 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.

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1 COMMISSIONER PHILLIPS: Counsel, before we go
2 on --

3 MR. STONE: Yes.

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

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

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

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

25 CHAIRMAN SIMONS: That's what the dissent

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

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

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

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

20 And this all came about in 2004 when Google
21 changed its policy and for the first time allowed
22 competitors to bid on someone else's trademark. Until
23 2004, this really didn't happen, because of Google's
24 policy and their large market share in the search
25 engine industry, but beginning in 2004 you'll see a

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

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

11 MR. STONE: Yes.

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

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

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

24 COMMISSIONER OHLHAUSEN: But this isn't a
25 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

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 (f t (-)T3e we have nothinonc [(end.002

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

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

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

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

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

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

15 And if you look at the market power issues,
16 which P want to touch on at least a bit, what you see
17 is you have an extraordinary number of people who could
18 enter this market or cona Fexpand into this market who
19 are not bound in any w2 Tby any of the settlement
20 agreements.

21 So here you have clearly no market power that
22 weFexercise because Walmart, who's not bound and who
23 sells contact lenses both in the stoTw and online and
24 who sells them at the same price, cona Fexpand their
25 capacity and just sell moTw 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 di.edaTw ()ket whare oc

capacity. j -0.002 Tw 0 -0.wholesal (and her testimony could easily expand or enter the)Tj 0 Tc s

1 They were larger than the online sellers. And we did
2 look at the eyecare professionals, and they were at
3 40 percent or a bit higher, far larger than anyone
4 else --

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

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

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

22 Okay. So that was hopefully responsive to that
23 question.

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

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

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

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

16 And Dr. Evans did not have any data of what a
17 diversion ratio would be in the event of a price
18 increase. Instead, he looked to a survey of what
19 1- 800 Contacts had done of what they call their
20 deadfile, which is consumers who have not purchased
21 from 1- 800 Contacts for a substantial period of time.

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

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

4 The vast majority said 1- 800 Contacts.

5 Now, they were asked the question on a scale
6 of 0 to 10, which is interesting, so he took 6 and
7 above and said, I'll take those as ones who would go to
8 1- 800 Contacts. He took 5, which happens to be right
9 in the middle, and those below and said, I'm going to
10 assume they'd go someplace else.

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

17 That was a mistake in his methodology. The
18 very next page of the survey shows that only
19 17 percent of the people who left 1- 800 Contacts
20 actually did go to other online sellers, 49 percent
21 went to eyecare professionals, so he just picked one
22 page.

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

1 raised their prices, that those consumers would go to
2 1- 800 Contacts.

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

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

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

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

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

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

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

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

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

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

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

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

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

13 CHAIRMAN SIMONS: All right.

14 MR. STONE: I think what's clear from his
15 testimony is that one of those benefits is to
16 encourage the investment in that trademark that
17 1- 800 Contacts made here, \$500 million in TV
18 advertising over the period of time that was covered by
19 that. That's a huge investment. That's why consumers
20 recognize it. That's why when they advertise, they're
21 advertising on TV, buy from us, not your eyecare
22 professional. They're not advertising against other
23 online sellers.

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

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

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

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

20 And in Actavis, indeed, the patent holder there
21 didn't get any relief they couldn't have gotten if they
22 had won at trial. They simply precluded a product from
23 being on the market. Indeed, they allowed it to enter
24 the market earlier than they might have if they won,
25 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

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

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

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

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

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

25 Now, the analytical framework employed in

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

4 And Cal Dental is entirely consistent with the
5 Mass Board, AMA, Polygram and Realcomp framework that
6 sets forth the three related, although distinct, in the
7 words of Realcomp, methods of carrying out our
8 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

1 competitive impact of restraints on discounters'
2 advertising.

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

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

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

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

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

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

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

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

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

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

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

25 Now, that was a case about labeling. In that

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

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

14 I mean, here, we have established the
15 obligation on the defendant to come forth with a
16 procompetitive justification. They have not done so.

17 In Clorox, the plaintiff failed to trigger the
18 obligation to come forth with a procompetitive
19 justification.

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

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

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

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

18 CHAIRMAN SIMONS: So let me ask you this.

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

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

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

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

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

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

17 The order we've asked the commission to enter
18 provides all kinds of ways they can settle litigation.
19 They can target confusing uses of names. They can
20 require clear disclosure of sources. They can target
21 false and deceptive advertising. They can settle
22 litigation, instead of wasting money in court, in any
23 number of ways that will not inevitably prevent all
24 uses of a trademark even if those uses are not
25 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

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

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

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

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

22 For example, if you actually had two companies
23 with confusingly similar names so you would have a
24 reason to believe that if you saw an ad for
25 1- 800 Contacts and an ad for 1-8-0- 0 Contacts, you

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

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

8 MR. MATHESON: They do not. It does not make a
9 whit of difference whether 1- 800 Contacts would have
10 lost or won every single case it brought. The
11 important thing is, on their face, these agreements
12 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.

1 And so if it was the case that one of the
2 thirteen sued competitors had been running confusing
3 ads and misusing 1- 800 Contacts' trademark,
4 1- 800 Contacts could have won that case and still
5 could not have gotten the relief that it gave to itself
6 with these horizontal agreements.

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

17 CHAIRMAN SIMONS: Let me ask you a question.

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

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

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

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

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

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

22 So here we are facing the Realcomp situation,
23 the Indiana Federation of Dentists situation and the
24 Polygram situation where the advertisements are
25 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-

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

6 COMMISSIONER PHILLIPS: If I may, just one
7 more.

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

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

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

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

25 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 0.002 Tw T* t24e levels of E

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

7 There are twenty- -- I mean, it appears --
8 apparently, there's a dispute about the direct
9 evidence. There's 22 paragraphs of findings in the
10 initial decision. Every week, 1- 800 Contacts tracked
11 the competitors showing up in response to searches for
12 its trademark, and every single week, it connected
13 successful good weeks with the elimination of rivals'
14 ads, and it noted that when rivals' ads showed up
15 1- 800 Contacts lost sales.

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

25 MR. MATHESON: Consumers are clearly worse off

1 because Memorial Eye left the market.

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

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

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

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

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

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

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

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

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

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

24 When you go to a drugstore, they put the
25 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?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

18 COMMISSIONER OHLHAUSEN: Counsel,
19 Respondent had noted that California Dental
20 said that the relevant antitrust question was not
21 whether advertising had been limited but, rather, the
22 limitation on advertising tended to limit total
23 delivery of the product being advertised.

24 So does this raise questions for us about the

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

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

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

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

15 I'm sorry. Did I --

16 COMMISSIONER CHOPRA: Yes.

17 MR. MATHESON: Thank you. Before moving on.

18 So having demonstrated direct effects and
19 having demonstrated the nature of the restraints, we
20 carried our burden in two different ways, but we also
21 demonstrated indirectly that this restraint is likely
22 to lead to anticompetitive effects because it locks up
23 79 percent of the sales in the market for the online
24 sale of contact lenses.

25 Now, there was some discussion of the critical

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

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

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

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

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

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

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

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

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

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

16 So that's the second method.

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

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

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

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

7 1- 800 Contacts has a 130,000 square foot
8 distribution facility. They stock more than
9 60,000 SKUs. Walmart stocks 400, so we are talking
10 about an order of magnitude difference. The next
11 largest, AC Lens, which is the -- stocks 32,000.

12 And Walmart came up as one of the major online
13 sellers. Walmart has never actually provided its own
14 online delivery. From 2008 until the end of 2012,
15 1- 800 Contacts ran Walmart's marketing and provided all
16 of the fulfillment for home deliveries. Starting
17 January 1, 2013, AC Lens took over.

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

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

25 MR. MATHESON: Walmart has outsourced the

1 fulfillment function of its online business since
2 2008.

3 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

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

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

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

13 WebEyeCare is the entrant that 1- 800 Contacts
14 has touted. The precise number is in camera, but
15 since they entered in 2009, they've obtained less than
16 2 percent of the online market, so growth in this space
17 is not easy. Barriers to entry are not low.

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

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

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

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 Tw O lh/ DA

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

5 O'Bannon v. NCAA in the Ninth Circuit in
6 2015 explicitly says you don't need to demonstrate a
7 reduction in output.

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

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

20 That's judicial experience. That's economic
21 theory. Judicial experience and economic theory in an
22 area of professional services characterized by enormous
23 asymmetry of information did not allow the
24 Supreme Court to confidently conclude that the
25 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 evolu

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

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

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

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

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

25 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-

1 CHAIRMAN SIMONS: Thank you, Mr. Matheson.
2 Mr. Stone, you're up.
3 MR. STONE: Thank you, Mr. Chairman.
4 Complaint counsel told us that there were
5 alternative ways by which they could shift the burden
6 of establishing procompetitive benefits to
7 1- 800 Contacts. One was to show direct evidence of
8 anticompetitive effects.
9 Here, they failed. No restrictions on output.
10 No supracompetitive prices. They had opportunities to
11 do that, and they did not.
12 They also failed to show market power.
13 And the market definition point I want to touch
14 on for a moment in a couple respects.
15 The first is with respect to the natural
16 experiment of the UPP. What did the manufacturers
17 intend by imposing resale price maintenance?
18 The evidence was clear. They intended to
19 benefit their customers who prescribe the lenses, the
20 eyecare professionals. The eyecare professionals were
21 upset that their market share was dropping and they
22 were facing price competition, so they said, We'll
23 force everybody up closer to your level.
24 It didn't force 1- 800 Contacts to move much,
25 but it forced other online sellers, the Walmarts, and

1 machine that allowed them to start receiving the
2 initial orders.

3 They didn't succeed to any huge extent, but
4 only because they didn't make the investment in brand
5 name and product for brand differentiation that
6 1- 800 Contacts made. Beyond that, they were
7 successful, and they overcame the barriers to entry.

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

14 And indeed, there was testimony -- and the
15 commission may have seen it themselves -- that Hubble
16 advertises on TV now, advertising their alternative.

17 They were the -- founded by two of the guys who founded
18 one of the razor blade companies, because they offer a
19 fixed fee and will supply you with a month's supply of
20 contacts just like you get a month's supply of razor
21 blades for a fixed fee.

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

25 With respect to Walmart, it may be useful to

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

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

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

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

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

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

1 to consumers in brand differentiation and product
2 differentiation and encouraging investment as
3 1- 800 Contacts did in building its brand name and
4 reputation.

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

9 So I want to turn now --

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

11

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

13 Yes, Commissioner.

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

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

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

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

11 MR. STONE: What they said, on page 2237, is:
12 "In our view, these considerations" -- referring to the
13 five factors -- "taken together, outweigh the single
14 strong consideration -- the desirability of
15 settlements -- that led the Eleventh Circuit to provide
16 near- automatic antitrust immunity to reverse payment
17 settlements."

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

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

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

7 MR. STONE: No. I think --

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

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

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

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

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

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

reason analysis needs to be done on the spectrum that's

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

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

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

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

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

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

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

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

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

1 Interestingly, no evidence at the hearing that
2 any one of the settling parties ever asked
3 1- 800 Contacts, Could I have a, quote, less restrictive
4 solution? Could you just make me use a disclaimer or
5 maybe change the text in some fashion?

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

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

12 The nonuse agreements that were entered here
13 are appropriate.

14 And the -- with respect to the breadth of the
15 negative keywords, I submit that if you look at
16 Mr. Craven's testimony in the transcript at
17 pages 643 through 650, he made clear that the
18 settlement agreements themselves show that only an
19 exact match negative keyword is all that's required,
20 because on the list of restricted terms it said
21 "1- 800 Contact" singular and "1- 800 Contacts" plural.

22 Only if you were using exact match would you
23 need to do that. If you expected the negative keyword
24 to be broad match, you'd only have to put in the
25 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

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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" --

CERTIFICATE OF REPORTER

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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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