Second Circuit Reverses the Commission and Orders Dismissal on 1-800-Contacts

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The Decision

1-800-Contacts is one of the largest sellers of contacts online. One of the principal ways consumers shop for contacts is through key word searches. In the past, certain 1-800-Contacts competitors purchased the keyword “1-800-Contacts.” That would place their advertisements at the top of the list of results. 1-800-Contacts sued these companies for trademark violation and settled with a good number of them. According to the Second Circuit, the settlements “include[] language that prohibits the parties from using each other’s trademarks, URLs, and variations of trademarks as search advertising keywords. The agreements also require the parties to employ negative keywords so that a search including one party’s trademarks will not trigger a display of the other party’s ads. The agreements do not prohibit parties from bidding on generic keywords such as ‘contacts’ or ‘contact lenses.’”

The Federal Trade Commission found these agreements inherently suspect and sued 1-800-Contacts for violating Section 5 of the FTC Act. An administrative law judge agreed, 1-800-Contacts appealed and the Commission denied the appeal. 1-800-Contacts then appealed to the Second Circuit. The Second Circuit disagreed that the behavior was “inherently suspect” and that the agreements on bidding were not bid rigging. And, after itself engaging in a rule of reason analysis, found no anticompetitive effect, that the Commission did not in fact rebut 1-800-Contact’s evidence of trademark protection, and that the Commission had not shown that a viable, less restrictive alternative existed.

The Second Circuit vacated the Commission’s decision and ordered the Commission to dismiss the administrative complaint.

Analysis

By buying 1-800-Contacts’ trademarks as keywords, its competitors are engaged in classical free riding. The only reason a consumer would type in “1-800-Contacts” in a search is because 1-800-Contacts has invested a great deal of time and money to develop its brand and build goodwill. When a consumer sees a competitor’s name and goes to that website, the competitor benefits from 1-800-Contacts investment without incurring any of the costs. This practice is the “real world” equivalent of putting up a sign in front of their store that says they are “Marshall Field’s” when in fact they are nothing of the sort. Customers go into the store thinking it’s Marshall Field’s. It’s no defense that those customers can leave and go to a different store. The settlements are also narrowly tailored to limit this free riding. It doesn’t, for example forbid them from buying “contacts” or their own trademarks and thus making their own investment in their brand.

Further, there is also no evidence that suggests being the first advertisement in a list of search results where the word searched is the name of the business confers market power. Indeed, one would think that if there was a competitive advantage to being first in a list of results where the word searched is the name of the business, it's because of the good will the business has created in its name. To call this arrangement "inherently suspect" is really just the Commission taking it upon themselves to declare these agreements per se illegal.

And it's not bid rigging. As the Second Circuit observes, 1-800-Contacts' competitors can buy their own trademarks as well as the generic terms. And the agreements allow the trademark holders to narrowly protect their protectable interest in forbidding free riding off their investment in their marks and goodwill. The Commission effectively backs into this conclusion by virtue of their initial assessment that the agreements are inherently suspect. They declare the practice without value, then conclude the practice is without value.

One could argue that the Court overreached by ordering the complaint dismissed. If the Commission failed to introduce evidence, because, for example, it used the wrong standard, it should have the opportunity to develop and introduce that evidence. By forbidding the Commission from doing so, the Second Circuit has assumed the role of fact finder.

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