In today’s digital economy, online competitive advertising plays a major role in the competitive process. Accordingly, rival firms have a greater incentive and opportunity to impose restraints on such advertising. Some restraints may be justified by trademark law, which prohibits certain marketing practices that confuse consumers about the source of a product. Alternatively, firms might enter into collusive trademark settlements that restrain forms of competitive advertising that do not raise any significant risk of confusion—an effort that could invite antitrust liability. However, unlike other types of IP settlements, there is relatively little case law or scholarship clarifying when trademark settlements between competitors run afoul of the antitrust laws.

This Article is an effort to fill that gap. We explain how the standard developed in the Supreme Court’s *Actavis* decision, a watershed ruling about patent settlements, can be adapted and applied to trademark cases. We articulate how courts can identify anticompetitive settlements without having to evaluate the merits of the underlying trademark infringement claims. Settlements imposing broad restraints on competitive targeted advertising may raise significant antitrust concerns that are unlikely to arise in run-of-the-mill settlements that merely restrain what marks a firm can attach to its product. We also consider and evaluate a number of possible procompetitive justifications for restrictive trademark settlements. Our analysis uncovers substantial errors in the first appellate decision addressing these restraints.
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ANTITRUST AND TRADEMARK SETTLEMENTS

Introduction

The interface between antitrust and intellectual property has a rich and complex history. A major focus of litigation and debate is IP settlements between rivals, in which the firms agree to restrain competitive activity in a manner that may or may not be justified by IP law. This area has traditionally dealt with patent and copyright law. By contrast, the intersection with trademark law is a relatively undeveloped field.

The rapid and continuing growth of online commerce guarantees that this is a temporary state of affairs, and that the antitrust/trademark intersection will have an important role to play in the future. In today’s digital economy, online marketing practices are a central feature of the competitive process. For example, in an online market, the absence of a traditional storefront means that firms are especially dependent on advertising to let consumers know about what products and prices they are offering and how they compare to those of competitors.

Of course, not all marketing practices constitute lawful competition. Trademark law protects a firm against marketing activity that creates a risk of consumer confusion—particularly confusion as to the identity of the seller of a product. However, competitive advertising that creates no risk of confusion is both lawful and desirable. The problem is that firms dislike competitive advertising, whether or not it creates a risk of confusion. Consequently, firms have an incentive to enter into agreements that restrain competitive advertising in ways that are not justified by trademark law. Such agreements may violate the antitrust laws, just like anticompetitive settlements involving patents or copyrights. However, at present, there is relatively little case law or scholarship shedding light on when this is the case.

This article is an effort to fill that gap. We analyze the competitive effects of trademark settlements and propose a means to assess whether a particular settlement is an unlawful restraint of trade, with a view to reconciling antitrust concerns about competitive markets with the policy interests underpinning trademark law.

The antitrust concerns are well illustrated by the restrictive settlements between 1-800 Contacts (“1-800”)—the leading online retailer of contact lenses—and its competitors, such as Walgreens. These agreements restrain competitive advertising on online search engines, and

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1 The canonical example is “passing off,” where a firm sells a product using a mark that deliberately resembles the trademark of an established brand. This creates the false impression that the firm’s product is associated with the better-known brand.
recently provoked the Federal Trade Commission (FTC) to bring an antitrust action against 1-800.² Competitors like Walgreens ran advertisements that appeared alongside Google’s search results when a user searched for 1800contacts. The ads made it easy for consumers to learn about Walgreens’ lower prices. 1-800’s suit alleged that the ads confused users and thus infringed the 1-800 CONTACTS trademark. Rather than litigating the suit to conclusion, the parties settled. In these settlements, each firm agrees not to run ads triggered by a search for the other firm. Among other things, this deprives consumers who search for 1-800 from learning about the better prices offered by Walgreens.

Does this settlement violate antitrust law? Winning a trademark suit, of course, is not an antitrust violation, even when it acts to restrict competitive activity. But a litigated injunction and a private agreement are not necessarily equal in the eyes of the law. Answering this question is urgent. Settlements have become a frequent feature of online competition in industries ranging from airlines to hotels to credit cards. Antitrust enforcers and private plaintiffs in the United States and Europe have challenged these settlements as unlawful restraints of trade, with mixed results.³ Meanwhile, some of the country’s largest advertisers have reached similar agreements with their competitors, with the blessing and encouragement of industry commentators. Our article provides a practical framework that courts can use to evaluate the antitrust implications of such settlements.

Our first step is to distinguish two types of trademark settlements. Most settlements merely limit a competitor’s ability to choose its own mark.⁴ That is, they restrict what mark the competitor can attach to its own product. In such cases, the firm can “invent around” any trademark issue by choosing a different mark. The perceived ease of doing so yields the conclusion that trademarks are a “weak” IP right compared to patents, in terms of their exclusionary potential, and hence unworthy of antitrust attention. Search advertising settlements, by contrast, limit a competitor’s ability to target the incumbent for competition by means of a trademarked term, typically the incumbent’s brand name.⁵ Such settlements restrain an important mode of competition, one that is particularly important to lower-priced rivals. In this context, the “weak trademark” intuition simply does not apply.

Our proposed approach draws upon the analogous antitrust evaluation of patent settlements that restrain competition. An important point of connection is to recognize that litigation—specifically, the expected result of trademark litigation between the parties—is the relevant benchmark for

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² 1-800 Contacts, Inc. v. Federal Trade Commission, 1 F.4th 102 (2d Cir. 2021).
³ See infra Part I.A.
⁴ See infra Part I.B.
⁵ See infra Part I.C.
evaluating a settlement’s competitive effects.6 This is the basic rule applied in the cases involving patent settlements,7 and the same logic supports its application in trademark cases. The possession of a trademark does not provide an unqualified right to restrain competitive advertising. Only marketing practices shown to create a significant risk of consumer confusion would be enjoined by a court. Accordingly, the relevant baseline for evaluating a settlement is the expected result of litigation. For example, if a win is 50% likely, then the litigation baseline is one-half the difference between the effect of winning and the effect of losing. From a consumer standpoint, the relevant question is whether the settlement confers less welfare than this baseline. This approach, embraced by courts in the context of patent settlements, applies equally to trademarks.

Assessing liability presents a practical challenge, because the answer to this question might seem to depend upon the probability of winning the trademark case, a quantity that may be difficult to determine. But, as in the patent context, this is not actually necessary in practice. Rather, it is sufficient to assess antitrust liability based on the nature of the firms’ agreement. We explain how to identify anticompetitive settlements without evaluating the merits of the underlying trademark claim.8 Such settlements fall into one of two silos. Some settlements exceed the scope of the trademark—that is, they restrain competition to a greater extent than a trademark judgment would. Other settlements are anticompetitive due to a collusive bargaining problem that persuades an accused infringer to accept a significantly stronger restraint than it expects to incur from a court’s judgment. As we explain, settlements in both categories will usually confer less expected benefit than litigation, a conclusion that can be established without any need to study the merits of the trademark claim. We also analyze various practical complications that arise when using these tools.

Finally, we assess several potential justifications for otherwise problematic settlements.9 The most obvious, at first blush, is that a settlement might vindicate the interests of trademark law, by avoiding consumer confusion arising from the alleged infringement. However, ordinary settlements already protect against confusion to a degree commensurate with the likelihood that the trademark plaintiff would win its case. To justify an even more restrictive outcome would require a showing that confusion ought to be avoided to a degree greater than that already provided by trademark law, a conclusion that faces important conceptual and practical challenges.

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6 See infra Part II.A; cf. Mark A. Lemley & Carl Shapiro, Probabilistic Patents, J. ECON. PERSP., Spring 2005, at 75.
8 See infra Parts II.B-C.
9 See infra Part III.
Along the way, we identify important errors in the Second Circuit’s recent decision in *1-800*—the first appellate decision on the antitrust implications of trademark settlements involving online advertising.\(^{10}\) The court vacated a decision by the FTC that imposed antitrust liability for 1-800’s settlements with rivals. As we explain, the *1-800* court wrongly conflated the two types of trademark settlement, incorrectly dismissed the relevance of settlement terms that exceeded the mark’s scope, and failed to recognize the risk of collusive bargaining, among other significant errors.

This Article proceeds in three parts. Part I identifies the anticompetitive harms from search advertising settlements and explains why the conventional wisdom about weak trademarks does not apply. Part II explicates the probabilistic approach to trademarks and identifies conditions under which an unreasonable settlement may be identified. Part III considers possible procompetitive justifications and provides a framework for their evaluation.

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**I. The Competitive Effects of Settlement**

This Part sets out two types of trademark litigation and the settlements associated with each type. The first type, considered in Part I.A, challenges the use of trademarks to facilitate targeted competition between the mark owner and a competitor. The second type, considered in Part I.B, challenges the selection of a brand name—in the jargon of trademark law, a source identifier—that is confusingly similar to that of the mark owner. The competitive effects of these two types of settlement are quite different, a point elaborated in Part I.C.

**A. Limits on Targeted Competition**

Search advertising settlements arise in the context of Google’s search ads, which appear above or below the ordinary (“organic” or “natural”) results on the search engine results page (SERP).\(^{11}\) For example, Walgreens has promoted its online contacts business by buying ads that appear when a Google user searches for *1800contacts*. Google sells the ad space to Walgreens in an auction at which 1-800 and other firms might also bid. The auction system, called Google Ads, matches bidders with a particular user query. The auction winner is decided based on both the price bid and the quality of the ad, particularly the likelihood that the ad will be clicked by a user.

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\(^{10}\) *1-800 Contacts, Inc.* v. Federal Trade Commission, 1 F.4th 102 (2d Cir. 2021).

\(^{11}\) This account is a simplification of the actual search advertising process. Google has a share of search advertising in excess of 80%. Initial Decision at *40, In re 1-800 Contacts, Inc.*, No. 9372, 2017 FTC LEXIS 125 (F.T.C. Oct. 27, 2017). The similar analysis for other search engines is omitted for simplicity.
Search ads are a powerful way for sellers to connect with customers. A user searching for 1800contacts is likely to be interested in buying contact lenses. Buying an ad that appears on the SERP for a rival’s name is particularly potent. The online setting makes it easy to view competitive offerings side by side, facilitating comparison shopping. Because of these benefits, search ads, triggered by a search for a rival’s name, are commonly used in marketing products and services to consumers. In online retailing of contact lenses, retailers have found it an effective way to attract sales.\textsuperscript{12}

The trademark infringement question arises when the advertiser targets a user query that is a trademarked term, such as 1-800 CONTACTS. In its trademark suit, 1-800 alleged that the Walgreens ads infringed its mark and sought an injunction to prevent their appearance on the SERP for 1800contacts.\textsuperscript{13} Instead of litigating this question to judgment, the parties settled. The settlement prohibits Walgreens ads from appearing on the SERP for 1800contacts, much as if 1-800 had won its trademark suit.\textsuperscript{14} The agreements are also reciprocal, in that 1-800 agrees not to place ads in response to a user search for, say, walgreens. In addition to Walgreens, 1-800 entered settlements with thirteen other rivals that, together with 1-800, account for the lion’s share of online contact sales.\textsuperscript{15} The settlements have no effect on Google’s organic search results.

Agreeing with a rival to limit search advertising cuts off one mode of competition for customers. Moreover, this mode is particularly well suited to helping a price-cutter get the word out about its lower prices by targeting potential customers of its more expensive rival. Suppressing such advertising tends to limit the effectiveness of price competition.\textsuperscript{16}

The likely effect is particularly strong where, as with online sales of contacts, lesser known rivals have lower prices, and consumers are

\textsuperscript{12} Id. at *143 (“Paid search advertising . . . is an important method for marketing contacts online . . .”).

\textsuperscript{13} See id. at *89.

\textsuperscript{14} In fact, the settlement reaches beyond what 1-800 could accomplish if it had won the trademark suit. See infra Part II.B.

\textsuperscript{15} 1-800 makes a majority of online contact sales. 1-800 Contacts, Inc. v. Federal Trade Commission, 1 F.4th 102 (2d Cir. 2021). The settling competitors account for another thirty percent. 1-800 Contacts, 2017 FTC LEXIS 125, at *143–44.

unaware of the price differential.\textsuperscript{17} The expected result of suppression is higher prices,\textsuperscript{18} injuring consumers.

Search advertising agreements have become an important feature of online competition in many industries in which online sales play an important role, from airlines to hotels to credit cards.\textsuperscript{19} Industry consultants report that the practice is commonplace.\textsuperscript{20} The agreements take several forms. Some cover rival manufacturers, rival service providers, or rival retailers. Others have been reached between an upstream provider and a downstream retailer, such as a clothing manufacturer and a reseller or a hotel and an online travel agent, and potentially protect the manufacturer or hotel’s own online sales from reseller competition.\textsuperscript{21} Agreements have also been reached between mark owners (such as American Airlines) and Google, the supplier of advertising space.

Search advertising settlements have attracted the attention of antitrust enforcers and private plaintiffs.\textsuperscript{22} In the leading case in the United States thus far, the FTC challenged 1-800’s settlements as unlawful restraints of trade. The European Commission, after identifying the issue in a study of e-commerce,\textsuperscript{23} condemned settlements reached between a clothing

\textsuperscript{17}Initial Decision at 206–07, 1-800 Contacts, Inc., No. 9372, 2017 FTC LEXIS 125 (F.T.C. Oct. 27, 2017).

\textsuperscript{18}A full market analysis requires evaluation of substitute channels, including from an ophthalmologist or optometrist, and stores such as PearleVision and Lenscrafters. The ALJ concluded that 1-800’s settlements likely led consumers to pay higher prices. \textit{id.} at 345.


\textsuperscript{23}European Commission, E-commerce Sector Inquiry (2017).
manufacturer and its competing online retailers that protected the manufacturer’s e-store. National competition enforcers in Europe have raised concerns about settlements in airlines, credit cards, hotels, and broadband, among other industries.

The cases have had mixed results. In the single appellate ruling thus far, in 2021 the Second Circuit vacated the FTC’s judgment that 1800’s settlements with rivals violate antitrust law. The court declined to decide whether the FTC had proved an anticompetitive effect, while expressing skepticism that trademark settlements can have such an effect. It rested judgment instead on the claimed procompetitive benefits of avoiding litigation expense and “protecting [1-800’s] trademark rights.” The court further concluded the FTC’s asserted failure to show that these benefits could be accomplished in a manner less harmful to competition. We return to these points below.

Despite their importance, search advertising agreements have received little scholarly attention. In the meantime, industry commentators have urged firms to reach such deals with their competitors. For example, one article—written by lawyers for an audience of in-house counsel—advises, as a “cost-efficient solution” for protecting trademarks, “to approach your competitors and agree not to bid on each other’s respective trademarks . . . .” As an alternative to a written agreement, a “gentleman’s agreement” is suggested, the prospect of defection is considered, and a nod to antitrust liability is made. Industry consultants suggest “handshake agreements” with competitors not to advertise on the SERP for a competitor’s brand name.

25 UK Competition and Markets Authority, Digital Comparison Tools Market Study (2017); Netherlands Authority for Consumers and Markets, Price Effects of Non-Brand Bidding Agreements in the Dutch Hotel Sector (2019). The Netherlands authority points to online travel agents as a particularly potent competitor because they expose customers to competing brands.
26 1-800 Contacts, 1 F.4th at 111–12 (reviewing procedural history).
27 Id. at 119–20.
28 Id. at 120–22.
29 The main exceptions are Weinstein, supra note 20 (discussing potential anticompetitive effects); and Geoffrey A. Manne, Hal Singer & Joshua D. Wright, Antitrust Out of Focus: The FTC’s Myopic Pursuit of 1800 Contacts’ Trademark Settlements, ANTITRUST SOURCE, Apr. 2019 (opposing antitrust liability); see also Giuseppe Colangelo, Competing Through Keyword Advertising in the EU and the US (TTLF Working Paper 2020) (summarizing developments in various jurisdictions).
31 See id. (concluding that given antitrust concerns, agreement “must be carefully crafted”).
B. Limits on a Choice of Brand Name

Antitrust scrutiny of search settlements has taken place against a background of skepticism that trademarks can ever be used as an anticompetitive tool. It is frequently objected that trademark settlements are not a fit subject for antitrust inquiry. The ground is that trademark is regarded as a particularly weak form of intellectual property right, compared to (say) patent law. It is often asserted that most trademarks confer only “slight monopoly power.” The dismissive conclusion is that exclusion by a mark holder ordinarily is not worth the “heavy artillery” of antitrust law.

The typical case that prompts this reaction is something like the following real world case. The maker of LYSOL kitchen disinfectant faced fresh entry from the makers of PINE-SOL, already a well-known mark for floor cleaners. The entrant wished to offer a competing kitchen disinfectant under the PINE-SOL name. The incumbent filed a trademark suit alleging that use of the PINE-SOL name raised an unacceptably great risk of confusion, and sought to enjoin entry on that basis.

The parties ultimately reached a settlement restricting the use of the PINE-SOL mark. The settlement granted PINE-SOL some competitive running room, compared to the degree of exclusion initially sought by the LYSOL mark owner. Such “consent-to-use” agreements commonly arise when a mark owner seeks to restrict the choice of mark of an alleged infringer. The agreement amounts to a compromise in the closeness of competition permitted to the maker of PINE-SOL.

In response, the competition minded critic might shrug, so what? The worst that happens, as a consequence of litigation or settlement, is that the rival must choose a different mark to serve as its source identifier. There is a risk here of being too dismissive. Inventing around can be expensive enough to limit entry. One scenario, perhaps illustrated by the PINE-SOL example, arises when having a well-recognized brand is an important terms (urging, as solution to competitor bidding, that target “[c]reate a handshake agreement with your competitors”).


34 Sheridan, 530 F.3d at 595.

35 See Clorox Co. v. Sterling Winthrop, 117 F.3d 50, 52–54 (2d Cir. 1997) (summarizing the terms of settlement).

36 Id.

element of success. If building a brand is expensive, then redeploying an existing brand from floor cleaners to disinfectants is a relatively important form of entry. 38 Preventing that move is consequently a useful form of entry deterrence. 39 A second scenario is that exclusive use of a term denoting a particular product attribute raises a rival’s cost of developing a differentiated mark. 40 Economic theory predicts lower investment by rivals, higher consumer search costs as to the rivals’ products, decreased industry supply, and deadweight loss. 41

In Clorox, the Court of Appeals considered the real-world PINE-SOL settlement. The court found the consent-to-use agreement reached by the parties to be “common” and indeed “favored, under the law.” 42 Thus, “[i]n the absence of evidence to the contrary it is reasonable to presume that such arms-length agreements are pro-competitive.” 43 The court also took the opportunity to express severe skepticism that trademark settlements can be anticompetitive. It opined that “[t]rademarks are by their nature non-exclusionary” 44 and that it is “difficult to show that an unfavorable trademark agreement creates antitrust concerns.” 45

C. Reconsidering the “Weak Trademarks” Critique

The “weak trademarks” critique and Clorox’s dismissive attitude toward antitrust liability are rooted in the particular kind of trademark claim discussed in Part I.B. In these cases, the restraint limits a rival’s ability to choose its own mark. This type of agreement, however, should not be conflated, however, with a restraint that limits a rival’s ability to target the incumbent for comparative advertising—that is, to advertise how one’s own product (or price) compares to that of an established competitor. The two situations are quite different. A restraint on competitive advertising cannot be invented around in the way that a restriction on one’s trade dress frequently can.

38 See Clorox, 117 F.3d at 52–54 (summarizing PINE-SOL dispute).
39 Acquiring or licensing a different existing mark from another firm, though costly, might support entry in some cases.
40 For example, suppose the producer of PLAY-DOH secures an injunction preventing a rival from marketing under the FUNDOUGH mark, forcing the latter to choose a less similar mark. Exclusive use of “doh”/“dough” to denote toy modeling compound raises its competitors’ costs. See Beebe & Hemphill, supra note 37. In partial recognition of this problem, trademark law prohibits exclusive use of generic terms. Kellogg Co. v. National Biscuit Co., 305 U.S. 111, 116–17 (1938).
42 Clorox, 117 F.3d at 55; id. at 60 (“favored”).
43 Id. at 60.
44 Id. at 55–56.
The competitive harm of a restraint on truthful and non-confusing competitive advertising is different in kind from the sort of settlement at issue in \textit{Clorox}. It restrains an important mode of competition—one that is especially important for competitive entry. If a market is currently served by a large incumbent, a rival may seek to enter by offering consumers a better deal. To communicate this to consumers may entail comparative advertising highlighting the difference in price or product features. Courts have long recognized that such competitive advertising is critical to the competitive process.\textsuperscript{46} The effect is likely to be particularly pronounced in markets for undifferentiated products that are sold mainly online.

To be sure, firms have many other ways to advertise, even if this avenue is cut off. However, an agreement need not restrain all possible forms of competition, or all forms of competitive advertising, in order to have an appreciable anticompetitive effect. It is enough to restrain a form of competitive advertising that is especially important within the relevant market. That is the case with search advertising targeting the incumbent’s mark. Such ads are the most direct and effective way to let the incumbent’s customers know about what their other options are. The available alternatives do not replace the competitive benefits of comparative advertising.\textsuperscript{47}

The 1-800 court missed this fundamental difference. It relied heavily on the \textit{Clorox} analysis of consent-to-use agreements, quoting and emphasizing all of the statements quoted above.\textsuperscript{48} This reliance was incorrect because in \textit{Clorox}, an entrant’s choice of mark was at stake, and this was the context in which the dismissive dicta was offered. Moreover, although it is true, as the 1-800 court suggested, that most trademark

\textsuperscript{46} Smith v. Chanel, Inc., 402 F.2d 562, 568–69 (9th Cir. 1968) (“The most effective way (and in some cases the only practical way) in which others may compete . . . is to tell the public they have [produced the product], and if they could be barred from this effort [trademark owners] would have found a way to acquire a practical monopoly . . . to which they are not legally entitled.”)

\textsuperscript{47} Beyond the suppression of downstream competition, search advertising agreements have a further upstream anticompetitive effect, by excluding a rival bidder in certain advertising auctions. The immediate victim of lost upstream competition is Google, for whom search advertising is the main source of profits. Much as with an old-fashioned bidding ring, a restraint on bidding transfers wealth from the seller (Google) to the buyers (advertisers) and distorts the market for advertising. This upstream harm is not a distinctive feature of trademark settlements, and therefore not a focus of the present paper.

\textsuperscript{48} See 1-800, 1 F.4th at 116 (“[t]rademarks are by their nature non-exclusionary”) (quoting \textit{Clorox}, 117 F.3d at 55–56); id. at 119 (same); id. at 116 (“Agreements to protect trademarks, then, should not immediately be assumed to be anticompetitive—in fact, \textit{Clorox} tells us to presume they are procompetitive.”); id. at 119 (“agreements to protect trademark interests are ‘common, and favored, under the law.’”’) (quoting \textit{Clorox}); id. (“As a result, “it is difficult to show that an unfavorable trademark agreement creates antitrust concerns.”’) (quoting \textit{Clorox}).
II. Identifying Anticompetitive Settlements

As explained in Part I, prohibiting a rival’s targeted advertising can result in significant competitive harm. Nevertheless, if a mark owner wins a trademark suit, and thereby excludes its rival through an injunction, there is no antitrust violation. Here, trademark law displaces antitrust law, notwithstanding any harm to competition. This result is unsurprising and consistent with other limited exemptions from antitrust to effectuate (for example) the policies behind labor law, agricultural policy, and legalized export cartels.

The analysis is different if the parties settle rather than litigating to judgment. Trademark law does not confer a right to exclude, simply by virtue of possessing a trademark. It merely grants a right to try to exclude by bringing a trademark suit. A private agreement that reproduces the effect of an injunction—or goes beyond it—does not enjoy the same protected status. Thus, settlements that harm competition, beyond the limits of trademark law, are unreasonable restraints of trade. In this Part, we offer an approach to identifying those unreasonable settlements.

As we explain in Part II.A, antitrust law accommodates its overlap with trademark law by prohibiting settlements that, by restraining competition, leave consumers worse off than the expected outcome of litigation. The remainder of the Part spells out two types of settlements that leave consumers worse off. The first is a settlement with a term that is overbroad—that is, a term that exceeds what the mark owner could achieve through litigation. The second is a settlement that results from collusive bargaining, in which the mark owner induces its competitor to compete less by sharing the profits from avoided competition. Such settlements are the subjects of Parts II.B and II.C, respectively.

A. Ordinary Bargains and the Litigation Benchmark

Settlements of trademark litigation are not only common but also typically harmless from an antitrust perspective. Consider, for example, the PINE-SOL settlement. This agreement permitted the sale of certain types of PINE-SOL disinfectants, such as non-aerosol pump sprays, while

\[49\] Cf. Lemley & Shapiro, supra note 6.
prohibiting others. It also provided that the PINE-SOL product must be marketed primarily as a cleaner rather than a disinfectant.

Ordinary settlements have two important features. First, the result is a compromise. The parties agree to permit some, but not all, of the particular uses sought by the alleged infringer. The settlement thus offers less competition, compared to the outcome if the alleged infringer won, and more competition, compared to the state of affairs if the mark owner won.

Second, the compromise is the result of a hard-fought bargaining process between competitors. The mark owner argues for as much restraint as possible, arguing that it is likely to win its suit. The alleged infringer pushes in the other direction, making the opposite argument. The agreed upon set of uses is a compromise, a bargain reflecting the probability of success. The middle ground reached by the parties thus reflects the parties’ expectations about the outcome of litigation if taken to conclusion.

This ordinary bargain is an appropriate baseline for considering the competitive effects of a particular settlement. In other words, a relevant baseline for evaluating a settlement is the expected consumer welfare from litigation that has an uncertain outcome. For example, if a win is 50% likely, then the litigation baseline is one-half the difference between the effect of winning and the effect of losing. From a consumer standpoint, the relevant question is whether the settlement confers less welfare than this baseline.

Two points about the litigation benchmark bear emphasis. First, it is not enough for an antitrust plaintiff to show that the settlement harms consumers compared to the fully competitive outcome. The proper approach takes account of the possibility that the mark owner might otherwise win the trademark suit and exclude competition. Second, consumers may be harmed not only by the settlement of “weak” trademark claims that the alleged infringer is likely to win, but also by strong claims. The upshot is that even if the mark owner is likely to win the suit, consumers are harmed if the settlement restricts competition even more than the expected outcome of litigation, without compensating consumer benefit.

The litigation baseline is drawn from the analogous assessment of patent settlements. In *Actavis*, the Supreme Court held that patent settlements that eliminate the “risk of competition” are properly subject to antitrust scrutiny. The particular context was a settlement of so-called “reverse payment” settlements, a subject considered in more detail below.

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50 Clorox, 117 F.3d at 53–54.
51 Id. (acknowledging harm when there is “even a small risk of invalidity”).
53 See infra Part II.C.
In taking this approach, the Court explicitly rejected an alternative approach, drawn to the so-called “scope of the patent,” that arguably had been applied in older cases. The scope of the patent test granted safe harbor to settlements that were no more restrictive than what could be achieved through a litigated injunction. On this view, a settlement permitting entry one day prior to patent expiration would be immune from antitrust challenge. In rejecting this view, the Court recognized the fundamental difference between successful litigation and an untested assertion of infringement.

The litigation baseline is now a widely adopted rubric for evaluating patent settlements. The same approach is appropriate for the evaluation of trademark settlements. A trademark does not afford a certain right to exclude a rival’s use of an allegedly confusing mark, but rather, a right to try to exclude it. The mark owner might or might not win the trademark infringement suit. In this sense, trademarks, like patents, are probabilistic rights. Settlements are problematic from an antitrust standpoint when, by restricting competition, they provide consumers with less benefit than litigation.

However, the focus on the “probabilistic” rights and the “expected value” of litigation may provoke practical concerns about administrability. How is court supposed to figure out the IP owner’s probability of winning a counterfactual lawsuit? Courts would prefer not to conduct an IP trial within the antitrust case, an unappetizing “turducken” task that the Actavis Court worried would “prove time consuming, complex, and expensive.”

However, the standard espoused in Actavis and advocated here does not ask the courts to confront such difficulties. Indeed, when evaluating patent settlements in practice, courts generally do not engage in any speculation about litigation probabilities. The remainder of this Part

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55 Id. at 147 (acknowledging “that the agreement’s ‘anticompetitive effects fall within the scope of the exclusionary potential of the patent’” while rejecting the implication “that that fact . . . can immunize the agreement from antitrust attack”).
56 See id. (discussing lower court’s adoption of scope-of-the-patent test).
57 See Aaron Edlin, Herbert Hovenkamp, C. Scott Hemphill & Carl Shapiro, Activating Actavis, Antitrust Mag., Fall 2013, at 16; In re Cipro Cases I & II, 348 P.3d 845 (Cal. 2015); Impax Laboratories, Inc. v. FTC, 994 F.3d 484 (5th Cir. 2021). For an argument that the baseline includes alternative, less restrictive settlements, see Edlin et al., Activating Actavis.
58 Cf. Lemley & Shapiro, supra note 6.
60 Actavis, 570 U.S. at 153.
discusses important contexts in which anticompetitive effects can be evaluated without assessing the merits of the trademark case.

B. Overbreadth

The first type of problematic settlement contains an overbroad term that restricts competition beyond the nominal scope of the mark. In other words, even if the mark owner won the trademark suit and secured an injunction, it could not thereby suppress the competitive conduct in question. In the patent context, courts have acknowledged the anticompetitive nature of overbroad settlement terms—for example, by restricting competition from products that make no conceivable use of the patented technology.61 The same principle applies to trademark settlements.

As discussed above, most trademark settlements are compromises that stop short of what the mark owner could achieve through litigation. Exceptions arise when the settlement prevents competitive conduct that does not even arguably infringe the trademark. Here are two examples drawn from the 1-800 litigation, centered on trademark’s requirements that the conduct must produce a likelihood of confusion and constitute a use in commerce.

Likelihood of confusion. Trademark infringement requires a likelihood of consumer confusion, a determination that depends on the specific nature of the defendant’s marketing practices. If a settlement restrains a broad category of activity that does not inherently create a risk of confusion, then the restraint goes beyond the scope of trademark law. For example, suppose an incumbent’s rival puts up a new billboard whose text allegedly creates a risk of consumer confusion. An injunction would merely proscribe the confusing text. If the settlement prohibits the rival from putting up any billboard advertisements, such an agreement goes beyond the scope of trademark law, because it proscribes even noninfringing billboard advertisements.

1-800’s settlements arguably go beyond the scope of the trademark for analogous reasons.62 Buying a trademarked keyword, in itself, is not

61 See, e.g., Valley Drug Co. v. Geneva Pharm., Inc., 344 F.3d 1294, 1311 n.26 (11th Cir. 2003) (distinguishing In re Cardizem CD Antitrust Litig., 332 F.3d 896, 907–08 (6th Cir. 2003), on the ground that the agreement contained restrictions broader than patent at issue); In re Terazosin Hydrochloride Antitrust Litig., 352 F. Supp. 2d 1279, 1297 n.16, 1317 (S.D. Fla. 2005) (on remand from Valley Drug, concluding that the agreement contained restrictions broader than the patent at issue, and indicating antitrust significance of that fact).

an infringing act. The likelihood of confusion hinges on the nature of the defendant’s advertisement, such as its text and appearance. If it is misleading—for example, if its text falsely implies that the defendant’s product or website is affiliated with the trademark owner—then it could very well create an actionable risk of consumer confusion. But absent such facts, there is no reason to suspect that consumers will be confused.

Nevertheless, 1-800’s settlements with competitors impose a blanket ban on all ads on the SERP for 1800contacts, even those creating no risk of confusion. To be sure, some particular ads could be confusing, but a court would not on that basis prohibit the defendant from running any ads triggered by the trademark, regardless of whether they infringe. Thus, the restraint is more restrictive than any relief a mark owner could hope to obtain from litigation.

Use in commerce. Trademark infringement also requires that the alleged infringer make a “use in commerce” of the plaintiff’s mark. Courts have concluded, controversially, that bidding on a trademark term to

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65 By analogy, if a defendant’s semiconductor chip design is held to infringe a patent, the court will only enjoin sales of the infringing chip. It will not issue a blanket ban under which the defendant cannot sell any chips at all.
trigger an ad\textsuperscript{66} qualifies as such a use.\textsuperscript{67} However, not all bidding strategies require the advertiser to proactively choose the trademarked term.

An alternative and popular bidding strategy is to employ a generic keyword, such as \textit{contact lens}, as a “broad” match.\textsuperscript{68} When a user searches for 1800\textit{contacts}, Google determines whether the Walgreens ad keyed to \textit{contact lens} is sufficiently pertinent to the user search for 1800\textit{contacts} that the Walgreens bid should be included in the auction. Broad-match advertising campaigns are often a cost-effective way of reaching customers.\textsuperscript{69}

Notably, in this broad-match campaign, Walgreens makes no proactive selection of the 1800\textit{contacts} keyword. Google, not Walgreens, makes the connection between the \textit{contact lens} campaign and the 1800\textit{contacts} query. As a consequence, Walgreens makes no use in commerce, and without any such use, 1-800’s infringement claim against Walgreens must fail.\textsuperscript{70}

Nevertheless, 1-800’s settlements prohibit Walgreens from showing ads in response to a user search for 1800\textit{contacts}, even when Walgreens is merely bidding on \textit{contact lens} in broad match. This restriction is accomplished by requiring Walgreens to implement 1800\textit{contacts} as a “negative keyword,”\textsuperscript{71} which instructs Google not to display the ad for any user search for the negative keyword.\textsuperscript{72} This term goes beyond the scope of the trademark, because it restricts competitive activity in a manner that trademark litigation never would.\textsuperscript{72}

\textsuperscript{66}This might be accomplished through either an “exact” match or a “phrase” match. An exact match bids on user queries for 1800\textit{contacts} but omits other queries. A phrase match includes the advertiser in the bidding for longer queries such as 1800\textit{contacts coupon}.


\textsuperscript{68}Broader match types using a particular keyword result in potential inclusion in a larger set of auctions: broad match > phrase match > exact match. Bidding on the 1800\textit{contacts} keyword in broad match would, like phrase match, produce matches if the user searched for (inter alia) 1800\textit{contacts} or 1800\textit{contacts coupon}.

\textsuperscript{69}Initial Decision at 198–200, 1-800 Contacts, Inc., No. 9372, 2017 FTC LEXIS 125 (F.T.C. Oct. 27, 2017) (discussing this evidence).

\textsuperscript{70}Here, we discuss settlement terms that fall outside the scope of a trademark infringement claim. Depending on the facts, a particular settlement might, of course, fall within the scope of some other legal claim asserted by the plaintiff, such as false advertising.

\textsuperscript{71}1-800 Contacts, 2017 FTC LEXIS 125, at 48–50. In fact, the settlement goes further, by also prohibiting ads for user searches that merely \textit{include} the negative keyword (even if they also include additional content). \textit{Id.} at 99–100.

\textsuperscript{72}Here are two further examples. [1] Walgreens bids on \textit{contacts} in phrase match, resulting in an ad on the SERP for 1800 \textit{contacts} (with a space). This possibility arises because the 1-800 CONTACTS brand name includes the name of the generic category, contacts. [2] Walgreens bids on \textit{cheap lenses} in phrase match, resulting in an ad on the SERP for 1800\textit{contacts cheap lenses}. 
The 1-800 court concluded that 1-800’s trademark claims, if victorious in court, “might have permitted it to preclude competitors from bidding on its trademarked terms in search advertising auctions or running advertisements on those terms.”73 The court apparently believed that the restraints fell within the scope of 1-800’s trademark rights. However, this unreasoned assertion is contradicted by the lack of any plausible trademark claim against those ads that raised no risk of confusion and those triggered by the broad-match process.

Whenever a restraint goes beyond the scope of the trademark right, this fact precludes any trademark-based safe harbor. In that case, the liability question is assessed in the same manner employed in cases not involving IP. The first question is whether the agreement restrains inter-firm competition in some way. If the deal includes any restrictions on noninfringing competitive advertising, such as the restraints in 1-800, then the answer to this question is almost certainly Yes. The burden then shifts to the defendant to argue that the restraint nevertheless serves a procompetitive purpose. We explore the latter query in Part III.

C. Collusive Bargaining

The second type of problematic settlement need not restrain competition beyond the nominal scope of the trademark right. The problem is that the hard-fought bargain associated with an ordinary settlement—the arms’ length negotiation emphasized by Clorox—is replaced by collusion. Rather than pushing for a settlement with as little restraint as possible, the infringer accepts the highly restrictive settlement preferred by the IP owner.

As an illustration, consider reverse payment settlements of patent litigation.74 Here is how the Supreme Court described the situation: “Company A sues Company B for patent infringement. The two companies settle under terms that require (1) Company B, the claimed infringer, not to produce the patented product until the patent’s term expires, and (2) Company A, the patentee, to pay B many millions of

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73 1-800 Contacts, Inc. v. Federal Trade Commission, 1 F.4th 102, 113 (2d Cir. 2021) (internal quotation marks omitted).
dollars.” Note that in this example, the resulting restraint is no more restrictive than an injunction, and thus does not exceed the nominal scope of the patent.

The concern is that by paying the alleged infringer, the patentee delays or otherwise eliminates the risk of competition from the alleged infringer, typically a generic drug maker whose entry would lower prices. Reverse payments accomplish this by letting the accused infringer share in the profits generated by suppressing competition. The payment distorts the bargaining process between the rights holder and the infringer. This is a little like a professional boxer paying his opponent to take a dive. The payment persuades the firm to accept a restraint that is excessive in the sense that it is significantly more restrictive than the expected result of litigation, as determined by the merits of the IP claims.

Absent such a profit-sharing mechanism, no profit maximizing firm would agree to be restrained excessively in this sense. Instead, as discussed above, the firms will typically settle on terms that reflect the expected outcome of litigation—for example, by bargaining over an intermediate date at which the infringer will be allowed to enter the market. Such a settlement may well restrict competition, but to a degree that is commensurate with the merits of the underlying IP claims. This is consistent with the thrust of IP policy, for it means the agreement’s impact on competition will be strong if and only if the underlying IP claim is strong. Accordingly, settlements not involving problematic profit-sharing terms generally do not raise antitrust concerns, even when they restrain competition substantially.

When a firm uses a reverse payment or other strategy to facilitate collusive bargaining, we can infer that the agreement will cause harm, as it will result in less consumer welfare than expected from litigation. Thus, a natural focus of analysis is the nature of the firms’ agreement, and in particular, whether the agreement subverts the accused infringer’s bargaining incentives.

A direct payment to the infringer is not the only means to facilitate collusive bargaining. A closely related strategy is a quid pro quo between

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75 Federal Trade Commission v. Actavis, Inc., 570 U.S. 136, 140–41 (2013). The payment is “reverse” because “the settlement requires the patentee to pay the alleged infringer, rather than the other way around.” Id.

76 See Actavis, 570 U.S. at 158 (The firms “may . . . settle in other ways, for example, by allowing the generic manufacturer to enter the patentee's market prior to the patent's expiration, without the patentee paying the challenger to stay out prior to that point”).

77 Cf. Carl Shapiro, Antitrust Limits to Patent Settlements, 34 RAND J. ECON. 391 (2003) (arguing that the relevant antitrust standard should be to condemn IP settlements only when they cause more harm to consumers than the expected result of litigation).

reciprocal restraints.\textsuperscript{79} That is, rather than one firm paying the other to accept an excessive restraint, both firms agree that they will both be restrained excessively in parallel. This dynamic is familiar in cartels. A single firm would not agree to be the only firm whose price is raised far above the competitive level; its rivals could then steal all of its sales by undercutting it. But it accepts a sacrifice, which confers a benefit on rivals, in exchange for similar sacrifices from its rivals.

Patent settlements involving reciprocal restraints are often condemned as antitrust violations.\textsuperscript{80} For example, in \textit{Summit Technology}, two firms each controlled various patents related to specialized machines used in eye surgery.\textsuperscript{81} They agreed to form a patent pool, which charged each firm high royalties. The two firms then split the pool’s proceeds.\textsuperscript{82} A royalty obligation is a very ordinary restraint—certainly within the scope of the patent.\textsuperscript{83}

Conventional royalty settlements do not raise antitrust concerns.\textsuperscript{84} But the defendants’ reciprocal royalty scheme was highly problematic. The royalties naturally induced both firms to raise their prices (by raising their costs). The expenditures were ultimately recouped by virtue of the firms’ ownership of the patent pool. Under this arrangement, it is in both firms’ interest to set an excessive royalty rate in order to force their prices upward.\textsuperscript{85} The firms ultimately abandoned this arrangement after the FTC challenged it.\textsuperscript{86}

A second example arises in the pharmaceutical industry as a variant of the reverse payment problem. The branded drug maker may compensate

\textsuperscript{79} For an economic analysis demonstrating that reverse payments and reciprocal restraints both lead to the same kind of collusive bargaining problem, see Erik Hovenkamp \& Jorge Lemus, \textit{Antitrust Limits on Patent Settlements: A New Approach}, J. INDUSTRIAL ECON. (forthcoming 2021); Hovenkamp, \textit{supra} note 78, at 450–57.

\textsuperscript{80} In some such cases, the defendants’ arrangement was scarcely distinguishable from an ordinary cartel, in which case its illegality is fairly obvious. \textit{See}, e.g., United States v. National Lead, 332 U.S. 319 (1947) (condemning a settlement in which competitors agreed to confine themselves to separate territories to avoid competition); United States v. Masonite Corp. 316 U.S. 265 (1942) (condemning a settlement in which the firms agreed to fix prices).

\textsuperscript{81} In the Matter of Summit Technology, Inc., 127 F.T.C. 208 (1999).

\textsuperscript{82} \textit{Id.} at 209–10.

\textsuperscript{83} A royalty raises the accused infringer’s costs, which will push its price upward and diminish its sales. But an injunction would prohibit \textit{all} sales of the allegedly infringing product, which is clearly a more restrictive result.

\textsuperscript{84} \textit{See} Hovenkamp \& Lemus, \textit{supra} note 80, at 10–12 (demonstrating, in a model of oligopoly competition, that absent a collusive inducement, a firm will not agree to pay a royalty that diminishes its competitive vitality to a materially greater extent than the expected result of litigation).

\textsuperscript{85} This allows the firms to emulate the results of price-fixing without having to form an explicit agreement to fix prices. For further discussion of the economics behind this scheme, \textit{see}, e.g., Carl Shapiro, \textit{Patent Licensing and R&D Rivalry}, 75 AM. ECON. REV. 25, 26 (1985).

\textsuperscript{86} \textit{Summit Technology}, 127 F.T.C. at 217.
the generic drug maker not with cash, but rather a promise not to launch its own competing generic drug. In exchange, the generic firm will accept a more anticompetitive result—a longer delay in market entry—than it would otherwise agree to, based on the merits of the IP claim. The resulting settlement restrains generic entry by both firms, not just the generic challenger. Courts have recognized the anticompetitive effects of such settlements.87

Trademark settlements may exploit reciprocal restraints to suppress competitive advertising. For example, mutual agreements not to advertise using the other’s keywords restrain both firms in parallel, prohibiting each from using the other’s trademark to trigger keyword advertisements. This kind of reciprocity can have a major impact on the firms’ bargaining, regardless of the merit of the underlying infringement claims. By default, neither firm has an incentive to agree to abstain from running the ads; each relies on such ads to steal sales from the other. However, the firms earn larger profits if they simply agreed to stop competing in this way, both by avoiding the expense of the ads and by reducing the potency of and hence incentive for price competition. This is analogous to an agreement in which two cross-town rivals agree not to put up billboards in one another’s territories. It does not entirely eliminate competition, but it does eliminate an important relevant channel of competition, which is a sufficient basis for antitrust liability.88

The 1-800 court wrongly ignored the danger of collusive bargaining. The court saw the settlement as merely the result of “hard-nosed trademark negotiations.”89 It suggested that “what is reasonably necessary [to settle] . . . is likely to be determined by competitors during settlement negotiations.”90 In other words, the court suggested that there is no need to worry that competitors might agree to improper or excessive restraints when settling an IP dispute.

The court once again relied heavily on its analysis of a consent-to-use agreement in Clorox.91 There, the court had had stated that “[w]here large competitors each represent their respective trademark interests, unless one party is irrational, the result should accord with how the parties view their respective rights.”92 That is true as applied to an ordinary bargain in which the parties negotiate over some dimension of competition that is the

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87 See, e.g., King Drug Co. of Florence v. SmithKline Beecham Corp., 791 F.3d 388, 394 (3d Cir. 2015) (condemning a no-authorized generic settlement); see also Edlin et al., Actavis Inference, supra note 74 (discussing no-AG agreements as a reciprocal restraint).
88 See supra Part I.C.
89 1-800 Contacts, Inc. v. Federal Trade Commission, 1 F.4th 102, 120 (2d Cir. 2021).
90 Id. at 121 (citing Clorox).
91 Id. at 122 (relying on Clorox, 117 F.3d at 59–60, as basis for granting deference to parties “arm’s length use agreements negotiated by the parties”).
92 Clorox Co. v. Sterling Winthrop, Inc., 117 F.3d 50, 61 (2d Cir. 1997).
subject of a trademark suit. But the result does not apply when the firms have an opportunity to reciprocally exchange concessions in which each firm avoids competition. Thus, the 1-800 court was wrong to conclude that “while trademark agreements limit competitors from competing as effectively as they otherwise might, we owe significant deference . . . to those agreements.” 93 This perspective ignores the incentive and opportunity to engage in collusive bargaining.

III. Assessing Justifications

Restraints on competitive activity are lawful if they have reasonable procompetitive justifications. What are the potential justifications for a restrictive trademark settlement? One commonly accepted justification is simply the avoidance of the costly and time-consuming litigation process. It is for this reason that private settlements are typically viewed favorably in all types of private disputes.

In this Part, we consider some additional justifications related to trademark law and policy that defendants might raise. We also consider when a plaintiff might overcome such arguments by demonstrating the existence of a less restrictive alternative to the challenged agreement.

A. Protecting Trademark Rights

A defendant might attempt to justify its settlement by arguing that it helps the trademark owner to protect its legal rights—that is, to vindicate its claim that an infringer had engaged in trademark infringement. The 1-800 court accepted defendant’s argument that “protecting [1-800’s] trademark rights” offered a cognizable justification for its agreements with rivals. 94

This argument runs up against the fundamental constraint that any asserted justification must be attributable to the challenged conduct. That is, the benefit must be present thanks to the conduct and absent without it. Here, the conduct is the choice of a particular settlement rather than litigating to judgment. The procompetitive effects of the settlement, then, are limited to the benefits conferred by settlement relative to litigation.

In measuring the effects of the settlement relative to litigation, it is crucial to recognize that the status quo of trademark litigation already protects the mark owner’s legal rights. After all, the mark owner is entitled to an injunction if it wins its case. Thus, the prevention of harmful confusion cannot to be attributed to a settlement, to whatever degree litigation could be expected to achieve that result. Consider, for example, the ordinary bargain discussed in Part II.A. Such a settlement would grant the mark owner partial protection that is commensurate with the strength

93 1-800, 1 F.4th at 122.
94 Id. at 119–20.
of its legal case and approximates the expected benefit from litigation. That settlement would provide some protection, to be sure, but not incremental benefit beyond the expected results of the trademark case.

Of course, some settlements do provide an incremental benefit to the mark owner—for example, by completely removing any competitive advertising, even though the legal case for doing so as a matter of trademark law is weak or nonexistent. However, it is doubtful that such a benefit qualifies as a justification within the antitrust analysis.

For example, suppose that two competitors agree not to run comparative advertising that so much as reference one another’s brand names. They argue that this is necessary because referencing a rival necessarily creates an undue risk of confusion. They make this argument, notwithstanding its rejection as a matter of trademark law, which recognizes that the use of a rival’s trade name is necessary for desirable comparative advertising, and thus views it as generally lawful, absent specific evidence of likely confusion.

Accepting the defendant’s argument grants a mark owner more protection than trademark law provides. Antitrust law accommodates trademark law by stepping aside when a trademark plaintiff wins its cases and secures an injunction, and by accepting the partial degree of lost competition reflected in an ordinary settlement bargain. We see no basis for interpreting antitrust law to go further and protect trademark rights even more than the degree provided for in trademark law itself. Antitrust law should not second-guess such determinations.

B. Avoiding Free Riding

A second trademark-related argument is that proscribing otherwise-lawful competitive advertising serves the asserted procompetitive purpose of curbing “free riding” by the mark owner’s rivals, which could help to bolster incentives for investment in one’s own brand. In the context of keyword advertising, the argument would proceed as follows. A firm that does most of its business online may invest heavily in making consumers familiar with its brand. That way consumers are more likely to seek out

\footnote{Deere & Co. v. MTD Prod., Inc., 41 F.3d 39, 44 (2d Cir. 1994) (truthful comparative advertising “serves the beneficial purpose of imparting factual information about the relative merits of competing products”).}

\footnote{Smith v. Chanel, Inc., 402 F.2d 562, 569 (9th Cir. 1968) (“in the absence of misrepresentation or confusion as to source or sponsorship a seller in promoting his own goods may use the trademark of another to identify the latter’s goods”).}

the firm when they shop online. For example, 1-800 pioneered online sales of contact lenses and made substantial investments in marketing to make consumers aware of the lower prices available online. But a competitor might attempt to free ride on 1-800’s brand by targeting ads at consumers who search for 1800contacts. This might diminish the incentive of firms like 1-800 to invest in their brands. If true, a restraint on such free riding could stimulate incentives for investment, and that would be a good thing.

This defense does not rely on the proposition that free riding is necessarily actionable under trademark law. There are a few cases suggesting that free riding may provide a basis for finding trademark infringement liability, but also reasons to doubt that trademark policy supports such a strong anti-free-riding policy. And there is ample judicial support within trademark law for the proposition that free riding is essential to the competitive process. Indeed, in many situations, terms like “free riding” and “copying” are just pejoratives for competitive activity that an incumbent doesn’t like.

At its core, the argument asserts that free riding on established brands is inefficient because it chills investment, and therefore it is desirable to restrain such activities. This argument, if accepted, would potentially establish a justification for all kinds of far-reaching restraints on targeted advertising, even when they create no risk of confusion.

The key problem with the free riding argument is that, even if its core premise is true, it does constitute a cognizable antitrust defense. That is, even if one is convinced that it would be efficient to restrain free riders, this would not provide a legal justification for doing so. If Congress passes IP legislation under which a given form of free riding is recognized as privileged competition, then courts applying the antitrust laws are obliged to accept that determination. Antitrust does not permit firms to engage in anticompetitive self-help to shore up a perceived deficit of IP protection. By way of analogy, one might take the position that twenty years of patent protection is not enough. But that policy perspective would not authorize

99 See Kenner Parker Toys Inc. v. Rose Art Indus., Inc., 963 F.2d 350, 353 (Fed. Cir. 1992) ("Both the mark's fame and the consumer’s trust in that symbol, however, are subject to exploitation by free riders"). For discussion and a critique of this position, see Beebe & Hemphill, supra note 37.
100 Id.
101 See, e.g., Smith v. Chanel, Inc., 402 F.2d 562, 568–69 (9th Cir. 1968) ("Disapproval of the copyist's opportunism may be an understandable first reaction, 'but this initial response to the problem has been curbed in deference to the greater public good. By taking his 'free ride,' the copyist, albeit unintentionally, serves an important public interest by offering comparable goods at lower prices.'") (citations omitted).
102 Moreover, if the avoidance of free riding were a key element of trademark law, that would raise the objection discussed in Part III.A, as such a settlement would protect an asserted trademark policy goal to a greater extent than trademark law itself.
a private agreement that restrains a competitor’s use of an invention for even longer.\textsuperscript{103}

The leading case on this point is \textit{Fashion Originators’ Guild of America v. FTC}. Designers in the 1930s were afflicted by style pirates, who copied and sold versions of their designs at a much lower price. The style pirates were free riding, legally—copyright did not cover the designs—albeit without any special legal encouragement. The designers joined forces and arranged a boycott of retailers that did business with pirates. The Court ultimately condemned the arrangement without regard to any claimed economic benefits from the avoidance of free riding. The case is often recognized for the proposition that firms are not entitled to create a “private IP system” whose restrictions on competitive activity reach farther than those stipulated by IP law.

This same point is also visible in the analogous context of competition between branded and generic drug makers. The brand incumbent often has made a large investment in R&D to develop and secure approval of the drug. When a generic rival threatens to enter the market, “piggybacking” on the brand’s investment, that effort is protected by antitrust law. The Court rejected the idea that defendants might justify a horizontal agreement that avoids competition on the ground that reduced competition increases profits, which in turn indues or is spent on investments in increased innovation.\textsuperscript{104}

More generally, the mere fact of investment provides no privileged basis under antitrust law to enter horizontal agreements to insulate oneself from free riding that takes the form of market competition.\textsuperscript{105} As a general matter, consumer benefits premised on reductions in competition are not cognizable. For example, engineers cannot refrain from price competition on the ground that competition will result in shoddy bridges.\textsuperscript{106} As the Supreme Court explained, considering this argument when a group of engineers made it, “the Rule of Reason does not support a defense based on the assumption that competition itself is unreasonable.”\textsuperscript{107}

To be sure, free-riding arguments are sometimes recognized as antitrust justifications. However, these arguments do not contend that we should permit firms to suppress competition in order to stimulate investments whose long-run value will offset the loss of competition. Rather, they argue that the elimination of free riding will help to enhance

\textsuperscript{103} See Hovenkamp, \textit{ supra} note 78, at 424 n.35 (a horizontal restraint that persists after patent expiration is a transparent antitrust violation).

\textsuperscript{104} In \textit{Actavis}, this argument was emphasized by the dissent but rejected by the Court. FTC v. Actavis, Inc., 570 U.S. 136, 167 (2013) (Roberts, C.J., dissenting) (emphasizing role of patents in encouraging innovation); id. at 176 (criticizing Court on ground that its ruling “weakens the protections afforded to innovators by patents”).

\textsuperscript{105} Smith v. Chanel, Inc., 402 F.2d 562, 568–69 (9th Cir. 1968) (“A large expenditure of money does not in itself create legally protectable rights”).


\textsuperscript{107} Id.
competition right away, such as by increasing output.\footnote{108} For example, antitrust law takes a lenient approach to certain vertical restraints, such as resale price maintenance and exclusive retail territories, on the ground that the restraint encourages the downstream retailer to exert effort and invest in quality enhancements, which would otherwise be undercut by other distributors of the same brand. The argument is that eliminating the free-rider problem ultimately enhances competition.

\textbf{C. Less Restrictive Alternatives}

For a justification to be successful, the defendant’s restraint must be reasonably necessary to achieve it. If not, there is no reason to permit the restraint. To this end, a plaintiff can overcome an asserted justification by showing the existence of a less restrictive alternative (LRA). LRAs are a standard method for establishing antitrust liability.\footnote{109} The LRA inquiry asks the factfinder to compare the defendant’s conduct to a hypothesized alternative that serves the same claimed goal and consider whether that alternative is less restrictive and therefore poses a lesser risk of harm to competition.

To offer a basis for liability, the asserted LRA needs to be feasible and practical, not speculative.\footnote{110} The defendants can contest feasibility, but doing so demands more than a bald assertion of some subjective difficulties that make the LRA unworkable. Otherwise, defendants could avoid liability by asserting highly subjective excuses that plaintiffs cannot realistically disprove.

For example, suppose a settlement contains a term that facilitates collusive bargaining, such as a reverse payment. A large majority of settlements do not contain this kind of term. Then the plaintiff has a very strong argument for the existence of an LRA: the firms could just settle without using the problematic term. After all, almost everyone else gets along fine without it. However, the defendants may make subjective arguments about why they “just can’t agree on terms” without the challenged conduct.\footnote{111} Such arguments should be viewed with caution. Reverse payment settlements of patent litigation furnish an apt example. Defendants sometimes argue that they need to use a reverse payment in order to settle because the patentee is risk averse and without a large

\footnote{108} Similarly, a restraint on free riding may enhance competition if it is ancillary to the formation of a joint venture. See, e.g., Polk Bros., Inc. v. Forest City Enterprises, Inc., 776 F.2d 185 (7th Cir. 1985).


\footnote{110} Hemphill, \textit{supra} note 109, at 983–86.

\footnote{111} See Hovenkamp, \textit{supra} note 78, at 473.
payment to the alleged infringer, settlement will fail and the patentee will experience the risk bearing cost. 112

There are good reasons to reject this argument on substantive grounds,113 but a further important objection relates to administrability. A patentee’s claim that it is risk averse will likely be very difficult for an antitrust plaintiff to evaluate, because it concerns the patentee’s subjective feelings toward risk. Moreover, if such a defense were permitted, there is a risk of widespread abuse. The same argument applies to trademark settlements. The defendants might assert some subjective reasons why they need the term in order to achieve a settlement. But they properly bear the burden of establishing the point.

The 1-800 court erred on this point. The Commission had proposed a number of less restrictive settlements—for example, a “disclosure requirement” under which a rival merely promises to clearly identify itself as the seller in ad’s text.114 But the court rejected these arguments. In effect, it held that the FTC was obliged to disprove the possibility that some subjective or context-specific difficulties might prevent 1-800 from reaching an amicable settlement without a blanket ban on keyword advertising.115 Such a demanding proof requirement is likely to be prohibitive in virtually all cases. Indeed, while the court was deeply concerned about the practical difficulties of enforcing trademark rights,116 it expressed no concern at all for the equally important project of maintaining administrable antitrust standards.

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113 See Hovenkamp, supra note 78, at 474; Edlin et al., Actavis and Error Costs, supra note 112.
115 1-800 Contacts, Inc. v. Federal Trade Commission, 1 F.4th 102, 121 (2d Cir. 2021) (holding that the Commission “failed to consider the practical reasons for the parties entering into the Challenged Agreement . . . [It] did not consider, for example, how the parties might enforce such a requirement moving forward or give any weight to how onerous such enforcement efforts would be for private parties.”).
116 Id.
Conclusion

There are significant differences between trademarks and other forms of IP. For instance, trademarks are not intended to confer a right to restrain or exclude competitors in the same sense that patents and copyrights do. Nevertheless, trademark agreements between competitors do sometimes restrain activities that are relevant to the competitive process, such as competitive advertising. And these agreements may raise antitrust concerns, such as when they restrain a markedly broader set of activities than a court’s injunction typically would.

In such cases, courts should of course be cognizant of the distinctive features of trademark law. But this can and should be done in the course of applying the same general framework used to evaluate other types of IP settlements. The first inquiry is whether the restraints in question go beyond what a trademark judgment would ever prescribe. If so, then it cannot be saved by trademark law; it should thus be evaluated under the same standards applied to horizontal agreements not involving IP. Second, if the restraint does fall within the scope of the IP right, then it should be condemned if it contains problematic terms designed to generate collusive bargaining outcomes, such as a reverse payment or a quid pro quo between reciprocal restraints.