ANALYSIS OF PROPOSED CONSENT ORDER TO AID PUBLIC COMMENT IN *UNION OIL COMPANY OF CALIFORNIA*, DOCKET NO. 9305

The Federal Trade Commission has accepted for public comment an Agreement Containing Consent Order ("Agreement") with Union Oil Company of California ("Union Oil") to resolve matters charged in an Administrative Complaint issued by the Commission on March 4, 2003 ("Complaint"). Pursuant to the Agreement, Union Oil provisionally has agreed to be bound by a proposed consent order ("Proposed Consent Order").

The Agreement has been placed on the public record for thirty (30) days for receipt of comments from interested members of the public. The Agreement is for settlement purposes only and does not constitute an admission by Union Oil that the law has been violated as alleged in the Complaint or that the facts alleged in the Complaint, other than jurisdictional facts, are true. The Proposed Consent Order remedies alleged anticompetitive effects arising from Union Oil's conduct, as alleged in the Complaint.

I. The Commission's Complaint

The Complaint alleges that Respondent Union Oil engaged in a series of acts to subvert state regulatory standard-setting procedures relating to low emissions gasoline. To address California's serious air pollution problems, the California Air Resources Board ("CARB") initiated proceedings in the late 1980s to set regulations and standards governing the composition of low emissions, reformulated gasoline ("RFG"). The Complaint alleges that Union Oil actively participated in CARB RFG rulemaking proceedings and engaged in a pattern of bad-faith, deceptive conduct, exclusionary in nature, that enabled it to undermine competition and harm consumers. The Complaint states that Union Oil also engaged in deceptive and exclusionary conduct through its participation in two private industry groups – the Auto/Oil Air Quality Improvement Program ("Auto/Oil") and the Western States Petroleum Association ("WSPA"). According to the Complaint, Union Oil thereby illegally monopolized, attempted to monopolize, and otherwise engaged in unfair methods of competition in violation of Section 5 of the FTC Act in both the technology market for the production and supply of CARB-compliant "summer-time" gasoline, and the downstream "summer-time" gasoline product market.

Union Oil is a public corporation, organized in, and doing business under, the laws of California. Union Oil is a wholly-owned operating subsidiary of Unocal Corporation, a holding company incorporated in Delaware. Prior to 1997, Union Oil owned and operated refineries in California as a vertically-integrated producer, refiner, and marketer of petroleum products. In 1997, Union Oil sold its west coast refining, marketing, and transportation assets. Currently, Union Oil's primary business activities involve oil and gas exploration and production.

The Complaint alleges that during the CARB "Phase 2" RFG rulemaking proceedings in 1990-1994, Union Oil made a series of materially false and misleading statements. According to the allegations in the Complaint, Union Oil willfully and intentionally:

a. Represented to CARB and other participants that Union Oil's emissions research

results showing, *inter alia*, the relationships between certain gasoline properties and automobile emissions, were "nonproprietary," in "the public domain," or otherwise were available to CARB, industry members, and the general public – without disclosing that Union Oil intended to assert its proprietary interests (as manifested in pending patent claims) in the results of this research;

b. Represented to CARB that a "predictive model" – *i.e.*, a mathematical model that predicts whether the emissions that would result from varying certain gasoline properties in a fuel are equivalent to the emissions resulting from a specified and fixed fuel formulation – would be "cost-effective" and "flexible," without disclosing that Union Oil's assertion of its proprietary interests would undermine the cost-effectiveness and flexibility of such a model; and

c. Made statements and comments to CARB and other industry participants relating to the cost-effectiveness and flexibility of the regulations that further reinforced the materially false and misleading impression that Union Oil had relinquished or would not enforce any proprietary interests in its emissions research results.

According to the Complaint, Union Oil continued to conceal its intention to obtain a competitive advantage through the enforcement of its proprietary interests relating to RFG even after Union Oil received notice that the pending patent claims were allowed and issued. The Complaint alleges that Union Oil thereby led CARB and two private industry groups – Auto/Oil and WSPA (and their respective industry members) – to believe that Union Oil did not have, or would not enforce, any proprietary interests or intellectual property rights associated with its emissions research results.

The Complaint alleges that Union Oil's conduct caused CARB to adopt Phase 2 "summer-time" RFG regulations that substantially overlapped with Union Oil's concealed pending patent claims. But for Union Oil's deception, according to the Complaint, CARB would not have adopted RFG regulations substantially incorporating Union Oil's proprietary interests; the terms on which Union Oil was later able to enforce its proprietary interests would have been substantially different; or both.

The Complaint alleges that but for Union Oil's deceptive conduct, industry participants in Auto/Oil and WSPA would have taken actions including, but not limited to, (a) advocating that CARB adopt regulations that minimized or avoided infringement of Union Oil's patent claims; (b) advocating that CARB negotiate license terms substantially different from those that Union Oil was later able to obtain; and/or (c) incorporating knowledge of Union Oil's pending patent rights in their capital investment and refinery reconfiguration decisions to avoid and/or minimize potential infringement.

According to the Complaint, Union Oil did not announce the existence of its proprietary interests and patent rights relating to RFG until January 1995 – shortly before the relevant CARB Phase 2 RFG regulations were to go into effect. The Complaint alleges that, by that time,

the refining industry had spent billions of dollars in capital expenditures to modify their refineries to comply with the CARB Phase 2 RFG regulations, in reliance on Union Oil's representations that its research results were in "the public domain." The Complaint states that once CARB and the refiners had become locked into the Phase 2 regulations, Union Oil commenced vigorous enforcement of its patent rights through litigation and licensing, and obtained four additional patents based on the same RFG research results.

Union Oil's misrepresentations, according to the Complaint, have harmed competition and led directly to the acquisition of monopoly power for the technology to produce and supply California "summer-time" reformulated gasoline (mandated for up to eight months of the year, from approximately March through October). The Complaint alleges that Union Oil's conduct also permitted it to undermine competition and harm consumers in the downstream product market for "summer-time" reformulated gasoline in California. The Complaint alleges that without recourse, Union Oil's conduct would continue materially to cause or threaten to cause further substantial injury to competition and to consumers.

According to the Complaint, Union Oil's enforcement of its RFG patents has resulted, *inter alia*, in a jury determination of a 5.75 cents per gallon royalty on gasoline produced by major California refiners comprising approximately 90 percent of the current refining capacity of CARB-compliant RFG in the California market. The Complaint alleges that Union Oil also has publicly announced that it will license its RFG patent portfolio, with fees ranging from 1.2 to 3.4 cents per gallon, to "non-litigating" refiners.

The Complaint alleges that Unocal's conduct could result in an estimated annual cost of more than $500 million to the refining industry. According to the Complaint, Union Oil's own economic expert has testified under oath that 90 percent of any royalty would be passed through to consumers in the form of higher gasoline prices.

II. Terms of the Proposed Consent Order

The Commission has provisionally entered into an Agreement with Union Oil in settlement of the Complaint. As discussed below, the provisions of the Agreement are conditioned upon the completion of certain steps in Chevron Corporation's merger with Unocal Corporation, as contemplated by the Agreement and Plan of Merger dated as of April 4, 2005, among Unocal Corporation, ChevronTexaco Corporation, and Blue Merger Sub Inc.

In order to remedy the alleged anticompetitive effects, Union Oil has agreed to take several actions. First, it will cease and desist from any and all efforts, and will not undertake any new efforts to: (a) assert or enforce any of Union Oil's Relevant U.S. Patents against any person; (b) recover any damages or costs for alleged infringements of any of the Relevant U.S. Patents; or (c) collect any fees, royalties or other payments, in cash or in kind, for the practice of any of the Relevant U.S. Patents, including but not limited to fees, royalties, or other payments, in cash or in kind, to be collected pursuant to any License Agreement. These obligations become effective as of the "Merger Effective Date," which is defined as the earlier of (1) the date that the

certificate of merger for the Merger is filed with the Secretary of State of Delaware or such later time as specified in such certificate of merger, or (2) the date that Chevron Corporation acquires control of Unocal Corporation, as "control" is defined by 16 C.F.R. § 801.1(b).

Second, the Proposed Consent Order requires that, within thirty (30) days following the Merger Effective Date, Union Oil shall file, or cause to be filed, with the United States Patent and Trademark Office, the necessary documents pursuant to 35 U.S.C. § 253, 37 C.F.R. § 1.321, and the Manual of Patent Examining Procedure to disclaim or dedicate to the public the remaining term of the Relevant U.S. Patents. The Proposed Consent Order further requires that Union Oil shall correct as necessary, and shall not withdraw or seek to nullify, any disclaimers or dedications filed pursuant to the Proposed Consent Order.

Third, the Proposed Consent Order requires that, within thirty (30) days following the Merger Effective Date, Union Oil shall move to dismiss, with prejudice, all pending legal actions relating to the alleged infringement of any Relevant U.S. Patents, including but not limited to the following actions pending in the United States District Court for the Central District of California: *Union Oil Company of California v. Atlantic Richfield Company, et al.*, Case No. CV-95-2379-CAS and *Union Oil Company of California v. Valero Energy Corporation*, Case No. CV-02- 00593 SVW.

Paragraph V of the Proposed Consent Order requires Union Oil to distribute a copy of the Proposed Consent Order and the Complaint in this matter to certain interested parties, including (1) any person that Union Oil has contacted regarding possible infringement of any of the Relevant U.S. Patents, (2) any person against which Union Oil is, or was, involved in any legal action regarding possible infringement of any of the Relevant U.S. Patents, (3) any licensee or other Person from which Union Oil has collected any fees, royalties or other payments, in cash or in kind, for the practice of the Relevant U.S. Patents, and (4) any person that Union Oil has contacted with regard to the possible collection of any fees, royalties or other payments, in cash or in kind, for the practice of the Relevant U.S. Patents.

Paragraph V also requires Union Oil to distribute a copy of the Proposed Consent Order and the Complaint to Union Oil's present and future officers and directors having responsibility for any of its obligations under the Proposed Consent Order, and to employees and agents having managerial responsibility for any of its obligations under the Proposed Consent Order.

Paragraphs VI, VII and VIII of the Proposed Consent Order contain standard reporting, access, and notification provisions designed to allow the Commission to monitor compliance with the order. Paragraph IX provides that the Proposed Consent Order shall terminate twenty (20) years after the date it becomes final.

III. Opportunity for Public Comment

The Proposed Consent Order has been placed on the public record for thirty (30) days for receipt of comments by interested persons. Comments received during this thirty-day comment

period will become part of the public record. After thirty (30) days, the Commission will again review the Proposed Consent Order and the comments received and will decide whether it should withdraw from the Proposed Consent Order or make final the Agreement's Proposed Consent Order.

By accepting the Proposed Consent Order subject to final approval, the Commission anticipates that the competitive problems alleged in the Complaint will be resolved. The purpose of this analysis is to invite public comment on the Proposed Consent Order, and to aid the Commission in its determination of whether it should make final the Proposed Consent Order contained in the Agreement. This analysis is not intended to constitute an official interpretation of the Proposed Consent Order, nor is it intended to modify the terms of the Proposed Consent Order in any way.