

# **FEDERAL TRADE COMMISSION DECISIONS**

**FINDINGS, OPINIONS, AND ORDERS  
JULY 1, 2004 TO DECEMBER 31, 2004**

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**MEMBERS OF THE FEDERAL TRADE COMMISSION**  
**DURING THE PERIOD JULY 1, 2004 TO DECEMBER 31, 2004**

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Took oath of office June 4, 2001.

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Took oath of office December 17, 1997.

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\* Resigned, effective August 15, 2004.

\*\* Resigned, effective August 31, 2004.

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Commission Opinion

**IN THE MATTER OF**

**UNION OIL COMPANY OF CALIFORNIA**

OPINION OF THE COMMISSION AND ORDER IN REGARD TO  
ALLEGED VIOLATIONS OF SEC. 5 OF THE  
FEDERAL TRADE COMMISSION ACT

*Docket 9305; File No. 0110214*

*Complaint, March 4, 2003--Opinion and Order, July 6, 2004*

The Complaint in this matter concerned a series of actions taken by Respondent Union Oil Company of California, an international energy firm, with respect to proceedings conducted by the California Air Resources Board (“CARB”) to set regulations and standards governing the composition of low emissions, reformulated gasoline (“RFG”), in an effort to reduce California air pollution levels. The Administrative Law Judge granted the respondent’s motions to dismiss the complaint and issued an Initial Decision. In a unanimous Opinion, the Commission determined to reverse and vacate the Initial Decision, reinstate the Complaint, and remand for further consideration of the Complaint allegations. The Commission determined that neither the *Noerr-Pennington* doctrine nor the claimed absence of Commission jurisdiction provided an adequate basis for the respondent’s motions to dismiss. The Commission concluded in particular that the *Noerr-Pennington* claims could not be sustained if the Complaint’s allegations were taken as established; that the jurisdictional argument was flawed as a matter of law; and therefore that the case should be remanded for factual development.

*Participants*

For the Commission: *J. Robert Robertson, Chong S. Park, David F. Conn, Peggy Bayer Femenella, John Roberti, Lisa Fialco, Suzanne Michel, Lore Unt, Thomas Krattenmaker, Harry Schwirk, Dean C. Graybill, John S. Martin, Richard B. Dagen, Geoffrey D. Oliver, Rendell A. Davis, Jr., Daniel P. Ducore, Terri Martin, Robert A. Walters, Elizabeth J. Grimm, Paige E. Pidano, Jessica Picone, Diana Cowen, Guru Raj, Kathleen Jones, Yasmine Carson, Mark D. Williams, Jeffrey H. Fischer, and Mark Frankena.*

For the Respondent: *Martin R. Lueck and David W. Beehler, Robins, Kaplan, Miller & Ciresi, and Joseph Kattan and Chris Wood, Gibson, Dunn & Crutcher.*

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**OPINION OF THE COMMISSION**

BY MURIS, Chairman, For A Unanimous Commission:

A private business allegedly has used false and misleading statements to induce a government body to issue regulatory standards that conferred market power upon the firm. Respondent argues that, even taking the Complaint's factual allegations as established as is required at this preliminary stage, its deliberate use of misrepresentations to secure monopoly power is protected from antitrust challenge under the *Noerr-Pennington* doctrine, which shelters certain petitioning for government action. We disagree.

On March 4, 2003, the Federal Trade Commission issued an administrative complaint alleging, *inter alia*, that the Union Oil Company of California ("Unocal") engaged in unfair methods of competition through knowing and willful misrepresentations, to the California Air Resources Board ("CARB") and to competing gasoline refiners, that Unocal lacked, or would not assert, patent rights concerning automobile emissions research results. The Complaint further alleged that, through these misrepresentations, Unocal (1) induced CARB to adopt reformulated gasoline standards that substantially overlapped Unocal's patent claims and (2) induced other refiners to reconfigure their refineries in ways that subsequently exposed them to Unocal's patent claims. According to the Complaint, Unocal claims it is entitled to hundreds of millions of dollars in royalties from refiners who are now required to follow CARB's standards.

Administrative litigation ensued. Unocal filed two motions to dismiss. One argued that Unocal's conduct involved petitioning the government and hence was immune from antitrust liability. The other asserted that the Complaint failed to state sufficient allegations that Unocal possessed, or dangerously threatened to possess, monopoly power.

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On November 25, 2003, Administrative Law Judge D. Michael Chappell issued an Initial Decision concluding that the *Noerr-Pennington* doctrine protects much of the conduct alleged to constitute unfair methods of competition and that the FTC lacks jurisdiction over the remaining allegations because they depend on resolution of substantial questions of patent law.<sup>1</sup> Judge Chappell dismissed the Complaint in its entirety. Complaint Counsel have appealed. For the reasons stated below, we reverse and vacate the Initial Decision, reinstate the Complaint, and remand for further consideration of the Complaint's allegations.

I. BACKGROUND

A. The Commission's Complaint

This case involves Unocal's actions in state regulatory proceedings concerning low-emissions, reformulated gasoline ("RFG") standards to address California's air pollution problems. The Complaint, *inter alia*, states the following allegations.<sup>2</sup>

1. Unocal, CARB, and the Reformulated Gasoline Proceedings

Prior to 1997, Unocal owned and operated refineries in California as a vertically integrated producer, refiner, and

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<sup>1</sup> The Initial Decision denied without prejudice the remainder of Unocal's motion regarding market power.

<sup>2</sup> Omissions and rewordings of the Complaint's allegations are solely for ease of exposition in addressing the specific issues currently before the Commission. Nothing in this Opinion is intended to change the content of the Complaint, which remains the sole charging document in this proceeding.



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marketer of petroleum products.<sup>3</sup> In March 1997, Unocal completed the sale of its west coast refining, marketing, and transportation assets, but it continues to engage in oil and gas exploration and production. *Id.* Moreover, Unocal's 2001 annual report, filed with the United States Securities and Exchange Commission, lists another of its key business activities as "[p]ursuing and negotiating licensing agreements for reformulated gasoline patents with refiners, blenders and importers."<sup>4</sup>

In late 1988, the California legislature amended the California Clean Air Act to require CARB, a department of the California Environmental Protection Agency, to reduce harmful automobile emissions, and directed CARB to achieve this goal through new standards for automobile fuels and low-emission vehicles. ¶ 21. CARB's specific legislative mandate, promulgated in California Health and Safety Code Section 43018, provided, *inter alia*, that CARB:

- a. Take "necessary, cost-effective, and technologically feasible" actions to achieve "reduction in the actual emissions of reactive, organic gases of at least 55 percent, a reduction in emissions of oxides of nitrogen of at least 15 percent from motor vehicles" no later than December 31, 2000;

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<sup>3</sup> ¶ 13. Paragraph references indicate paragraphs in the Complaint.

<sup>4</sup> ¶ 14. Unocal is the owner, by assignment, of the following patents relating to low-emissions, reformulated gasoline: United States Patent No. 5,288,393 (issued February 22, 1994); United States Patent No. 5,593,567 (issued January 14, 1997); United States Patent No. 5,653,866 (issued August 5, 1997); United States Patent No. 5,837,126 (issued November 17, 1998); United States Patent No. 6,030,521 (issued February 29, 2000). ¶ 15. These patents all derive from, and receive priority as if they were filed with, patent application No. 07/628,488, filed on December 13, 1990. ¶ 15.

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b. Take actions "to achieve the maximum feasible reduction in particulates, carbon monoxide, and toxic air contaminants from vehicular sources"; and

c. Adopt standards and regulations that would result in "the most cost-effective combination of control measures on all classes or motor vehicles and motor vehicle fuels" including the "specification of vehicular fuel composition."

¶ 21.

Following the 1988 California Clean Air Act amendments, CARB embarked on two rulemakings relating to low-emissions RFG. In these proceedings – Phase 1 and Phase 2, respectively – CARB prescribed limits on specific gasoline properties. ¶ 22. In the Phase 2 RFG proceedings, on which this case focuses, CARB developed stringent standards for low-emissions RFG. ¶ 24.

## 2. Alleged Misrepresentations to CARB

The Complaint alleges that, beginning in 1990 and continuing throughout the CARB Phase 2 RFG rulemaking process, Unocal provided "materially misleading" information to CARB "for the purpose of obtaining competitive advantage." ¶ 35. According to the Complaint, "This information was materially misleading in light of Unocal's suppression of facts relating to its proprietary interests in its emissions research results and Unocal's active prosecution of patents based on these research results." *Id.* Unocal gave CARB this information in private meetings with CARB, through participation in CARB's public workshops and hearings, and through industry groups that also were commenting on the CARB regulations. *Id.*

On June 11, 1991, CARB held a public workshop regarding the Phase 2 RFG regulations. The specifications CARB proposed for discussion at this public workshop did not include a T50 specification, *viz.*, a specification based on the temperature at which 50 percent of a fuel evaporates. ¶¶ 30, 36. Nine days later,

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Unocal presented to CARB's staff the results of its "5/14 Project" emissions research program to show that "cost-effective" regulations could be achieved through adoption of a "predictive model" and to convince CARB of the importance of T50. ¶¶ 37, 78a. Unocal's then-pending patent application contained numerous claims that included T50 as a critical limitation, in addition to other fuel properties that CARB proposed to regulate. ¶ 37. Unocal's management, however, decided not to disclose Unocal's pending '393 patent application to CARB's staff. ¶ 38.

On July 1, 1991, Unocal provided CARB with the actual emissions prediction equations developed in the "5/14 Project." Unocal requested that CARB "hold these equations confidential, as we feel that they may represent a competitive advantage in the production of gasoline." ¶ 39. Nevertheless, Unocal stated:

If CARB pursues a meaningful dialogue on a predictive model approach to Phase 2 gasoline, Unocal will consider making the equations and underlying data public as required to assist in the development of a predictive model.

*Id.*

Following CARB's agreement to develop a predictive model, the Complaint alleges, Unocal made its emissions research results, including the test data and equations underlying its "5/14 Project," publicly available. ¶ 40. In an August 27 letter, Unocal stated to CARB:

Please be advised that Unocal now considers this data to be non-proprietary and available to CARB, environmental interest groups, other members of the petroleum industry, and the general public upon request.

¶ 41. The Complaint continues: "Read separately or in conjunction with Unocal's July 1, 1991 letter, the August 27, 1991 letter created the materially false and misleading impression that Unocal agreed to give up any 'competitive advantage' it may have

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had relating to its purported invention and arising from its emissions research results.” ¶ 42; *see* ¶ 78b. Unocal made numerous subsequent statements and comments to CARB that “reinforced the materially false and misleading impression” that Unocal had created. ¶ 78c.

The Complaint further alleges that in “reasonable reliance on Unocal's representation that the information was no longer proprietary, CARB used Unocal's equations in setting a T50 specification.” ¶ 43. Subsequently, in October 1991, CARB published Unocal's equations in public documents supporting the proposed Phase 2 RFG regulations. *Id.* On November 22, 1991, CARB adopted Phase 2 RFG regulations that set standards for the composition of low-emissions RFG with specific limits for eight gasoline properties. ¶ 44. Unocal's pending patent claims recited limits for five of those eight properties, including T50. *Id.*

In June 1994, CARB amended the Phase 2 regulations to include, as an alternative method of complying, a predictive model that was intended to provide refiners with additional flexibility. ¶ 47. This “predictive model” permits a refiner to comply with the RFG regulations by producing fuel that is predicted – based on its composition and the levels of the eight properties – to have emissions equivalent to a fuel that meets the strict gasoline property limits set forth in the regulations. *Id.* During the development of the predictive model, Unocal submitted comments to CARB touting the predictive model as offering “flexibility” and furthering CARB's mandate of “cost-effective” regulations. ¶ 48. Allegedly, these statements were “materially false and misleading because Unocal suppressed the material fact that assertion of its proprietary rights would materially increase the cost and reduce the flexibility of the proposed regulations.” *Id.*

In sum, the Complaint states that “[t]hroughout its communications and interactions with CARB prior to January 31, 1995, Unocal failed to disclose that it had pending patent rights, that its patent claims overlapped with the proposed RFG

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regulations, and that Unocal intended to charge royalties.” ¶ 79. Citing as examples CARB’s inclusion of a specification for T50 in its Phase 2 RFG regulations and its adoption of a "predictive model" that included T50 as one of the parameters, the Complaint alleges that “Unocal's misrepresentations and materially false and misleading statements caused CARB to adopt Phase 2 RFG regulations that substantially overlapped with Unocal's concealed patent claims.” ¶ 45. The Complaint concludes: “But for Unocal's fraud, CARB would not have adopted RFG regulations that substantially overlapped with Unocal's concealed patent claims; the terms on which Unocal was later able to enforce its proprietary interests would have been substantially different; or both.” ¶ 80.

### 3. Alleged Misrepresentations to Industry Groups

The Complaint also alleges that Unocal made misrepresentations to two industry groups. During the CARB RFG rulemaking, Unocal actively participated in the Auto/Oil Air Quality Improvement Research Program ("Auto/Oil"), a cooperative, joint research program involving the major domestic automobile manufacturers and fourteen oil companies. ¶ 50. The Auto/Oil joint research venture sought to conduct research to measure and evaluate automobile emissions and the potential improvements in air quality achievable through, and relative costs of, the use of reformulated gasolines and other techniques. ¶ 51. The Auto/Oil Agreement provided that “[n]o proprietary rights will be sought nor patent applications prosecuted on the basis of the work of the Program unless required for the purpose of ensuring that the results of the research by the Program will be freely available, without royalty, in the public domain.” ¶ 52. Thus, “once data and information were in fact presented to the Auto/Oil Group, they became the ‘work of the Program.’ ” ¶ 53.

On September 26, 1991, Unocal presented to Auto/Oil the results of Unocal's emissions research, including the test data, equations, and directional relationships derived from the “5/14” Project. ¶ 54. According to the Complaint, Unocal informed

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Auto/Oil participants that “the data had been made available to CARB and were in the public domain” and that “the data would be made available to Auto/Oil participants.” *Id.* By these representations and through subsequent testing – as part of the Auto/Oil Program – of the 5/14 fuel property relationships, Unocal’s 5/14 work allegedly became part of the “work” of the Auto/Oil Program. ¶¶ 54-55.

During the CARB RFG rulemaking, Unocal also actively participated in the Western States Petroleum Association ("WSPA"), a trade association of firms engaged in petroleum exploration, production, refining, transportation, and marketing. ¶ 56. WSPA commissioned, and submitted to CARB, three cost studies in connection with the Phase 2 RFG rulemaking. *Id.* One of these studies, used by CARB to determine the cost-effectiveness of the proposed Phase 2 RFG standards, incorporated information relating to royalty rates associated with non-Unocal patents and could have incorporated costs associated with Unocal’s pending patents. ¶ 57. According to the Complaint, however, Unocal’s presentation of its "5/14 Project" research results to WSPA on September 10, 1991 “created the materially false and misleading impression that Unocal's emissions research results, including the data and equations, were nonproprietary and could be used by WSPA or its individual members without concern for the existence or enforcement of any intellectual property rights.” ¶ 58.

The Complaint alleges that Unocal’s interactions with Auto/Oil and WSPA prior to January 31, 1995, failed to disclose Unocal’s pending patent rights and its intention to charge royalties, ¶¶ 83, 88; included “false and misleading statements concerning its proprietary interests in the results of its emissions research,” ¶¶ 84, 89; and “breached fiduciary duties” to the other members of the associations. ¶¶ 84, 89. “None of the participants in the WSPA or Auto/Oil groups knew of the existence of Unocal's proprietary interests and/or pending patent rights at any time prior to the issuance of the '393 patent in February 1994, by which time most, if not all, of the oil company participants to these groups

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had made substantial progress in their capital investment and refinery modification plans for compliance with the CARB Phase 2 regulations.” ¶ 59. Thus, “But for Unocal's fraud, these participants in the rulemaking process would have taken actions including, but not limited to, (a) advocating that CARB adopt regulations that minimized or avoided infringement on Unocal's patent claims; (b) advocating that CARB negotiate license terms substantially different from those that Unocal was later able to obtain; and/or (c) incorporating knowledge of Unocal's pending patent rights in their capital investment and refinery reconfiguration decisions to avoid and/or minimize potential infringement.” ¶ 90.

#### 4. Unocal’s Patent Applications

The Complaint alleges that the relevant Unocal patent claims all derive from patent application No. 07/628,488, filed on December 13, 1990. ¶ 15. Following the November 1991 adoption of CARB’s Phase 2 RFG specifications, Unocal amended its patent claims in March 1992 to ensure that the claims more closely matched the regulations. ¶ 60; *see supra* note 4.

The Complaint further alleges that on or about July 1, 1992, Unocal received an office action from the U.S. Patent and Trademark Office (“PTO”) indicating that most of Unocal's pending patent claims had been allowed, and that, in February 1993, after submission of additional amendments, Unocal received a notice of allowance from the PTO for all its pending claims. ¶¶ 61-62. Unocal allegedly did not disclose this information to CARB or other participants to the CARB Phase 2 RFG rulemaking. *Id.*

The PTO issued the '393 patent to Unocal on February 22, 1994. Unocal, however, waited until January 31, 1995, to issue a press release announcing the patent’s issuance. ¶ 64. According to the Complaint, “CARB first became aware of Unocal's '393 patent” shortly after that press release. ¶ 49.

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5. Unocal's Patent Enforcement Efforts

On April 13, 1995, ARCO, Exxon, Mobil, Chevron, Texaco, and Shell sued in federal district court to invalidate Unocal's '393 patent. Unocal counterclaimed for infringement of that patent. The jury determined that Unocal's '393 patent was valid and infringed, and found that the refiners must pay a royalty of 5.75 cents per gallon for the period from March through July 1996 for sales of infringing gasoline in California. ¶ 68. The United States Court of Appeals for the Federal Circuit subsequently affirmed the trial court's judgment, and the refiner-defendants have made payments totaling \$91 million to Unocal for damages, costs, and attorneys' fees. ¶ 69. An accounting action is still ongoing to determine damages for infringing the '393 patent during subsequent periods. ¶ 70.

On January 23, 2002, Unocal sued Valero Energy Company for willful infringement of both the '393 patent and the '126 patent. In its complaint, Unocal seeks damages at the rate of 5.75 cents per gallon, trebled for willful infringement. ¶ 71.

Moreover, "Unocal also has enforced its patent claims through licensing activities." ¶ 72. To date, Unocal has entered license agreements with eight refiners, blenders, and/or importers covering the use of all five RFG patents. Unocal has publicly stated that it expects to reap up to \$150 million a year from licensing its RFG patents. ¶ 14.

6. The Alleged Violations

The Complaint alleges that "Unocal's fraudulent conduct has resulted in Unocal's acquisition of market power in the following markets: the technology market for the production and supply of CARB-compliant "summer-time" gasoline in California, and the downstream product market for CARB-compliant "summer-time" gasoline in California." ¶ 91; *see* ¶¶ 73-75. Allegedly, "The extensive overlap between the CARB RFG regulations and the Unocal patent claims makes avoidance of the Unocal patent



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claims technically and/or economically infeasible.” ¶ 92. Refiners, having “invested billions of dollars in sunk capital investments without knowledge of Unocal's patent claims to reconfigure their refineries in order to comply with the CARB Phase 2 RFG regulations . . . cannot produce significant volumes of non-infringing CARB-compliant gasoline without incurring substantial additional costs,” ¶ 93, and “CARB cannot now change its RFG regulations sufficiently to provide flexibility for refiners and others to avoid Unocal's patent claims.” ¶ 94. Had Unocal disclosed its proprietary interests and pending patent rights earlier, CARB would have been able to consider the potential costs imposed by the Unocal patents, and the harm to competition and to consumers would have been avoided. *Id.* Instead, Unocal allegedly “has exercised, and continues to exercise, its market power through business conduct by enforcing its patents through litigation and licensing activities.” ¶ 95.

After asserting harm to competition and substantial consumer injury, ¶¶ 97-98, the Complaint concludes that Unocal has violated Section 5 of the FTC Act by monopolizing, attempting to monopolize, and unreasonably restraining trade in the technology market for the production and supply of CARB-compliant “summer-time” gasoline to be sold in California and by attempting to monopolize, and restraining trade in, the downstream goods market for CARB-compliant “summer-time” gasoline. ¶¶ 99-103.

#### B. The Initial Decision

None of the alleged facts have been proved or disproved. No trial has been held. The Administrative Law Judge’s (the “ALJ’s”) Initial Decision dismissed the Complaint on the basis of Unocal’s motions. As a general matter, the Initial Decision (cited as the “ID”) assumes that the Complaint’s allegations are true and asks whether, if proved, they would be sufficient to establish a

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violation of Section 5.<sup>5</sup> It concludes, under two separate lines of reasoning, that those allegations are insufficient.

One line of analysis entails the *Noerr-Pennington* doctrine, under which “[t]hose who petition the government for redress are generally immune from antitrust liability.”<sup>6</sup> The Initial Decision holds that “*Noerr-Pennington* immunizes Respondent’s efforts to induce CARB to adopt regulations on low-emissions, reformulated gasoline.” ID at 68. Moreover, that Decision concludes, “[t]o the extent that Respondent’s alleged conduct towards Auto/Oil Group and WSPA were part of Respondent’s scheme to induce CARB to act, it constitutes indirect petitioning protected by *Noerr-Pennington*.” *Id.*

In reaching these conclusions, the Initial Decision rejected claims that the alleged false and misleading nature of Unocal’s petitioning vitiates application of *Noerr-Pennington*. It considered and rejected two possible bases for exception to the doctrine. First, it ruled that the “sham” exception is inapplicable when the petitioner seeks to gain monopoly power through the *outcome* of the government action, rather than through abuse of the governmental *process*. ID at 48-49. Second, it rejected application of an exception to *Noerr-Pennington* drawn from

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<sup>5</sup> Although the Initial Decision includes little independent fact-finding, the ALJ does supplement his analysis of the Complaint with findings based on official notice of some of the statutes governing CARB, the Notice of Public Hearing through which CARB initiated the rulemaking, and CARB’s Final Statement of Reasons for Rulemaking.

<sup>6</sup> ID at 31, quoting *Professional Real Estate Investors, Inc. v. Columbia Pictures Indus.*, 508 U.S. 49, 56 (1993). The doctrine derives its name from two Supreme Court cases, *Eastern R.R. President’s Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961), and *United Mine Workers v. Pennington*, 381 U.S. 657 (1965).

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principles of *Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.*, 382 U.S. 172 (1965), in which the Supreme Court ruled that enforcement of a patent obtained by fraud can constitute monopolization. The Initial Decision found that to the extent that *Walker Process* principles support an exception to *Noerr-Pennington*, they do so only when governmental action is “quasi-adjudicatory and dependent on the petitioner for factual information.” ID at 50, 68. Although the ALJ acknowledged that misrepresentations are outside the *Noerr-Pennington* doctrine “where the agency is using an adjudicatory process,” ID at 33, he found Unocal’s alleged misrepresentations protected because CARB’s Phase 2 RFG rulemaking process was “quasi-legislative.” ID at 32-40. Responding to claims that application of *Noerr-Pennington* is particularly inappropriate here because CARB necessarily relied on the truth and accuracy of information provided by Unocal, the ALJ observed that entities other than Unocal also provided some input: “because CARB was not wholly dependent on Respondent in its rulemaking proceeding,” the ALJ reasoned, “*Noerr-Pennington* applies.” ID at 40-43.

The Initial Decision also rejected arguments suggesting that Unocal’s conduct falls outside the scope of protected petitioning. To the argument that the doctrine does not apply when an agency is unaware that it is being asked to adopt or participate in a restraint of trade, the ALJ answered, “[I]t is clear that Respondent engaged in petitioning conduct,” ID at 44, and concluded that “there is no requirement that the agency know what the effect of its legislation will be . . . .” ID at 47. In response to contentions that differences between the FTC Act and the Sherman Act suggest a narrower reach for *Noerr-Pennington* protections under the former, the Initial Decision ruled that *Noerr-Pennington* protection is as “fully available” in cases alleging unfair methods of competition under the FTC Act as in cases based on the Sherman Act. ID at 51-55.

Regarding Unocal’s communications to Auto/Oil, WSPA, and their participants, the Initial Decision held that “[m]isrepresentations to third parties as a means of influencing the

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government's passage of laws fall within the bounds of *Noerr-Pennington*." ID at 56. It found that Unocal's alleged actions with respect to the private industry groups were "part of an alleged scheme to induce these third parties to influence CARB." ID at 57. It concludes that such conduct "constitutes indirect petitioning protected by *Noerr-Pennington*." ID at 68.

The Initial Decision applied a second line of analysis to the few allegations that remained after its *Noerr-Pennington* holdings, specifically, those allegations based on misrepresentations made to the Auto/Oil Group and to WSPA that were "independent of [Unocal's] alleged scheme to induce CARB to act." ID at 56. The Initial Decision identifies these allegations as culminating with Complaint ¶ 90(c), which states that "[b]ut for Unocal's fraud," the participants in Auto/Oil and WSPA would have taken actions "incorporating knowledge of Unocal's pending patent rights in their capital investment and refinery reconfiguration decisions to avoid and/or minimize potential infringement," with the result that "harm to competition and consumers . . . would have been avoided." The ALJ did not find these allegations covered by *Noerr-Pennington*, but rather held that the Commission lacked jurisdiction to resolve them.

According to the ALJ, "harm beyond that caused by CARB's regulations cannot be determined without knowing the scope of Respondent's patents, whether or not Auto/Oil Group and WSPA could have invented around those patents, and whether any such newly created products or methods could have avoided infringement." ID at 61. Necessarily embedded within these inquiries, he reasoned, are issues of patent claim interpretation and infringement. Citing 28 U.S.C. § 1338(a)<sup>7</sup> and the Supreme Court's opinion in *Christianson v. Colt Indus. Operating Corp.*,

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<sup>7</sup> 28 U.S.C. § 1338(a) vests original jurisdiction over "any civil action arising under any Act of Congress relating to patents" in the federal district courts.

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486 U.S. 800 (1988),<sup>8</sup> the ALJ concluded that the Complaint requires resolution of substantial questions of federal patent law; that it therefore “arises under” the federal patent law; and that only the federal courts, not the FTC, have the necessary jurisdiction. “Because the Commission does not have jurisdiction to adjudicate the scope of Respondent’s patents and whether the third parties could compete with other products or methods without infringing on valid patents, the allegations of the Complaint with respect to Respondent’s conduct towards Auto/Oil Group and WSPA are dismissed.” ID at 67.

## II. STANDARD FOR EVALUATING MOTIONS TO DISMISS

As a matter of Commission practice, a motion to dismiss is treated analogously to a motion in federal court under Federal Rule of Civil Procedure 12(b)(6) to dismiss a complaint for failure to state a cause of action upon which relief can be granted: the Commission inquires whether the Complaint’s allegations, if proved, are sufficient to make out a violation of Section 5. *See TK-7 Corp*, 1989 FTC Lexis 32, \*3 (1989); *Florida Citrus Mutual*, 50 F.T.C. 959, 961 (1954) (dismissal warranted when “the facts alleged do not state a cause of action”). In making that inquiry, the Commission assumes the Complaint’s factual allegations to be true and draws all reasonable inferences in favor of Complaint Counsel. *See TK-7* at \*3; 2 MOORE’S FEDERAL PRACTICE § 12.34[1][b] (3d ed. 2003); 5AWright & Miller, FEDERAL PRACTICE & PROCEDURE § 1357 (2003) (“the complaint is construed in the light most favorable to plaintiff and its allegations are taken as true”). A case in this posture does not raise the issue whether the Complaint’s factual allegations are true, but whether Complaint Counsel is entitled to offer evidence to support the allegations. *See* 2 MOORE’S FEDERAL PRACTICE

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<sup>8</sup> *Christianson* holds that a case arises under federal patent law when the “plaintiff’s right to relief necessarily depends on resolution of a substantial question of federal patent law.” 486 U.S. at 809.

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§ 12.34[1][a]. The Commission's review of an Initial Decision that grants a motion to dismiss, like its review of other Initial Decisions by administrative law judges, is *de novo*. 16 C.F.R. § 3.54.

III. AS A MATTER OF LAW, MISREPRESENTATION MAY SOMETIMES VITIATE THE *NOERR-PENNINGTON* DOCTRINE

Complaint Counsel appeal the Initial Decision's general application of the *Noerr-Pennington* doctrine on four principal grounds. They argue at greatest length that Unocal's conduct falls within a misrepresentation exception to the doctrine. In addition, they argue that *Noerr-Pennington* does not apply because (1) CARB's objective purpose was neither to adopt nor to participate in a restraint of trade; (2) harm from Unocal's conduct can be cured without overturning a government decision, burdening those who comply with that decision, or impairing communications between a party and a government agency; and (3) the petitioning exclusion applicable to proceedings alleging FTC Act violations, in contrast to those alleging Sherman Act violations, is only as broad as constitutionally required.

As discussed below, we resolve the *Noerr-Pennington* issues before us with an exception applicable, in appropriate circumstances, to misrepresentations. In so doing, we find it unnecessary to consider, as self-standing arguments, Complaint Counsel's theories premised on CARB's objective purposes and the nature of required remedies, although we find some elements of Complaint Counsel's discussion instructive. We do not reach the issue of a possible distinction between the scope of *Noerr-Pennington* protection under the FTC Act as opposed to the Sherman Act.

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A. *Noerr-Pennington*: Basic Principles and Evolution of the “Sham” Exception

Beginning with *Eastern R.R. President’s Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961), the Supreme Court has fashioned and applied a doctrine that bars Sherman Act challenges “predicated upon mere attempts to influence the passage or enforcement of laws.” *Id.* at 135. *Noerr* involved allegations that a group of railroads had jointly conducted a publicity campaign “designed to foster the adoption and retention of laws and law enforcement practices destructive of the trucking business” as well as “to create an atmosphere of distaste for the truckers among the general public” and “to impair the relationships existing between the truckers and their customers.” *Id.* at 129. Intertwining considerations of statutory construction with First Amendment principles, the Court found the challenged conduct beyond the coverage of the Sherman Act.

The Court first explained that “an attempt to persuade the legislature or the executive to take particular action” bears “very little if any resemblance to the combinations normally held violative of the Sherman Act . . . .” *Id.* at 136. This “essential dissimilarity” cautions against treating such conduct as trade restraints, the Court continued. *Id.* at 136-37. Next, the Court suggested that a limitation on the Sherman Act’s coverage was necessary for effective operation of a representative government. To hold that the Sherman Act forbids agreements “for the purpose of influencing the passage or enforcement of laws,” the Court explained, “would substantially impair the power of government to take actions through its legislature and executive that operate to restrain trade.” *Id.* at 137. The Court continued:

In a representative democracy such as this, these branches of government act on behalf of the people and, to a very large extent, the whole concept of representation depends upon the ability of the people to make their wishes known to their representatives. To hold that the government retains the power to act in this representative capacity and yet hold, at the same

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time, that the people cannot freely inform the government of their wishes would impute to the Sherman Act a purpose to regulate, not business activity, but political activity, a purpose which would have no basis whatever in the legislative history of that Act.

*Id.*

Finally, the Court turned to the First Amendment right of petitioning: “[A] construction of the Sherman Act” that forbids joint activity to influence the passage or enforcement of laws “would raise important constitutional questions.” *Id.* at 138. As the Court explained, “The right of petition is one of the freedoms protected by the Bill of Rights, and we cannot, of course, lightly impute to Congress an intent to invade these freedoms.” *Id.* The Court concluded, “[W]e think it clear that the Sherman Act does not apply to the activities of the railroads at least insofar as those activities comprised mere solicitation of governmental action with respect to the passage and enforcement of laws.” *Id.*

*Noerr* dealt primarily with efforts to influence legislation. Subsequently, the Supreme Court applied *Noerr*’s principles to petitioning directed at the executive branch,<sup>9</sup> as well as to administrative agencies and the courts.<sup>10</sup> “[I]t would be

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<sup>9</sup> *United Mine Workers v. Pennington*, 381 U.S. 657 (1965). Whereas *Noerr* had involved petitioning aimed at state government, *Pennington* applied similar principles to petitioning federal executive branch officials and independent agencies (the Secretary of Labor and the Tennessee Valley Authority). The Court emphasized that *Noerr* principles apply to efforts to influence government officials regardless of anticompetitive intent or purpose. *Id.* at 669-70.

<sup>10</sup> *California Motor Transport Co. v. Trucking Unlimited*, 404 U.S. 508, 510-11 (1972) (“The same philosophy governs the approach of citizens or groups of them to administrative agencies



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destructive of rights of association and of petition,” the Court stated, “to hold that groups with common interests may not, without violating the antitrust laws, use the channels and procedures of state and federal agencies and courts to advocate their causes and points of view respecting resolution of their business and economic interests vis-a-vis their competitors.”<sup>11</sup>

Nonetheless, the Court has clearly found a “sham” exception to *Noerr-Pennington*. As early as *Noerr* itself, the Court stated:

There may be situations in which a publicity campaign, ostensibly directed toward influencing governmental action, is a mere sham to cover what is actually nothing more than an attempt to interfere directly with the business relationships of a competitor and the application of the Sherman Act would be justified.

*Noerr*, 365 U.S. at 144. In *California Motor Transport*, the Court found such a sham and rejected *Noerr-Pennington* protection for multiple administrative and judicial challenges that one group of trucking firms brought to oppose their competitors’ applications for operating rights. The Court stressed that the antitrust plaintiff had alleged that the defendants “instituted the proceedings and actions . . . with or without probable cause, and regardless of the merits of the cases,” and concluded that “the allegations are not that the conspirators sought to influence public officials, but that they sought to bar their competitors from meaningful access to adjudicatory tribunals and so to usurp that decisionmaking process.” *California Motor Transport*, 404 U.S. at 512 (internal quotations omitted).

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(which are both creatures of the legislature, and arms of the executive) and to courts . . .”).

<sup>11</sup> *Id.*

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More recently, the Court explained that “[t]he ‘sham’ exception to *Noerr* encompasses situations in which persons use the governmental *process* – as opposed to the *outcome* of that process – as an anticompetitive weapon.”<sup>12</sup> Finally, in *Professional Real Estate Investors, Inc. v. Columbia Pictures Industries, Inc.*, 508 U.S. 49 (1993) (“*PREI*”), a case that held that *Noerr-Pennington* sheltered a single copyright infringement lawsuit from Sherman Act counterclaims, the Court offered a two-part definition of sham litigation:

First, the lawsuit must be objectively baseless in the sense that no reasonable litigant could realistically expect success on the merits. . . . Only if challenged litigation is objectively meritless may a court examine the litigant’s subjective motivation. Under this second part of our definition of sham, the court should focus on whether the baseless lawsuit conceals “an attempt to interfere directly with the business relationships of a competitor” through the “use [of] the governmental *process* – as opposed to the *outcome* of that process – as an anticompetitive weapon.”

*PREI*, 508 U.S. at 60-61 (citations omitted) (emphasis original).

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<sup>12</sup> *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 380 (1991) (emphasis original); see also *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 507 n.10 (1988) (observing that *Noerr* described a sham exception covering “activity that was not genuinely intended to influence governmental action”). *Omni* clarified that the restriction on access to governmental fora at issue in *California Motor Transport* supported the sham exception only because “the conspirators’ participation in the governmental process was itself claimed to be a ‘sham,’ employed as a means of imposing cost and delay.” *Omni*, 499 U.S. at 381-82.

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B. *Noerr-Pennington*: Judicial Assessment of Misrepresentation<sup>13</sup>

1. Legal Background

The Supreme Court has also suggested that some misrepresentations to governmental agencies fall outside of *Noerr-Pennington* protections, but it has left key questions unanswered.

Again, the line of analysis traces from *Noerr* itself. The plaintiff there alleged that the railroads' publicity campaign against the trucking industry was fraudulent, in that material prepared and produced by the railroads' public relations firm was made to appear as the spontaneously expressed views of independent persons and civic groups. Although it found this "third-party" technique unethical,<sup>14</sup> the Court ruled that it was "legally irrelevant." *Noerr*, 365 U.S. at 140-42. "Insofar as [the Sherman] Act sets up a code of ethics at all," the Court explained,

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<sup>13</sup> Our references to "misrepresentations" include material omissions as well. *See, e.g., Nobelpharma AB v. Implant Innovations, Inc.*, 141 F.3d 1059, 1070 (Fed. Cir.) (finding that a jury instruction "was not inconsistent with various opinions of the courts stating that omissions, as well as misrepresentations, may in limited circumstances support a finding of *Walker Process* fraud"), *cert. denied*, 525 U.S. 876 (1998).

<sup>14</sup> Although use of the third party technique allegedly was deceptive, the Court recognized that the district court did not find that the railroads' publicity campaign contained false content, but rather that the railroads took "a dramatic fragment of truth and by emphasis and repetition distort[ed] it into falsehood." *Noerr*, 365 U.S. at 134 n.8 (internal quotation omitted). The fact that both sides in *Noerr* used the third party technique, *id.* at 142 n.22, vividly indicates the "rough and tumble" nature of the political context in which the parties fought their lobbying battle.

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“it is a code that condemns trade restraints, not political activity, and as we have already pointed out, a publicity campaign to influence governmental action falls clearly into the category of political activity.” *Id.* at 140-41. Congress’ “caution in legislating with respect to problems relating to the conduct of political activities” would “go for naught if we permitted an extension of the Sherman Act to regulate activities of that nature simply because those activities have a commercial impact and involve conduct that can be termed unethical.” *Id.* at 141.

In contrast to *Noerr*’s holding that misrepresentations in a lobbying campaign in the political context were not subject to Sherman Act liability, subsequent cases apply different approaches for different contexts. As the Court explained, “Misrepresentations, condoned in the political arena, are not immunized when used in the adjudicatory process.” *California Motor Transport*, 404 U.S. at 513. More recently, in *Allied Tube*, 486 U.S. at 499, the Court stressed that “the applicability of *Noerr* immunity varies with the context and nature of the activity.” (Comma omitted.) Thus, A publicity campaign directed at the general public, seeking legislation or executive action, enjoys antitrust immunity even when the campaign employs unethical and deceptive methods. But in less political arenas, unethical and deceptive practices can constitute abuses of administrative or judicial processes that may result in antitrust violations.

*Id.* at 499-500 (citation omitted).

The Supreme Court followed a parallel approach in *Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.*, 382 U.S. 172 (1965). In that case, decided after both *Noerr* and *Pennington*, Walker Process, the defendant in a patent infringement suit, counterclaimed that Food Machinery had violated Section 2 of the Sherman Act by threatening to sue, and then suing, for the alleged infringement of a patent obtained through knowing and deliberate fraud on the Patent Office. An infringement action, like other court litigation, could not give rise to antitrust liability if sheltered by *Noerr-Pennington*. Without

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mentioning *Noerr-Pennington* considerations, however, the Court concluded that “the enforcement of a patent procured by fraud on the Patent Office may be violative of § 2 of the Sherman Act provided the other elements necessary to a § 2 case are present.”<sup>15</sup>

The statements in *California Motor Transport* and *Allied Tube* regarding misrepresentation were *dicta*, and the Court did not explain the relationship between its *Walker Process* holding and the *Noerr-Pennington* doctrine. Nor have the Supreme Court’s latest pronouncements resolved these issues. *Omni* rejected a “conspiracy” exception to *Noerr-Pennington*, applicable “when government officials conspire with a private party to employ government action as a means of stifling competition,” 499 U.S. at 382, but did not directly discuss misrepresentation. After detailing its two-part test for sham litigation, *PREI* did discuss misrepresentation, but only to state that it was *not* deciding how it should be analyzed. The Court stated:

In surveying the “forms of illegal and reprehensible practice which may corrupt the administrative or judicial processes and which may result in antitrust violations,” we have noted that “unethical conduct in the setting of the adjudicatory process

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<sup>15</sup> *Walker Process*, 382 U.S. at 174. The Court explained that a patent “ ‘is an exception to the general rule against monopolies and to the right to access to a free and open market’ ” and noted the “ ‘paramount’ ” public interest “ ‘in seeing that patent monopolies spring from backgrounds free from fraud or other inequitable conduct and that such monopolies are kept within their legitimate scope.’ ” *Id.* at 177, quoting *Precision Instrument Mfg. Co. v. Automotive Maintenance Machinery Co.*, 324 U.S. 806, 816 (1945). Consequently, the Court determined, a showing of knowing and willful misrepresentations in obtaining its patent would suffice “to strip Food Machinery of its exemption from the antitrust laws,” and expose it to potential antitrust liability for seeking to enforce the fraudulently obtained patent rights. *Walker Process*, 382 U.S. at 177.

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often results in sanctions” and that “[m]isrepresentations, condoned in the political arena, are not immunized when used in the adjudicatory process.” *California Motor Transport*, 404 U.S., at 512-13. We need not decide here whether and, if so, to what extent *Noerr* permits the imposition of antitrust liability for a litigant’s fraud or other misrepresentations. Cf. Fed. Rule Civ. Proc. 60(b)(3) (allowing a federal court to “relieve a party . . . from a final judgment” for “fraud . . . , misrepresentation, or other misconduct of an adverse party”); *Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.* 382 U.S. 172, 176-77 . . . .

*PREI*, 508 U.S. at 61 n.6.

Although Supreme Court law remains unsettled, the weight of lower court authority, spanning more than thirty years, has recognized that misrepresentations may preclude application of *Noerr-Pennington* in less political arenas than the legislative lobbying at issue in *Noerr* itself. For example, courts have refused to apply the doctrine to conduct involving misrepresentations to a state railroad commission in the setting of natural gas production quotas;<sup>16</sup> to the Interstate Commerce Commission in a ratemaking context;<sup>17</sup> to a state health planning agency considering an application for a certificate of need (“CON”);<sup>18</sup> to the Food & Drug Administration involving its

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<sup>16</sup> See *Woods Exploration & Producing Co. v. Aluminum Co. of America*, 438 F.2d 1286 (5<sup>th</sup> Cir. 1971), *cert. denied*, 404 U.S. 1047 (1972).

<sup>17</sup> See *Clipper Exxpress v. Rocky Mountain Motor Tariff Bureau*, 690 F.2d 1240 (9<sup>th</sup> Cir. 1982), *cert. denied*, 459 U.S. 1227 (1983).

<sup>18</sup> See *St. Joseph’s Hosp. v. Hospital Corp. of America*, 795 F.2d 948 (11<sup>th</sup> Cir. 1986); see also *Kottle v. Northwest Kidney Centers*, 146 F.3d 1056 (9<sup>th</sup> Cir. 1998) (finding that

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pharmaceutical drug approval process;<sup>19</sup> and to state securities administrators and the federal courts with respect to allegations of franchise law violations, racketeering, and securities fraud.<sup>20</sup> The United States Courts of Appeals for the District of Columbia Circuit,<sup>21</sup> the Second Circuit,<sup>22</sup> the Fifth Circuit,<sup>23</sup> the Sixth Circuit,<sup>24</sup> the Seventh Circuit,<sup>25</sup> the Eighth Circuit,<sup>26</sup> the Ninth

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misrepresentation in a CON proceeding would not be *Noerr*-protected but that allegations in the complaint were too vague to avoid dismissal), *cert. denied*, 525 U.S. 1140 (1999). *Armstrong Surgical Center, Inc., v. Armstrong County Memorial Hosp.*, 185 F.3d 154 (1999), *cert. denied*, 530 U.S. 1261 (2000), which takes a largely contrary approach, is discussed below.

<sup>19</sup> See *Israel v. Baxter Laboratories*, 466 F.2d 272 (D.C. Cir. 1972).

<sup>20</sup> See *Whelan v. Abell*, 48 F.3d 1247 (D.C. Cir. 1995).

<sup>21</sup> See, e.g., *Whelan; Israel*.

<sup>22</sup> See *Juster Assoc. v. City of Rutland, Vt.*, 901 F.2d 266 (2d Cir. 1990); *Litton Sys., Inc. v. American Tel. & Tel. Co.*, 700 F.2d 785 (2d Cir. 1983), *cert. denied*, 464 U.S. 1073 (1984).

<sup>23</sup> See *Woods Exploration*.

<sup>24</sup> See *Potters Medical Center v. City Hospital Ass'n*, 800 F.2d 568 (6<sup>th</sup> Cir. 1986).

<sup>25</sup> See *Metro Cable Co. v. CATV of Rockford, Inc.*, 516 F.2d 220 (7<sup>th</sup> Cir. 1975).

<sup>26</sup> See *Porous Media Corp. v. Pall Corp.*, 186 F.3d 1077 (8<sup>th</sup> Cir. 1999); *Razorback Ready Mix Concrete Co. v. Weaver*, 761 F.2d 484 (8<sup>th</sup> Cir. 1985).

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Circuit,<sup>27</sup> the Eleventh Circuit,<sup>28</sup> and the Federal Circuit,<sup>29</sup> expressing their views in diverse terms and in varying settings, all have indicated that in some contexts misrepresentations to government may vitiate *Noerr-Pennington* protection.<sup>30</sup>

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<sup>27</sup> See *Kottle; Liberty Lake Investments, Inc. v. Magnuson*, 12 F.3d 155 (9<sup>th</sup> Cir. 1993), *cert. denied*, 513 U.S. 818 (1994); *Clipper Express*.

<sup>28</sup> See *St. Joseph's Hospital*.

<sup>29</sup> See *Rodime PLC v. Seagate Technology, Inc.*, 174 F.3d 1294 (Fed. Cir. 1999), *cert. denied*, 528 U.S. 1115 (2000); *Nobelpharma* (in the context of a patent obtained by fraud).

<sup>30</sup> As discussed below, the Third Circuit has expressed doubt whether a misrepresentation exception still exists, but even this court suggests narrow circumstances in which misrepresentation may vitiate *Noerr-Pennington* protection. See *infra* Section III.C. The Fourth Circuit has declined to rule on whether a “fraud exception” exists but has disposed of cases on the assumption that it does. See *Baltimore Scrap Corp. v. David J. Joseph Co.*, 237 F.3d 394, 401-04 (4<sup>th</sup> Cir.) (concluding that “[i]f a fraud exception to *Noerr-Pennington* does exist, it extends only to the type of fraud that deprives litigation of its legitimacy,” not to situations in which “regardless of the alleged fraud, the outcome would have been the same”), *cert. denied*, 533 U.S. 916 (2001); see also *A Fisherman's Best, Inc. v. Recreational Fishing Alliance*, 310 F.3d 183, 192 (4<sup>th</sup> Cir. 2002) (observing that there is no “officially recognized” *Noerr-Pennington* exception for a smear campaign, misrepresentation, threats, or corrupt practices, but nonetheless considering whether misrepresentation was present as an element of an allegedly improper lobbying campaign).



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## 2. Policy Considerations

Ample policy grounds support a misrepresentation exception to the *Noerr-Pennington* doctrine.

a. *The First Amendment*: As *Noerr* itself suggested, 365 U.S. at 137-38, and as the Court has consistently maintained, the doctrine derives in part from First Amendment considerations. In *California Motor Transport*, 404 U.S. at 510-11, the Court explained that “it would be destructive of rights of association and of petition to hold that groups with common interests may not, without violating the antitrust laws, use the channels and procedures of state and federal agencies and courts to advocate their causes and points of view . . . .” Similarly, in *FTC v. Superior Court Trial Lawyers Ass’n*, 493 U.S. 411 (1990) (“*SCTLA*”), the Court described the *Noerr-Pennington* doctrine as “[i]nterpreting the Sherman Act in the light of the First Amendment’s Petition Clause.” *Id.*, 493 U.S. at 424. *Accord, BE & K Construction Co. v. National Labor Relations Bd.*, 536 U.S. 516, 525 (2002).

The Supreme Court has also made it clear that the First Amendment does not shelter knowing misrepresentations. Thus, the Court has declared that “the use of the known lie as a tool is at once at odds with the premises of democratic government and with the orderly manner in which economic, social, or political change is to be effected.”<sup>31</sup>

In the free speech arena, public officials can recover damages for defamatory falsehoods made “with actual malice,” that is, with knowledge of falsity or with reckless disregard for whether the communication is false or not. *See New York Times Co. v. Sullivan*, 376 U.S. 254, 279-80 (1964). This rule permits some defamatory falsehoods to escape challenge: some falsehood may be sheltered to avoid chilling truthful speech, but that reflects a

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<sup>31</sup> *Garrison v. State of Louisiana*, 379 U.S. 64, 75 (1964).

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by-product, rather than a goal, of First Amendment protections. As the Court has explained, although “there is no constitutional value in false statements of fact,” there is harm from chilling truthful speech, and “[t]he First Amendment requires that we protect some falsehood in order to protect speech that matters.” *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 340-41 (1974); *see also BE & K*, 536 U.S. at 531 (“while false statements may be unprotected for their own sake,” protection may be required to shelter “*speech that matters*”) (emphasis original). Stated differently, “erroneous statement . . . must be protected if the freedoms of expression are to have the breathing space that they need . . . to survive.”<sup>32</sup> That protection, however, has limits, and the presence of malice vitiates it.

The Court has applied analogous reasoning to petitioning, ruling that “petitions to the President that contain intentional and reckless falsehoods do not enjoy constitutional protection.”<sup>33</sup> As the Court explained, “The Petition Clause . . . was inspired by the same ideals of liberty and democracy that gave us the freedoms to speak, publish, and assemble,” and “there is no sound basis for granting greater constitutional protection to statements made in a petition to the President than other First Amendment expressions.”<sup>34</sup>

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<sup>32</sup> *New York Times*, 376 U.S. at 271-72 (internal quotations omitted). *See also Hustler Magazine v. Falwell*, 485 U.S. 46, 56 (1988) (ensuring necessary “breathing space” for First Amendment freedoms by requiring public figures who seek to demonstrate intentional infliction of emotional distress to show false statements of fact made with “actual malice”).

<sup>33</sup> *McDonald v. Smith*, 472 U.S. 479, 484 (1985) (internal quotation omitted) (upholding a libel action based on the petition).

<sup>34</sup> *Id.* at 485. Further linking its treatment of speech and petitioning, the Court tells us, “[j]ust as false statements are not immunized by the First Amendment right to freedom of speech,

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The courts of appeals have recognized that these limits on First Amendment protection may set bounds on *Noerr-Pennington*. Thus, in declining to apply the doctrine to knowing misrepresentations to state securities administrators and the federal courts, the U.S. Court of Appeals for the District of Columbia Circuit reasoned:

We see no reason to believe that the right to petition includes a right to file deliberately false complaints. . . . However broad the First Amendment right to petition may be, it cannot be stretched to cover petitions based on known falsehoods.

*Whelan*, 48 F.3d at 403, 404. Similarly, when the Ninth Circuit rejected protection for knowingly false statements to the Interstate Commerce Commission it explained:

There is no first amendment protection for furnishing with predatory intent false information to an administrative or adjudicatory body. The first amendment has not been interpreted to preclude liability for false statements.

*Clipper Express*, 690 F.2d at 1261. The court rejected defendants' argument that failure to shelter such statements would chill legitimate debate, because they allegedly "knew the falsity of their statements, and made those statements in a deliberate attempt

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baseless litigation is not immunized by the First Amendment right to petition." *Bill Johnson's Restaurants v. National Labor Relations Bd.*, 461 U.S. 731, 743 (1983) (citations omitted) (construing the National Labor Relations Act in light of potential First Amendment protection of an allegedly retaliatory lawsuit). In *BE & K*, the Court clarified that this statement did not indicate that baseless litigation is "*completely* unprotected," but rather, at most, that "such litigation should be protected 'just as' false statements are." *Id.*, 536 U.S. at 531 (determining that the National Labor Relations Act does not permit penalizing all unsuccessful, but reasonably based, retaliatory litigation).

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to mislead a regulatory body.” *Id.* at 1262. In essence, the focus on *deliberate* misrepresentation provides the same type of “breathing space” for petitioning in the *Noerr-Pennington* context as it provides in the free speech arena.

b. *Preserving Federalism and Protecting the Governmental Decision-Making Process*: The Supreme Court has explained that the *Noerr-Pennington* doctrine also serves, in part, as a corollary to the state action doctrine<sup>35</sup> and reflects the maxim that “where a restraint upon trade or monopolization is the result of valid governmental action, as opposed to private action, no violation of the [Sherman] Act can be made out.”<sup>36</sup> Unocal makes the latter point a central theme in its brief to the Commission.<sup>37</sup>

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<sup>35</sup> See *Omni*, 499 U.S. at 379-80 (finding it would be “peculiar” and “perhaps in derogation of . . . constitutional right . . . to establish a category of lawful state action that citizens are not permitted to urge”); *Noerr*, 365 U.S. at 135-37.

<sup>36</sup> *Noerr*, 365 U.S. at 136, citing *Parker v. Brown*, 317 U.S. 341 (1943).

<sup>37</sup> Unocal asks whether the challenged conduct would have had the same anticompetitive consequences even absent government action. “If the answer is ‘no,’” Unocal contends, “the conduct is *Noerr*-protected.” Answering Brief of Union Oil Company of California (“Unocal Brief”) at 1; see also *id.* at 11, 43, 49. Unocal derives its question from language in *SCTLA*, 493 U.S. at 425, where the Court rejected a *Noerr-Pennington* claim because the unlawful boycott there at issue had occurred *before* any governmental action. The court observed that the anticompetitive effects *while* the boycott lasted would have been precisely the same even if no legislation had been enacted. Unocal argues that rejection of the doctrine when the government action was immaterial means that the doctrine automatically applies in every instance that government action shapes the competitive effects of the challenged conduct. Nowhere does the

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Misrepresentation, however, undermines this line of analysis by blurring the distinction between private and governmental conduct. Misrepresentation undermines government's ability accurately and meaningfully to assess public benefit; it vests control over the outcome in the private purveyor of false information.

Courts have understood this point. For example, in *Woods Exploration*, defendant natural gas producers allegedly filed false demand forecasts with the Texas Railroad Commission to reduce competitors' gas production quotas, set by formula based on the demand forecasts. The Court of Appeals for the Fifth Circuit rejected defendants' contention that they did not violate the Sherman Act because it was the Railroad Commission's actions, not those of the defendant producers, that caused plaintiffs' injuries. Rather, the court concluded that in view of the misrepresentations, the Commission "neither was the real decision maker nor would have intended its order to be based on false facts."<sup>38</sup> Similarly, when the defendant cigarette manufacturers' submission of false purchase intentions allegedly caused the Department of Agriculture to set tobacco production quotas harmful to growers, the district court ruled that the defendants "do

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language of *SCTLA* support this conclusion. Nor does Unocal's conclusion comport with simple logic: "always" is not the only alternative to "never." Indeed, Unocal states a test that neither *Walker Process* nor the various appellate misrepresentation cases cited *supra* in Section III.B.1. would satisfy. See Transcript of Oral Argument at 30 (March 10, 2004) ("Tr.") (conceding that under Unocal's proposed test, *Walker Process* may not stand).

<sup>38</sup> *Woods Exploration*, 438 F.2d at 1295; see also *Armstrong*, 185 F.3d at 164 n.8 (distinguishing *Walker Process* as a case in which the government was "wholly dependent on the applicant for the facts" and thus "effectively and necessarily delegates to the applicant the factual determinations underlying the issuance of a patent").

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not have immunity for deceptive information provided to the USDA simply because the USDA ultimately sets the quota.”<sup>39</sup> In like vein, the Ninth Circuit has determined that misrepresentations that go to the core of a lawsuit or administrative proceeding may so deprive the government activity of legitimacy as to vitiate *Noerr-Pennington* protection.<sup>40</sup>

Leading commentators have agreed. Thus, Professor C. Douglas Floyd explains:

The [Supreme] Court’s decisions according immunity to state governmental action under *Parker v. Brown* assume that state action antitrust immunity is appropriate only if a governmental actor with statewide authority prospectively has determined that particular anticompetitive conduct should be approved as a matter of state policy. In cases involving the deliberate provision of false information to induce anticompetitive regulation by a state agency, however, no such deliberate determination has been made, because the authorization in question is based on a non-existent predicate. In effect, the processes of the government have been assumed by the private parties they purport to regulate. Thus, to the extent that *Noerr* immunity is accorded to private petitioning as a “corollary” to the immunity normally accorded to the effects of the completed governmental action that the petitioning seeks, the rationale for protection is significantly undermined where the governmental action in question has been induced by intentional

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<sup>39</sup> *DeLoach v. Philip Morris Cos.*, 2001-2 Trade Cas. (CCH) ¶ 73,409 at 91,434 (M.D.N.C. 2001).

<sup>40</sup> *See Kottle*, 146 F.3d at 1060-63; *Liberty Lake*, 12 F.3d at 159.

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misrepresentations, and therefore does not represent a deliberate determination of governmental policy.<sup>41</sup>

The Areeda & Hovenkamp *Antitrust Law* treatise summarizes succinctly: although no antitrust liability normally attaches when a *bona fide* lobbying campaign or presentation to an agency obtains the requested result – because “the government’s action, not the private campaign, is the cause of the plaintiff’s harm” – an “important exception” exists when “the agency would not have acted the way it did but for the impropriety.”<sup>42</sup>

Although we generally agree with the reasoning of these judicial and scholarly authorities, any rule regarding petitioning based on misrepresentation must be fashioned and applied with care, so as not to undermine principles of federalism and effective government decision making. Indeed, the Supreme Court has expressed profound concern with allowing plaintiffs to “look behind the actions of state sovereigns” to assert antitrust claims. *Omni*, 499 U.S. at 379. It has sought to avoid inquiries that require “deconstruction of the governmental process and probing of the official intent.” *Id.* at 377 (internal quotation omitted). Considerations of federalism, respect for the legitimacy of actions completed by coordinate branches of government, and the general unsuitability of antitrust statutes as tools for regulating political behavior all argue against excessive antitrust intrusion.<sup>43</sup>

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<sup>41</sup> C. Douglas Floyd, *Antitrust Liability for the Anticompetitive Effects of Governmental Action Induced by Fraud*, 69 ANTITRUST L.J. 403, 414-15 (2001) (footnotes omitted).

<sup>42</sup> 1 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 203h at 192 (2d ed. 2000) (emphasis omitted).

<sup>43</sup> *See Omni*, 499 U.S. at 377 (warning that subjecting a local zoning decision to *ex post facto* antitrust review would go far to compromise a state’s ability to regulate its domestic

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Although they are clearly reasons for caution, these reservations may be overcome in appropriate settings, as reflected by the substantial appellate case law identified in Section III.B.1. above and as further discussed in Section V.C. below.

In addition, considerations of effective government and the balance of likely costs and benefits may argue against opening the door too widely to antitrust actions flowing from misrepresentations to the government. In 1999 the FTC joined the United States in a brief that opposed *certiorari* in the Third Circuit's *Armstrong* litigation and that questioned whether the vindication of plaintiffs' rights in a few adjudicable and meritorious misrepresentation cases would warrant the judicial effort that would be involved and the private expense of litigating the many claims that likely would be rejected.<sup>44</sup> The brief also expressed doubt whether it would be worthwhile to focus antitrust law on the political nature of state actions and on abuses of state

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commerce), 378-79 (observing that the Sherman Act is directed at preventing trade restraints, not vindicating principles of good government); *Armstrong*, 185 F.3d at 162 (“Considerations of federalism require an interpretation of the Sherman Act that forecloses liability predicated on anticompetitive injuries that are inflicted by states acting as regulators. . . . Federalism requires this result both with respect to state actors and with respect to private parties who have urged the state action.”); 1 AREEDA & HOVENKAMP, ANTITRUST LAW ¶¶ 203b at 165 (antitrust laws “poorly designed” for policing the political process), 203h at 193 (“As a general matter the federal government must be slow to interfere in state political processes . . . .”); Floyd, 69 ANTITRUST L.J. at 440-44.

<sup>44</sup> See Brief for the United States and the Federal Trade Commission as Amici Curiae at 18, *Armstrong Surgical Center v. Armstrong County Memorial Hosp.*, 530 U.S. 1261 (2000) (No. 99-905).



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processes for which there are “presumably” other remedies.<sup>45</sup> Nonetheless, the brief concluded that there may be situations in which policy reservations are “muted” and “would be outweighed by the substantial public interest” in antitrust enforcement, and it refrained from concluding “that relief should never be available” in cases “alleging that competitive damages caused directly by some state action were procured by private parties, in violation of the antitrust laws, through abuse of the State’s administrative or judicial processes.”<sup>46</sup> Indeed, just one year later, in opposing *certiorari* in a challenge to the validity of one of Unocal’s RFG

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<sup>45</sup> *Id.*

<sup>46</sup> *Id.* at 18-19. Although Unocal lays considerable stress on the United States/FTC *Armstrong* brief, the emphasis is misplaced. This brief emphasized facts suggesting that the plaintiff in *Armstrong* was “not well placed” to argue that defendants had usurped the public decision making process. *Id.* at 20. Thus, the brief noted that the plaintiff was “able to challenge the representations and threats made by its opponents” but never sought clarification or reconsideration, and it observed that it was “not clear whether the Board’s decision depended on the alleged misrepresentation.” *Id.* Moreover, the brief expressly distinguished, and did not thereafter address, the situation in *Walker Process* in which *private enforcement* of the fraudulently procured patent was the basis of the antitrust claim. *Id.* at 13. Subsequently, its language addressed only cases in which the alleged injury was caused “directly” or “most directly” by government action – there, the denial of a CON application – rather than cases like the present, in which harm requires private enforcement of a patent. *Id.* at 13, 14, 15, 18. Overall, the brief’s primary message was that *Armstrong*, under the specific facts there presented, was not a case “in which the argument for liability can be forcefully advanced” and that review by the Supreme Court “should await the illumination of further experience with such claims” in the courts of appeals. *Id.* at 19-20.

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patents, the Brief for the United States stated that “other government agencies, such as the Federal Trade Commission, may impose non-patent remedies against parties who make affirmative misrepresentations to a public or private regulatory body involved in setting industry standards.”<sup>47</sup>

c. *The Importance of Maintaining Competition:* Antitrust law plays a critical role in maintaining a competitive marketplace, to the benefit of consumers and the nation’s economy. Indeed, the Supreme Court has termed the Sherman Act a “comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade.” *Northern Pac. Ry. v. United States*, 356 U.S. 1, 4 (1958). Because of the fundamental role assigned the antitrust laws, exceptions to, and limitations on, their broad reach are generally disfavored. As the Court has explained, “It is settled law that ‘immunity from the antitrust laws is not lightly implied.’ This canon of construction . . . reflects the felt indispensable role of antitrust policy in the maintenance of a free economy . . .” *United States v. Philadelphia National Bank*, 374 U.S. 321, 348 (1963).

Clearly, the Court found an implied limitation when it developed the *Noerr-Pennington* doctrine. Just as plainly, however, when confronting issues within the interstices of that doctrine, the benefits of competition and the harms from anticompetitive conduct must be among the factors considered. Expansive application of *Noerr-Pennington* has a cost, and awareness of that cost should play a role in assessing the boundary between exemption and potential liability.

Awareness of potential competitive harm is particularly important in settings like the one presented here. Government regulations such as CARB’s standards may impose potent entry

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<sup>47</sup> See Brief for the United States as *Amicus Curiae* at 19, *Atlantic Richfield Co. v. Union Oil Co. of California*, 531 U.S. 1183 (2001) (No. 00-249).

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barriers capable of preserving market power over extended periods of time. *See, e.g.*, IIA PHILLIP E. AREEDA, HERBERT HOVENKAMP, & JOHN L SOLOW, ANTITRUST LAW ¶ 421h at 73-74 (2d ed. 2002); DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 74, 100 (3d ed, 2000); ROBERT H. BORK, THE ANTITRUST PARADOX 347-49 (1978). Whereas an exercise of unprotected market power may sow the seeds of its own erosion if firms are free to enter and compete on equal terms with the incumbent, governmentally-enforced limits on entry may impede and even prevent that process. *See* Frank H. Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 31-33 (1984). Consequently, misrepresentations that distort government decision making in ways that create or shield market power may inflict severe and long-lasting public harm. Such considerations support our conclusion that the substantial public interest in antitrust enforcement may outweigh countervailing policy reservations when those concerns are sufficiently muted.

### C. The Interface between Misrepresentation and the “Sham” Exception

The courts of appeals have developed varying approaches when deciding whether *Noerr-Pennington* does or does not shield petitioning based on misrepresentations. In particular, they have analyzed two issues that the Supreme Court has left open: (i) the relationship between misrepresentations and the sham exception as formulated by *PREI*, and (ii) how to apply the distinction between the “less political arenas” in which, according to *California Motor Express* and *Allied Tube*, misrepresentations may vitiate *Noerr-Pennington* protection and those more political contexts in which, as in *Noerr* itself, misrepresentations have no such effect.

The Initial Decision holds that the *Noerr-Pennington* doctrine shields Unocal’s alleged conduct and that no exception to that protection applies. Although Complaint Counsel argued that the Complaint’s allegations fit within a “separate misrepresentation

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exception that is distinct from the ‘sham’ exception,”<sup>48</sup> the Initial Decision construed the argument narrowly as claiming either a sham or an exception derived from an extension of *Walker Process* principles. It held the sham exception inapplicable on grounds that it is confined to “situations in which persons use the governmental *process* as opposed to its *outcome* as an anticompetitive weapon,” whereas the Complaint alleges that Unocal sought monopoly through the outcome of the government action. ID at 48-49. It found that *Walker Process* principles require a quasi-adjudicatory setting and dependence on the petitioner for factual information, facts that it found absent in this case.

Unocal agrees with the ALJ’s conclusion that neither the sham exception nor any misrepresentation exception applies to its alleged conduct. Unocal Brief at 28 (sham), 23-43 (misrepresentation). It repeatedly, and pointedly, avoids conceding that any separate misrepresentation exception exists. *Id.* at 24-29. Indeed, it argues that *Walker Process* may not survive under its approach. *See supra* note 37.

As explained below, the Initial Decision and Unocal misread the law and misapply the underlying policies in two chief respects. First, they both are mistaken in the broad assertion that the case law precludes treating misrepresentation as a variant of sham. Moreover, whereas the Initial Decision perceives room for a very narrowly defined misrepresentation exception under facts that approximate those in *Walker Process*, Unocal refuses even to acknowledge that certain misrepresentations can ever vitiate *Noerr-Pennington* protection. As this section explains, although courts have attached varying labels to their analyses, the decided weight of precedent concludes that deliberate misrepresentation

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<sup>48</sup> Complaint Counsel’s Memorandum in Opposition to Union Oil Company of California’s (“Unocal”) Motion for the Dismissal of the Complaint Based Upon Immunity under *Noerr-Pennington* at 22.

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that cuts to the core of an administrative proceeding's legitimacy can fall outside *Noerr-Pennington* protections. Second, both the Initial Decision and Unocal are mistaken in the narrower conclusion that, even assuming that a misrepresentation exception exists, the CARB proceeding necessarily falls outside any allowable boundaries. We address this issue *infra* in Sections IV and V.

The courts have followed varying routes to the conclusion that misrepresentations may preclude application of *Noerr-Pennington*. Some courts have held that the misrepresentations at issue were not petitioning or otherwise fell entirely outside *Noerr-Pennington*. For example, the U. S. Court of Appeals for the Second Circuit ruled that AT&T's "unsupportable claims to the FCC regarding network harm" and "feigned cooperation" with an FCC advisory committee to further AT&T's opposition to proposed standards for interconnection devices "embraced much more than merely advocating a position before the FCC" and involved "actions not within the scope of the [*Noerr-Pennington*] doctrine."<sup>49</sup> Similarly, the Eleventh Circuit found a misrepresentation to a state health planning agency entirely beyond *Noerr-Pennington* coverage. The appeals court did not apply the sham exception, but rather explained, "[T]o find that a situation falls within an exception to a general rule, it must first be clear that the general rule itself is applicable."<sup>50</sup> Other courts

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<sup>49</sup> *Litton*, 700 F.2d at 806, 809. The court also held, in the alternative, that the sham exception applied because AT&T had acted not in the hope of influencing governmental action, but in the hope of delaying it. *Id.* at 809-12.

<sup>50</sup> *St. Joseph's Hospital*, 795 F.2d at 955; *see also DeLoach*, 2001-2 Trade Cas. (CCH) at 91,433-34 (finding that submission of false purchase intentions to a government agency to affect administrative determination of a tobacco production quota involved no policy-making process and fell outside *Noerr-Pennington* protections).

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analyze the issue in terms of a misrepresentation exception<sup>51</sup> or find deliberate misrepresentation “beyond the protection of *Noerr*” without labeling their doctrinal route.<sup>52</sup>

Still other courts analyze misrepresentations under the rubric of sham petitioning. Thus, the Ninth Circuit recognizes at least three distinct types of sham: (1) “bringing a single sham lawsuit (or a small number of such suits)”; (2) “the filing of a series of lawsuits . . . brought pursuant to a policy of starting legal proceedings without regard to the merits and for the purpose of injuring a market rival”; and (3) the use of “knowing fraud” or “intentional misrepresentations” that “deprive the litigation of its legitimacy.” *Kottle*, 146 F.3d at 1060-61. In *Kottle*, the court applied this third sham variant in the context of an administrative proceeding. *Id.* at 1061-63. Similarly, the Sixth Circuit has stated that “the knowing and willful submission of false facts to a government agency falls within the sham exception to the *Noerr-Pennington* doctrine,” *Potters Medical Center*, 800 F.2d at 580, and the Third Circuit has analyzed misrepresentation as raising the “sham” exception. *See Armstrong; Cheminor Drugs, Ltd. v. Ethyl Corp.*, 168 F.3d 119 (3d Cir.), *cert. denied*, 528 U.S. 871 (1999).

Whatever the nomenclature, the various approaches should lead to the same place. As the Areeda and Hovenkamp treatise states:

Of course, the policy is more important than the underlying labels, and in most cases it makes little difference whether we say that the provision of false information is unprotected by *Noerr* to begin with or that it falls into the sham exception to *Noerr*.

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<sup>51</sup> *See, e.g., Clipper Express*, 690 F.2d at 1259-63; *Livingston Downs Racing Ass’n v. Jefferson Downs Corp.*, 192 F.Supp.2d 519, 535-36 (M.D. La. 2001).

<sup>52</sup> *See, e.g., Whelan*, 48 F.3d at 1253-55.

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1 AREEDA AND HOVENKAMP, 1 ANTITRUST LAW ¶ 203f at 173. The label likely would make a significant difference, however, if misrepresentation were not merely classed with shams but also analyzed strictly under *PREI*'s "sham exception" standards. Such an approach, though consistent with, and suggested by, Unocal's arguments, is contrary to compelling policies of the law.

As suggested by three courts of appeals, the two-part test articulated in *PREI* for assessing claims of sham litigation is not well suited to address settings involving misrepresentations. Thus, the Ninth Circuit has adopted a rule that vitiates *Noerr-Pennington* protection when misrepresentations to a government agency deprive an administrative proceeding of its "legitimacy," treating this as an alternative, in the proper context, to *PREI*'s two-part test. See *Kottle*, 146 F.3d 1060-63; *Liberty Lake*, 12 F.3d at 158-59. Similarly, the D.C. Circuit treated "*PREI*'s two-part 'sham' test" as "inapplicable" when knowing fraud or intentional misrepresentations destroyed prior litigation's legitimacy. See *Whelan*, 48 F.3d at 1255 (citing *Liberty Lake*, 12 F.3d at 159). The Federal Circuit reached much the same result in a context that involved *Walker Process* fraud: "*PREI* and *Walker Process* provide alternative legal grounds on which a patentee may be stripped of its immunity from the antitrust laws . . . we need not find a way to merge these decisions. Each provides its own basis for depriving a patent owner of immunity from the antitrust laws . . . ."<sup>53</sup>

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<sup>53</sup> *Nobelpharma*, 141 F.3d at 1071. *Nobelpharma* emphasizes that *PREI*'s two-part test potentially provides a separate and independent basis for antitrust liability in addition to *Walker Process* principles. *Id.* By treating fraud before the PTO as support for a violation of Section 2 of the Sherman Act, the Supreme Court in *Walker Process* and the Federal Circuit in *Nobelpharma* indicate how seriously they view intentional fraud before administrative agencies.

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Leading commentators agree that courts must look beyond literal application of *PREI*'s sham test to analyze misrepresentations. Professors Areeda and Hovenkamp recognize that misrepresentations differ from traditional “sham” activities in that the purpose of misrepresentations *is* to obtain government action. *See* 1 AREEDA & HOVENKAMP, ANTITRUST LAW ¶¶ 203a at 164, 203f at 173. They emphasize, however, that rather than necessarily entitling misrepresentations to *Noerr-Pennington* protection, this fact merely should subject misrepresentations to a different analysis.<sup>54</sup> Professors Areeda and Hovenkamp observe that misrepresentation of facts peculiarly in petitioner's control poses a much more significant threat to competition than bringing lawsuits that no reasonable lawyer would have filed, *id.* ¶¶ 204a at 199, 205c2 at 230, and conclude that the literal standards of *PREI* should be confined to *PREI*'s general fact pattern, which involved the issue of *baseless theories*. *Id.*, ¶¶ 205b at 218-19, 205c at 228. Consequently, “The decision should not be read as disposing of a case in which the legal theories claimed in a lawsuit were perfectly reasonable but the plaintiff alleged facts known to be false or failed to disclose facts that it knew would defeat its claim.” *Id.*, ¶ 205b at 219.

In contrast, one appellate court, the U.S. Court of Appeals for the Third Circuit, treats misrepresentations as shams *and* conducts its analysis under the *PREI* standards. While the court expresses skepticism about the idea that misrepresentation may deprive a petitioner of *Noerr-Pennington* protection, *Armstrong*, 185 F.3d at 158, even its opinions leave room for finding misrepresentation a sham under appropriate circumstances. Two cases warrant emphasis. In *Cheminor*, the Third Circuit analyzed claims that the antitrust defendant had made false statements to the International Trade Commission regarding injury from alleged dumping of

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<sup>54</sup> *See id.*, ¶ 203f at 173-78; *see also* Floyd, 69 ANTITRUST L.J. at 421-22 (recognizing that imposition of antitrust liability in misrepresentation cases does not rest on application of the traditional “sham” exception).



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ibuprofen. Refusing to “carve out a new exception” to *Noerr-Pennington*, the court applied *PREI*’s objective test for “sham” litigation by setting aside the facts allegedly misrepresented and asking whether, absent those facts, the antitrust defendant’s claims still had an objective basis. *Cheminor*, 168 F.3d at 123. The court explained, “If the government’s action was not dependent upon the misrepresented information, the misrepresented information was not material and did not go to the core of [antitrust defendant’s] petition.” *Id.* at 124. In contrast, “[A] *material* misrepresentation that affects the very core of a litigant’s . . . case will preclude *Noerr-Pennington* immunity . . . .” *Id.* (emphasis original).

Subsequently, in *Armstrong*, the Third Circuit applied *PREI*’s subjective standard. There, an applicant for a certificate of need covering a new ambulatory surgical facility alleged that a competing hospital opposed the CON because the hospital’s own outpatient facility was nearing completion, despite knowledge that construction had stopped with only the building’s shell finished. The court found the sham exception unavailable under *PREI*’s subjective standard, given that the hospital’s purpose was to secure the requested outcome, denial of plaintiff’s CON. *Armstrong*, 185 F.3d at 158 n.2. The court summarized, “[T]he sham petitioning exception does not apply in a case like the one before us where the plaintiff has not alleged that the petitioning conduct was for any purpose other than obtaining favorable government action.” *Id.* at 158. Nonetheless, and despite misgivings based on considerations of federalism,<sup>55</sup> the court acknowledged that in narrow circumstances, such as when a government agency is wholly dependent on a petitioner for factual information on which the agency predicates its actions, the resulting government order may so reflect financially-interested

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<sup>55</sup> See *Armstrong*, 185 F.3d at 160-62, discussed *supra* in note 43.

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decision making that an exception from *Noerr-Pennington* is warranted.<sup>56</sup>

IV. *NOERR-PENNINGTON* IN THE CONTEXT OF  
MISREPRESENTATION: ANALYSIS AND SYNTHESIS

A. The Legal Framework

The ALJ applied *PREI*'s two-part test for evaluating sham litigation and found the subjective standard unsatisfied because Unocal allegedly sought to achieve a monopoly through the *outcome* of the CARB proceeding. ID at 48-49. We find that if misrepresentations are to be treated as a form of sham, then the appropriate approach must recognize that they raise issues different from traditional sham litigation. Rote application of *PREI*'s test under these circumstances would be inconsistent with the policy goals of the *Noerr-Pennington* doctrine.

Indeed, the ALJ's decision would mean that most misrepresentation to government, even when used to monopolize or otherwise cause anticompetitive harm,<sup>57</sup> would fall outside antitrust review. If the petitioner desires a governmental outcome, then building a monopoly through blatant lying would be

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<sup>56</sup> *Id.* at 164 n.8. The *Armstrong* opinion states that the facts allegedly misrepresented may not have been important to the outcome and that the government decision makers "recognized that there was a dispute and made a credibility determination concerning it." *Id.* at 163. See *infra* at Section IV.B.3.

<sup>57</sup> The harms may be substantial. See *1 AREEDA & HOVENKAMP, ANTITRUST LAW*, ¶ 205a at 215 (observing that, although it generally is easy to defend against baseless litigation, the "potential threat to competition is far greater when the adjudication plaintiff alleges nonpublic facts that it knows not to be true or fails to state nonpublic facts that it knows will defeat its claim.").

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protected. This result ignores the holdings of the many courts that have found intentional falsehoods actionable. It also rejects the well-established limitations on First Amendment protections for known falsehoods. It would protect petitioning leading to governmental action so distorted by misinformation that the result is contrary to the government's intention. Certainly, neither the facts nor the language of *PREI* requires that its test for sham litigation apply to the very different circumstances posed by misrepresentation.<sup>58</sup> Rather, the Court's express statement that it "need not decide here whether and, if so, to what extent *Noerr* permits the imposition of antitrust liability for a litigant's fraud or other misrepresentations," *PREI*, 508 U.S. at 61 n.6, recognizes that misrepresentations do not easily fit the "sham" analysis. Clearly, a proceeding fundamentally tainted by misrepresentation lacks the "genuine" nature that is the hallmark of what the Supreme Court seeks to protect.<sup>59</sup> As does the leading antitrust treatise, we read the *PREI* tests "in the context in which they were stated – that of a factually true but legally controversial claim" – and reject their rote application to claims for which "the underlying factual allegations were false."<sup>60</sup>

In so doing we do *not* suggest conflict with, or vitiation of, the *PREI* standards. We merely recognize that deliberate

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<sup>58</sup> See *Liberty Lake*, 12 F.3d at 158 ("As we read the Court's footnote 6, however, it does no more than reserve the issue of whether antitrust liability may be premised on a litigant's deceptive conduct which goes to the core of a lawsuit's legitimacy . . .").

<sup>59</sup> *PREI*, 508 U.S. at 61; see also *BE & K*, 536 U.S. at 532 (describing the *PREI* tests as "protect[ing] petitioning whenever it is *genuine*" and "protecting suits from antitrust liability whenever they are objectively or subjectively *genuine*") (emphasis added).

<sup>60</sup> 1 AREEDA & HOVENKAMP, ANTITRUST LAW, ¶ 205b at 227.

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misrepresentations that substantially affect the outcome of a proceeding or so infect its core to deprive the proceeding of legitimacy may not, in appropriate circumstances, qualify for *Noerr-Pennington* protection. This rule is consistent with the logic that underlies both *PREI*'s objective and subjective tests. According to *PREI*, the objective standard protects "reasonable effort[s] at petitioning for redress."<sup>61</sup> It distinguishes "objectively reasonable claims" from those in which "the administrative and judicial processes have been abused," *PREI*, 508 U.S. at 58, and it supplies "intelligible guidance." *Id.* at 60. Requiring that a misrepresentation infect the core of a proceeding similarly addresses conduct that is not a reasonable effort at petitioning and provides meaningful guidance.<sup>62</sup> This requirement also assures that the governmental process has truly been abused.

*PREI*'s subjective standard considers the litigant's "subjective motivation." *PREI*, 508 U.S. at 60. It "protects petitioning that is unmotivated by anticompetitive intent." *BE & K*, 536 U.S. at 528. Absent misrepresentation, *PREI*'s focus on whether a litigant seeks to use the outcome rather than the process does serve to identify anticompetitive intent. When misrepresentation is at issue, however, the outcome/process analysis is useless for assessing motivation; the very purpose of making the misrepresentation likely *is* to obtain the desired outcome. To treat this intention as dispositive is to shelter petitioning *because* of its anticompetitive goals. Indeed, granting protection to intentional misrepresentations would create perverse incentives to lie, in abuse of judicial and administrative processes. Not surprisingly, therefore, most courts and commentators have concluded that the

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<sup>61</sup> *PREI*, 508 U.S. at 60 n.5. Similarly, *BE & K* tells us the objective test protects "reasonably based petitioning from antitrust liability." *BE & K*, 536 U.S. at 528.

<sup>62</sup> *See BE & K*, 536 U.S. at 530-32 (drawing an analogy between baseless litigation and misrepresentation); *Bill Johnson's Restaurants*, 461 U.S. at 743 (same).

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outcome/process analysis is inappropriate in contexts involving misrepresentations. In such settings, a different inquiry – one focused on the knowing, deliberate nature of the falsity – serves to identify anticompetitive intent and fulfill the purposes of the subjective standard.<sup>63</sup>

In sum, we find no impediment in the law of sham petitioning to an antitrust challenge based on deliberate misrepresentation. Whether we view misrepresentation as a distinct variant of sham petitioning or as a separate exception to *Noerr-Pennington*, the fabric of existing law is rich enough to extend antitrust coverage, in appropriate circumstances, to anticompetitive conduct flowing from deliberate misrepresentations that undermine the legitimacy of government proceedings.

What are those appropriate circumstances? Both the ALJ and Unocal take too narrow a view of the second major issue left open by the Supreme Court – the treatment of misrepresentation in “less political arenas” than the legislative lobbying campaign at issue in *Noerr*. The Initial Decision focuses on the administrative law distinction between legislative and adjudicatory activities and opines that misrepresentations can vitiate *Noerr-Pennington* protection only in adjudicatory contexts. ID at 31-40. Unocal advances much the same arguments. Unocal Brief at 24-40.

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<sup>63</sup> In fact, the Supreme Court recently adapted *PRET*'s subjective test to fit the context of a National Labor Relations Act dispute. In *BE & K* the Court reasoned that petitioning is subjectively genuine if the petitioner's “purpose is to stop conduct he reasonably believes is illegal.” *BE & K*, 536 U.S. at 533-34 (emphasis original). The Court's subjective inquiry there was not whether the petitioner sought to win, but whether the petitioning was premised upon a belief in its legitimacy. Similarly, a focus here on knowing, deliberate falsity would bring much the same subjective inquiry to the consideration of misrepresentations: one cannot believe in the legitimacy of a petition based on known falsity.

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The case law, however, takes a much broader view than just administrative law distinctions. It considers both the context of the proceeding and the nature of the relevant communications. In the next sections, we pursue these two inquiries to develop boundaries for a misrepresentation exception that promotes the purposes of the *Noerr-Pennington* doctrine.

B. The Context of the Proceeding

The ALJ/Unocal and Complaint Counsel apply sharply conflicting analytical frameworks in building upon the Supreme Court's statement that the "applicability" of *Noerr-Pennington* "varies with the context and nature of the activity." *Allied Tube*, 486 U.S. at 499. The Initial Decision and Unocal emphasize the distinction between legislation and adjudication.<sup>64</sup> Applying administrative law principles, they cast the CARB proceeding as legislative.<sup>65</sup> At places the Initial Decision seems automatically to extend *Noerr-Pennington* protection to misrepresentations in all rulemakings, indeed in all administrative proceedings other than formal adjudications. *See* ID at 36-40. Unocal essentially equates rulemaking with legislation, terms this a political function, and urges that the ALJ correctly rejected application of a

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<sup>64</sup> *Compare* ID at 32 (misrepresentations made in the context of legislative activities are protected from antitrust liability) *with* ID at 33 ("By contrast, where the agency is using an adjudicatory process, misrepresentations are not immunized"); *compare* Unocal Brief at 25 ("If a fraud exception to *Noerr* immunity exists, it is confined to adjudicative proceedings.") *with id.* at 33 ("In the legislative setting, as *Noerr* held, even deception is tolerated by antitrust tribunals).

<sup>65</sup> *See, e.g.*, ID at 68 ("CARB's Phase 2 RFG rulemaking process was a legislative exercise"); ID at 40 ("CARB was not acting in an adjudicatory manner, but in a legislative manner"); Unocal Brief at 30-33.

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misrepresentation exception to an industry-wide rulemaking. *See* Unocal Brief at 24, 30-32.

As Complaint Counsel argue, however, the case law has focused more directly on the distinction between activities within and outside of the political arena. *See* CCAB at 26-29. Thus, when *California Motor Transport* discusses adjudication, it is in contrast to the “political arena.”<sup>66</sup> When *Allied Tube* discusses a publicity campaign seeking legislation or executive action, it is in contrast to “less political arenas.”<sup>67</sup> *Kottle* explains, “[T]his circuit has generally shaped the sham exception [broadly defined] according to our estimation of whether the executive entity in question more resembled a judicial body, or more resembled a political entity.”<sup>68</sup> The legislative/adjudicatory comparison may sometimes be a useful proxy for the distinction between activities inside and outside of the political arena. When it is not, however, the courts have not hesitated to reject the faulty proxy in favor of a more nuanced inquiry into the political or non-political nature of the context.<sup>69</sup> In sum, the case law suggests an inquiry focused on

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<sup>66</sup> *See California Motor Transport*, 404 U.S. at 513 (“Misrepresentations, condoned in the political arena, are not immunized when used in the adjudicatory process.”).

<sup>67</sup> *Allied Tube*, 486 U.S. at 499-500 (“But in less political arenas, unethical and deceptive practices can constitute abuses of administrative or judicial processes that may result in antitrust violations.”).

<sup>68</sup> *Kottle*, 146 F.3d at 1061. *See also Clipper Express* at 690 F.2d at 1261 (treating “political” and “adjudicatory” as the opposing spheres); *Livingston Downs*, 192 F.Supp.2d at 533 (asking whether the petitioned commission was “more akin to a political entity or to a judicial body”).

<sup>69</sup> Unocal acknowledges that *Clipper Express* treated a ratemaking, technically a rulemaking proceeding, as adjudicatory

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whether a proceeding is political or non-political, rather than on whether it is quasi-legislative or quasi-adjudicatory.<sup>70</sup>

The political/non-political distinction turns on several attributes directly linked to *Noerr-Pennington* policy concerns. The political arena is distinguishable from the non-political arena on the basis of the nature of government expectations; the degree of governmental discretion; the extent of necessary reliance on petitioners' factual assertions; and the ability to determine causation, linking the government's actions to petitioner's communications. We discuss each point in turn.

1. Governmental Expectations of Truthful Representation

Courts and commentators have recognized that the nature of politics places government on its guard, enabling it more readily to accommodate misrepresentations. As explained in *Kottle*, "Misrepresentations are a fact of life in politics," and the "political arena has a higher tolerance for outright lies than the judicial arena does."<sup>71</sup> As the Areeda and Hovenkamp treatise explains, "Society recognizes that politics is often a rough and tumble affair. . . . legislatures . . . have more political experience than the courts and . . . may be better able to appreciate the balance of contending forces." 1 AREEDA & HOVENKAMP, ANTITRUST LAW

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for purposes of applying *Noerr-Pennington* to a misrepresentation to the Interstate Commerce Commission. Unocal Brief at 27.

<sup>70</sup> See *supra* section III.B.1 (providing additional discussion of the relevant case law).

<sup>71</sup> *Kottle*, 146 F.3d at 1061-62. Similarly, the Ninth Circuit has expressed confidence that a city council and redevelopment agency, "acting in the political sphere, can accommodate false statements and reveal their falsity." *Boone v. Redevelopment Agency of San Jose*, 841 F.2d 886, 894 (9<sup>th</sup> Cir.) (internal citation omitted), *cert. denied*, 488 U.S. 965 (1988).



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¶ 203e at 167. In contrast, less political arenas present higher, and often clearer, norms of conduct: “the criteria of impropriety are most fully developed in the adjudicatory context and are loosest in the legislative arena. The executive and administrative worlds partake of both: sometimes one, sometimes the other, sometimes a hybrid.” *Id.*, ¶ 203f at 174 (footnote omitted).

## 2. The Degree of Governmental Discretion

“[T]he scope of immunity depends on the degree of political discretion exercised by the government agency.” *Kottle*, 146 F.3d at 1062 (internal citation omitted). The degree of discretion shapes the meaning of a proceeding’s legitimacy and the possibility of judicial review: with unfettered discretion, decision makers are free to act for whatever reasons they choose, without triggering court intervention. As Judge Robert Bork explains:

an executive officer . . . entrusted with what amounts to legislative discretion . . . is properly free to arrive at his conclusions in the manner he finds most expeditious. If he acts within the area of his lawful discretion, no court will interfere, and no court will impose liability, under the Sherman Act or any other statute, upon those who attempt by lawful means to persuade him to take one decision rather than another.

BORK, *THE ANTITRUST PARADOX* at 361. In such contexts, “legitimacy” of the decision-making process has no clear meaning.<sup>72</sup> Accountability in the face of such broad discretion is secured through the electorate, via the political, not the legal, system.

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<sup>72</sup> See *Kottle*, 146 F.3d at 1062 (stating that “[o]nly when administrative officials must follow rules is it meaningful to ask whether a petition before an agency was ‘objectively baseless,’ ” and indicating that similar considerations apply to intentional misrepresentations).

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In contrast, when discretion is substantially limited, there is a meaningful basis to define legitimacy and assess whether a misrepresentation has undermined it.<sup>73</sup> Such limits may come from enforceable, substantive standards in an underlying statute or from procedural requirements tying the decision-making process to facts in a record. *See Kottle*, 146 F.3d at 1062 (“executive entities are treated like judicial entities only to the extent that their actions are guided by enforceable standards subject to review”); *Boone*, 841 F.2d at 896 (stressing the absence of standards more definite than what is “necessary or desirable” and the lack of judicial review); *Metro Cable*, 516 F.2d at 228 (contrasting a legislative body, which operates in “a political setting” with freedom “to base its actions on information and arguments that come to it from any source,” with an adjudicatory body, which, “as a prerequisite to taking action” must “compile an evidentiary record through formal proceedings”). When a decision is predicated on fact-finding and dependent on a record, it is vital that those facts be accurate. *See Israel*, 466 F.2d at 278 (stating that “[n]o actions which impair the fair and impartial functioning of an administrative agency should be able to hide behind the cloak of an antitrust exemption”); *Woods Exploration*, 438 F.2d at 1297-98 (describing the alleged misrepresentations as an “attempt to undermine” a rule’s efficacy and an “abuse of the administrative process”); *DeLoach*, 2001-2 Trade Cas. ¶ 73,409 at 91,433-34 (explaining that submission of false data undermines governmentally determined production quotas). Legitimacy in such settings has objective meaning and may be assessed through judicial review relying on the factual record.

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<sup>73</sup> Consequently, a focus on discretion provides an operable tool for distinguishing the political and non-political arenas. In contrast, portions of Unocal’s Brief speak of “policy questions,” “policy considerations,” “policy judgments,” and “political judgments.” *See* Unocal Brief at 30, 31, 32, 35-36. Framing the inquiry in that fashion begs the questions of what is “policy” and what is “political.”

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## 3. The Extent of Necessary Reliance on the Petitioner's Factual Assertions

Proceedings outside the political arena may be more prone to reliance on a petitioner's factual assertions than activities characterized as political, and the need to so rely increases the likely harm of misrepresentations. *Clipper Express* draws the contrast starkly:

[T]he adjudicatory sphere is much different from the political sphere. There is an emphasis on debate in the political sphere, which could accommodate false statements and reveal their falsity. In the adjudicatory sphere, however, information supplied by the parties is relied on as accurate for decision making and dispute resolving. The supplying of fraudulent information thus threatens the fair and impartial function of these agencies and does not deserve immunity from the antitrust laws.

*Clipper Express*, 690 F.2d at 1261; *see also Boone*, 841 F.2d at 894 (explaining that agencies acting in political contexts can protect themselves against misrepresentations).

Similarly, the Areeda and Hovenkamp treatise places considerable emphasis on an agency's need to rely on information petitioners communicate:

There certainly is no privilege for misrepresentations to administrative agencies that base their decisions on information provided by the parties. Moreover, there is no reason here to differentiate for these purposes between adjudication and rule making or between rules grounded exclusively in a hearing record and those grounded in less formal procedures.

1 AREEDA & HOVENKAMP, ANTITRUST LAW ¶ 203e at 169 (footnotes omitted). The leading antitrust treatise thus rejects explicitly the more formal, administrative law distinctions on which the ALJ and Unocal rely.

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At the same time, courts have also recognized that an agency's practical ability to probe behind petitioners' assertions may shape the result. In *Woods Exploration* and *DeLoach*, where the agencies had no reasonable means to confirm or contradict the petitioners' demand projections and purchase intentions, the courts refused to apply *Noerr-Pennington*.<sup>74</sup> In contrast, the Third Circuit's *Armstrong* opinion noted that the government agencies "recognized that there was a dispute and made a credibility determination concerning it . . . conducted their own investigation, and afforded all interested parties an opportunity to set the record straight." *Armstrong*, 185 F.3d at 163. The court found that the CON proceeding at issue provided "extensive opportunities for error correction." *Id.* at 164. In these circumstances, it afforded *Noerr-Pennington* protection.

#### 4. The Ability to Determine Causation

Differences in the ability to establish a causal link between petitioning conduct and an ensuing governmental action also distinguish political from non-political arenas. In a truly political environment, it may be impossible to establish that a given misrepresentation caused the government to act as it did.<sup>75</sup> "The

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<sup>74</sup> See *Woods Exploration*, 438 F.2d at 1295 (finding "no opportunity for meaningful supervision or verification" and a "necessity" of "rely[ing] on the truthfulness" of the petitioners); *DeLoach*, 2001-2 Trade Cas. ¶ 73,409 at 91,434 (finding that the USDA "did not and, in fact, could not . . . investigate the accuracy of the submissions"); see also *In re Buspirone Patent Litigation*, 185 F.Supp.2d 363, 374 (S.D.N.Y. 2002) (refusing to apply *Noerr-Pennington* when the government agency had "neither the authority nor the ability to determine the accuracy of the representations" but rather was "required by law to rely directly upon them").

<sup>75</sup> Cf. *Omni*, 499 U.S. at 378 (noting that unlawful activity to influence governmental conduct may not change the ensuing

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necessary connections would be almost impossible to establish in the legislative context, where no one can say what combination of facts, arguments, politics, or other factors produced the legislation.” AREEDA & HOVENKAMP, *ANTITRUST LAW* ¶ 203f3 at 177. As we move to less political arenas, such determinations become feasible:

[I]t is often much more plausible to conclude in the adjudicative context that the provision of false information “caused” the judge or administrative officer to make the decision it did. Such a claim would be strongest in the case of *ex parte* proceedings where the proponent’s statements are not disputed, or when the information in question was exclusively in the control of the proponent.<sup>76</sup>

Similarly, courts making *Noerr-Pennington* assessments have considered the ability to determine causation. *Compare Nobelpharma*, 141 F.3d at 1071-72 (finding *Walker Process* fraud because “the patent would not have issued but for the misrepresentation or omission”) and *Kottle*, 146 F.3d at 1062-63 (relying in part on the presence of public hearings and written findings in determining that inquiry into the effect of misrepresentations on the proceeding’s legitimacy was appropriate), *with Cheminor*, 168 F.3d at 123-24, 127

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governmental action) and 383 (noting the obstacles to identifying lobbying that has produced “selfishly motivated agreement with public officials”).

<sup>76</sup> AREEDA & HOVENKAMP, *ANTITRUST LAW* ¶ 203e at 170 (footnote omitted); *see also id.*, ¶ 203f3 at 177 (although agencies engaging in quasi-legislative activities often behave as legislatures, “the relevant procedures may approximate the adjudicatory and the path of decision may be clearer”), ¶ 203h at 193 (with a formal record and a statement of reasons, “it may be quite possible to see the causal connection between a particular impropriety and the tribunal’s order”).

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(determining that the government’s action “was not dependent upon the misrepresented information” and finding the petitioning protected) *and Baltimore Scrap*, 237 F.3d at 402-03 (finding that the alleged fraud did not affect the outcome and therefore could not vitiate *Noerr-Pennington* protection).

C. The Nature of the Relevant Communications

The *Noerr-Pennington* inquiry also requires consideration of the nature of the relevant communications. Three issues stand out: a misrepresentation or omission must be deliberate, subject to factual verification, and central to the legitimacy of the affected governmental proceeding.

1. Deliberate Misrepresentation/Omission

The Supreme Court has left no doubt that something more than mere error is necessary. The Court spoke in terms of “unethical conduct” and “forms of illegal and reprehensible practice which may corrupt the administrative or judicial processes,” *California Motor Transport*, 404 U.S. at 512-13; “unethical and deceptive practices [that] can constitute abuses of administrative or judicial processes,” *Allied Tube*, 486 U.S. at 500; and “knowingly and willfully misrepresenting facts,” *Walker Process*, 382 U.S. at 177. See also *Liberty Lake*, 12 F.3d at 159 (looking to “knowing fraud” and “intentional misrepresentations”); *Potters Medical Center*, 800 F.2d at 581 (“Only known falsity supports an antitrust offense.”). Professors Areeda and Hovenkamp explain, “There is no policy ground to impose antitrust punishments on those who make innocent errors in their dealings with governments. Without knowing falsity, moreover, there would not be the ‘abuse’ of government process that is the key to ousting *Noerr* . . . .” 1 AREEDA & HOVENKAMP, ANTITRUST LAW ¶ 203f1 at 174.

2. Factual Verifiability

As the leading treatise states, “If false information is to be actionable in an antitrust suit, the falsity must be clear and

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apparent with respect to particular and sharply defined facts.” 1 AREEDA & HOVENKAMP, ANTITRUST LAW ¶ 203f2 at 175 (footnote omitted). In contrast, “the antitrust court . . . should not review the ‘truth’ of arguments or of general statements about the world.” *Id.*

### 3. Centrality to Legitimacy

Finally, to vitiate *Noerr-Pennington* protection a misrepresentation must be of central significance, such that it undermines the very legitimacy of the government proceeding. The courts have made this an essential element in the inquiry. Some require that the misrepresentations “deprive the litigation of its legitimacy.” *See Kottle*, 146 F.3d at 1060; *Liberty Lake*, 12 F.3d at 159. Others ask whether the misrepresentations infect “the very core” of the case. *See Cheminor*, 168 F.3d at 124. Still others ask whether the government action would have resulted “but for” the misrepresentation or omission. *See Nobelpharma*, 141 F.3d at 1071 (requiring, in a *Walker Process* analysis, that “the patent would not have issued but for the misrepresentation or omission”); *see also* 1 AREEDA & HOVENKAMP, ANTITRUST LAW ¶ 205c2 at 232 (requiring that the antitrust plaintiff show that “the tribunal’s adverse decision depended on the provision of false information”) and ¶ 203h at 192 (framing the inquiry in terms of whether “the agency would not have acted the way it did *but for* the impropriety”) (emphasis original).

Having established a framework of analysis and identified the factors that require consideration, we turn in the next section to assess whether the Complaint is insufficient as a matter of law.

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V. *NOERR-PENNINGTON* DOES NOT BAR THE  
COMPLAINT AS A MATTER OF LAW

A. The Complaint's Allegations about the Context of the Proceeding

For purposes of evaluating the political nature of governmental activities, legislative lobbying presents one extreme, judicial trials the other. Rulemaking, of the type at issue in the CARB proceeding, typically falls within a more difficult middle ground.<sup>77</sup> To evaluate CARB's activities, we must examine the Complaint's factual allegations under each of the factors identified above and form an overall assessment based on "the totality of the circumstances." See *Kottle*, 146 F.3d at 1062. Under this analytical framework, the facts the Complaint alleges, if established, and with all inferences drawn in Complaint Counsel's favor, would support a conclusion that CARB's activities fell outside the political arena.

This is a substantially broader inquiry than that conducted by the ALJ. In determining that CARB's proceeding was legislative rather than adjudicative, the Initial Decision focused on the degree of CARB's discretion; even there, its analysis was incomplete. It asked whether the CARB proceeding was more akin to rulemaking/legislation or to adjudication, rather than considering whether the proceeding was political or non-political in the *Noerr-Pennington* sense. Unocal discusses a broader range of factors but fails to demonstrate that CARB, in this situation, acted as a political entity.

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<sup>77</sup> See generally *Kottle*, 146 F.3d at 1061 (explaining that whereas in the legislative branch the sham exception is "extraordinarily narrow," and in the judicial branch *Noerr-Pennington* exceptions are well-recognized, the executive branch is "radically diverse," uses widely varying procedures, and exhibits "greatly varying levels of discretion," so that the sham exception must be shaped based on the circumstances presented).



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## 1. CARB's Expectations of Truthful Representation

The Complaint alleges facts that, if established, would support a finding that CARB's rulemaking proceeded under expectations of truthfulness. Specifically:

- Paragraph 17 alleges, "Given the scientific and technical nature of the issues involved, CARB relies on the accuracy of the data and information presented to it in the course of rulemaking proceedings."
- Paragraph 25 alleges that "In its Phase 2 RFG proceedings, CARB did not conduct any independent studies of its own, but relied on industry to provide the needed research and resulting knowledge."<sup>78</sup>
- Paragraph 17 alleges that California's Administrative Procedures Act requires "the development of an evidentiary basis for any proposed regulations,"<sup>79</sup> and Paragraph 18 alleges that CARB's regulations are subject to judicial

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<sup>78</sup> Unocal disputes this allegation. *See* Unocal Brief at 5 (quoting CARB's Final Statement of Reasons for Rulemaking (October 1992)); Surreply of Union Oil Company at 1-2. Complaint Counsel challenge Unocal's assertions. *See* Reply Brief of Counsel Supporting the Complaint at 2 (quoting a brief filed by Unocal in other litigation). Rather than attempting to resolve this dispute – which would require facts placing the bare language of the quoted materials in proper context – we note that the debate highlights a factual issue that appears to require resolution through trial, not through briefing on a motion to dismiss.

<sup>79</sup> *See* Cal. Gov't Code §§ 11340 *et seq.*

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review to determine, *inter alia*, whether the agency's action was "lacking in evidentiary support."<sup>80</sup>

- Paragraphs 39 through 42 suggest that one Unocal communication that allegedly created a "materially false and misleading impression" was the *quid pro quo* for CARB's "agreement to develop a predictive model."<sup>81</sup>
- Paragraphs 21, 37 and 48 (first and second sentences), 42, and 48 (third sentence), respectively, allege that CARB's statutory mandate requires that it consider the cost-effectiveness of its actions; that discussions between Unocal and CARB focused on the cost-effectiveness of regulations under consideration; that Unocal created the misleading impression that it had "agreed" to give up any "competitive advantage" it may have had "relating to its purported invention and arising from its emissions research results"; and that Unocal's statements suppressed the "material fact that assertion of its proprietary rights would materially increase the cost and reduce the flexibility of the proposed regulations."

As Judge Bork explains, "Our society requires a wide-open political process, robust and free. It also requires that there be more formal, constrained procedures for the establishment of certain types of facts and the application of particular policies.

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<sup>80</sup> See Cal. Gov't Code § 11350.

<sup>81</sup> Unocal argues that the communication alleged in Paragraph 41 preceded the formal opening of CARB's Phase 2 RFG proceeding and therefore could not have been subject to any constraints attendant upon the rulemaking Unocal Brief at 39. The Complaint, however, alleges a continuing pattern of conduct that maintained the alleged false and misleading impression throughout the rulemaking. See, e.g., Complaint, ¶¶ 2-4, 46, 48, 61, 64, 78c, and 79.

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Processes of the latter type must be guarded from abuse if they are to be effective.” BORK, *THE ANTITRUST PARADOX* at 360. The cited allegations – directed toward the nature of the issues involved, CARB’s reliance on industry research and knowledge, the procedures under which CARB operated, its course of dealing with Unocal, and the specific context in which CARB received necessary assurances regarding Unocal’s intentions – all depict a process of Judge Bork’s “latter type,” an effort to establish essential facts under norms indicating expectations of truthfulness.

## 2. The Degree of CARB’s Discretion

CARB operated with substantial limits on its discretion derived from a combination of enforceable statutory standards, required reliance on an evidentiary record, and the presence of judicial review.

Analysis drawn from the California Clean Air Act alone is ambiguous. The statute mandates that CARB take “necessary, cost-effective, and technologically feasible” actions to achieve specific percentage reductions of reactive, organic gases and nitrogen oxides by specific dates, but it leaves CARB with discretion how this may be achieved. Cal. Health & Safety Code § 43018(b). For particulates, carbon monoxide, and toxic air contaminants, the statute sets no specific percentages or dates, but rather mandates “maximum feasible reductions” and the “most cost-effective combination of control measures.” *Id.* at §§ 43018 (b)-(c). *See* Complaint, ¶ 21.

Complaint Counsel concede that the statute leaves discretion regarding “determination of the gasoline properties to be regulated and the limits to be set for these properties,” but argue that these were technical decisions circumscribed by the statutory mandate. To Complaint Counsel, the legislature made the central policy decisions – whether to regulate automobile emissions and the amount by which to reduce them and/or the applicable deadlines – leaving it to CARB to exercise technical expertise in implementing the legislature’s policies. CCAB at 35-38. Unocal,

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on the other hand, argues that CARB possessed and exercised broad discretion under a statute that left it to the agency to balance conflicting mandates and make tradeoffs between emission reductions and economic objectives.<sup>82</sup>

It appears that the California legislature imposed significant standards concerning the amount and timing of pollution reductions and specified the factors to be applied in resolving the remaining issues, but left subsidiary, though still important, choices to CARB. Plainly some measure of discretion is inherent in all but ministerial government decision making. A modicum of discretion, by itself, does not necessarily render a proceeding political when the legislature has mandated the ultimate objectives and identified specific considerations to be balanced. *See Livingston Downs*, 192 F.Supp.2d at 534 (treating the fact that statutes “enumerate several criteria the Commission was obligated to weigh” as evidence that its discretion was circumscribed, so that the proceeding should be regarded as adjudicatory for *Noerr-Pennington* purposes). An overall judgment must depend on the *degree* of discretion removed by legislative mandate and the *degree* of discretion left to the agency, and in close cases clear answers may prove elusive.

In this case, however, other discretion-limiting factors are present. CARB’s discretion *was* substantially confined by its need to base its actions on facts in the record. CARB was required by statute to maintain a record of its Phase 2 RFG proceeding. Cal. Gov’t Code § 11347.3. It had to make written findings justifying its actions. *Id.* at § 11346.7 (1991 through 1993). It needed an

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<sup>82</sup> Unocal Brief at 33-37. The Initial Decision merely listed the determinations that the statute left open to CARB’s discretion and observed that the statute provided “only” benchmarks and interests that CARB must keep in mind. The Initial Decision never addressed what those benchmarks/interests were, much less the nature of their interplay with matters left to CARB’s discretion. ID at 34-35.

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evidentiary basis for its decisions: Cal Gov't Code §§ 11349.1 and 11350 provide, respectively, that review by the Office of Administrative Law and then by the courts be based on the file of rulemaking required by § 11347.3. *See* Complaint, ¶¶ 17, 26.

Moreover, the presence and nature of judicial review further limit CARB's discretion. The Complaint alleges that all CARB regulations are subject to review, both by California's Office of Administrative Law and then by the courts. ¶ 18. Pursuant to California Government Code § 11350(b) (1991) and § 11350(b)(1) (1992 to the present), a regulation may be declared invalid if the agency's "determination that the regulation is reasonably necessary to effectuate the purpose of the statute . . . is not supported by substantial evidence." A leading analyst of California administrative law explains that the legislative history of the 1982 amendment that added the substantial evidence requirement to the judicial review statute "makes clear that the legislature intended a significant intensification of the factual support for a regulation."<sup>83</sup>

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<sup>83</sup> Michael Asimow, *The Scope of Judicial Review of Decisions of California Administrative Agencies*, 42 UCLA L. REV. 1157, 1230 (1995). Unocal argues that, although the governing statute requires "substantial evidence," in practice review is more deferential. Unocal Brief at 38 n.17. The one case that Unocal relies upon for interpreting the "substantial evidence nomenclature," *Western Oil & Gas Ass'n v. Air Resources Bd.*, 37 Cal.3d 502, 508 (1984), however, was issued in 1984, and does not reference the amendments that first added the substantial evidence test, effective in 1983. The case is an appeal from a 1980 trial court order, following CARB actions in 1976-1977, *id.* at 508, and the intermediate appellate opinion states that even amendments to the Government Code in 1980 came too late to be "specifically applicable." *See Western Oil & Gas Ass'n v. Air Resources Bd.*, 181 Cal.Rptr. 199, 202-03 (Cal. Ct. App. 1982), *vacated on other grounds*, 37 Cal.3d 502. In any case, even the language relied upon by Unocal acknowledges a requirement of

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The requirements that CARB base its actions on an evidentiary record and subject its regulations to judicial review based on substantial evidence in that record are significant limits on its discretion of a type that courts have found telling. For example, the U.S. Court of Appeals for the Seventh Circuit contrasted the situation of a city council that “need not, as a prerequisite to taking action, compile an evidentiary record through formal proceedings” with “an adjudicatory setting,” in which the government “can act only on the basis of a record made at hearings.” *Metro Cable*, 516 F.2d at 228, 232. Similarly, the presence of judicial review has contributed to findings that a proceeding was not political. See *Livingston Downs*, 192 F.Supp.2d at 534. In like fashion, the procedural constraints on CARB’s discretion are significant indicia that its Phase 2 RFG proceeding fell outside the political arena.<sup>84</sup>

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judicial review to determine whether an action is “lacking in evidentiary support.” 37 Cal.3d at 509. Unocal elsewhere cites a second California case for the proposition that judicial review of CARB proceedings is highly deferential. Unocal Brief at 31, citing *Western States Petroleum Ass’n v. Superior Court of Los Angeles County*, 9 Cal.4th 559, 572 (1995). That opinion merely rejects judicial consideration of extra-record evidence; it in no sense detracts from judicial review on the basis of evidence in the record. See *id.* The specific judicial review provision discussed, Public Resources Code § 21168.5, was not California Government Code § 11350, at issue here. See *id.*

<sup>84</sup> Unocal argues that *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), treats Environmental Protection Act rulemakings under the federal Clean Air Act as part of the political process, Unocal Brief at 2, 32, 37, and observes that CARB termed its authority in the RFG Phase 2 proceeding “analogous” to that in Environmental Protection Agency rulemakings. See Tr. at 59-60, citing CARB’s Final Statement of Reasons for Rulemaking at 193. *Chevron*, however, does not reach as broadly as Unocal contends. It deals

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## 3. The Extent of CARB's Reliance on Unocal's Factual Assertions

Paragraph 80 of the Complaint alleges that CARB “reasonably relied” on Unocal’s misrepresentations. Factual inquiry may demonstrate that CARB was dependent on Unocal for information regarding its patent applications and its intentions with regard to enforcing its patent rights. The Initial Decision erred in concluding that the numerous comments submitted by other parties on various subjects during the rulemaking proceeding necessarily indicated that CARB was not “wholly dependent” on Unocal for the relevant facts. ID at 40-43. Dependence must be assessed with reference to the specific information allegedly misrepresented. For example in *Woods Exploration*, the fact that plaintiffs’ natural gas demand forecasts may have been accurate did not protect defendants’ misrepresentations of their own share of total anticipated demand. See *Woods Exploration*, 438 F.2d at 1289, 1292. Similarly, *Clipper Exxpress* “made numerous filings with the ICC during the protest period,” yet that fact did not preclude antitrust scrutiny of the protestants’ misrepresentations. *Clipper Exxpress*, 690 F.2d at 1257. Indeed, the Initial Decision’s reasoning seemingly would eliminate any misrepresentation

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with a question of law – a statutory interpretation involving definition of a statutory term – not a matter based upon a fact-finding process and subject to substantial evidence review. Indeed, *Chevron*’s own language shows its limits: “In contrast, an agency to which Congress has delegated policy-making responsibilities may, within the limits of that delegation, properly rely upon the incumbent administration’s views of wise policy to inform its judgment.” *Chevron*, 467 U.S. at 865 (emphasis added). This presupposes, and is limited to, a policy-making context. Unocal fails to demonstrate why the fact that an agency as a general matter has some policy-making authority necessarily means that, in any specific context, it is operating within the political arena in the sense relevant to the *Noerr-Pennington* inquiry.

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exception in any litigation or contested adjudication, because the presence of an opposing party ensures that the judge or adjudicator is not “wholly dependent” on the petitioner in all respects.

Factual inquiry may show that no other party could provide information regarding Unocal’s patent claims and its intention to enforce them. Under the rules of the patent system then in force, the Patent and Trademark Office maintained patent applications under terms of strict confidentiality. *See* 35 U.S.C. § 122 (prior to 1999 amendments). Moreover, the Complaint, ¶¶ 60-67, alleges that, even following adoption of the CARB Phase 2 RFG requirements, Unocal amended its claims “to ensure that [they] more closely matched the regulations” and filed additional, related patent applications with priority dating from the original 1990 application. Given these evolving claims, the ultimate content of Unocal’s patent claims may have been foreseeable only to Unocal at the time of CARB’s rulemaking. Furthermore, even if all claims were known, Unocal allegedly did not reveal its intentions with regard to enforcement of its patent rights, *see, e.g.*, Complaint, ¶¶ 2-3. No party other than Unocal may have been able to shed light on this issue, and CARB may have been wholly dependent on Unocal’s factual assertions with respect to the issues most relevant to this proceeding.

#### 4. The Ability to Determine the Effect of the Misrepresentations on CARB’s Decision

The Complaint’s allegations, if established, would appear to demonstrate an ability to identify a causal link between Unocal’s alleged misrepresentations and CARB’s actions. The Complaint alleges that CARB was required to develop “an evidentiary basis” for its regulations and that CARB “issued written findings on the results of its rulemaking proceedings.” ¶¶ 17, 26. CARB, by statute, had to maintain, and be able to justify its actions based upon evidence in, an administrative record. Cal. Gov’t Code §§ 11347.3 and 11350. Indeed, CARB’s Final Statement of Reasons for Rulemaking, attached as Appendix 1 to Unocal’s



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Brief and taken as the subject of official notice by the ALJ, ID at 8-10, may establish some key elements of causation. For example, it identifies Unocal's study as "the only study that evaluated T50 and provided a statistical analysis" and states that it is the results of Unocal's study that "form the basis for the T50 specification." CARB Final Statement of Reasons for Rulemaking at 69. Moreover, Paragraph 27 of the Complaint alleges that Unocal's management and employees understood that information and data relating to the compliance costs or to the cost-effectiveness of the Phase 2 regulations were material to the rulemaking. If so, information in Unocal's possession would contribute to a showing about causation.

All of these considerations, of course, must be placed in proper context through fact-finding procedures. What we conclude now – when we must take the Complaint's allegations as established and draw all inferences in favor of Complaint Counsel – is that CARB's Phase 2 RFG proceedings exhibit the expectations of truthfulness, limits on governmental discretion, need to rely on petitioners' factual assertions, and ability to determine causation typically associated with activities outside the political arena.

#### B. The Complaint's Allegations about the Nature of the Relevant Communications

The Complaint alleges precisely the type of misrepresentation that courts and analysts have found to vitiate *Noerr-Pennington* protection in contexts outside the political arena. To begin, the Complaint plainly alleges that Unocal's conduct was deliberate, knowing, and willful. *See, e.g.*, ¶ 1 (alleging a "pattern of bad-faith, deceptive conduct"), ¶¶ 3, 77, 78, ("alleging "knowing and willful misrepresentations"), and ¶¶ 5 and 80 (alleging "fraud").

Next, the alleged misrepresentations/omissions relate to specific, verifiable facts. The Complaint alleges that Unocal, through misrepresentations/omissions, conveyed and maintained the false impression that it did not claim, or did not intend to assert, intellectual property rights implicated by CARB's

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standards. If Unocal asserted patent rights that it had previously represented either did not exist or would not be asserted, then the discrepancy would be clear, apparent, and factually verifiable.

Finally, the Complaint states allegations that, if established, would demonstrate the necessary central significance to CARB's decision making. *See, e.g.*, ¶ 45 (Unocal's alleged misrepresentations "caused CARB to adopt" regulations that substantially overlapped Unocal's patent claims). Indeed, ¶¶ 5 and 80 aver, "But for Unocal's fraud, CARB would not have adopted RFG regulations that substantially overlapped with Unocal's concealed patent claims; the terms on which Unocal was later able to enforce its proprietary interests would have been substantially different; or both."<sup>85</sup> Moreover, the governing statute makes cost-effectiveness a key element. Cal. Health & Safety Code § 43018(b). Paragraph 79 of the Complaint alleges that Unocal failed to disclose information that "would have impacted" CARB's analysis of this key element. We need not – and do not – decide, at this point, precisely what level of causality is essential to make *Noerr-Pennington* inapplicable. We do conclude that the very clear causation alleged in the Complaint would satisfy this aspect of the inquiry.

C. Denial of *Noerr-Pennington* Protection Would Not Raise Policy Concerns

The nature and context of Unocal's alleged communications work to minimize the policy concerns that the FTC, the courts, and commentators have voiced against an overly broad misrepresentation exception to *Noerr-Pennington*.

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<sup>85</sup> Paragraph 90 of the Complaint explains that participants in Auto/Oil and WSPA would have advocated that CARB "negotiate license terms substantially different from those that Unocal was later able to obtain."

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*First:* The deliberate and knowing nature of the alleged misrepresentations negates impact on even the broadest First Amendment considerations. There should be no chilling of legitimate petitioning and no sacrifice of necessary breathing space from a case confined to deliberate fraud.

*Second:* The alleged misrepresentations cut so clearly to the core of CARB's proceeding that there is no question of imposing antitrust liability based on valid government action. According to the Complaint, CARB did not know that it was taking action that would subject the California oil industry and California consumers to Unocal's patent claims and ensuing market power.<sup>86</sup> Nor do there appear to have been means for CARB or others to counterbalance the effect of Unocal's alleged fraud and to provide the "independent investigation, . . . open process, and extensive opportunities for error correction" highlighted in *Armstrong*, 185 F.3d at 164; here, the relevant information was uniquely in Unocal's knowledge and control.<sup>87</sup> As pled, the facts show that this is not a case like *Omni*, in which it was impractical to identify

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<sup>86</sup> Indeed, California has stated to the Supreme Court that Unocal sought to "commandeer" CARB's regulations and to "hijack," "distort," and "plunder" California's regulatory process. *Amici Curiae* Brief of [California and 33 States] and the District of Columbia in Support of Petition for Writ of Certiorari at 4-5, *Atlantic Richfield Co. v. Union Oil Co. of California*, 531 U.S. 1183 (2001) (No. 00-249).

<sup>87</sup> After-the-fact corrections also appear to have been impossible. The Complaint alleges that CARB cannot now change its regulations sufficiently to provide flexibility for third parties to avoid Unocal's patent claims. ¶ 94. Refiners have invested billions of dollars in sunk capital investments to comply with CARB Phase 2 RFG regulations, ¶ 93, and trial may show that "[r]epeal of the regulations would not undo the economic commitment to them." Brief of California *et al.* as *Amici Curiae* in support of the Complaint at 22 ("States' Brief").

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lobbying that produced a selfishly motivated city council ordinance, but rather a case like *Walker Process*, *Woods Exploration*, and *DeLoach*, in which misrepresentation effectively supplanted government action and the courts attributed anticompetitive harm to the underlying private conduct. *See supra* Section III.B.2.b.

*Third:* The context minimizes federalism concerns and reservations concerning regulation of political behavior. The conduct challenged does not flow directly from CARB's regulations. Rather, the Complaint emphasizes that the proximate cause of alleged competitive harm was Unocal's *enforcement* of its patent rights.<sup>88</sup> Moreover, the remedy sought – requiring that Unocal cease and desist from enforcing its RFG patents on gasoline sold in, or imported or exported to or from, California<sup>89</sup> – will not require a change in, or repeal of, any CARB regulations. Consequently, there is no reassessment of CARB's determination of public welfare and no regulation of the outcome of the state's political processes.

*Fourth:* The availability of objective information should lessen, and perhaps eliminate, any need to look behind CARB's decision making process. The presence of an administrative record and a written statement of reasons presenting CARB's reasoning may establish critical facts concerning the role played by Unocal's communications. Development of a factual record in this proceeding will enable an assessment of these, and any

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<sup>88</sup> ¶ 95. Complaint Counsel, CCAB at 22-24, analogize to *Walker Process*, in which the antitrust offense was based on *enforcement* of the fraudulently obtained patent. *Id.*, 382 U.S. at 174. Of course, the violation alleged here, as in *Walker Process*, is not a mere refusal to license. The contention that misrepresentation, or fraud, contributed to the acquisition of monopoly power is a key element of the allegations.

<sup>89</sup> Complaint, at Notice of Relief ¶¶ 1-3.

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similar, evidentiary materials, with knowledge of their context and an understanding of their significance to the allegations in the Complaint.

*Fifth:* This is not a case in which unwanted interference with a state decision maker is likely. CARB, joined by California and 21 other States, has filed an *amicus* brief in support of Complaint Counsel's position ("States' Brief"). The *amici* assert a "governmental interest in insuring that citizens who participate in administrative rule-making processes do not make misrepresentations or fraudulently withhold important facts," and CARB specifically expresses concern for "the integrity of its administrative processes." States' Brief at 4, 22. According to the *amici*, "Limiting the immunity provided by the *Noerr-Pennington* Doctrine helps to protect the integrity of these administrative proceedings." *Id.* at 22. Of course, participants' briefs do not establish any fact of record, but the filing of this *amicus* brief does suggest that any prudential concerns over unwanted intrusion are attenuated here. Courts have found similar representations persuasive. *See Clipper Express*, 690 F.2d at 1262 n.34 (discussing an ICC *amicus* brief that voiced concern over misrepresentations in administrative proceedings and supported antitrust review).

All of these factors mute policy concerns that in other circumstances might raise reservations over the denial of *Noerr-Pennington* protection for a misrepresentation to the government. Moreover, as discussed in Section III.B.2.c. above, there are also compelling reasons to avoid a blanket antitrust exemption for such misrepresentations. We conclude therefore that there is no basis either in policy or in the nature and context of Unocal's alleged communications to CARB for dismissing the Complaint as a matter of law, without trial or determination of any facts, because of *Noerr-Pennington*.

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## VI. UNOCAL'S COMMUNICATIONS WITH INDUSTRY GROUPS

The Initial Decision splits its treatment of Unocal's communications with the private industry groups, Auto/Oil and WSPA. It concludes that "[t]o the extent that" Unocal's alleged conduct toward Auto/Oil and WSPA was "part of [Unocal's] scheme to induce CARB to act, it constitutes indirect petitioning protected by *Noerr-Pennington*." ID at 68. In contrast, "[t]o the extent" that the alleged misrepresentations to the industry groups "were not part of [Unocal's] scheme to solicit favorable government action," the Initial Decision does not apply *Noerr-Pennington*. ID at 56, 59. The Initial Decision thus highlights the allegation that but for Unocal's fraud, the Auto/Oil and WSPA participants would have incorporated knowledge of Unocal's pending patent rights in their capital investment and refinery reconfiguration decisions, either to avoid or to minimize potential infringement. *See* ID at 60, citing Complaint, ¶ 90(c). Unocal argues that even those aspects of its communications that allegedly were directed toward affecting competitors' investment decisions were incidental effects of protected petitioning and therefore protected under *Noerr-Pennington*. Unocal Brief at 49.

Of course, if factual development shows that Unocal's direct communications to CARB fall outside *Noerr-Pennington* protection, there would be no question of indirect petitioning or incidental effects. If, however, Unocal's communications to CARB ultimately are protected by *Noerr-Pennington*, the status of communications to the industry groups remains a relevant issue. We conclude that Unocal misstates the controlling principles in ways that overstate potential protection for its communications to the industry groups and that the Initial Decision's formulation of the issue is ambiguous and, at a minimum, requires clarification.

In this context, both the ALJ and Unocal misapply *Noerr*. *Noerr* involved a publicity campaign sponsored by railroads as a means of influencing the adoption, retention, and enforcement of laws unfavorable to the trucking business. *Id.*, 365 U.S. at 129.

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The Court rejected the contention that, because the railroads also wished “to destroy the goodwill of the truckers among the public generally and among the truckers’ customers” and actually inflicted such injury, the publicity campaign was not protected. *Id.* at 142. As the Court explained, “There are no specific findings that the railroads attempted directly to persuade anyone not to deal with the truckers.” *Id.* “Moreover,” the Court continued, “all of the evidence in the record, both oral and documentary, deals with the railroads’ efforts to influence the passage and enforcement of laws.” *Id.* “In the light of this,” the Court concluded, harm to the truckers’ relationships with the public and with customers was no more than “an incidental effect” of a type “inevitable, whenever an attempt is made to influence legislation by a campaign of publicity . . . .” *Id.* at 143.

Here, the allegations are sharply different. There allegedly *was* direct misrepresentation to the industry groups and their participants. If the allegations are established, then there *would be* evidence of efforts to influence private business conduct. As alleged by the Complaint, the harm incurred as a result of communications to private parties was neither “incidental” nor “inevitable” but rather a distinct, free-standing, and potentially substantial source of competitive harm.

Under the Supreme Court’s subsequent analysis in *Allied Tube*, such conduct is not protected. Like the Auto/Oil research joint venture and the WSPA trade association, *Allied Tube* involved conduct – private standard-setting activity – that antitrust traditionally has scrutinized. *Id.*, 486 U.S. at 500, 505-07. The privately-determined standards in *Allied Tube* sometimes were adopted into state codes and sometimes were not. The plaintiff, however, sought damages only for harm resulting from the private standard alone (*e.g.*, the stigma experienced even in states that did not adopt the standard).<sup>90</sup> Terming the relevant conduct

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<sup>90</sup> *Allied Tube*, 486 U.S. at 498 n.2. Although the Court suggested that such effects might still enjoy *Noerr-Pennington*

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“commercial activity with a political impact” rather than “political,” *id.* at 507, the Supreme Court refused to apply *Noerr-Pennington* to “any antitrust liability flowing from the effect the [private] standard has of its own force in the marketplace.” *Id.* at 509-10.

Under this analysis, even if communications to CARB are protected, misrepresentations to the industry groups would be actionable if they caused substantial competitive harm from their “own force in the marketplace.” That is precisely what the Complaint alleges. Independent of its allegations concerning effects on CARB, the Complaint avers that Unocal induced other oil companies to make technology adoption decisions premised on the reasonable belief that Unocal had no relevant patent rights or no intention to enforce such rights.<sup>91</sup> If CARB had never existed, competitors still may have been harmed if induced unwittingly to subject themselves to Unocal’s patent claims. Alternatively, even given CARB’s regulation, had competitors known of Unocal’s patent claims and enforcement intentions from the start – before locking in to specific refinery configurations – they allegedly may have found ways to comply with CARB’s requirements without infringing Unocal’s patents. In either case, harm derives from

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protection if “incidental to a valid effort to influence governmental action,” it found that the defendants’ petitioning activity was invalid and therefore unprotected without resolving the question of “incidental status” of the competitive harm. *See id.* at 502-03.

<sup>91</sup> Unocal contends that “a vague patent disclosure policy” cannot serve as a basis for a finding of fraud in the private standard-setting context. The Complaint, however, traces liability to Unocal’s affirmative presentations and representations to the industry groups. *See, e.g.*, ¶¶ 54 and 58. These considerations may require both factual development and careful analysis of the substantive reach of the antitrust laws.



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unnecessarily infringing Unocal's hidden patent claims and is independent of CARB regulation.

Consequently, Unocal's claims lack merit and the Initial Decision potentially protects too much. The same conduct simultaneously may be "part of [Unocal's] alleged scheme to induce CARB to act," and yet have substantial marketplace effects independent of CARB's actions. Under the principles of *Allied Tube*, such conduct would support an antitrust violation based upon the independent effects.<sup>92</sup> To the extent that the Initial Decision suggests otherwise, it errs.<sup>93</sup>

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<sup>92</sup> This remains so notwithstanding that antitrust liability predicated on inducing CARB to act potentially could be protected as indirect petitioning. *See Allied Tube*, 486 U.S. at 503.

<sup>93</sup> Much of the Initial Decision's wording in this context is ambiguous, leaving it unclear whether conduct that was "part of [Unocal's] scheme to induce CARB to act" remains actionable to the extent that it also causes independent competitive harm. Some of the language suggests that the ALJ incorrectly assumed that conduct with one kind of effect is cleanly separable from conduct with the other. *See, e.g.*, ID at 2 ("conduct directed toward Auto/Oil Group and WSPA, independent of the conduct directed toward CARB"), 59 (beginning with the heading "Conduct directed at Auto/Oil Group and WSPA separate from conduct directed at CARB"). The Initial Decision identifies Complaint Paragraphs 83, 84 (partial), 88, 89 (partial), and 90(c) as surviving its *Noerr-Pennington* analysis. ID at 59-60. To this list our analysis would add Paragraphs 50-59, 81-82, 84 (phrase relating to violation of the integrity of Auto/Oil's procedures), 85-87, 89 (phrase relating to violation of the integrity of WSPA's procedures), and 90 (first and last sentences) from the paragraphs specifically devoted to Unocal's communications with Auto/Oil and WSPA.

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Unocal's *Noerr-Pennington* motion rests on the proposition that a private business may lie to a government rule maker, misrepresent its intentions regarding the enforcement of its patent rights, and then swing the trap shut after the government has enacted regulations that overlap with the patents. According to Unocal, a firm may thereby amass market power and enforce patent rights buttressed by a government mandate in ways never understood nor intended by the government agency, with absolute impunity from antitrust review. Unocal argues that regard for First Amendment freedoms and concern with interference with, or deconstruction of, governmental decision making require this result.

The First Amendment Right to Petition helps to protect, preserve, and promote representative democracy. This protection, however, is not limitless, especially with respect to intentional, egregious misrepresentation. Too broad a shield for false petitioning would actually jeopardize the representative system that it seeks to guard. The more that petitioners mislead the government, the more that government mis-leads the public. Consequently, it is not surprising that the First Amendment finds no value in false statements for their own sake, and protects misrepresentations only when necessary to protect speech that matters. When fraud controls the outcome, and the misrepresentation is intentional, denying protection to the "liar in petitioner's clothing" jeopardizes no speech that matters. Virtually all recent cases hold that in some circumstances false petitioning does not enjoy protection. Moreover, virtually all agree that First Amendment and federalism considerations require that the circumstances justifying denial of *Noerr-Pennington* protection be reasonably-bounded and clearly drawn. We join this consensus.

As a matter of law, therefore, we hold that misrepresentation can warrant denial of *Noerr-Pennington* protection, pursuant either to a separate doctrinal exception or a variant of the sham

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exception. We hold, however, that false petitioning loses *Noerr-Pennington* protection only in limited circumstances, such as when the petitioning occurs outside the political arena; the misrepresentation is deliberate, factually verifiable, and central to the outcome of the proceeding or case; and it is possible to demonstrate and remedy this effect without undermining the integrity of the deceived governmental entity. In addition, we emphasize that, even if *Noerr-Pennington* considerations do not protect the false petitioning, no liability arises under the FTC, Sherman, or Clayton Acts unless that conduct is anticompetitive. These limitations will ensure, with a substantial margin for error, that the possibility of antitrust challenge will neither chill petitioning that merits protection nor undermine the decision-making functions of other governmental entities. This approach, moreover, will also help make certain that intentionally and egregiously false petitioning does not cause competitive injury.

#### VII. THE COMMISSION HAS JURISDICTION OVER THE ISSUES PLED IN THE COMPLAINT

The Initial Decision ruled that “[t]o the extent that the alleged misrepresentations made to the Auto/Oil Group and to WSPA were not part of [Unocal’s] scheme to solicit favorable governmental action,” the allegations of the Complaint require resolution of substantial questions of federal patent law over which the Commission lacks jurisdiction. ID at 59. According to the Initial Decision, “The scope of [Unocal’s] patents, the scope of any competitor’s patents, whether any of the competitor products or methods that could be created or invented infringed, and whether refineries could be reconfigured so as to avoid or minimize infringement of [Unocal’s] patents” are “substantial patent law issues” that the Complaint raises yet lie beyond Commission jurisdiction. ID at 69. Unocal supports the Initial Decision’s analysis and urges that “this matter may only be brought, if at all, in a federal district court which has original jurisdiction over patent questions.” Unocal Brief at 52. As discussed below, the ALJ and Unocal err through an unduly narrow reading of the FTC Act; an overly broad reading of the

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statute that confers patent law jurisdiction upon the federal courts; and a fundamental misinterpretation of the nature of the Commission's inquiry when patents are among the relevant assets of firms alleged to have unlawfully created or exercised market power.

A. The FTC Act Confers Broad Jurisdiction

The FTC Act confers broad power to prevent unfair methods of competition. Congress had “an abiding purpose to vest both the Commission and the courts with adequate powers to hit at every trade practice, then existing or thereafter contrived, which restrained competition or might lead to such restraint if not stopped in its incipient stages.” *FTC v. Cement Institute*, 333 U.S. 683, 693 (1948). The ALJ and Unocal misread congressional intent in arguing that the lack of express language relating to patent questions evinces an intent to limit the FTC's role. Rather, the Supreme Court explains that the statutory prohibition of “unfair methods of competition” confers a “broad delegation of power” to the FTC: Congress “intentionally left development of the term ‘unfair’ to the Commission rather than attempting to define the many and variable unfair practices which prevail in commerce.” *Atlantic Refining Co. v. FTC*, 381 U.S. 357, 367 (1965) (internal quotation omitted).<sup>94</sup>

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<sup>94</sup> See also *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 240 (1972), citing S. Rep. No. 597, 63d Cong., 2d Sess. 13 (1914) (explaining that a general declaration condemning unfair practices was preferable to an effort to enumerate them because “after writing 20 of them into the law it would be quite possible to invent others”), and H.R. Conf. Rep. No. 1142, 63<sup>rd</sup> Cong., 2d Sess. 19 (1914) (“There is no limit to human inventiveness in this field. Even if all known unfair practices were specifically defined and prohibited, it would be at once necessary to begin over again.”).

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Congress certainly was aware that antitrust and unfair competition cases could involve patent issues,<sup>95</sup> yet neither the ALJ nor Unocal identify anything in the statute or legislative history suggesting the claimed jurisdictional limit. As several provisions in the FTC Act demonstrate,<sup>96</sup> when Congress wishes to limit FTC jurisdiction, it knows how to do so. Given Congress' purpose to empower the Commission broadly and its deliberate choice to avoid enumerating specific suspect practices, no jurisdictional constraint should be implied.

Indeed, both the Commission and the federal courts have reached this conclusion before. In *American Cyanamid Co.*, 63 F.T.C. 1747, 1855-57 (1963), the Commission expressly found that it had jurisdiction over allegations of unfair methods of competition that were based on a substantial issue of patent law. Although the appeals court vacated the Commission's opinion on other grounds, it affirmed the jurisdictional finding: "The Federal Trade Commission Act contains no statutory exemption of Patent Office proceedings, and we find nothing in the Act indicating any intention to set aside the Patent Office as a 'city of refuge.' "

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<sup>95</sup> A catalog of antitrust/unfair competition cases compiled while Congress considered and passed the FTC and Clayton Acts in 1914 includes substantial discussion of patent-related cases. *See, e.g.*, JOSEPH E. DAVIES, BUREAU OF CORPORATIONS, TRUST LAWS AND UNFAIR COMPETITION at LI, 115-17, 389-94, 471-72, 495 (1915) (citing cases dealing with the terms under which patent rights may be licensed or involving bad faith threats of infringement suits directed at customers or distributors of competitors).

<sup>96</sup> *See, e.g.*, 15 U.S.C. § 44 (exempting from FTC jurisdiction the activities of firms not organized to carry on business for profit), § 45(a)(2) (exempting from FTC jurisdiction banks, savings and loan institutions, meat packers, certain common carriers, and air carriers), and § 46 (exempting from FTC investigatory authority "the business of insurance").

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*American Cyanamid Co. v. FTC*, 363 F.2d 757, 771 (6<sup>th</sup> Cir. 1966).

The issue in *American Cyanamid* – inequitable conduct before the Patent Office – did not involve the scope or infringement of a patent, but the Initial Decision errs in distinguishing its jurisdictional findings on that basis. *See* ID at 65-66 (concluding that resolution of allegations in the Complaint “goes far beyond what was required in *American Cyanamid*”). The U.S. Court of Appeals for the Federal Circuit has ruled that issues of patent enforceability (which include inequitable conduct), just like issues of patent validity and infringement, are substantial issues of patent law for purposes of jurisdictional determinations. *See Hunter Douglas, Inc. v. Harmonic Design, Inc.*, 153 F.3d 1318, 1330-31 (Fed. Cir. 1998) (“We see no reason why our jurisdictional jurisprudence should distinguish [validity and enforceability] from [infringement]”), *cert. denied*, 525 U.S. 1143 (1999), *overruled in part on other grounds, Midwest Indus., Inc. v. Karavan Trailers, Inc.*, 175 F.3d 1356 (Fed. Cir. 1999). The ALJ has drawn a distinction without a difference, and *American Cyanamid*’s conclusion that the FTC Act reaches unfair methods of competition that involve patent issues applies equally to this case.

B. Section 1338(a) is Inapplicable on its Face

Finding no basis in the FTC Act for limiting the Commission’s jurisdiction, the ALJ and Unocal rely heavily on the statute that vests federal district courts with jurisdiction over patent matters, 28 U.S.C. § 1338(a). Section 1338(a) provides:

The district courts shall have original jurisdiction of any civil action arising under any Act of Congress relating to patents, plant variety protection, copyrights and trademarks. Such jurisdiction shall be exclusive of the courts of the states in patent, plant variety protection and copyright cases.

The Initial Decision treats this case as arising under the patent laws and concludes that § 1338(a) vests exclusive jurisdiction in

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the federal district courts and thereby precludes jurisdiction within the FTC. ID at 63. It is apparent, however, from its very face that § 1338(a) has no bearing on Commission jurisdiction: this proceeding is not a “civil action”; the FTC is not one of the “courts of the states”; and this proceeding does not “aris[e] under” a patent statute.

### 1. This Proceeding is not a Civil Action

The Commission’s adjudicatory actions are “proceedings,” not the “civil action[s]” referenced in § 1338(a). See *Pepsico, Inc. v. FTC*, 472 F.2d 179, 184 (2d Cir. 1972) (distinguishing a Commission proceeding from a civil action), *cert. denied*, 414 U.S. 876 (1973). The FTC Act carefully distinguishes between “proceedings” before the Commission and “civil actions” before federal district courts.<sup>97</sup> Section 1338(a) deals only with civil actions, and the present administrative *proceeding* falls entirely outside its coverage.

### 2. Jurisdiction exclusive of the “courts of the states” is not exclusive of the FTC

Nor does § 1338(a)’s grant of jurisdiction “exclusive of the courts of the states” pertain to the Commission. The FTC is a federal administrative agency, not a court of a state. Indeed, by insisting that § 1338(a) excludes FTC jurisdiction notwithstanding that statute’s clearly limited language, the ALJ disregards a prior Commission holding. In *American Cyanamid*, the Commission squarely held that “no inference can be drawn from the statute

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<sup>97</sup> Compare 15 U.S.C. § 45(b) (authorizing the Commission to conduct an administrative “proceeding” when it has reason to believe that a person has engaged in unfair methods of competition) with 15 U.S.C. § 45(m) (authorizing the Commission to commence a “civil action . . . in a district court of the United States” to obtain civil penalties for violations of the Commission’s rules and orders).

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[§ 1338(a)] that Congress made federal court jurisdiction of actions arising under patent laws exclusive of this Commission as well as state courts.” 63 F.T.C. at 1856. As an appellate court explains, “Simple logic dictates that because federal courts have jurisdiction exclusive of the states provides no help in deciding whether their jurisdiction is also exclusive of an administrative proceeding within the executive branch.”<sup>98</sup>

Relying on rhetoric to supply what the words of the statute do not, the ALJ warned that unless § 1338(a) were read to exclude more than the courts of the states, “tax courts, the Court of Claims, etc.” would be able to decide patent cases. ID at 63. As even Unocal acknowledges, Unocal Brief at 57, however, the Court of Claims *does* have jurisdiction over patent claims, see 28 U.S.C. § 1498(a), and the U.S. Tax Court *does* consider factors such as “the scope of the patents, the potential availability of noninfringing substitutes, the potential for litigation over the validity of the patents, and how such matters might affect the royalty rate that would be set by parties bargaining at arm’s length” in forming a judgment about reasonable arm’s-length consideration.<sup>99</sup>

Unocal would overcome the clear words of the statute with the assertion that FTC jurisdiction would undermine congressional goals of uniform enforcement of the patent laws. The answer here is the same that the Supreme Court recently gave in refusing to confer exclusive appellate jurisdiction on the Federal Circuit whenever there is a patent-law counterclaim: “Our task here is not to determine what would further Congress’s goal of ensuring patent-law uniformity, but to determine what the words of the

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<sup>98</sup> *Miss America Org. v. Mattel, Inc.*, 945 F.2d 536, 541 (2d Cir. 1991) (involving activities of the Treasury Department and the U.S. Customs Service).

<sup>99</sup> *See Podd v. Commissioner*, 75 T.C.M. (CCH) 2575 (1998).



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statute must fairly be understood to mean.” *Holmes Group, Inc. v. Vornado Air Circulation Systems, Inc.*, 535 U.S. 826, 833 (2002). Here, the grant of jurisdiction “exclusive of the courts of the states” cannot fairly be understood to mean “exclusive of the Federal Trade Commission.”

3. This case does not “arise under” the patent laws

Another reason for our finding that § 1338(a) is inapplicable is that this proceeding does not “aris[e] under any Act of Congress relating to patents.” According to the Supreme Court, a case arises under the patent laws only when a “well-pleaded complaint establishes either that federal patent law creates the cause of action or that the plaintiff’s right to relief necessarily depends on resolution of a substantial question of federal patent law, in that patent law is a necessary element of one of the well-pleaded claims.” *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 808-09 (1988). The ALJ and Unocal assert that this proceeding depends on resolution of substantial questions of patent law.<sup>100</sup> The Court tells us, however, that “a claim

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<sup>100</sup> The nature of this dependence has been something of a moving target. Unocal’s motion to dismiss argued that establishing market power and defining markets required patent construction and infringement determinations. *See, e.g.*, Unocal’s Motion for Dismissal of the Complaint and Memorandum in Support for Failure to Make Sufficient Allegations that Respondent Possesses or Dangerously Threatens to Possess Market Power at 8-10, 12-15 (“Unocal’s Market Power Motion”). The Initial Decision focused on the allegations involving communications to Auto/Oil and WSPA and concluded that demonstrating harm to their participants requires proof of infringement. ID at 61-62, 64, 69. On appeal Unocal recasts the issue, contending now that “the Complaint’s fraud allegations necessarily require a determination of what Unocal did and did not patent as well as a claim construction and infringement analysis,” and that proof of harm requires construing Unocal’s patents and

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supported by alternative theories in the complaint may not form the basis for § 1338(a) jurisdiction unless patent law is essential to each of those theories.” *Id.* at 810.

Here there are alternative theories that do not require resolution – or necessarily even consideration – of issues regarding patent construction or infringement. Misrepresentation might be established by comparing Unocal’s conduct in creating the allegedly false and misleading impression that it would not enforce any patent rights with its subsequent enforcement activities. *See, e.g.*, Complaint, ¶¶ 2-4, 9, 42, 58, 66-72, 77-78, 82-83, and 85. Market power and competitive harm might be established through the course of dealing among Unocal and third parties, as reflected by Unocal’s licensing activities and the responses of third parties to Unocal’s threats and suits.<sup>101</sup> The findings of the federal courts regarding third-party infringement of one of Unocal’s RFG patents might supplement these inquiries. *See, e.g.*, ¶¶ 9, 68-70. Under *Christianson*, the fact that the claims are supported by theories that do not require resolution of substantial questions of patent law demonstrates that this proceeding does not arise under the patent laws.

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determining their scope and the infringing or noninfringing status of alternatives. Unocal Brief at 52-54.

<sup>101</sup> *See, e.g.*, ¶¶ 8-9, 14, 68-72, 95. Unocal does not raise on appeal its prior contention that market definition requires determining the scope of its patents. In any case, Paragraph 74 of the Complaint, which defines a technology market, merely identifies the relevant Unocal technology by reference to Unocal’s RFG patent claims. It requires inclusion of alternatives to that technology, but no infringement determinations. The question of which alternatives compete with Unocal’s technologies is a familiar question in antitrust law, not a substantial question of patent law.

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## C. Assessment of Likely Competitive Effects Does Not Require Resolving Patent Issues

The ALJ/Unocal jurisdictional arguments falter on one further ground: the assessment of likely competitive effects in this case will not require actual resolution of substantial questions of patent law. In assessing market power and competitive harm, the FTC determines only likelihoods. It does not resolve patent questions in the sense at issue in *Christianson* and § 1338(a), but only reaches conclusions regarding how they likely would be resolved. Actual rulings on construction and infringement, of course, remain with the courts.

We need look no farther than Unocal's own brief for illustrative examples. In one cite, Unocal provides the parenthetical "ITC may not award infringement damages, which 'may only be provided by the United States District Courts . . . .'"<sup>102</sup> Of course, the FTC has no intention of "award[ing] infringement damages." We may conclude that certain technologies are likely to infringe and therefore may not provide a significant competitive check on whatever market power Unocal may possess, but this does not find infringement. Similarly, another Unocal parenthetical describes a case as "explaining ITC's lack of jurisdiction to render binding legal conclusions on validity, given district court's original jurisdiction under § 1338."<sup>103</sup> Again, nothing the FTC will do in this case will constitute a "binding legal conclusion" of either validity or invalidity.

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<sup>102</sup> Unocal Brief at 61, citing *Bio-Technology General Corp. v. Genentech, Inc.*, 80 F.3d 1553, 1564 (Fed. Cir.), cert. denied, 519 U.S. 911 (1996).

<sup>103</sup> Unocal Brief at 61, citing *In re Convertible Rowing Exerciser Patent Litigation*, 814 F. Supp. 1197, 1206-07 (D. Del. 1993).

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In fact, the specific portion of the Complaint that the Initial Decision dismissed for want of jurisdiction on its very face deals with likelihoods. It alleges that participants in Auto/Oil and WSPA would have taken actions “incorporating knowledge of Unocal’s *pending* patent rights in their capital investment and refinery reconfiguration decisions to avoid and/or minimize *potential* infringement.” ¶ 90(c) (emphasis added). There is no hint of reliance on definitive claim construction or infringement rulings, but rather an allegation based upon patent rights that remained in prosecution, infringement that remained potential, and competitive harms that entail an assessment of likelihoods. This is not an inquiry that requires resolution of substantial questions of patent law.

VIII. INSTRUCTIONS ON REMAND AND CONCLUSION

We reverse and vacate the Initial Decision. Neither the *Noerr-Pennington* doctrine nor the claimed absence of FTC jurisdiction provides an adequate basis for Unocal’s motions to dismiss. The *Noerr-Pennington* claims cannot be sustained if the Complaint’s allegations are taken as established. The jurisdictional argument is flawed as a matter of law.

This proceeding now requires factual development, and we remand for that purpose. The ALJ’s deadline for filing motions for summary decision passed before the Initial Decision was issued, and we expect that the proceeding will now move quickly to the adjudicatory hearing.<sup>104</sup> The Administrative Law Judge

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<sup>104</sup> See Scheduling Order at 2 (April 9, 2003) (establishing September 19, 2003 as the deadline for “motions for summary decision”). Although the ALJ denied portions of Unocal’s Market Power Motion without prejudice, large portions of that motion rely upon the claimed limits on FTC jurisdiction that this opinion rejects. See Unocal Market Power Motion at 2, 8-10, 15 (explaining how the market power arguments rely on the asserted absence of jurisdiction). In light of the many months that this

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should conduct appropriate proceedings for resolving disputed facts and substantiating or rejecting the allegations of the Complaint. Unocal, of course, may raise all appropriate defenses, including any renewed arguments concerning *Noerr-Pennington* protections, based on the forthcoming factual record.

If Unocal continues to assert *Noerr-Pennington* protection, the ALJ will need to resolve any relevant, disputed facts regarding the context of CARB's proceeding and the nature of Unocal's alleged misrepresentations/omissions. In addition to determining the specific content and contextual significance of the communications/omissions relied upon by Complaint Counsel, the ALJ's inquiry should include, without limitation, consideration of:

- CARB's expectations of truthful representation, focusing, *inter alia*, on: the governing procedures, the nature of the issues and information involved, CARB's fact-finding process and the extent of its dependence on industry research and knowledge, and the course of dealing between CARB and Unocal with regard to the subject matter of the communications;
- the degree of CARB's discretion in light of relevant statutory standards, required reliance on an evidentiary record, and the presence of judicial review;
- the extent of CARB's dependence on Unocal for information regarding its patent applications and its intentions with regard to enforcing its patent rights;
- the ability to determine the effect of the misrepresentations on CARB's decision; and

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proceeding already has been delayed, we urge the ALJ to resolve arguments regarding the surviving portions of Unocal's Market Power Motion, if any, without delay of the adjudicatory hearing.

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- the extent to which any relevant misrepresentation/omission was deliberate, factually verifiable, and central to the outcome of CARB's proceeding.

From the totality of the circumstances revealed by the fact-finding, the ALJ should draw conclusions of law pursuant to the framework of analysis described in Sections IV and V above. If the ALJ determines that *Noerr-Pennington* protects Unocal's communications with CARB, he must also determine whether the facts establish *Noerr-Pennington* protection for Unocal's communications to Auto/Oil and WSPA, pursuant to the principles articulated in Section VI.

Thorough and careful analysis of these questions should greatly facilitate the Commission's ultimate resolution of this case. The Commission retains the responsibility to decide both legal and factual questions in administrative litigation. *See* 16 C.F.R. § 3.54(a) (2002); *Amrep Corp.*, 102 F.T.C. 1362, 1670 (1983) ("the Commission, not the ALJ, has the ultimate responsibility for finding of facts").<sup>105</sup> Ideally, an Initial Decision will reflect the ALJ's reasoned, independent marshaling of the record, with appropriate findings of fact and conclusions of law, so that the Commission can assess the evidence and bring this complex matter to a timely close.

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<sup>105</sup> *See also Schering Plough Corp.*, Docket No. 9297, slip op. at 8 (F.T.C. Dec. 18, 2003) ("The Commission may review *de novo* both the factual findings and the legal conclusions of the Administrative Law Judge. 16 C.F.R. § 3.54(a). This *de novo* review includes findings on the credibility of witnesses.") (footnote omitted), *petition for review docketed*, No. 04-10688-AA (11<sup>th</sup> Cir. Feb. 13, 2004); *R. R. Donnelley & Sons Co.*, 120 F.T.C. 36, 137 (1995) ("The Commission reviews this matter *de novo*."). *See generally Hernandez v. National Transp. Safety Bd.*, 15 F.3d 157, 158 (10<sup>th</sup> Cir. 1994) (explaining that the Board serves as the ultimate finder of fact, even with respect to credibility determinations).

## Commission Opinion

Depending on the factual record to be developed, Unocal may or may not be subjecting competitors and consumers to massive, anticompetitive royalties and increases in the price of gasoline based on an exercise of unlawfully obtained market power. It is unfortunate that an erroneous Initial Decision has substantially delayed development of that record. It is now time for the ALJ assiduously to assemble the facts and compile a record necessary and sufficient for resolving the underlying issues.

Final Order

**ORDER REVERSING AND VACATING THE INITIAL  
DECISION AND ORDER AND REMANDING FOR  
FURTHER PROCEEDINGS**

The Commission has heard the appeal of Counsel Supporting the Complaint from the Initial Decision dismissing the Complaint in this proceeding and has considered the briefs and oral arguments in support of and in opposition to the appeal. For the reasons stated in the accompanying Opinion, the Commission has determined to reverse and vacate the Initial Decision and to vacate the Order accompanying it, and to remand this matter for further proceedings. Accordingly,

IT IS ORDERED that the Initial Decision granting Respondent's motions to dismiss the Complaint in this proceeding be, and hereby is, reversed and vacated, and that the Order accompanying the Initial Decision be, and hereby is, vacated;

IT IS FURTHER ORDERED that this matter be, and hereby is, remanded to an Administrative Law Judge for further proceedings in accordance with the accompanying Opinion; and

IT IS FURTHER ORDERED that an Administrative Law Judge schedule an adjudicative hearing to begin as soon as practicable.



Complaint

**COMPLAINT**

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by said Act, the Federal Trade Commission (“Commission”), having reason to believe that Union Oil Company of California (hereinafter, “Unocal” or “Respondent”) has violated Section 5 of the Federal Trade Commission (“FTC”) Act, as amended, 15 U.S.C. § 45, and it appearing to the Commission that a proceeding in respect thereof would be in the public interest, hereby issues its complaint, stating its charges as follows:

**Nature of the Case**

1. This case involves Unocal’s subversion of state regulatory standard-setting proceedings relating to low emissions gasoline standards. To address California’s serious air pollution problems, the California Air Resources Board (“CARB”) initiated rulemaking proceedings in the late 1980s to determine “cost-effective” regulations and standards governing the composition of low emissions, reformulated gasoline (“RFG”). Unocal actively participated in the 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. Through a pattern of anticompetitive acts and practices that continues even today, Unocal has illegally monopolized, attempted to monopolize, and otherwise engaged in unfair methods of competition in both the technology market for the production and supply of CARB-compliant “summer-time” RFG and the downstream CARB “summer-time” RFG product market.
2. During the RFG rulemaking proceedings in 1990-1994, Unocal made materially false and misleading statements including, but not limited to, the following:
  - a. Representing to CARB and other participants that its emissions research results showing, *inter alia*, the

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directional relationships between certain gasoline properties (most notably the midpoint distillation temperature of gasoline or "T50") on automobile emissions were "nonproprietary," were in "the public domain," or otherwise were available to CARB, industry members, and the general public, without disclosing that Unocal intended to assert its proprietary interests (as manifested in pending patent claims) in these research results;

- b. Representing to CARB that a "predictive model" -- *i.e.*, a mathematical model that predicts whether the resulting emissions from varying certain gasoline properties (including T50) 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 Unocal's assertion of its proprietary interests would undermine the cost-effectiveness and flexibility of such a model;
  - c. Making 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 Unocal had relinquished or would not enforce any proprietary interests in its emissions research results.
3. Through its knowing and willful misrepresentations and other bad faith, deceptive conduct, Unocal created and maintained the materially false and misleading impression that it did not possess, or would not enforce, any relevant intellectual property rights that could undermine the cost-effectiveness and flexibility of the CARB RFG regulations.
  4. Although Unocal knew by July 1992 that most of the pending patent claims based on its emissions research had been allowed by the United States Patent and Trademark Office, Unocal concealed this material information from CARB and other participants in the CARB RFG proceedings. Until Unocal's

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public announcement of its RFG patent rights on January 31, 1995, Unocal continued to perpetuate the false and misleading impression that it did not possess, or would not enforce, any proprietary interests relating to RFG.

5. But for Unocal's fraud, CARB would not have adopted RFG regulations that substantially overlapped with Unocal's concealed patent claims; the terms on which Unocal was later able to enforce its proprietary interests would have been substantially different; or both. Unocal's misrepresentations, on which CARB and other participants in the rulemaking process reasonably and detrimentally relied, 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). Unocal's "patent ambush" also has permitted it to undermine competition and harm consumers in the downstream product market for "summer-time" reformulated gasoline in California.
6. Unocal did not announce the existence of its proprietary interests and patent rights relating to RFG until shortly before CARB's Phase 2 regulations were to go into effect. 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. After CARB and the refiners had become locked into the Phase 2 regulations, however, Unocal commenced its patent enforcement efforts by publicly announcing its RFG patent rights and its intention to collect royalty payments and fees. Since Unocal's public announcement of the issuance of its first RFG patent on January 31, 1995, Unocal has obtained four additional patents and vigorously enforced its RFG patent rights through litigation and licensing activities.
7. The anticompetitive conduct by Unocal that is at issue in this action has materially caused or threatened to cause substantial

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harm to competition, and will in the future materially cause or threaten to cause further substantial injury to competition and to consumers.

8. The threatened or actual anticompetitive effects of Unocal's conduct include but are not limited to the following:
  - a. increased royalties (or other payments) associated with the use of technology to refine, produce, and supply low emissions, reformulated gasoline for the California market;
  - b. increases in the price of low emissions, reformulated gasoline in California;
  - c. reductions in the manufacture, output, and supply of low emissions, reformulated gasoline for the California market; and
  - d. decreased incentives, on the part of refiners, blenders, and importers, to produce and supply low emissions, reformulated gasoline to the California market.
9. Unocal's enforcement of its patent rights has resulted, *inter alia*, in a jury determination of a 5.75 cents per gallon royalty on gasoline produced by ARCO, Shell, Exxon, Mobil, Chevron, and Texaco that infringed the first of Unocal's five RFG patents – United States Patent No. 5,288,393 (the "393 patent"). These major refiners are still embroiled with Unocal in a pending accounting action to determine the total amount of infringement damages owed to Unocal for the period August 1996 through December 2000. Unocal also has sued Valero Energy Company ("Valero") seeking the imposition of a 5.75 cents per gallon royalty (and treble damages) on gasoline produced by Valero that infringes the '393 patent and the fourth of Unocal's five RFG patents – United States Patent No. 5,837,126 (the "126 patent"). Taken together, the major refiners and Valero comprise approximately 90 percent of the current refining capacity of CARB-compliant RFG in the

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California market. Unocal has publicly announced that its “uniform” RFG licenses, with fees ranging from 1.2 to 3.4 cents per gallon, are available to “non-litigating” refiners.

10. Were Unocal to receive a 5.75 cents per gallon royalty on all gallons of “summer-time” CARB RFG produced annually for the California market, this would result in an estimated annual cost of more than \$500 million (assuming approximately 14.8 billion gallons per year California consumption, with up to 8 months of CARB summer-time gasoline requirements). Unocal’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 retail gasoline prices.

**Respondent**

11. Union Oil Company of California is a public corporation organized, existing, and doing business under, and by virtue of, the laws of California. Its office and principal place of business is located at 2141 Rosecrans Avenue, Suite 4000, El Segundo, California 90245. Since 1985, Union Oil Company of California has done business under the name “Unocal.” Unocal is a wholly-owned, operating subsidiary of Unocal Corporation, a holding company incorporated in Delaware.
12. Unocal is, and at all relevant times has been, a corporation as “corporation” is defined by Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44; and at all times relevant herein, Unocal has been, and is now, engaged in commerce as “commerce” is defined in the same provision.
13. Prior to 1997, Unocal owned and operated refineries in California as a vertically integrated producer, refiner, and marketer of petroleum products. In March 1997, Unocal completed the sale of its west coast refining, marketing, and transportation assets to Tosco Corporation. Currently,

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Unocal's primary business activities involve oil and gas exploration and production, as well as production of geothermal energy, ownership in proprietary and common carrier pipelines, natural gas storage facilities, and the marketing and trading of hydrocarbon commodities.

14. In its annual report for the year 2001 filed with the United States Securities and Exchange Commission, Form 10-K, Unocal lists as another of its key business activities: “[p]ursuing and negotiating licensing agreements for reformulated gasoline patents with refiners, blenders and importers.” Unocal has publicly announced that it expects to reap up to \$150 million in revenues a year from licensing its RFG patents.
15. Unocal is the owner, by assignment, of the following patents relating to low emissions, reformulated gasoline: United States Patent No. 5,288,393 (issued February 22, 1994); United States Patent No. 5,593,567 (issued January 14, 1997); United States Patent No. 5,653,866 (issued August 5, 1997); United States Patent No. 5,837,126 (issued November 17, 1998); United States Patent No. 6,030,521 (issued February 29, 2000). These patents all arise from the same scientific discovery and are related in that they all claim priority based on patent application No. 07/628,488, filed on December 13, 1990. These patents share the identical specification.

**California Air Resources Board (CARB)**

16. The California Air Resources Board is a department of the California Environmental Protection Agency. Established in 1967, CARB's mission is to protect the health, welfare, and ecological resources of California through the effective and efficient reduction of air pollutants, while recognizing and considering the effects of its actions on the California economy. CARB fulfills this mandate by, among other

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things, setting and enforcing standards for low emissions, reformulated gasoline.

17. California's Administrative Procedures Act governs CARB's rulemaking proceedings and requires, *inter alia*, notice of any proposed regulations, the development of an evidentiary basis for any proposed regulations, the solicitation of public comments, and the conduct of hearings. Given the scientific and technical nature of the issues involved, CARB relies on the accuracy of the data and information presented to it in the course of rulemaking proceedings.
18. All CARB regulations are subject to review by California's Office of Administrative Law to ensure that such regulations meet statutory standards of necessity, authority, clarity, consistency, reference and nonduplication. CARB's regulations are subject to judicial review to determine whether the agency acted within its delegated authority, whether the agency employed fair procedures, and whether the agency's action was arbitrary, capricious, or lacking in evidentiary support.

**Reformulated Gasoline in California**

19. CARB's RFG regulations had their genesis in an effort by California to study the viability of alternative fuels for motor vehicles, such as methanol. In 1987, the California legislature passed AB 234, which resulted in the formation of a panel to study the environmental impact of alternative fuels and to develop a proposal to reduce emissions. This panel included representatives from the refining industry, including Roger Beach, a high level Unocal executive who later became the Chief Executive Officer and Chairman of the Board of Unocal.
20. Based in substantial part on the representations of oil industry executives that the oil industry could, and would,

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develop gasoline that would be cleaner-burning and cheaper than methanol, the AB 234 study panel eventually recommended exploring reformulated gasoline as an alternative to methanol.

21. In late 1988, the California legislature amended the California Clean Air Act to require CARB to take actions to reduce harmful car emissions, and directed CARB to achieve this goal through the adoption of new standards for automobile fuels and low-emission vehicles. CARB's authority in conducting its Phase 2 RFG rulemaking proceedings was circumscribed by an express and limited delegation of authority by the legislature. CARB's specific legislative mandate, set forth in California Health and Safety Code Section 43018, provided, *inter alia*, that CARB undertake the following actions:
  - a. Take "necessary, cost-effective, and technologically feasible" actions to achieve "reduction in the actual emissions of reactive, organic gases of at least 55 percent, a reduction in emissions of oxides of nitrogen of at least 15 percent from motor vehicles" no later than December 31, 2000;
  - b. Take actions "to achieve the maximum feasible reduction in particulates, carbon monoxide, and toxic air contaminants from vehicular sources";
  - c. Adopt standards and regulations that would result in "the most cost-effective combination of control measures on all classes or motor vehicles and motor vehicle fuels" including the "specification of vehicular fuel composition."
22. Following the 1988 California Clean Air Act amendments, CARB embarked on two rulemaking proceedings relating to low emissions, reformulated gasoline. In these rulemaking



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proceedings – Phase 1 and Phase 2, respectively – CARB prescribed limits on specific gasoline properties.

23. The Phase 1 RFG proceedings resulted in the adoption of regulations in 1990 mandating a reduction in Reid Vapor Pressure (“RVP”), the elimination of leaded gasoline, and a requirement that deposit control additives be included in gasoline. The Phase 1 regulations did not require refiners to make large capital investments.
24. CARB’s Phase 2 RFG proceedings represented an effort by CARB to develop stringent standards for low emissions, reformulated gasoline. Participants to the Phase 2 RFG proceedings understood that the CARB Phase 2 RFG regulations would require refiners to make substantial capital investments to reconfigure their refineries to produce compliant gasoline.
25. In its Phase 2 RFG proceedings, CARB did not conduct any independent studies of its own, but relied on industry to provide the needed research and resulting knowledge.
26. CARB’s Phase 2 RFG proceedings were quasi-adjudicative in nature. In the course of these proceedings, CARB adhered to the procedures set forth in the California Administrative Procedures Act. CARB provided notice of proposed regulations; provided the language of these proposed regulations and a statement of reasons; solicited and accepted written comments from the public; and conducted lengthy hearings at which oral testimony was received. CARB also issued written findings on the results of its rulemaking proceedings. Following adoption of the regulations, several parties sought judicial review of the CARB Phase 2 RFG regulations that provided small refiners with a two-year exemption for compliance with the regulations.

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27. Unocal management and employees understood that information and data relating to the potential costs of complying with, or relating to the cost-effectiveness of, the Phase 2 regulations were material to CARB's RFG rulemaking proceedings.

**Unocal's RFG Research**

28. By 1989, Unocal management knew that CARB intended to achieve significant emissions reductions by regulating the chemical and physical properties of gasoline sold in California. Unocal scientists from the company's Science and Technology Division began to design experiments to determine how controlling various properties of gasoline affected automobile emissions. In January 1990, Unocal scientists conducted in-house emissions testing of various gasoline fuels in a single car to determine which gasoline properties had the greatest emissions impact.
29. On May 14, 1990, Unocal scientists Michael Croudace and Peter Jessup presented the preliminary results of the emissions research program to the highest levels of Unocal's management to obtain approval and funding for additional, confirmatory research. These research results were presented to the members of Unocal's Executive Committee, including Richard Stegemeier, the Chief Executive Officer and Chairman of the Board of Unocal. Unocal management approved funding for additional emissions testing, and this project became known as the "5/14 Project."
30. Unocal management approved the filing of a patent application covering the invention and discovery that sprang from the "5/14 Project," specifically the Unocal scientists' purportedly novel discovery of the directional relationships between eight fuel properties – RVP, T10 (the temperature at which 10 percent of a fuel evaporates), T50 (the temperature at which 50 percent of a fuel evaporates), T90

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(the temperature at which 90 percent of a fuel evaporates), olefin content, aromatic content, paraffin content, and octane – and three types of tailpipe emissions – *i.e.*, incompletely burned or unburned hydrocarbons (“HC”), carbon monoxide (“CO”), and nitrogen oxides (“NOx”).

31. Unocal management made prosecution of the patent application a high priority. Unocal’s chief patent counsel, Gregory Wirzbicki, personally undertook the task of prosecuting the patent application.
32. On December 13, 1990, Unocal filed with the United States Patent and Trademark Office a patent application, No. 07/628,488. This application presented Unocal’s emissions research results, including the regression equations and underlying data; detailed the directional relationships between the fuel properties and emissions studied in the “5/14 Project;” and set forth composition and method claims relating to low emissions, reformulated gasoline. All five Unocal RFG patents referred to in paragraph 15 are the progeny of the '488 application.

**Unocal’s Conduct Before CARB**

33. Prior to and after the filing of the patent application on December 13, 1990, Unocal employees and management discussed and considered the potential competitive advantage and corporate profit that could be extracted through effectuating an overlap between the CARB regulations and Unocal’s patent claims.
34. During the same time that Unocal participated in the CARB RFG rulemaking proceedings, specific discussions took place within the company concerning how to induce the regulators to use information supplied by Unocal so that Unocal could realize the huge licensing income potential of its pending patent claims.

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35. Beginning in 1990, and continuing throughout the CARB Phase 2 RFG rulemaking process, Unocal provided information to CARB for the purpose of obtaining competitive advantage. Unocal gave CARB this information in private meetings with CARB, through participation in CARB's public workshops and hearings, as well as by participating in industry groups that also were providing input into the CARB regulations. This information was materially misleading in light of Unocal's suppression of facts relating to its proprietary interests in its emissions research results and Unocal's active prosecution of patents based on these research results.
36. On June 11, 1991, CARB held a public workshop regarding the Phase 2 RFG regulations. This workshop included discussions of CARB staff's proposed gasoline specifications – *i.e.*, the levels at which certain gasoline properties should be set – to reduce the emissions from gasoline-fueled vehicles. The set of specifications proposed by CARB for discussion at this public workshop did not include a T50 specification.
37. On June 20, 1991, Unocal presented to CARB staff the results of its "5/14 Project" to show CARB that "cost-effective" regulations could be achieved through adoption of a "predictive model" and to convince CARB of the importance of T50. Unocal's pending patent application contained numerous claims that included T50 as a critical limitation, in addition to other fuel properties that CARB proposed to regulate.
38. Prior to the presentation to CARB, Unocal management decided not to disclose Unocal's pending '393 patent application to CARB staff.
39. On July 1, 1991, Unocal provided CARB with the actual emissions prediction equations developed in the "5/14 Project." Unocal requested that CARB "hold these

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equations confidential, as we feel that they may represent a competitive advantage in the production of gasoline.” But Unocal went on to state:

If CARB pursues a meaningful dialogue on a predictive model approach to Phase 2 gasoline, Unocal will consider making the equations and underlying data public as required to assist in the development of a predictive model.

40. Following CARB’s agreement to develop a predictive model, Unocal made its emissions research results, including the test data and equations underlying its “5/14 Project,” publicly available.
41. On August 27, 1991, Unocal unequivocally stated in a letter to CARB that its emissions research data were “nonproprietary.” Specifically, Unocal stated:

Please be advised that Unocal now considers this data to be non-proprietary and available to CARB, environmental interest groups, other members of the petroleum industry, and the general public upon request.
42. At the time Unocal submitted its August 27, 1991 letter to CARB, it did not disclose to CARB its proprietary interests in the “5/14 Project” data and equations, its prosecution of a patent application, or its intent to enforce its proprietary interests to obtain licensing income. Read separately or in conjunction with Unocal's July 1, 1991 letter, the August 27, 1991 letter created the materially false and misleading impression that Unocal agreed to give up any "competitive advantage" it may have had relating to its purported invention and arising from its emissions research results.

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43. In reasonable reliance on Unocal's representation that the information was no longer proprietary, CARB used Unocal's equations in setting a T50 specification. Subsequently, in October 1991, CARB published Unocal's equations in public documents supporting the proposed Phase 2 RFG regulations.
44. On November 22, 1991, the CARB Board adopted Phase 2 RFG regulations that set particular standards for the composition of low emissions, reformulated gasoline. These regulations specified limits for eight gasoline properties: RVP, benzene, sulfur, aromatics, olefins, oxygen, T50, and T90. Unocal's pending patent claims recited limits for five of the eight properties specified by the regulations: T50, T90, olefins, aromatics, and RVP.
45. Unocal's misrepresentations and materially false and misleading statements caused CARB to adopt Phase 2 RFG regulations that substantially overlapped with Unocal's concealed patent claims. Specifically, for example, CARB included a specification for T50 in its Phase 2 RFG regulations and eventually adopted a "predictive model" that included T50 as one of the parameters.
46. Prior to the final approval of the CARB Phase 2 RFG regulations in November 1992, Unocal submitted comments and presented testimony to CARB opposing CARB's proposal to grant small refiners a two-year exemption for complying with the regulations. Unocal vigorously opposed this proposed exemption on the grounds that it would increase the costs of compliance and undermine the cost-effectiveness of the CARB Phase 2 RFG regulations. In making these statements, Unocal again failed to disclose that it had proprietary rights that would materially increase the cost and reduce the cost-effectiveness and flexibility of the regulations that CARB had adopted in reasonable reliance on Unocal's representations.

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47. CARB amended the Phase 2 regulations in June 1994 to include a predictive model as an alternative method of complying with the regulations that was intended to provide refiners with additional flexibility. At the urging of numerous companies, including Unocal, this “predictive model” permits a refiner to comply with the RFG regulations by producing fuel that is predicted – based on its composition and the levels of the eight properties – to have equivalent emissions to a fuel that meets the strict gasoline property limits set forth in the regulations.
48. During the development of the predictive model, Unocal continued to meet with CARB, providing testimony and information. Unocal submitted comments to CARB touting the predictive model as offering “flexibility” and furthering CARB’s mandate of “cost-effective” regulations. These statements were materially false and misleading because Unocal suppressed the material fact that assertion of its proprietary rights would materially increase the cost and reduce the flexibility of the proposed regulations.
49. On February 22, 1994, the United States Patent Office issued the ’393 patent. CARB first became aware of Unocal’s ’393 patent shortly after Unocal’s issuance of a press release on January 31, 1995.

**Unocal’s Participation in Industry Groups**

50. During the CARB RFG rulemaking, Unocal actively participated in the Auto/Oil Air Quality Improvement Research Program (“Auto/Oil” or the “Program”), a cooperative, joint research program between the automobile and oil industries. By agreement dated October 14, 1989, the big three domestic automobile manufacturers – General Motors, Ford, and Chrysler – and representatives from fourteen oil companies, including Unocal, entered into a

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joint research agreement in accordance with the National Cooperative Research Act of 1984 (“Auto/Oil Agreement”).

51. The stated objective of the Auto/Oil joint research venture was to plan and carry out research and tests designed to measure and evaluate automobile emissions and the potential improvements in air quality achievable through the use of reformulated gasolines, methanol, and other alternative fuels, and to evaluate the relative cost-effectiveness of these various improvements.
52. The Auto/Oil Agreement provided that “[t]he results of research and testing of the Program will be disclosed to government agencies, the Congress and the public, and otherwise placed in the public domain.” This agreement specifically provided for the following dedication of any and all intellectual property rights to the public:

No proprietary rights will be sought nor patent applications prosecuted on the basis of the work of the Program unless required for the purpose of ensuring that the results of the research by the Program will be freely available, without royalty, in the public domain.
53. While the Auto/Oil Agreement permitted participating companies to conduct independent research, and further permitted them to withhold the fruits of such independent research from the Auto/Oil Group, once data and information were in fact presented to the Auto/Oil Group, they became the “work of the Program.”
54. Unocal viewed its participation in industry groups, such as Auto/Oil, as an integral part of its strategy of deception for the purpose of obtaining a competitive advantage therefrom. On September 26, 1991, Unocal presented to Auto/Oil the results of Unocal’s emissions research, including the test



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data, equations, and corresponding directional relationships between fuel properties and emissions derived from the “5/14 Project.” Unocal management authorized this presentation, which was substantially similar to that made to CARB on June 20, 1991. Unocal informed Auto/Oil participants that the data had been made available to CARB and were in the public domain. Unocal also represented that the data would be made available to Auto/Oil participants. Unocal’s 5/14 work thus became part of the “work” of the Auto/Oil Program.

55. Unocal’s 5/14 work also became part of the Auto/Oil Program through the subsequent testing – as part of the Program – of the 5/14 fuel property relationships.
56. During the CARB Phase 2 RFG rulemaking proceedings, Unocal also actively participated in the Western States Petroleum Association (“WSPA”), an oil industry trade association that represents companies accounting for the bulk of petroleum exploration, production, refining, transportation and marketing in the western United States. WSPA, as a group, actively participated in the CARB RFG rulemaking process. WSPA commissioned, and submitted to CARB, three cost studies in connection with the CARB Phase 2 RFG rulemaking.
57. One cost study commissioned by WSPA incorporated information relating to process royalty rates associated with non-Unocal patents and was used by CARB to determine the cost-effectiveness of the proposed CARB Phase 2 RFG standards. This WSPA cost study estimated the costs of the proposed regulations on a cents-per-gallon basis and estimated the incremental costs associated with regulating specific gasoline properties. This WSPA study could have incorporated costs associated with potential royalties flowing from Unocal’s pending patent rights.

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58. On September 10, 1991, Unocal presented its "5/14 Project" emissions research results to WSPA. Unocal management authorized the presentation of the research results to WSPA. This Unocal presentation created the materially false and misleading impression that Unocal's emissions research results, including the data and equations, were nonproprietary and could be used by WSPA or its individual members without concern for the existence or enforcement of any intellectual property rights.
59. None of the participants in the WSPA or Auto/Oil groups knew of the existence of Unocal's proprietary interests and/or pending patent rights at any time prior to the issuance of the '393 patent in February 1994, by which time most, if not all, of the oil company participants to these groups had made substantial progress in their capital investment and refinery modification plans for compliance with the CARB Phase 2 RFG regulations.

**Unocal's Patent Prosecution and Enforcement**

60. Following the November 1991 adoption of CARB Phase 2 RFG specifications, Unocal amended its patent claims in March 1992 to ensure that the patent claims more closely matched the regulations. In some cases, Unocal's patent claims were narrowed to resemble the regulations.
61. On or about July 1, 1992, Unocal received an office action from the U.S. Patent and Trademark Office indicating that most of Unocal's pending patent claims had been allowed. Unocal did not disclose this information to CARB or other participants to the CARB Phase 2 RFG rulemaking.
62. Subsequently, after the submission of additional amendments, Unocal received a notice of allowance from the U.S. Patent and Trademark Office for all of its pending claims in February 1993. Unocal did not disclose this

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information to CARB or other participants to the CARB Phase 2 RFG rulemaking.

63. In June 1993, Unocal filed a divisional application (No. 08/77,243) of its original patent application that allowed Unocal to pursue additional patents based on the discoveries of the "5/14 Project."
64. The U.S. Patent and Trademark Office issued the '393 patent to Unocal on February 22, 1994. Unocal waited until January 31, 1995, to issue a press release announcing issuance of the '393 patent. The Unocal press release stated that the '393 patent "covers many of the possible fuel compositions that refiners would find practical to manufacture and still comply with the strict California Air Resources Board (CARB) Phase 2 requirements."
65. In March 1995, Unocal met separately with California Governor Pete Wilson and CARB and made assurances that Unocal would not enjoin or otherwise impair the ability of refiners to produce and supply to the California market gasoline that complied with the CARB Phase 2 RFG regulations. In or about the same time period, CARB expressed its own concern to Unocal about the coverage of the patent and even sought and received from Unocal a license to use the '393 patent in making and using test fuels.
66. On March 22, 1995, five days after meeting with CARB staff, Unocal filed a continuation patent application (No. 08/409,074) claiming priority to the original December 1990 application. Unocal did not inform CARB or Governor Wilson that it intended to obtain additional RFG patents.
67. Unocal subsequently filed additional continuation patent applications on June 5, 1995 (No. 08/464,544), August 1, 1997 (No. 08/904,594), and November 13, 1998 (No. 08/191,924), all claiming priority based on Unocal's original December 13, 1990 patent application.

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68. On April 13, 1995, ARCO, Exxon, Mobil, Chevron, Texaco, and Shell filed suit in the United States District Court for the Central District of California seeking to invalidate Unocal's '393 patent. Unocal filed a counterclaim for patent infringement of the '393 patent. The jury in this private litigation determined that Unocal's '393 patent was valid and infringed, and found that the refiners must pay a royalty rate of 5.75 cents per gallon for the period from March through July 1996 for sales of infringing gasoline in California.
69. The United States Court of Appeals for the Federal Circuit subsequently affirmed the trial court's judgment. The United States Supreme Court denied the refiner-defendants' petition for a writ of certiorari. The refiner-defendants have made payments totaling \$91 million to Unocal for damages, costs, and attorneys' fees.
70. An accounting action is still ongoing in the United States District Court for the Central District of California to determine damages for infringement of the '393 patent by the refiners for the period from August 1, 1996, through December 31, 2000. The court ruled in August 2002 that the 5.75 cents per gallon royalty fee awarded by the jury would apply to all infringing gasoline produced and/or supplied in California.
71. On January 23, 2002, Unocal sued Valero Energy Company in the Central District of California for willful infringement of both the '393 patent and the '126 patent (see Paragraph 9). In its complaint, Unocal seeks damages at the rate of 5.75 cents per gallon for all infringing gallons, and treble damages for willful infringement.
72. Unocal also has enforced its patent claims through licensing activities. To date, Unocal has entered into license agreements with eight refiners, blenders and/or importers covering the use of all five RFG patents. The terms of these

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license agreements are confidential. Unocal has announced that these license agreements feature a “uniform” licensing schedule that specifies a range from 1.2 to 3.4 cents per gallon depending on the volume of gasoline falling within the scope of the patents. As a licensee practices under the license more frequently, the licensing fee per gallon is reduced.

**Relevant Product and Geographic Markets**

73. Unocal has obtained and exercised market power and/or monopoly power in two relevant product markets.
74. One relevant product market consists of the technology claimed in patent application No. 07/628,488 (filed on December 13, 1990) and Unocal’s issued RFG patents, and any alternative technologies that enable firms to refine, produce, and supply CARB-compliant “summer-time” RFG for sale in California at comparable or lower cost, and comparable or higher effectiveness, without practicing the Unocal technology. The relevant geographic market for such technology is worldwide.
75. Another relevant market consists of CARB-compliant “summer-time” RFG produced and supplied for sale in California. The relevant geographic market is California.

**Unocal’s Materially False and Misleading Statements During CARB’s RFG Proceedings Led to its Market Power**

76. By engaging in fraudulent conduct in connection with the CARB rulemaking proceedings, Unocal unlawfully obtained market power. Unocal obtained unlawful market power through affirmative misrepresentations, materially false and misleading statements, and other bad-faith, deceptive conduct that caused CARB to enact regulations that overlapped almost entirely with Unocal’s pending patent rights.

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77. Unocal, through its management and authorized employees, made knowing and willful misrepresentations to CARB by making materially false and misleading statements and/or by suppressing facts while giving information of other facts that were likely to mislead for want of communication of the suppressed facts. Unocal's statements were materially false and misleading in that they failed to disclose Unocal's proprietary interests in its emissions research data, and/or Unocal's intention and efforts to obtain competitive advantage and corporate profit through enforcement of its intellectual property rights.
78. Unocal's knowing and willful misrepresentations to CARB include, but are not limited to, the following:
  - a. Unocal presented its emissions research results to CARB on June 20, 1991, for the purpose, *inter alia*, of showing CARB the relationship between T50 and automobile exhaust emissions; and it represented that a predictive model that included T50 would be "cost effective" and flexible without disclosing that the assertion of its proprietary rights would materially increase the cost and reduce the flexibility of such a model. Unocal represented that these data and equations were confidential to Unocal, and "may represent a competitive advantage" to Unocal.
  - b. Having previously asserted that its equations might provide it with a competitive advantage, Unocal informed CARB by letter, dated August 27, 1991, that its emissions research data thereafter would be "nonproprietary" and available to CARB, industry members, and the general public. By this representation, Unocal created the materially false and misleading impression that Unocal had relinquished or would not enforce any proprietary interests in its emissions research results.

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- c. On numerous occasions after August 27, 1991, Unocal made statements and comments to CARB relating to the “cost effectiveness” of CARB Phase 2 regulations, and the “flexibility” offered by the implementation of a predictive model to reduce refiner compliance costs. These statements and comments include, but are not limited to, both written and/or oral statements made to CARB on the following dates: October 29, 1991, November 21, 1991, November 22, 1991, March 16, 1992, June 19, 1992, August 14, 1992, September 4, 1992, June 3, 1994, and June 9, 1994. Under the circumstances, these statements further reinforced the materially false and misleading impression that Unocal had no proprietary interests in its emissions research results and/or that Unocal had disclaimed any and all such proprietary rights and would not seek to enforce these rights.
79. Throughout its communications and interactions with CARB prior to January 31, 1995, Unocal failed to disclose that it had pending patent rights, that its patent claims overlapped with the proposed RFG regulations, and that Unocal intended to charge royalties. Unocal hence failed to disclose material information that would have impacted CARB’s analysis of the cost-effectiveness of the Phase 2 RFG regulations. Unocal instead perpetuated false and misleading impressions concerning the nature of its proprietary interests in its “5/14 Project” research results.
80. CARB reasonably relied on Unocal’s misrepresentations and materially false and misleading statements in developing the Phase 2 RFG regulations. But for Unocal’s fraud, CARB would not have adopted RFG regulations that substantially overlapped with Unocal’s concealed patent claims; the terms on which Unocal was later able to enforce its proprietary interests would have been substantially different; or both.

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81. Unocal, through its management and authorized employees, made knowing and willful misrepresentations to participants in the Auto/Oil joint venture by making materially false and misleading statements and/or by suppressing facts while giving information of other facts which were likely to mislead for want of communication of the suppressed facts.
82. Unocal made a presentation to Auto/Oil on September 26, 1991, at which Unocal shared its research results with the group. Unocal informed Auto/Oil that CARB also had been provided with Unocal's data and equations, and that these data and equations were in the public domain. Unocal represented that it would supply its data to the Auto/Oil Group and its members. Unocal's statements were materially false and misleading in that they failed to disclose Unocal's proprietary interests in its emissions research results and Unocal's intention and efforts to obtain competitive advantage through enforcement of its intellectual property rights.
83. Throughout all of its communications and interactions with Auto/Oil prior to January 31, 1995, Unocal failed to disclose that it had pending patent rights, that its patent claims overlapped with the proposed RFG regulations, and that Unocal intended to charge royalties.
84. By deceptive conduct that included, but was not limited to, false and misleading statements concerning its proprietary interests in the results of its emissions research results, Unocal violated the letter and spirit of the Auto/Oil Agreement and breached its fiduciary duties to the other members of the Auto/Oil joint venture. Such deceptive conduct violated the integrity of the Auto/Oil joint venture's procedures and subverted Auto/Oil's process of providing accurate and nonproprietary research data and information to CARB.



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85. Unocal, through its management and authorized employees, made knowing and willful misrepresentations to members of WSPA by making materially false and misleading statements and/or by suppressing facts while giving information of other facts which were likely to mislead for want of communication of the suppressed facts. Unocal's statements were materially false and misleading in that they failed to disclose Unocal's proprietary interests in its emissions research results and/or Unocal's intention and efforts to obtain competitive advantage through enforcement of its intellectual property rights.
86. Unocal made a presentation to WSPA on September 10, 1991, relating to its emissions research. At, or shortly following this presentation, Unocal provided to WSPA members the data and equations derived from this emissions research. In its interactions with WSPA, Unocal created the materially false and misleading impression that Unocal did not have any proprietary interests or intellectual property rights associated with its emissions research results.
87. Unocal actively participated in WSPA committees that discussed the potential cost implications of the CARB Phase 2 RFG regulations. Unocal knew that royalties were considered in a cost study commissioned by WSPA for submission to CARB.
88. Throughout all of its communications and interactions with WSPA prior to January 31, 1995, Unocal failed to disclose that it had pending patent rights, that its patent claims overlapped with the proposed RFG regulations, and that Unocal intended to charge royalties.
89. By deceptive conduct that included, but was not limited to, false and misleading statements concerning its proprietary interests in the results of its emissions research results, Unocal breached its fiduciary duties to the other members of WSPA. Such deceptive conduct violated the integrity of the

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WSPA's procedures and subverted WSPA's process of providing accurate data and information to CARB.

90. Participants in Auto/Oil and WSPA reasonably relied on Unocal's misrepresentations and material omissions. But for Unocal's fraud, these participants in the rulemaking process would have taken actions including, but not limited to, (a) advocating that CARB adopt regulations that minimized or avoided infringement on Unocal's patent claims; (b) advocating that CARB negotiate license terms substantially different from those that Unocal was later able to obtain; and/or (c) incorporating knowledge of Unocal's pending patent rights in their capital investment and refinery reconfiguration decisions to avoid and/or minimize potential infringement. As a result, if other participants in WSPA or Auto/Oil had known the truth, the harm to competition and consumers, as described in this Complaint, would have been avoided.
91. Unocal's fraudulent conduct has resulted in Unocal's acquisition of market power in the following markets: the technology market for the production and supply of CARB-compliant "summer-time" gasoline in California, and the downstream product market for CARB-compliant "summer-time" gasoline in California.
92. The extensive overlap between the CARB RFG regulations and the Unocal patent claims makes avoidance of the Unocal patent claims technically and/or economically infeasible.
93. Refiners in California invested billions of dollars in sunk capital investments without knowledge of Unocal's patent claims to reconfigure their refineries in order to comply with the CARB Phase 2 RFG regulations. These refiners cannot produce significant volumes of non-infringing CARB-compliant gasoline without incurring substantial additional costs.

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94. CARB cannot now change its RFG regulations sufficiently to provide flexibility for refiners and others to avoid Unocal's patent claims. Had Unocal disclosed its proprietary interests and pending patent rights to CARB earlier, CARB would have been able to consider the potential costs of the Unocal patents in establishing its regulations, and the harm to competition and to consumers, as described in this Complaint, would have been avoided.
95. Unocal has exercised, and continues to exercise, its market power through business conduct by enforcing its patents through litigation and licensing activities. Through its litigation and licensing related to its RFG patents, Unocal has enforced, or threatened to enforce, its patents against those refiners that control in excess of 95 percent of the capacity for the manufacture and/or sale of CARB-compliant gasoline in California. Unocal's enforcement of its patent rights is the proximate cause of substantial competitive harm and consumer injury.
96. Unocal is not shielded from antitrust liability pursuant to the Noerr-Pennington doctrine for numerous reasons as a matter of law and as a matter of fact including, but not limited to, the following: (i) Unocal's misrepresentations were made in the course of quasi-adjudicative rulemaking proceedings; (ii) Unocal's conduct did not constitute petitioning behavior; and (iii) Unocal's misrepresentations and materially false and misleading statements to Auto/Oil and WSPA, two non-governmental industry groups, were not covered by any petitioning privilege.

**Anticompetitive Effects of Unocal's Conduct**

97. The foregoing conduct by Unocal has materially caused or threatened to cause substantial harm to competition and will, in the future, materially cause or threaten to cause further substantial injury to competition and consumers, absent the issuance of appropriate relief in the manner set

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forth below. The threatened or actual anticompetitive effects of Unocal's conduct include, but are not limited to, those set forth in Paragraph 8 above.

98. Unocal's enforcement of its patent portfolio has caused, and will cause, substantial consumer injury. Unocal's own economic expert has testified under oath that 90 percent of any royalty costs associated with the patents will be passed through to consumers in the form of higher retail gasoline prices.

**First Violation Alleged**

99. As described in Paragraphs 1-98 above, which are incorporated herein by reference, Unocal has willfully engaged in anticompetitive and exclusionary acts and practices, undertaken since the early 1990s, and continuing even today, whereby it has wrongfully obtained monopoly power in the technology market for the production and supply of CARB-compliant "summer-time" gasoline to be sold in California, which acts and practices constitute unfair methods of competition in violation of Section 5 of the FTC Act.

**Second Violation Alleged**

100. As described in Paragraphs 1-98 above, which are incorporated herein by reference, Unocal has willfully engaged in anticompetitive and exclusionary acts and practices, undertaken since the early 1990s, and continuing even today, with a specific intent to monopolize the technology market for the production and supply of CARB-compliant "summer-time" gasoline to be sold in California, resulting, at a minimum, in a dangerous probability of monopolization in the aforementioned market, which acts and practices constitute unfair methods of competition in violation of Section 5 of the FTC Act.

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**Third Violation Alleged**

101. As described in Paragraphs 1-98 above, which are incorporated herein by reference, Unocal has willfully engaged in anticompetitive and exclusionary acts and practices, undertaken since the early 1990s, and continuing even today, with a specific intent to monopolize the downstream goods market for CARB-compliant “summer-time” gasoline to be sold in California, resulting, at a minimum, in a dangerous probability of monopolization in the aforementioned market, which acts and practices constitute unfair methods of competition in violation of Section 5 of the FTC Act.

**Fourth Violation Alleged**

102. As described in Paragraphs 1-98 above, which are incorporated herein by reference, Unocal has willfully engaged in anticompetitive and exclusionary acts and practices, undertaken since the early 1990s, and continuing even today, whereby it has unreasonably restrained trade in the technology market for the production and supply of CARB -compliant “summer-time” gasoline to be sold in California, which acts and practices constitute unfair methods of competition that harm consumers in violation of Section 5 of the FTC Act.

**Fifth Violation Alleged**

103. As described in Paragraphs 1-98 above, which are incorporated herein by reference, Unocal has willfully engaged in anticompetitive and exclusionary acts and practices, undertaken since the early 1990s, and continuing even today, whereby it has unreasonably restrained trade in the downstream goods market for CARB-compliant “summer-time” gasoline to be sold in California, which acts and practices constitute unfair methods of competition that harm consumers in violation of Section 5 of the FTC Act.

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**Notice**

Notice is hereby given to the Respondent that the fourth day of June, 2003, at 10 a.m., or such later date as determined by an Administrative Law Judge of the Federal Trade Commission, is hereby fixed as the time and Federal Trade Commission offices, 600 Pennsylvania Avenue, N.W., Washington, D.C. 20580, as the place when and where a hearing will be had before an Administrative Law Judge of the Federal Trade Commission, on the charges set forth in this complaint, at which time and place you will have the right under the FTC Act to appear and show cause why an order should not be entered requiring you to cease and desist from the violations of law charged in the complaint.

You are notified that the opportunity is afforded to you to file with the Commission an answer to this complaint on or before the twentieth (20<sup>th</sup>) day after service of it upon you. An answer in which the allegations of the complaint are contested shall contain a concise statement of the facts constituting each ground of defense; and specific admission, denial, or explanation of each fact alleged in the complaint or, if you are without knowledge thereof, a statement to that effect. Allegations of the complaint not thus answered shall be deemed to have been admitted.

If you elect not to contest the allegations of fact set forth in the complaint, the answer shall consist of a statement that you admit all of the material facts to be true. Such an answer shall constitute a waiver of hearings as to the facts alleged in the complaint and, together with the complaint, will provide a record basis on which the Administrative Law Judge shall file an initial decision containing appropriate findings and conclusions and an appropriate order disposing of the proceeding. In such answer, you may, however, reserve the right to submit proposed findings and conclusions under § 3.46 of the Commission's Rules of Practice for Adjudicative Proceedings and the right to appeal the initial decision to the Commission under § 3.52 of said Rules.

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Failure to answer within the time above provided shall be deemed to constitute a waiver of your right to appear and contest the allegations of the complaint and shall authorize the Administrative Law Judge, without further notice to you, to find the facts to be as alleged in the complaint and to enter an initial decision containing such findings, appropriate conclusions, and order.

The ALJ will schedule an initial prehearing scheduling conference to be held not later than 14 days after the last answer is filed by any party named as a Respondent in the complaint. Unless otherwise directed by the ALJ, the scheduling conference and further proceedings will take place at the Federal Trade Commission, 600 Pennsylvania Avenue, N.W., Room 532, Washington, D.C. 20580. Rule 3.21(a) requires a meeting of the parties' counsel as early as practicable before the prehearing scheduling conference, and Rule 3.31(b) obligates counsel for each party, within 5 days of receiving a respondent's answer, to make certain initial disclosures without awaiting a formal discovery request.

**Notice of Contemplated Relief**

Should the Commission conclude from the record developed in any adjudicative proceedings in this matter that Respondent's conduct violated Section 5 of the Federal Trade Commission Act as alleged in the complaint, the Commission may order such relief as is supported by the record and is necessary and appropriate, including but not limited to:

1. Requiring Respondent to cease and desist all efforts it has undertaken by any means, including without limitation the threat, prosecution, or defense of any suits or other actions, whether legal, equitable, or administrative, as well as any arbitration, mediation, or any other form of private dispute resolution, through or in which Respondent has asserted that any person or entity, by manufacturing, selling, distributing, or otherwise using motor gasoline to be sold in California

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infringes any of Respondent's current or future United States patents that claim priority back to U.S. Patent Application Number No. 07/628,488 filed December 13, 1990 or any other Patent Application filed before January 31, 1995.

2. Requiring Respondent not to undertake any new efforts by any means, including without limitation the threat, prosecution, or defense of any suits or other actions, whether legal, equitable, or administrative, as well as any arbitration, mediation, or any other form of private dispute resolution, through or in which Respondent has asserted that any person or entity, by manufacturing, selling, distributing, or otherwise using motor gasoline to be sold in California infringes any of Respondent's current or future United States patents that claim priority back to U.S. Patent Application Number No. 07/628,488 filed December 13, 1990 or any other Patent Application filed before January 31, 1995.
3. Requiring Respondent to cease and desist all efforts it has undertaken by any means, including without limitation the threat, prosecution, or defense of any suits or other actions, whether legal, equitable, or administrative, as well as any arbitration, mediation, or any other form of private dispute resolution, through or in which Respondent has asserted that any person or entity, by manufacturing, selling, distributing, or otherwise using motor gasoline, for import or export to or from the state of California, infringes any of Respondent's current or future United States patents that claim priority back to U.S. Patent Application No. 07/628,488 filed December 13, 1990 or any other Patent Application filed before January 31, 1995.
4. Requiring Respondent to employ, at Respondent's cost, a Commission-approved compliance officer who will be the sole representative of Respondent for the purpose of communicating Respondent's patent rights relating to any standard or regulations under consideration by (a) any standard-setting organization of which Respondent is a member; and/or (b) any state or federal governmental entity



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that conducts rulemaking proceedings in which Respondent participates.

5. Such other or additional relief as is necessary to correct or remedy the violations alleged in the complaint.

WHEREFORE, THE PREMISES CONSIDERED, the Federal Trade Commission on this fourth day of March, 2003, issues its complaint against said Respondent.

Initial Decision

## **INITIAL DECISION**

By D. Michael Chappell, Administrative Law Judge

### **I. INTRODUCTION**

#### **A. Procedural Background**

This Initial Decision is filed pursuant to Rule 3.22(e) of the Commission's Rules of Practice which requires that "when a motion to dismiss a complaint . . . is granted with the result that the proceeding before the Administrative Law Judge is terminated, the Administrative Law Judge shall file an initial decision in accordance with the provisions of § 3.51. 16 C.F.R. § 3.22(e). As set forth below, the motions to dismiss filed by Respondent Union Oil Company of California ("Respondent" or "Unocal") are granted in part with the result that the proceeding before the Administrative Law Judge is terminated. Accordingly, this Initial Decision is filed in accordance with the provisions of Rule 3.51 of the Commission's Rules of Practice. 16 C.F.R. § 3.51(c).

Respondent filed two motions to dismiss pursuant to Rule 3.22(e) of the Commission's Rules of Practice, on April 2, 2003. The first motion seeks dismissal of the Complaint based upon immunity under Noerr-Pennington ("Motion"). Complaint Counsel filed its opposition on April 21, 2003 ("Opposition"). By Order dated August 25, 2003, the parties were ordered to file reply briefs. Respondent filed its reply brief on September 9, 2003 ("Reply"). Complaint Counsel filed its response to Respondent's reply brief on September 26, 2003 ("Sur-reply").

Respondent's second motion seeks dismissal of the Complaint for failure to make sufficient allegations that Respondent possesses or dangerously threatens to possess monopoly power ("Market Power Motion"). Complaint Counsel filed its opposition on April 21, 2003 ("Market Power Opposition").

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**B. Summary of Decision**

As set forth below, there is no set of facts that Complaint Counsel could introduce in support of the violations of law that are alleged in the Complaint that would overcome Noerr-Pennington immunity with respect to Respondent's efforts to solicit government action. Accordingly, Respondent's motion to dismiss the Complaint based upon immunity under Noerr-Pennington is **GRANTED IN PART** as to all violations alleged and all allegations of the Complaint, except the allegations of Respondent's conduct directed toward the Auto/Oil Air Quality Improvement Research Program ("Auto/Oil Group") and the Western States Petroleum Association ("WSPA"), independent of the conduct directed toward the California Air Resources Board ("CARB").

As set forth below, with respect to the allegations of Respondent's conduct directed toward Auto/Oil Group and WSPA, independent of the conduct directed toward CARB, there is no set of facts that Complaint Counsel could introduce in support of the violations of law that are alleged in the Complaint that would establish that the Commission has jurisdiction to resolve the substantial patent issues which are entangled in and raised by the allegations and violations of the Complaint. The motion is **GRANTED IN PART** to the extent that the Commission lacks jurisdiction to decide the fundamental and substantial patent issues raised by the allegations of the Complaint. Because of this determination, the remaining issues raised by Respondent's motion to dismiss for failure to make sufficient allegations that Respondent possesses or dangerously threatens to possess monopoly power are not reached. Accordingly, the remainder of Respondent's Market Power Motion is **DENIED WITHOUT PREJUDICE**.

Therefore, as discussed in detail below, no allegations or violations of the Complaint remain and the Complaint in Docket 9305 is dismissed in its entirety.

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## II. POSITIONS OF THE PARTIES

### A. Summary of the Allegations of the Complaint and Answer

#### 1. Complaint

According to the Complaint, in the 1980s, the California Air Resources Board ("CARB") initiated rulemaking proceedings to determine "cost-effective" regulations and standards governing the composition of low emissions, reformulated gasoline ("RFG"). Complaint at P1. The Complaint alleges that, through misrepresentations and omissions, Respondent influenced the outcome of CARB's Phase 2 reformulated gasoline rulemaking. Complaint at PP35, 37, 39, 41, 42, 46, 48. On November 22, 1991, CARB adopted Phase 2 RFG regulations that set particular standards for the composition of low emissions, reformulated gasoline. Complaint at P44. CARB's Phase 2 RFG regulations substantially overlap with patents held by Respondent relating to low emissions, reformulated gasoline. Complaint at PP15, 32, 45.

In addition, the Complaint alleges that during the CARB RFG rulemaking, Respondent participated in the Auto/Oil Group, a cooperative, joint research program between automobile and oil industries, and in the WSPA, an oil industry trade association. Complaint at PP50, 56. The Complaint alleges that Respondent made misrepresentations and material omissions to the Auto/Oil Group and WSPA and that, but for Respondent's fraud, these participants in the rulemaking process would have taken actions including, but not limited to, (a) advocating that CARB adopt regulations that minimized or avoided infringement on Respondent's patent claims; (b) advocating that CARB negotiate license terms substantially different from those that Respondent was later able to obtain; and/or (c) incorporating knowledge of Respondent's pending patent rights in their capital investment and refinery reconfiguration decisions to avoid and/or minimize potential infringement. Complaint at P90.

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The Complaint further alleges that Respondent did not announce the existence of its proprietary interests and patent rights relating to RFG until shortly before CARB's Phase 2 regulations were to go into effect. Complaint at P6. 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 regulations. *Id.* After CARB and the refiners had become locked into the Phase 2 regulations, Respondent commenced patent enforcement efforts by publicly announcing its RFG patent rights and its intention to collect royalty payments and fees. *Id.* Since Respondent's public announcement of the issuance of its first RFG patent on January 31, 1995, Respondent has obtained four additional patents and enforced its RFG patent rights through litigation and licensing activities. *Id.*

The Complaint charges Respondent with the legal violations of engaging in anticompetitive and exclusionary practices, whereby, in the markets defined in the Complaint, Respondent has wrongfully obtained monopoly power, has attempted monopolization, and has unreasonably restrained trade, in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45.

**2. Answer**

Respondent's Answer denied the substantive allegations of the Complaint. In addition, Respondent, in its Answer, asserted that there are two basic underpinnings of the Complaint which are unsupportable and eviscerate any viability to the Complaint. First, Respondent avers that the Complaint implicitly and incorrectly suggests that when the word "non-proprietary" or "proprietary" is used, a representation is made as to the status of patent rights, and that Respondent's opinion on the flexibility and cost effectiveness of a predictive model is not a representation on the status of patent rights. Second, Respondent asserts in the introduction to the Answer, that its conduct is petitioning conduct, immune from antitrust scrutiny.

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## **B. Summary of Arguments Made Regarding Respondent's Motion to Dismiss Based On Noerr-Pennington Immunity**

### **1. Respondent's arguments in support**

Respondent moves to dismiss the Complaint on the ground that the conduct alleged in the Complaint is immunized from antitrust liability under the Noerr-Pennington doctrine. See *Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961); *United Mine Workers v. Pennington*, 381 U.S. 657 (1965). Respondent asserts that CARB, an administrative agency, exercised quasi-legislative authority in enacting the Phase 2 RFG regulations. Respondent argues that its involvement in CARB's Phase 2 RFG rulemaking was political petitioning conduct, protected under Noerr-Pennington. Thus, Respondent argues, Respondent should be shielded from antitrust liability regardless of its motives or the effects of the governmental action. Respondent further asserts that the Complaint does not allege facts sufficient to support the "sham" exception to the Noerr-Pennington doctrine. See *Professional Real Estate Investors, Inc. v. Columbia Pictures, Inc.*, 504 U.S. 49 (1993). In addition, Respondent argues that the exception to Noerr immunity recognized in contexts involving the enforcement of patent rights obtained through knowing fraud on the Patent and Trademark Office is inapplicable to this proceeding. See *Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.*, 382 U.S. 172 (1965).

Respondent also asserts that immunity under the Noerr-Pennington doctrine extends to causes of action brought under Section 5 of the FTC Act. Finally, Respondent asserts that the Complaint's allegations that Respondent made misrepresentations to two private bodies, the Auto/Oil Group and WSPA, do not take Respondent's activities outside of the realm of Noerr protected political activities.

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## **2. Complaint Counsel's arguments in opposition**

Complaint Counsel argues first that the motion to dismiss is inappropriate because there are factual disputes and because the Complaint "specifically alleges" that Noerr-Pennington immunity does not apply here as a "matter of fact." Opposition at 2; Complaint at P96. Complaint Counsel next argues that Respondent's fraudulent statements were made to an agency acting in a quasi-adjudicative manner and that misrepresentations are not immunized when made in an adjudicatory setting or where the agency is dependent upon the petitioner for information. Complaint Counsel further asserts that Noerr-Pennington immunity does not extend to situations where the government agency is unaware that it is being asked to adopt or participate in a restraint of trade.

In addition, Complaint Counsel argues that Respondent's conduct is outside the reach of Noerr-Pennington because the harm was caused not by CARB's adoption of the regulations, but by Respondent's enforcement of its patents. Complaint Counsel also asserts that Respondent's conduct falls under the sham exception to the Noerr-Pennington doctrine. Next, Complaint Counsel argues that Noerr does not immunize Respondent's conduct because this action is brought under the FTC Act, and not the Sherman Act. Finally, Complaint Counsel argues that Respondent's conduct towards Auto/Oil Group and WSPA, is not shielded by Noerr-Pennington and states an independent cause of action.

### **C. Summary of Arguments Made Regarding Respondent's Motion to Dismiss Based On Failure to Make Sufficient Allegations That Respondent Possesses or Dangerously Threatens to Possess Monopoly Power**

#### **1. Respondent's arguments in support**

Respondent's motion to dismiss based on failure to make sufficient allegations that Respondent possesses or dangerously threatens to possess monopoly power raises several issues.

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However, the only issues raised by Respondent in that motion that are decided herein are as follows: whether the allegations of the Complaint arise under patent law; and whether the FTC has jurisdiction to decide the substantial questions of patent law alleged in the Complaint. The remaining issues are not reached because the determination on the Noerr-Pennington motion and the determination of the jurisdictional argument make any analysis of the remaining issues raised in the Market Power Motion unnecessary.

Respondent argues that the allegations of this Complaint arise under patent law because they require an inquiry into claim construction and infringement. Respondent further argues that jurisdiction to decide issues arising under patent law lies solely with federal courts and that the Commission does not have jurisdiction to decide the patent issues raised by the Complaint.

## **2. Complaint Counsel's arguments in opposition**

Complaint Counsel asserts that the allegations of this Complaint do not arise under patent law. Complaint Counsel further asserts that the Commission has jurisdiction to decide issues that touch on patent law.

### **III. EVIDENTIARY STANDARDS**

#### **A. Motion to Dismiss Standard**

Rule 3.22(e) of the Commission's Rules of Practice authorizes the filing of a motion to dismiss a complaint. 16 C.F.R. § 3.22(e). Although the Commission's Rules of Practice do not have a rule identical to Rule 12(b)(6) of the Federal Rules of Civil Procedure, the Commission has acknowledged a party's right to file, and the Administrative Law Judge's authority to rule on, a motion to dismiss for failure to state a claim upon which relief could be granted. E.g., *In re Times Mirror Co.*, 92 F.T.C. 230 (1978); *In re Florida Citrus Mutual*, 50 F.T.C. 959, 961 (1954) (ALJ may "dismiss a complaint if in his opinion the facts alleged do not state a cause of action.").



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Rule 3.11(b)(2) of the Commission's Rules of Practice sets forth that the Commission's complaint shall contain a "clear and concise factual statement sufficient to inform each respondent with reasonable definiteness of the type of acts or practices alleged to be in violation of the law." 16 C.F.R. § 3.11(b)(2). This rule requires that the complaint contain "a factual statement sufficiently clear and concise to inform respondent with reasonable definiteness of the types of acts or practices alleged to be in violation of law, and to enable respondent to frame a responsive answer." *In re New England Motor Rate Bureau, Inc.*, 1986 FTC LEXIS 5, \*114 (1986). A motion to dismiss for failure to state a claim upon which relief can be granted is judged by whether "a review of the complaint clearly shows that the allegations, if proved, are sufficient to make out a violation of Section 5." *In re TK-7 Corp.*, 1989 FTC LEXIS 32, \*3 (1989).

For purposes of a motion to dismiss, "the factual allegations of the complaint are presumed to be true and all reasonable inferences are to be made in favor of complaint counsel." *TK-7 Corp.*, 1989 FTC LEXIS 32, \*3 (citing *Miree v. DeKalb County*, 433 U.S. 25, 27 n.2 (1977); *Jenkins v. McKeitchen*, 395 U.S. 411, 421-22 (1969)). If the motion to dismiss raises material issues of fact which are in dispute, dismissal is not appropriate. *In re Herbert R. Gibson, Sr.*, 1976 FTC LEXIS 378, \*1 (1976); *In re Jewell Companies, Inc.*, 81 F.T.C. 1034, 1035-36 (1972) (denying motion to dismiss where there was a substantial dispute on questions of fact). See also *In re College Football Assoc.*, 1990 FTC LEXIS 485, \*4 (1990) (Where facts are needed to make determination on a "close question," the motion to dismiss will be denied.).

**B. Factual Allegations Accepted as True; Conclusions of Law Not Accepted as True**

The standard used in Commission proceedings mirrors the standard used for evaluating motions to dismiss raised in federal district courts under Rule 12(b)(6) of the Federal Rules of Civil Procedure. The Supreme Court has held that it "is axiomatic that a complaint should not be dismissed unless 'it appears beyond doubt

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that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *McClain v. Real Estate Bd. of New Orleans, Inc.*, 444 U.S. 232, 246 (1980) (quoting *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)). Moreover, it is well established that, in ruling on a motion to dismiss, allegations in the complaint must be accepted as true and construed favorably to the plaintiff. *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974). "In antitrust cases, where 'the proof is largely in the hands of the alleged conspirators,' dismissals prior to giving the plaintiff ample opportunity for discovery should be granted very sparingly." *Hospital Building Co. v. Trustees of Rex Hosp.*, 425 U.S. 738, 746 (1976) (quoting *Poller v. Columbia Broad.*, 368 U.S. 464, 473 (1962)).

While well-pleaded allegations are taken as admitted, "conclusions of law and unreasonable inferences or unwarranted deductions of fact are not admitted." *Hiland Dairy, Inc. v. Kroger Co.*, 402 F.2d 968, 973 (8th Cir. 1968); *Violanti v. Emery Worldwide A-CF*, 847 F. Supp. 1251, 1255 (M.D. Pa. 1994) (conclusory allegations of law need not be accepted as true). On motions to dismiss, courts routinely reject allegations that are, or contain, legal conclusions. E.g., *United Mine Workers of America, Inc. v. Wellmore Coal Corp.*, 609 F.2d 1083, 1085 (4th Cir. 1979) (allegation that plaintiff acted under color of state law was a legal conclusion and insufficient to survive a motion to dismiss); *Donald v. Orfila*, 618 F. Supp. 645, 647 (D.D.C. 1985) (allegations that official acted in bad faith beyond the scope of his authority so as not to be entitled to immunity were legal conclusions and thus were not admitted for purposes of a motion to dismiss). "Were it otherwise, Rule 12(b)(6) would serve no function, for its purpose is to provide a defendant with a mechanism for testing the legal sufficiency of the complaint." *United Mine Workers*, 609 F.2d at 1086.

The Complaint specifically alleges that "Unocal is not shielded from antitrust liability pursuant to the Noerr-Pennington doctrine for numerous reasons as a matter of law and as a matter of fact . . ." (Complaint at P96) (emphasis added). Whether or not Noerr-Pennington immunity applies to the facts alleged

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requires a legal conclusion and clearly is a matter of law. See *Razorback Ready Mix Concrete Co, Inc. v. Weaver*, 761 F.2d 484, 488 (8th Cir. 1985). Whether or not an issue is a matter of fact or is a matter of law is also a legal determination. In *Mark Aero, Inc. v. Trans World Airlines, Inc.*, 580 F.2d 288 (8th Cir. 1978), although the complaint alleged that the agency was an adjudicatory body, the Court of Appeals dismissed the complaint after finding that defendant's actions, including misrepresentations to the agency and city council, were genuine political activity. *Id.* at 293, 297. In the instant case, paragraph 96 of the Complaint is not a properly plead factual allegation in so far as it alleges a conclusion of law; it need not be, and is not, taken as true for purposes of Respondent's motion to dismiss.

**C. Matters Which May Be Considered on a Motion to Dismiss and For Which Official Notice May Be Taken**

In ruling on a motion to dismiss, it is appropriate to consider the allegations of the complaint, as well as documents attached to or specifically referenced in the complaint, and matters of public record. *Hoffman-LaRouche Inc. v. GenPharm, Inc.*, 50 F. Supp. 2d 367, 377 (D.N.J. 1999) (citing *Pittsburgh v. West Penn Power Co.*, 147 F.3d 256, 259 (3d Cir. 1998); 5A Charles A. Wright & Arthur R. Miller, *Federal Practice & Procedure* § 1357 at 299 (2d ed. 1990)). The Complaint specifically references California Health and Safety Code § 43018 and California's Administrative Procedure Act. Complaint at PP17, 18, 21, and 26. As set forth below, it is also appropriate to take official notice of the statutes governing CARB, the Notice of Public Hearing through which CARB initiated the rulemaking, and the Final Statement of Reasons for Rulemaking, all of which are beyond dispute.

The Commission's Rules of Practice authorize the use of official notice. 16 C.F.R. § 3.43(d) ("when any decision of an Administrative Law Judge or of the Commission rests, in whole or in part, upon the taking of official notice of a material fact not appearing in evidence of record, opportunity to disprove such noticed fact shall be granted any party making timely motion therefor"). Because the Commission Rule does not define official

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notice, it is appropriate to look to Federal Rule of Evidence ("F. R. Evid.") 201(b). "A judicially noticed fact must be one not subject to reasonable dispute in that it is either (1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned." F. R. Evid. 201(b).

Under Commission precedent, official notice may be taken of references "generally accepted as reliable." In *re* Thompson Medical Co., 104 F.T.C. 648, 790 (1984). The Commission and Administrative Law Judges have frequently taken official notice of statutes and regulations. E.g., In *re* New England Motor Rate Bureau, Inc., 1989 FTC LEXIS 62, \*16 n.6 (1989) (amendment to New Hampshire statute); In *re* Great Atlantic & Pacific Tea Co., 85 F.T.C. 601, 608 (1975) (Trade Regulation Rule); In *re* Blanton Co., 53 F.T.C. 580, 588 (1954) (regulations of the Secretary of Agriculture in the Federal Register).

Federal Rule of Evidence 201 authorizes federal courts to take judicial notice of adjudicative facts on a motion to dismiss. *Zimora v. Alamo Rent-A-Car, Inc.*, 111 F.3d 1495, 1503 (10th Cir. 1997). This includes taking notice of regulations and statutes. See *id.* at 1504 (to the extent that plaintiff's allegations conflicted with the provisions of the ordinance, plaintiff's allegations were appropriately rejected or ignored). In *Kottle v. Northwest Kidney Centers*, 146 F.3d 1056 (9th Cir. 1988), where the district court relied upon the public records of the administrative agency in ruling on a motion to dismiss on Noerr-Pennington grounds, the Court of Appeals held that these records were properly the subject of judicial notice. *Id.* at 1064 n.7. Moreover, the Commission has taken official notice of changes in an agency's amendments to regulations in determining to dismiss a complaint. In *re* Marcor Inc., 90 F.T.C. 183, 185 (1977).

Respondent, in its motion, specifically cited to the California Clean Air Act (Cal. Health & Safety Code § 39601) and Chapter 3.5 (commencing with Section 11340) of the Government Code, and cited to and attached the Notice of Public Hearing through

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which CARB initiated the rulemaking and the Final Statement of Reasons for Rulemaking. Motion at 11-12, 23 n.7, and Appendices B and D. Complaint Counsel had an opportunity to disprove these statutes and agency materials of which official notice is taken not only through the filing of its Opposition, but was also provided an additional opportunity when directed to submit additional briefing by Order dated August 25, 2003. These statutes and public documents were relied upon by Respondent and their veracity and accuracy were not disputed by Complaint Counsel.

**D. Motions To Dismiss Involving Noerr-Pennington**

Courts routinely resolve, on a motion to dismiss, the legal issue of whether Noerr-Pennington immunity shields a defendant. E.g., *A.D. Bedell Wholesale Co. v. Philip Morris Inc.*, 263 F.3d 239, 250 (3rd Cir. 2001); *Baltimore Scrap Corp. v. The David J. Joseph Co.*, 237 F.3d 394, 396 (4th Cir. 2001); *Manistee Town Ctr. v. Glendale*, 227 F.3d 1090, 1091 (9th Cir. 2000). In *Kottle*, the court examined, on a motion to dismiss, whether an administrative agency bore many of the indicia of a true adjudicatory proceeding, such as conducting public hearings, accepting written and oral arguments, issuing written findings after hearing, and whether its decision was appealable to determine whether the sham exception to Noerr-Pennington applied. 146 F.3d at 1059. See also *Armstrong Surgical Center v. Armstrong City Mem'l Hosp.*, 185 F.3d 154, 163 (3d Cir. 1999) ("On the facts alleged in the complaint, it is also clear that the state decision makers were disinterested, conducted their own investigation, and afforded all interested parties an opportunity to set the record straight."). Thus, although other courts have deferred ruling on whether the Noerr-Pennington doctrine applies until after discovery, e.g., *Fox News Network v. Time Warner, Inc.*, 962 F. Supp. 339, 345 (E.D.N.Y. 1997); *Israel v. Baxter Laboratories, Inc.*, 466 F.2d 272 (D.C. Cir. 1972), where, as here, the dispositive issues are legal, there are no facts within reasonable dispute, and the issues can be resolved on a motion to dismiss, it is appropriate to do so.

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Furthermore, courts, in ruling on motions to dismiss based on Noerr-Pennington, review the statutory authority under which an agency is acting to determine whether the conduct challenged in the complaint occurred in a political setting. For example, in *Mark Aero*, despite allegations in the complaint that the Aviation Department and the city council were "adjudicatory bodies," the court, upon reviewing state statutes, concluded that city council's passage of ordinances was an exercise of legislative power. 580 F.2d at 290. In *Metro Cable Co. v. CATV of Rockford, Inc.*, 516 F.2d 220, 228 (7th Cir. 1975), on a motion to dismiss, the court determined that the city council was a body to which the state had delegated legislative powers, that the council did not need to compile an evidentiary record through formal proceedings, and that its members were subject to lobbying and other forms of ex parte influence, to conclude that the conduct challenged in the complaint occurred in a political setting. In *St. Joseph's Hosp., Inc. v. Hosp. Corp. of Am.*, 795 F.2d 948, 955 (11th Cir. 1986), the Court of Appeals for the Eleventh Circuit reviewed the statute applicable to the State Health Planning Agency's (SHPA) action in issuing a certificate of need and found that each application was reviewed individually according to a process which required consideration of a number of health planning issues, any interested party could have submitted information to SHPA in connection with the application, the initial review was conducted without an evidentiary hearing, the Act provided for a separate review board to handle any appeals from SHPA decisions, and the review board, at its discretion, could grant discovery rights prior to conducting a mandatory evidentiary hearing. This analysis led the court to determine, on a motion to dismiss, that the agency was acting in an adjudicatory manner. *Id.* Thus, a determination of whether CARB was acting in a legislative or adjudicative manner may properly be made on a motion to dismiss by review of the applicable statutes, as well as the factual allegations of the Complaint. As discussed below, other issues raised by Respondent's motions and Complaint Counsel's responses do not require the resolution of genuine factual disputes and are properly decided on the motions to dismiss.

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**E. Burden of Proof**

Noerr-Pennington immunity is not merely an affirmative defense. *McGuire Oil Co. v. MAPCO, Inc.*, 958 F.2d 1552, 1558 n.9 (11th Cir. 1992). "Rather, 'the antitrust plaintiff has the burden of establishing that the defendant restrained trade unreasonably, which cannot be done when the restraining action is that of the government.'" *Id.* (quoting *P. Areeda and H. Hovenkamp*, *Antitrust Law* § 203.4c). The antitrust plaintiff also bears the burden of proving that the action of the defendant comes within the sham exception to Noerr-Pennington. *Westmac, Inc. v. Smith*, 797 F.2d 313, 318 (6th Cir. 1986). Thus, the burden falls on Complaint Counsel to allege facts sufficient to show that Noerr-Pennington immunity does not attach to Respondent's actions.

In addition, where jurisdiction is limited to only that power authorized by statute, the burden of establishing jurisdiction rests upon the party asserting jurisdiction. *Kokkonen v. Guardian Life Ins. Co. of Am.*, 511 U.S. 375, 377 (1994). If a complaint before the Federal Trade Commission does not allege sufficient facts to confer jurisdiction, it must be dismissed. *In re R.J. Reynolds Tobacco Co., Inc.*, 111 F.T.C. 539, 541 (1988). Thus, the burden is on Complaint Counsel to demonstrate that jurisdiction exists over all violations alleged in the Complaint.

**IV. STATEMENT OF FINDINGS**

Rule 3.22(e) of the Commission's Rules of Practice requires that when a motion to dismiss a complaint is granted with the result that the proceeding before the Administrative Law Judge is terminated, the Administrative Law Judge shall file an initial decision in accordance with the provisions of § 3.51. 16 C.F.R. § 3.22(e). Rule 3.51(c) requires an initial decision to include a statement of findings and conclusions and an appropriate rule or order. 16 C.F.R. § 3.51(c). Accordingly, this section sets forth as findings those facts alleged in the Complaint that are taken as true only for the limited purpose of ruling on both motions to dismiss. Citations to specific numbered findings of fact in this Initial Decision are designated by "F."

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Allegations that are not relevant to the issues decided are not included. As discussed above (section III.B. *supra*) argumentative language and allegations that constitute legal conclusions need not be taken as true and are not included as findings of fact.

As is permitted when ruling on a motion to dismiss, official notice may appropriately be taken of legislative and public agency materials. (Section III.C. *supra*). Therefore, this section also includes excerpts from the Notice of Public Hearing through which CARB initiated the rulemaking at issue, the Final Statement of Reasons for Rulemaking, and the statutes governing CARB, upon which this order granting the motion to dismiss on Noerr-Pennington grounds and the Initial Decision are based. The Notice of Public Hearing and the Final Statement of Reasons for Rulemaking are Appendices B and D to Respondent's motion for dismissal based on Noerr-Pennington, available at [www.ftc.gov/os/adjpro/d9305/index.htm](http://www.ftc.gov/os/adjpro/d9305/index.htm).

## **A. Facts As Alleged in the Complaint**

### **1. Respondent**

1. Union Oil Company of California is a public corporation organized, existing, and doing business under, and by virtue of, the laws of California. Its office and principal place of business is located at 2141 Rosecrans Avenue, Suite 4000, El Segundo, California 90245. Since 1985, Union Oil Company of California has done business under the name "Unocal." Unocal is a wholly-owned, operating subsidiary of Unocal Corporation, a holding company incorporated in Delaware. Complaint at P11.

2. Unocal is, and at all relevant times has been, a corporation as "corporation" is defined by Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44; and at all times relevant herein, Unocal has been, and is now, engaged in commerce as "commerce" is defined in the same provision. Complaint at P12.

3. Prior to 1997, Unocal owned and operated refineries in California as a vertically integrated producer, refiner, and



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marketer of petroleum products. In March 1997, Unocal completed the sale of its west coast refining, marketing, and transportation assets to Tosco Corporation. Currently, Unocal's primary business activities involve oil and gas exploration and production, as well as production of geothermal energy, ownership in proprietary and common carrier pipelines, natural gas storage facilities, and the marketing and trading of hydrocarbon commodities. Complaint at P13.

4. In its annual report for the year 2001 filed with the United States Securities and Exchange Commission, Form 10-K, Unocal lists as another of its key business activities: "pursuing and negotiating licensing agreements for reformulated gasoline patents with refiners, blenders and importers." Unocal has publicly announced that it expects to earn up to \$ 150 million in revenues a year from licensing its RFG patents. Complaint at P14.

**2. Respondent's patents**

5. Unocal is the owner, by assignment, of the following patents relating to low emissions, reformulated gasoline: United States Patent No. 5,288,393 (issued February 22, 1994); United States Patent No. 5,593,567 (issued January 14, 1997); United States Patent No. 5,653,866 (issued August 5, 1997); United States Patent No. 5,837,126 (issued November 17, 1998); and United States Patent No. 6,030,521 (issued February 29, 2000). Complaint at P15.

6. On May 13, 1990, Unocal scientists presented the preliminary research results of their emissions research program to the highest levels of Unocal's management to obtain approval and funding for additional, confirmatory research. Unocal's management approved funding for additional emissions testing, and this project became known as the "5/14 Project." Complaint at P29.

7. Unocal's management approved the filing of a patent application covering the invention and discovery that sprang from the 5/14 Project. Specifically, the Unocal scientists' novel

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discovery of the directional relationships between eight fuel properties -- RVP, T10, T50, T90, olefin content, aromatic content, paraffin content, and octane -- and three types of tailpipe emissions -- i.e., incompletely burned or unburned hydrocarbons, carbon monoxide, and nitrogen oxides. Complaint at P30.

8. On December 13, 1990, Unocal filed with the United States Patent and Trademark Office a patent application, No. 07/628,488. This application presented Unocal's emissions research results, including the regression equations and underlying data; detailed the directional relationships between the fuel properties and emissions studied in Unocal's 5/14 Project; and set forth composition and method claims relating to low emissions, reformulated gasoline. Complaint at P32.

### **3. California Air Resources Board ("CARB")**

9. The California Air Resources Board ("CARB") is a department of the California Environmental Protection Agency. Established in 1967, CARB's mission is to protect the health, welfare, and ecological resources of California through the effective and efficient reduction of air pollutants, while recognizing and considering the effects of its actions on the California economy. CARB fulfills the mandate by, among other things, setting and enforcing standards for low emissions, reformulated gasoline. Complaint at P16.

### **4. Reformulated gasoline in California**

10. CARB initiated rulemaking proceedings in the late 1980s to determine "cost-effective" regulations and standards governing the composition of low emissions, reformulated gasoline. Unocal actively participated in the CARB RFG rulemaking proceedings. Complaint at P1.

11. CARB's RFG regulations had their genesis in an effort by California to study the viability of alternative fuels for motor vehicles, such as methanol. In 1987, the California legislature passed AB 234, which resulted in the formation of a panel to

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study the environmental impact of alternative fuels and to develop a proposal to reduce emissions. This panel included representatives from the refining industry, including Roger Beach, a high level Unocal executive who later became the Chief Executive Officer and Chairman of the Board of Unocal. Complaint at P19.

12. Based in substantial part on the representations of oil industry executives that the oil industry could, and would develop gasoline that would be cleaner-burning and cheaper than methanol, the AB 234 study panel recommended exploring reformulated gasoline as an alternative to methanol. Complaint at P20.

13. In late 1988, the California legislature amended the California Clean Air Act to require CARB to take actions to reduce harmful car emissions, and directed CARB to achieve this goal through the adoption of new standards for automobile fuels and low emission vehicles. CARB's legislative mandate, set forth in California Health and Safety Code Section 43018, provided, inter alia, that CARB undertake the following actions:

- a. Take "necessary, cost-effective, and technologically feasible" actions to achieve "reduction in the actual emissions of reactive, organic gases of at least 55 percent, a reduction in emissions of oxides of nitrogen of at least 15 percent from motor vehicles" no later than December 31, 2000;
- b. Take actions "to achieve the maximum feasible reduction in particulates, carbon monoxide, and toxic air contaminants from vehicular sources";
- c. Adopt standards and regulations that would result in "the most cost-effective combination of control measures on all classes of motor vehicles and motor vehicle fuels" including the "specification of vehicular fuel composition."

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Complaint at P21.

14. Following the 1998 California Clean Air Act amendments, CARB embarked on two rulemaking proceedings relating to low emissions, reformulated gasoline. In these rulemaking proceedings -- Phase 1 and Phase 2 -- CARB prescribed limits on specific gasoline properties. Complaint at P22.

15. CARB's Phase 2 RFG proceedings represented an effort by CARB to develop stringent standards for low emissions, reformulated gasoline. Participants to the Phase 2 RFG proceedings understood that the CARB Phase 2 RFG regulations would require refiners to make substantial capital investments to reconfigure their refineries to produce compliant gasoline. Complaint at P24.

16. In its Phase 2 RFG proceedings, CARB did not conduct any independent studies of its own, but relied on the industry to provide research and information. Complaint at P25.

17. In the course of CARB's Phase 2 RFG proceedings, CARB adhered to the procedures set forth in the California Administrative Procedure Act. CARB provided notice of proposed regulations; provided the language of these proposed regulations and a statement of reasons; solicited and accepted written comments from the public; and conducted lengthy hearings at which oral testimony was received. CARB also issued written findings on the results of its rulemaking proceedings. Following adoption of the regulations, several parties sought judicial review of the CARB Phase 2 RFG regulations that provided small refiners with a two-year exemption for compliance with the regulations. Complaint at P26.

### **5. Unocal's conduct before CARB**

18. Prior to and after the filing of the patent application on December 13, 1990, Unocal employees and management discussed and considered the potential competitive advantage and corporate profit that could be gained through effectuating an

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overlap between the CARB regulations and Unocal's patent claims. Complaint at P33.

19. During the same time that Unocal participated in the CARB RFG rulemaking proceedings, specific discussions took place within the company concerning how to induce the regulators to use information supplied by Unocal so that Unocal could realize the licensing income potential of its pending patent claims. Complaint at P34.

20. Beginning in 1990, and continuing throughout the CARB Phase 2 RFG rulemaking process, Unocal provided information to CARB for the purpose of obtaining competitive advantage. Unocal gave CARB this information in private meetings with CARB, through participation in CARB's public workshops and hearings, as well as by participating in industry groups that also were providing input into the CARB regulations. Unocal suppressed facts relating to its proprietary interests in its emissions research results. Complaint at P35.

21. On June 11, 1991, CARB held a public workshop regarding the Phase 2 RFG regulations. This workshop included discussions of CARB staff's proposed gasoline specifications -- i.e., the levels at which certain gasoline properties should be set -- to reduce the emissions from gasoline-fueled vehicles. The set of specifications proposed by CARB for discussion at this workshop did not include a T50 specification. Complaint at P36.

22. On June 20, 1991, Unocal presented to CARB staff the results of its 5/14 Project to show CARB that "cost-effective" regulations could be achieved through adoption of a "predictive model" and to convince CARB of the importance of T50. Unocal's pending patent application contained numerous claims that included T50 as a critical limitation, in addition to other fuel properties that CARB proposed to regulate. Complaint at P37.

23. Prior to the presentation to CARB, Unocal's management decided not to disclose Unocal's pending '393 patent application to CARB staff. Complaint at P38.

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24. On July 1, 1991, Unocal provided CARB with the actual emissions prediction equations developed in the 5/14 Project. Unocal requested that CARB "hold these equations confidential, as we feel that they may present a competitive advantage in the production of gasoline." But Unocal went on to state: "If CARB pursues a meaningful dialogue on a predictive model approach to Phase 2 gasoline, Unocal will consider making the equations and underlying data public as required to assist in the development of a predictive model." Complaint at P39.

25. Following CARB's agreement to develop a predictive model, Unocal made its emissions results, including the test data and equations underlying its 5/14 Project, publicly available. Complaint at P40.

26. On August 27, 1991, Unocal stated in a letter to CARB that its emissions research data were "nonproprietary." Specifically, Unocal stated: "Please be advised that Unocal now considers this data to be nonproprietary and available to CARB, environmental interests, groups, other members of the petroleum industry, and the general public upon request." Complaint at P41.

27. At the time Unocal submitted its August 27, 1991 letter to CARB, it did not disclose to CARB its proprietary interests in the 5/14 Project data and equations, its prosecution of a patent application, or its intent to enforce its proprietary interests to obtain licensing income. Complaint at P42.

28. CARB used Unocal's equations in setting a T50 specification. Subsequently, in October 1991, CARB published Unocal's equations in public documents supporting the proposed Phase 2 RFG regulations. Complaint at P43.

29. On November 22, 1991, the CARB Board adopted Phase 2 RFG regulations that set particular standards for the composition of low emissions, reformulated gasoline. These regulations specified limits for eight gasoline properties: RVP, benzene, sulfur, aromatics, olefins, oxygen, T50, and T90. Unocal's pending patent claims recited limits for five of the eight properties

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specified by the regulations: T50, T90, olefins, aromatics, and RVP. Complaint at P44.

30. The Phase 2 RFG regulations substantially overlapped with Unocal's patent claims. For example, CARB included a specification for T50 in its Phase 2 RFG regulations and eventually adopted a "predictive model" that included T50 as one of the parameters. Complaint at P45.

31. Although Unocal knew by July 1992 that most of the pending patent claims based on its emissions research had been allowed by the United States Patent and Trademark Office, Unocal did not disclose this material information to CARB and other participants in the CARB RFG proceedings. Complaint at P4.

32. Prior to the final approval of the CARB Phase 2 RFG regulations in November 1992, Unocal submitted comments and presented testimony to CARB opposing CARB's proposal to grant small refiners a two-year exemption for complying with the regulations. Unocal opposed this proposed exemption on the grounds that it would increase the costs of compliance and undermine the cost-effectiveness of the CARB Phase 2 RFG regulations. In making these statements, Unocal did not disclose that it had proprietary rights that would materially increase the cost and reduce the cost-effectiveness and flexibility of the regulations that CARB had adopted. Complaint at P46.

33. CARB amended the Phase 2 regulations in June 1994 to include a predictive model as an alternative method of complying with the regulations that was intended to provide refiners with additional flexibility. At the urging of numerous companies, including Unocal, this "predictive model" permits a refiner to comply with the RFG regulations by producing fuel that is predicted -- based on its composition and the levels of the eight properties -- to have equivalent emissions to a fuel that meets the strict gasoline property limits set forth in the regulations. Complaint at P47.

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34. During the development of the predictive model, Unocal continued to meet with CARB, providing testimony and information. Unocal submitted comments to CARB touting the predictive model as offering "flexibility" and furthering CARB's mandate of "cost-effective" regulations. Complaint at P48.

35. Unocal made statements and comments to CARB relating to the "cost effectiveness" of CARB Phase 2 regulations, and the "flexibility" offered by the implementation of a predictive model to reduce refiner compliance costs. These statements and comments include, but are not limited to, both written and/or oral statements made to CARB on the following dates: October 29, 1991, November 21, 1991, November 22, 1991, March 16, 1992, June 19, 1992, August 14, 1992, September 4, 1992, June 3, 1994 and June 9, 1994. Complaint at P78.

36. Throughout its communications and interactions with CARB prior to January 31, 1995, Unocal did not disclose that it had pending patent rights, that its patent claims overlapped with the proposed RFG regulations, and that Unocal intended to charge royalties. Complaint at P79.

37. On February 22, 1994, the United States Patent Office issued the '393 patent. CARB first became aware of Unocal's '393 patent shortly after Unocal's issuance of a press release on January 31, 1995. Complaint at P49.

## **6. Unocal's participation in industry groups**

38. During the CARB RFG rulemaking, Unocal actively participated in the Auto/Oil Air Quality Improvement Research Program ("Auto/Oil Group"), a cooperative, joint research program between the automobile and oil industries. By agreement dated October 14, 1989, the big three domestic automobile manufacturers -- General Motors, Ford, and Chrysler -- and representatives from fourteen oil companies, including Unocal, entered into a joint research agreement in accordance with the National Cooperative Research Act of 1984 ("Auto/Oil Agreement"). Complaint at P50.



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39. The stated objective of the Auto/Oil joint research venture was to plan and carry out research and tests designed to measure and evaluate automobile emissions and the potential improvements in air quality achievable through the use of reformulated gasolines, methanol, and other alternative fuels, and to evaluate the relative cost-effectiveness of these various improvements. Complaint at P51.

40. The Auto/Oil Agreement provided that "the results of research and testing of the Program will be disclosed to government agencies, the Congress and the public, and otherwise placed in the public domain." This agreement specifically provided for the following dedication of any and all intellectual property rights to the public: "No proprietary rights will be sought nor patent applications prosecuted on the basis of the work of the Program unless required for the purpose of ensuring that the results of the research by the Program will be freely available, without royalty, in the public domain." Complaint at P52.

41. While the Auto/Oil Agreement permitted participating companies to conduct independent research, and further permitted them to withhold the fruits of such independent research from the Auto/Oil Group, once data and information were in fact presented to the Auto/Oil Group, they became the "work of the Program." Complaint at P53.

42. On September 26, 1991, Unocal presented to the Auto/Oil Group the results of Unocal's emissions research, including the test data, equations, and corresponding directional relationships between fuel properties and emissions derived from the 5/14 Project. Unocal's management authorized this presentation, which was substantially similar to that made to CARB on June 20, 1991. Unocal informed Auto/Oil participants that the data had been made available to CARB and were in the public domain. Unocal also represented that the data would be made available to Auto/Oil participants. Complaint at P55. Unocal failed to disclose Unocal's proprietary interests in its emissions research results and Unocal's intention and efforts to enforce its intellectual property rights. Complaint at P82.

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43. Throughout all of its communications and interactions with the Auto/Oil Group prior to January 31, 1995, Unocal failed to disclose that it had pending patent rights, that its patent claims overlapped with the proposed RFG regulations, and that Unocal intended to charge royalties. Complaint at P83.

44. During the CARB Phase 2 RFG rulemaking proceedings, Unocal also actively participated in the Western States Petroleum Association ("WSPA"), an oil industry trade association that represents companies accounting for the bulk of petroleum exploration, production, refining, transportation and marketing in the western United States. WSPA, as a group, actively participated in the CARB RFG rulemaking process. WSPA commissioned, and submitted to CARB, three cost studies in connection with the CARB Phase 2 RFG rulemaking. Complaint at P56.

45. One cost study commissioned by WSPA incorporated information relating to process royalty rates associated with non-Unocal patents and was used by CARB to determine the cost-effectiveness of the proposed CARB Phase 2 RFG standards. This WSPA cost study estimated the costs of the proposed regulations on a cents-per-gallon basis and estimated the incremental costs associated with regulating specific gasoline properties. This WSPA study could have incorporated costs associated with potential royalties flowing from Unocal's pending patent rights. Complaint at P57.

46. On September 10, 1991, Unocal presented its 5/14 Project emissions research results to WSPA. Unocal's management authorized the presentation of the research results to WSPA. This Unocal presentation created the impression that Unocal's emissions research results, including the data and equations, were nonproprietary and could be used by WSPA or its individual members without concern for the existence or enforcement of any intellectual property rights. Complaint at P58.

47. Throughout all of its communications and interactions with WSPA prior to January 31, 1995, Unocal failed to disclose

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that it had pending patent rights, that its patent claims overlapped with the proposed RFG regulations, and that Unocal intended to charge royalties. Complaint at P88.

48. None of the participants in the WSPA or Auto/Oil Group knew of the existence of Unocal's proprietary interests and/or pending patent rights at any time prior to the issuance of the '393 patent in February 1994, by which time most, if not all, of the oil company participants to these groups had made substantial progress in their capital investment and refinery modifications plans for compliance with the CARB Phase 2 RFG regulations. Complaint at P59.

### **7. Unocal's patent prosecution and enforcement**

49. Following the November 1991 adoption of CARB Phase 2 RFG specifications, Unocal amended its patent claims in March 1992 so that the patent claims more closely matched the regulations. In some cases, Unocal's patent claims were narrowed to resemble the regulations. Complaint at P60.

50. On or about July 1, 1992, Unocal received an office action from the U.S. Patent and Trademark Office indicating that most of Unocal's pending patent claims had been allowed. Unocal did not disclose this information to CARB or other participants to the CARB Phase 2 RFG rulemaking. Complaint at P61.

51. Subsequently, after the submission of additional amendments, Unocal received a notice of allowance from the U.S. Patent and Trademark Office for all of its pending claims in February 1993. Unocal did not disclose this information to CARB or other participants to the CARB Phase 2 RFG rulemaking. Complaint at P62.

52. In June 1993, Unocal filed a divisional application (No. 08/77,243) of its original patent application that allowed Unocal to pursue additional patents based on the discoveries of the 5/14 Project. Complaint at P63.

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53. The U.S. Patent and Trademark Office issued the '393 patent to Unocal on February 22, 1994. On January 31, 1995, Unocal issued a press release announcing issuance of the '393 patent. The Unocal press release stated that the '393 patent "covers many of the possible fuel compositions that refiners would find practical to manufacture and still comply with the strict California Air Resources Board (CARB) Phase 2 requirements." Complaint at P64.

54. In March 1995, Unocal met separately with California Governor Pete Wilson and CARB and made assurances that Unocal would not enjoin or otherwise impair the ability of refiners to produce and supply to the California market gasoline that complied with the CARB Phase 2 RFG regulations. In or about the same time period, CARB expressed its own concern to Unocal about the coverage of the patent and even sought and received from Unocal a license to use the '393 patent in making and using test fuels. Complaint at P65.

55. On March 22, 1995, five days after meeting with CARB staff, Unocal filed a continuation patent application (No. 08/409/074) claiming priority to the original December 1990 application. Unocal did not inform CARB or Governor Wilson that it intended to obtain additional RFG patents. Complaint at P66.

56. Unocal subsequently filed additional continuation patent applications on June 5, 1995 (No. 08/464,544), August 1, 1997 (No. 08/904,594), and November 13, 1998 (No. 08/191,924), all claiming priority based on Unocal's original December 13, 1990 patent application. Complaint at P67.

57. On April 13, 1995, ARCO, Exxon, Mobil, Chevron, Texaco, and Shell filed suit in the United States District Court for the Central District of California seeking to invalidate Unocal's '393 patent. Unocal filed a counterclaim for patent infringement of the '393 patent. The jury in this private litigation determined that Unocal's '393 patent was valid and infringed, and found that the refiners must pay a royalty rate of 5.75 cents per gallon for the

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period from March through July 1996 for sales of infringing gasoline in California. Complaint at P68.

58. The United States Court of Appeals for the Federal Circuit subsequently affirmed the trial court's judgment. The United States Supreme Court denied the refiner-defendants' petition for a writ of certiorari. The refiner-defendants have made payments totaling \$ 91 million to Unocal for damages, costs, and attorneys' fees. Complaint at P69.

59. An accounting action is still ongoing in the United States District Court for the Central District of California to determine damages for infringement of the '393 patent by the refiners for the period from August 1, 1996, through December 31, 2000. The court ruled in August 2002 that the 5.75 cents per gallon royalty fee awarded by the jury would apply to all infringing gasoline produced and/or supplied in California. Complaint at P70.

60. On January 23, 2002, Unocal sued Valero Energy Company in the Central District of California for willful infringement of both the '393 patent and the '126 patent. In its complaint, Unocal seeks damages at the rate of 5.75 cents per gallon for all infringing gallons, and treble damages for willful infringement. Complaint at P71.

61. Unocal also has enforced its patent claims through licensing activities. To date, Unocal has entered into license agreements with eight refiners, blenders and/or importers covering the use of all five RFG patents. The terms of these license agreements are confidential. Unocal has announced that these license agreements feature a "uniform" licensing schedule that specifies a range from 1.2 to 3.4 cents per gallon depending on the volume of gasoline falling within the scope of the patents. As a licensee practices under the license more frequently, the licensing fee per gallon is reduced. Complaint at P72.

62. Refiners in California invested billions of dollars in sunk capital investments without knowledge of Unocal's patent claims to reconfigure their refineries in order to comply with the CARB

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Phase 2 RFG regulations. These refiners cannot produce significant volumes on non-infringing CARB-compliant gasoline without incurring substantial costs. Complaint at P93.

63. Were Unocal to receive a 5.75 cents per gallon royalty on all gallons of "summertime" CARB RFG produced annually for the California market, this would result in an estimated annual cost of more than \$ 500 million (assuming approximately 14.8 billion gallons per year California consumption, with up to 8 months of CARB summer-time gasoline requirements). Complaint at P10.

**B. Legislative and Agency Materials of Which Official Notice is Taken**

**1. Notice of Public Hearing**

64. CARB issued its Notice of Public Hearing to Consider Adoption of and Amendments to Regulations Regarding Reformulated Gasoline (Phase 2 Gasoline Specifications), and the Wintertime Oxygen Content of Gasoline on September 24, 1991, ["Notice of Public Hearing"] in connection with the Phase 2 regulations. Notice of Public Hearing, p.1.

65. The Notice of Public Hearing states that the Air Resources Board ("the Board") will conduct a public hearing to consider the adoption of and amendments to regulations to establish more stringent gasoline specifications for Reid vapor pressure ("RVP"), distillation temperatures, and sulfur, benzene, olefin, oxygen and aromatic hydrocarbon content starting in 1996. Notice of Public Hearing, p. 1.

66. The Notice of Public Hearing states that the Board staff has prepared a Staff Report for the proposed Phase 2 reformulated gasoline proposal that is available to the public. Notice of Public Hearing, p. 6.

67. The Notice of Public Hearing states that based on cost data submitted to the Board, the staff has determined that the

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regulations will cost between 14 cents per gallon to 20 cents per gallon, if the entire cost is passed on to the consumer. The total capital investment costs to the refiners are estimated to be in the range of four to seven billion dollars. Notice of Public Hearing, p. 7.

68. The Notice of Public Hearing states that the staff estimates that implementation of Phase 2 specifications will result in ozone precursor emission reductions of about 190 tons per day in 1996. Emissions of CO will be reduced by about 1300 tons per day and sulfur oxides by 40 tons per day. Other Phase 2 specifications will also result in reduced toxic emissions. Notice of Public Hearing, p. 7.

69. The Notice of Public Hearing states that the staff is conducting an independent cost analysis using the Process Industry Modeling System refinery model. Notice of Public Hearing, p. 7.

70. The Notice of Public Hearing states that before taking final action on the proposed regulatory action, the Board must determine that no alternative considered by the agency would be more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons than the proposed action. Notice of Public Hearing, pp. 7-8.

71. The Notice of Public Hearing states that the public may present comments relating to this matter orally or in writing. The Board encourages members of the public to bring to the attention of staff in advance of the hearing any suggestions for modification of the proposed regulatory action. Notice of Public Hearing, p. 8.

## **2. Final Statement of Reasons For Rulemaking**

72. The California Air Resources Board issued its Final Statement of Reasons for Rulemaking, Including Summary of Comments and Agency Response relating to the public hearing to

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consider the adoption and amendments to Phase 2 gasoline specifications held on November 21-22, 1991. ["Final Statement of Reasons for Rulemaking"].

73. Final Statement of Reasons for Rulemaking states: "the statutes do not mandate what specific fuel characteristics must be controlled, how stringent those controls should be, what the compliance dates should be, to whom the controls should apply, whether the limits should be statewide or limited to areas with substantial air pollution problems, whether the limits should apply year-round or only during seasons with bad air quality, whether all batches of fuel should be subject to the same limit or an 'averaging' program of some sort should be instituted, how the controls should be enforced, and whether there should be provisions granting temporary 'variances' based on unforeseen unique events." Final Statement of Reasons for Rulemaking, p. 190.

74. The Final Statement of Reasons for Rulemaking states that the Board conducted a hearing at which it received oral and written comments on the regulatory proposals. Final Statement of Reasons for Rulemaking, p. 1.

75. The Final Statement of Reasons for Rulemaking states that the staff conducted an informal public workshop on October 14, 1991 to discuss the Phase 2 RFG regulatory proposal. Final Statement of Reasons for Rulemaking, p. 17, n.5.

76. The Final Statement of Reasons for Rulemaking contains a summary of the comments the Board received on the Phase 2 RFG regulations during the formal rulemaking process and the Board's responses to the comments. Final Statement of Reasons for Rulemaking, p. 3.

77. An attachment to the Final Statement of Reasons for Rulemaking shows that 51 entities, including automobile companies, assemblymen, business associations, chemical companies, environmental associations, forestry associations, labor unions, oil companies, petroleum associations, refiners'



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associations, and trucking associations, all provided comments to the Board during the formal rulemaking process. Final Statement of Reasons for Rulemaking, pp. A-1 - A-6.

### **3. Statutory authority under which CARB's regulations were adopted**

78. The Notice of Public Hearing states that CARB's regulatory action is proposed under that authority granted in sections 39600, 39601, 43013, 43018, and 43101 of the Health and Safety Code and *Western Oil and Gas Ass'n v. Orange County Air Pollution Control District*, 14 Cal. 3d 411, 121 Cal. Rptr. 249 (1975). Notice of Public Hearing, p. 8.

79. CARB also has the authority to conduct adjudicatory hearings. The procedures for hearings can be found at Cal. Code Regs. tit. 17 § § 60040-60053. The provisions of this article do not apply to review of decisions related to programs or actions of air pollution control or air quality management districts. Cal. Health & Safety Code § 60040.

80. The Notice of Public Hearing does not state that CARB's regulatory action is proposed under the authority granted in sections 60040-60053 of the Health and Safety Code. Notice of Public Hearing, p. 8.

81. Section 39600 of the Health and Safety Code states: The state board shall do such acts as may be necessary for the proper execution of the powers and duties granted to, and imposed upon, the state board by this division and by any other provision of law. Cal. Health & Safety Code § 39600.

82. Section 39601 of the Health and Safety Code states, in part:

(a) The state board shall adopt standards, rules, and regulations in accordance with the provisions of Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code, necessary for the proper execution of

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the powers and duties granted to, and imposed upon, the state board by this division and by any other provision of law . . . ;

(c) The standards, rules, and regulations adopted pursuant to this section shall, to the extent consistent with the responsibilities imposed under this division, be consistent with the state goal of providing a decent home and suitable living environment for every Californian. Cal. Health & Safety Code § 39601.

83. Section 43013 of the Health and Safety Code states, in part:

(a) The state board may adopt and implement motor vehicle emission standards, in-use performance standards, and motor vehicle fuel specifications for the control of air contaminants and sources of air pollution which the state board has found to be necessary, cost-effective, and technologically feasible, to carry out the purposes of this division, unless preempted by federal law . . . .

(e) Prior to adopting or amending any standard or regulation relating to motor vehicle fuel specifications pursuant to this section, the state board shall, after consultation with public or private entities that would be significantly impacted . . . do both of the following:

(1) Determine the cost-effectiveness of the adoption or amendment of the standard or regulation. The cost-effectiveness shall be compared on an incremental basis with other mobile source control methods and options.

(2) Based on a preponderance of scientific and engineering data in the record, determine the technological feasibility of the adoption or amendment of the standard or regulation. . . .

(f) Prior to adopting or amending any motor vehicle fuel specification pursuant to this section, the state board shall do both of the following:

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(1) To the extent feasible, quantitatively document the significant impacts of the proposed standard or specification on affected segments of the state's economy. The economic analysis shall include, but is not limited to, the significant impacts of any change on motor vehicle fuel efficiency, the existing motor vehicle fuel distribution system, the competitive position of the affected segment relative to border states, and the cost to consumers.

(2) Consult with public or private entities that would be significantly impacted to identify those investigative or preventive actions that may be necessary to ensure consumer acceptance, product availability, acceptable performance, and equipment reliability. The significantly impacted parties shall include, but are not limited to, fuel manufacturers, fuel distributors, independent marketers, vehicle manufacturers, and fuel users. Cal. Health & Safety Code § 43013.

84. Section 43018 of the Health and Safety Code states, in part:

(a) The state board shall endeavor to achieve the maximum degree of emission reduction possible from vehicular and other mobile sources in order to accomplish the attainment of the state standards at the earliest practicable date.

(b) Not later than January 1, 1992, the state board shall take whatever actions are necessary, cost-effective, and technologically feasible in order to achieve, not later than December 31, 2000, a reduction in the actual emissions of reactive organic gases of at least 55 percent, a reduction in emissions of oxides of nitrogen of at least 15 percent from motor vehicles. These reductions in emissions shall be calculated with respect to the 1987 baseline year. The state board also shall take action to achieve the maximum feasible reductions in particulates, carbon monoxide, and toxic air contaminants from vehicular sources.

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(c) In carrying out this section, the state board shall adopt standards and regulations which will result in the most cost-effective combination of control measures on all classes of motor vehicles and motor vehicle fuel, including, but not [\*57] limited to, all of the following:

(1) Reductions in motor vehicle exhaust and evaporative emissions.

(2) Reductions in emissions from in-use emissions from motor vehicles through improvements in emission system durability and performance.

(3) Requiring the purchase of low emission vehicles by state fleet operators.

(4) Specification of vehicular fuel composition.

(d) In order to accomplish the purposes of this division, and to ensure timely approval of the district's plans for attainment of the state air quality standards by the state board, the state board shall adopt the following schedule for workshops and hearings to consider the adoption of the standards and regulations required pursuant to this section:

(1) Workshops on the adoption of vehicular fuel specifications for aromatic content, diesel fuel quality, light-duty vehicle exhaust emission standards, and revisions to the standards for new vehicle certification and durability to reflect current driving conditions and useful vehicle life shall be held not later than March 31, 1989. . . .

(2) Notwithstanding Section 43830, workshops on the adoption of regulations governing gasoline Reid vapor pressure, and standards for heavy-duty and medium-duty vehicle emissions, shall be held not later than January 31, 1990. . . .

(3) Workshops on the adoption of regulations governing detergent content, emissions from off-highway vehicles, vehicle

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fuel composition, emissions from construction equipment and farm equipment, motorcycles, locomotives, utility engines, and to the extent permitted by federal law, marine vessels, shall be held not later than January 31, 1991. . . .

(e) Prior to adopting standards and regulations pursuant to this section, the state board shall consider the effect of the standards and regulations on the economy of the state, including, but not limited to, motor vehicle fuel efficiency . . . . Cal. Health & Safety Code § 43018.

85. Section 43101 of the Health and Safety Code states: The state board shall adopt and implement emission standards for new motor vehicles for the control of emissions therefrom, which standards the state board has found to be necessary and technologically feasible to carry out the purposes of this division. Prior to adopting such standards, the state board shall consider the impact of such standards on the economy of the state, including, but not limited to, their effect on motor vehicle fuel efficiency. The state board shall submit a report of its findings on which the standards are based to the Legislature within 30 days of adoption of the standards. Such standards may be applicable to motor vehicle engines, rather than to motor vehicles. Cal. Health & Safety Code § 43101.

#### **4. California Administrative Procedure Act**

86. The Notice of Public Hearing and Cal. Health & Safety Code § 39601 state that CARB's public hearing and adoption of regulations shall be conducted in accordance with the California Administrative Procedure Act, Title 2, Division 3, Part 1, Chapter 3.5 (commencing with section 11340) of the Government Code ["California APA"]. Notice of Public Hearing, p. 8; Cal. Health & Safety Code § 39601.

87. Part 1 of Division 3 of Title 2 of the Government Code governs state departments and agencies within the executive department. Cal. Gov't. Code, Part 1, Division 3. Chapter 3.5 is entitled "Administrative Regulations and Rulemaking." Cal.

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Gov't. Code, Part 1, Division 3, Chapter 3.5. Chapter 3.5 encompasses Sections 11340 through 11351. Id.

88. Section 11340.1 of the California APA declares the intent to establish an Office of Administrative Law which is charged with reviewing adopted regulations for the purpose of reducing the number of regulations and to improve the quality of those regulations adopted. It is the intent of the Legislature that neither the Office of Administrative Law nor the court should substitute its judgment for that of the rulemaking agency. Cal. Gov't Code § 11340.1

89. Section 11342 of the California APA defines "regulation" as every rule, regulation, order, or standard of general application. Cal. Gov't Code § 11342.

90. Section 11346 of the California APA states:

(a) It is the purpose of this chapter to establish basic minimum procedural requirements for the adoption, amendment, or repeal of administrative regulations. Except as provided in Section 11346.1, the provisions of this chapter are applicable to the exercise of any quasi-legislative power conferred by any statute heretofore or hereafter enacted . . .

(b) An agency that is considering adopting, amending, or repealing a regulation may consult with interested persons before initiating regulatory action pursuant to this article. Cal. Gov't Code § 11346.

91. Section 11346.3 of the California APA states:

(a) State agencies proposing to adopt . . . any administrative regulation shall assess the potential for adverse economic impact on California business enterprises and individuals. Cal. Gov't Code § 11346.3

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92. Section 11346.4 of the California APA requires notice of the proposed action prior to hearing and close of the public comment period. Cal. Gov't Code § 11346.4.

93. Section 11346.45 of the California APA requires agencies proposing to adopt regulations to involve parties who would be subject to the proposed regulations in public discussions regarding those proposed regulations. This requirement is not imposed where the state agency is required to implement federal law and regulations for which there is little or no discretion on the part of the state to vary. Cal. Gov't Code § 11346.45.

94. Section 11346.8 of the California APA states that if a public hearing is held, both oral and written statements, arguments, or contentions, shall be permitted. If a public hearing is not scheduled, the state agency shall afford any interested person the opportunity to present statements, arguments or contentions in writing. The state agency shall consider all relevant matter presented to it before adopting, amending, or repealing any regulation. In any hearing under this section, the state agency shall have authority to administer oaths or affirmations. Cal. Gov't Code § 11346.45.

95. The Notice of Public Hearing indicates that CARB's adoption of regulations was required to be in accordance with Chapter 3.5 ("Administrative Regulations and Rulemaking"). Cal. Health & Safety Code § 39601. It was not required to be in accordance with Chapter 4 ("Administrative Hearings"), Chapter 4.5 ("Administrative Adjudication: General Provisions"), or Chapter 5 ("Administrative Adjudication: Formal Hearing"). See Cal. Gov't. Code, Part 1, Division 3.

## **V. ANALYSIS AND CONCLUSIONS OF LAW**

### **A. Overview of the Noerr-Pennington Doctrine**

The evolution of the judicially created immunity from antitrust liability under the Noerr-Pennington doctrine begins in *Eastern Railroad Presidents Conference v. Noerr Motor Freight*,

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Inc., 365 U.S. 127 (1961). In *Noerr*, truck operators and their trade association alleged that railroads and their trade association conspired to restrain trade in violation of Sections 1 and 2 of the Sherman Act by engaging in a publicity campaign against the truckers designed to foster the adoption and retention of laws and law enforcement practices destructive of the trucking business. *Id.* at 129. The defendants argued that their activities could not create liability under the Sherman Act when they were only trying to inform the public and the legislature of certain facts. The Supreme Court agreed, noting "that where a restraint upon trade or monopolization is the result of valid governmental action, as opposed to private action, no violation of the [Sherman] Act can be made out." *Id.* at 136 (citing *United States v. Rock Royal Co-op*, 307 U.S. 533 (1939); *Parker v. Brown*, 317 U.S. 341 (1943)).

The Supreme Court based its finding of immunity from antitrust liability on two premises. First, to hold an entity liable under antitrust laws for actions taken to influence the passage or enforcement of laws "would substantially impair the power of government to take actions through its legislature and executive that operate to restrain trade." *Noerr*, 365 U.S. at 137. The Supreme Court explained:

In a representative democracy such as this, these branches of government act on behalf of the people and, to a very large extent, the whole concept of representation depends upon the ability of the people to make their wishes known to their representatives. To hold that the government retains the power to act in this representative capacity and yet hold, at the same time, that the people cannot freely inform the government of their wishes would impute to the Sherman Act a purpose to regulate, not business activity, but political activity, a purpose which would have no basis whatever in the legislative history of that Act.

*Id.* at 137.



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The second premise for immunity from antitrust liability stems from the Constitutional right to "petition the Government for redress of grievances," U.S. Const. amend I, cl. 6. "The right of petition is one of the freedoms protected by the Bill of Rights, and we cannot, of course, lightly impute to Congress an intent to invade these freedoms." Noerr, 356 U.S. at 138. Thus, the Supreme Court held that the Sherman Act does not apply to the activities that "comprised mere solicitation of governmental action with respect to the passage and enforcement of laws." *Id.* at 138.

The antitrust immunity established in Noerr for attempts to influence governmental action was reaffirmed in *United Mine Workers v. Pennington*, 381 U.S. 657 (1965). In *Pennington*, the union and large coal companies agreed upon steps to exclude the marketing, production, and sale of non-union coal. Together they successfully approached the Secretary of Labor to obtain a minimum wage requirement for employees of contractors selling coal to the Tennessee Valley Authority ("TVA"), making it difficult for small companies to compete for TVA term contracts. Other executive action was also sought and obtained. The Supreme Court held that the actions seeking changes in policy or law by the government were immune from antitrust liability, "regardless of intent or purpose." *Id.* at 670. "[The] legality of the conduct 'was not at all affected by any anti-competitive purpose it may have had,' . . . even though the 'sole purpose in seeking to influence the passage and enforcement of laws was to destroy . . . competitors . . .'" *Id.* at 669 (citation omitted). Accord *Mark Aero*, 580 F.2d at 294 (Noerr shields from antitrust liability a concerted effort to influence public officials regardless of intent or purpose.); *Clipper Exxpress v. Rocky Mountain Motor Tariff Bureau, Inc.*, 690 F.2d 1240, 1254 (9th Cir. 1982) ("Genuine efforts to induce governmental action are shielded by Noerr even if their express and sole purpose is to stifle or eliminate competition.").

In *California Motor Transport Co. v. Trucking Unlimited*, 404 U.S. 508 (1972), the Supreme Court extended the Noerr-Pennington doctrine to attempts to influence administrative and

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adjudicatory bodies. *Id.* at 510. Lower courts have made clear that lobbying efforts designed to influence a state administrative agency's decision are within the ambit of the Noerr-Pennington doctrine. *Kottle*, 146 F.3d at 1059; *Tarabishi v. McAlester Regional Hosp.*, 951 F.2d 1558, 1570 n.17 (10th Cir. 1991); *St. Joseph's Hosp.*, 795 F.2d at 955. "Noerr-Pennington immunity extends to efforts to influence all branches of government, including state administrative agencies." *Livingston Downs Racing Assoc. v. Jefferson Downs Corp.*, 192 F. Supp. 2d 519, 532 (M.D. La. 2001).

### **B. Noerr-Pennington Provides Immunity to Conduct Alleged in the Complaint**

The Supreme Court has a broad view of Noerr-Pennington immunity. "Those who petition the government for redress are generally immune from antitrust liability." *Professional Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc.*, 508 U.S. 49, 56 (1993). Accord *Kottle*, 146 F.3d at 1059 (The Noerr-Pennington doctrine "sweeps broadly and is implicated by both state and federal antitrust claims that allege anticompetitive activity in the form of lobbying or advocacy before any branch of either federal or state government.").

Complaint Counsel argues that the conduct alleged in the Complaint is not immunized by Noerr-Pennington because: (1) CARB was acting in a quasi-adjudicatory setting; (2) CARB was dependent on Respondent for information; and (3) regardless of whether the agency's actions are determined to be adjudicatory or legislative, there is no immunity where an agency is unaware that it is being asked to adopt or participate in a restraint of trade. The Complaint specifically alleges:

Unocal is not shielded from antitrust liability pursuant to the Noerr-Pennington doctrine for numerous reasons . . . including, but not limited to, the following: (i) Unocal's misrepresentations were made in the course of quasi-adjudicative rulemaking

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proceedings; (ii) Unocal's conduct did not constitute petitioning behavior . . . . n1

Complaint at P96.

n1 Paragraph 96 of the Complaint alleges that Respondent is not shielded from antitrust liability for a third reason, that "Unocal's misrepresentations and materially false and misleading statements to Auto/Oil and WSPA, two non-governmental industry groups, were not covered by any petitioning privilege." Complaint at P96. This issue is discussed at Section V.E. *infra*.

Notwithstanding this legal conclusion contained within the factual allegations of the Complaint, the facts alleged in the Complaint, the legislative and agency materials relating to CARB's rulemaking, and applicable case law demonstrate that CARB's Phase 2 RFG rulemaking process was a quasi-legislative proceeding and that Respondent's conduct did constitute political petitioning behavior.

### **1. CARB's Phase 2 reformulated gasoline rulemaking process was quasi-legislative**

#### **a. Distinction made between legislative versus adjudicatory arena**

Noerr and its progeny hold that misrepresentations are condoned if made in the political process, but may result in antitrust liability if made in the adjudicative process. This distinction between the context (legislative versus adjudicatory) in which misrepresentations are made is set forth most clearly in *Professional Real Estate Investors*:

In surveying the "forms of illegal and reprehensible practice which may corrupt the administrative or judicial processes and which may result in antitrust violations," we have noted that "unethical conduct in

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the setting of the adjudicatory process often results in sanctions" and that "misrepresentations, condoned in the political arena, are not immunized when used in the adjudicatory process."

508 U.S. at 61 n.6 (quoting *California Motor Transport*, 404 U.S. at 512-13). Misrepresentations condoned in the legislative arena extend to deliberate deception. "A publicity campaign directed at the general public, seeking legislation or executive action, enjoys antitrust immunity even when the campaign employs unethical and deceptive methods." *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 499-500 (1988). In *Noerr* itself, where the private party engaged in conduct that could be "termed unethical" and "deliberately deceived the public and public officials" in its successful lobbying campaign, the Supreme Court said, "deception, reprehensible as it is, can be of no consequence so far as the Sherman Act is concerned." *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 383-84 (1991); *Noerr*, 365 U.S. at 141, 145.

Circuit courts applying the *Noerr-Pennington* doctrine hold that misrepresentations made in the context of legislative activities are immune from antitrust liability. E.g., *Armstrong Surgical Center*, 185 F.3d at 162 (liability for injuries caused by states acting as regulators is precluded even where it is alleged that a private party urging the action did so by bribery, deceit or other wrongful conduct that may have affected the decision making process); *Kottle*, 146 F.3d at 1060 ("the political arena has a higher tolerance for outright lies than the judicial arena does"); *Boone v. Redevelopment Agency of San Jose*, 841 F.2d 886, 894 (9th Cir. 1988) (misrepresentations of facts made by defendant real estate developer to the city council relating to the city council's decision to not construct a parking garage is conduct that "certainly falls within the ambit of the *Noerr-Pennington* doctrine"); *First Am. Title Co. v. South Dakota Land Title Assn.*, 714 F.2d 1439, 1447 (8th Cir. 1983) (lobbying campaign alleged to involve "a misuse of the lobbying process' through the use of false statements and inaccuracies made by defendants to the state legislature" protected by *Noerr-Pennington* doctrine); *Metro*

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Cable, 516 F.2d at 228 (when a legislative body granted an exclusive franchise to defendant, allegedly due to defendant's illicit conduct, the complaint was dismissed, because while the legislature could have had an adjudicatory body issue the license, it chose not to do so); Woods Exploration & Producing Co., v. Aluminum Company of America, Inc., 438 F.2d 1286, 1297 (5th Cir. 1971) ("The germination of the allowable formula was political in the Noerr sense, and thus participation in those rule-making proceedings would have been protected.").

By contrast, where the agency is using an adjudicatory process, misrepresentations are not immunized. California Motor Transport, 404 U.S. at 512-13; Allied Tube, 486 U.S. at 499-500 ("in less political arenas, unethical and deceptive practices can constitute abuses of administrative or judicial processes that may result in antitrust violations"). E.g., St. Joseph's Hosp., 795 F.2d at 955 (a governmental agency passing on specific certificate applications is acting judicially; misrepresentations under these circumstances do not enjoy Noerr immunity); Clipper Exxpress, 690 F.2d at 1261 ("fraudulent furnishing of false information to an agency in connection with an adjudicatory proceeding can be the basis for antitrust liability").

Thus, apparently seeking to circumvent Noerr-Pennington immunity, the Complaint alleges that "CARB's Phase 2 RFG proceedings were quasi-adjudicative in nature." Complaint at P26. Complaint Counsel argues that "where, as here, a party makes material misrepresentations in the course of 'adjudicatory' proceedings, such misconduct brings the case within the independent misrepresentation exception to Noerr." Opposition at 20. Despite this conclusory allegation, if the conduct complained about is genuine petitioning in the legislative context, the violations alleged in the complaint must be dismissed. See Mark Aero, 580 F.2d at 292-93, 97. As set forth in the following section, the facts, as alleged in the Complaint, guided by the statutory authority governing CARB, and demonstrated in the Notice of Public Hearing through which CARB initiated the rulemaking and in the Final Statement of Reasons for

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Rulemaking, establish that the Phase 2 RFG proceedings were legislative, and not adjudicative.

**b. Determination of whether action is legislative or adjudicatory**

"As a necessary prologue to any Noerr-Pennington immunity analysis, . . . the Court must determine whether . . . an executive agency is more akin to a political entity or to a judicial body." *Livingston Downs Racing Assoc. v. Jefferson Downs Corp., et al.*, 192 F. Supp. 2d 519, 533 (M.D. La. 2001). When the issue is whether a deliberate misrepresentation is protected, "the basis of the type of governmental body involved (legislative or administrative) and the function it exercises (rule-making or adjudicative) also "shed light on whether the (parties being charged) were engaged in "political activity . . . ." *United States v. AT&T Co.*, 524 F. Supp. 1336, 1362 n.108 (D.D.C. 1981) (quoting *Federal Prescription Service, Inc. v. Am. Pharmaceutical Ass'n*, 663 F.2d 253 (D.C. Cir. 1981)).

A determination of whether CARB was acting in a quasi-legislative manner, as argued by Respondent, or in a quasi-adjudicatory manner, as argued by Complaint Counsel, may be made by an examination of the following: (1) the level of political discretion granted to CARB; (2) whether CARB was setting policy; (3) the procedures used during the rulemaking; and (4) the authority invoked by CARB in adopting the Phase 2 RFG regulations. It is also useful to note that the California Supreme Court has characterized CARB's rulemakings as "quasi-legislative." *Western States Petroleum Ass'n v. Superior Court*, 9 Cal. 4th 559, 565 (1995).

**(i) Political discretion**

One factor in determining whether an executive agency is acting in a legislative or adjudicative manner depends upon the "degree of political discretion exercised by the government agency." *Kottle*, 146 F.3d at 1061. Complaint Counsel asserts that CARB, in using its technical expertise to design the applicable

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regulations, was merely carrying out the California legislature's mandate to implement certain policy judgments, rather than acting in an independent political manner. Opposition at 24. However, it is apparent, on the facts alleged in the Complaint, that CARB exercised political discretion. F. 9 (Complaint at P16) ("CARB's mission is to protect the health, welfare, and ecological resources of California through the effective and efficient reduction of air pollutants, while recognizing and considering the effects of its actions on the California economy."). The regulations enacted by CARB "set particular standards for the composition of low emissions RFG. These regulations specify limits for eight RFG properties: RVP, benzene, sulfur, aromatics, olefins, oxygen, T50, and T90." F. 29 (Complaint at P44).

The statutory guidelines that govern CARB's rulemaking give CARB broad discretion to do such acts as may be necessary, consistent with the goal of providing a suitable living environment for every Californian. F. 81, 82 (Cal. Health & Safety Code § § 39600, 39601). The statute lists only benchmarks that CARB's regulations must fulfill and interests that CARB must keep in mind when formulating its regulations. F. 83, 84 (Cal. Health & Safety Code § § 43013, 43018). CARB retains discretion in deciding what standards it will actually impose to achieve the maximum degree of emission reduction possible from vehicular or other mobile sources. See F. 83, 84 (Cal. Health & Safety Code § § 43013, 43018). Nowhere does the statute state what properties of RFG must be regulated. See F. 83-85 (Cal. Health & Safety Code § § 43013, 43018, 43101). Nor does the statute set limits to be placed upon such properties. *Id.* However, these two factors are critical components of the Phase 2 regulations and were the topics of Respondent's petitioning conduct as alleged in the Complaint. F. 21, 22 (Complaint at PP36, 37).

The California Air Resources Board described the breadth of its rulemaking discretion in the Final Statement of Reasons for Rulemaking for its Phase 2 rules as follows:

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The statutes do not mandate what specific fuel characteristics must be controlled, how stringent those controls should be, what the compliance dates should be, to whom the controls should apply, whether the limits should be statewide or limited to areas with substantial air pollution problems, whether the limits should apply year-round or only during seasons with bad air quality, whether all batches of fuel should be subject to the same limit or an "averaging" program of some sort should be instituted, how the controls should be enforced, and whether there should be provisions granting temporary "variances" based on unforeseen unique events.

F. 73. Thus, CARB exercised political discretion in promulgating the Phase 2 RFG regulations, indicating that CARB was acting in a quasi-legislative manner.

**(ii) Policy setting**

In deciding whether an agency is acting in a legislative or adjudicative manner, courts have focused on whether the agency has been granted the authority to create policy on its own, or is limited in its authority to apply policy that was previously established to a particular set of facts. See *Israel v. Baxter Labs., Inc.*, 466 F.2d 272, 276-77 (D.C. Cir. 1976) (Noerr-Pennington does not apply to private party efforts to influence an agency that is not in a position to make governmental policy, but rather carries out policy already made); *Woods*, 438 F.2d at 1298 (Noerr-Pennington is "inapplicable to the alleged filing of false nominations [since] this conduct was not action designed to influence policy, which is all the Noerr-Pennington rule seeks to protect."). The California Supreme Court has found that CARB is vested with broad discretion performing its quasi-legislative rulemaking function and its decisions are entitled to a "high degree of deference." *Western States Petroleum Ass'n*, 9 Cal. 4th at 572.



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Rulemaking concerns policy judgments to be applied generally in cases that may arise in the future. *Portland Audubon Soc'y v. Endangered Species*, 984 F.2d 1534, 1540 (9th Cir. 1993). Rulemaking normally refers to the prospective allocation of benefits and penalties according to a specific standard that reflects the policy choice of the rulemaker. *Association of Nat'l Advertisers, Inc. v. FTC*, 617 F.2d 611, 615 (D.C. Cir. 1979). By contrast, "where an agency's task 'is to adjudicate disputed facts in particular cases,' an administrative decision is quasi-judicial." *Portland Audubon*, 984 F.2d at 1540. "An adjudication refers to the application of a pre-existing legal standard to a well-defined set of controverted facts to determine whether a particular person or group of persons should receive a benefit or penalty." *Association of Nat'l Advertisers*, 617 F.2d at 615. In *Boone*, in determining *Noerr-Pennington* immunity, the court distinguished between actions involving the application of rules to specific parcels of property, which it deemed adjudicative in nature, and those affecting the future rights of many individuals, such as a redevelopment plan, which it deemed legislative in nature. 841 F.2d at 896.

The factual allegations of the Complaint leave no doubt that CARB's Phase 2 rulemaking was setting policy to be applied generally to the industry and affecting consumers in the future. CARB convened its rulemaking to enact regulations "governing the composition of low emissions, reformulated gasoline . . ." F. 10 (Complaint at P1). The Complaint further avers that CARB conducted the rulemaking pursuant to legislation that required the agency "to take actions to reduce harmful car emissions." F. 13 (Complaint at P21). Approximately 14.8 billion gallons of RFG are sold each year in California. F. 63 (Complaint at P10). To comply with Phase 2, industry participants had to modify their refineries, which, in the aggregate, cost "billions of dollars." F. 15, 62 (Complaint at PP24, 93). Phase 2 substantially affects a large number of consumers through higher prices for summer time compliant gasoline. F. 63 (Complaint at P10). No allegations in the Complaint indicate that CARB's Phase 2 rulemaking was in any way a judicial determination of the rights and obligations of specific parties before it.

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In addition, the Notice of Public Hearing through which CARB initiated the rulemaking states that CARB staff estimated future costs of between 14 cents per gallon to 20 cents per gallon, if the entire cost is passed on to the consumer, and capital investment costs to the refiners to be in the range of four to seven billion dollars. F. 67. The Notice of Public Hearing also states that CARB staff estimated that implementation of Phase 2 specifications will result in ozone precursor emission reductions of about 190 tons per day in 1996, that emissions of CO will be reduced by about 1300 tons per day and sulfur oxides by 40 tons per day, and that other Phase 2 specifications will also result in reduced toxic emissions. F. 68. These effects are not determined by individuals' specific factual circumstances, but rather are broad effects on all individuals who purchase RFG and who breathe the air in California. Thus, the application and effect of Phase 2 is more consistent with what has traditionally been understood to be legislation, not an adjudication.

**(iii) Procedures used**

In formal adjudications, certain procedures must be followed to comport with the Due Process Clause. *Goldberg v. Kelly*, 397 U.S. 254, 268 (1970) (welfare recipients could not be terminated from the program without an adjudicatory proceeding where they could present their case orally, confront adverse witnesses, appear with or through an attorney, and receive a decision based exclusively on the hearing record). See also *Association of Nat'l Advertisers, Inc. v. FTC*, 617 F.2d 611, 635 (D.C. Cir. 1979) ("Congress never intended that participants in informal rulemaking . . . would have the type of wide-ranging cross-examination rights afforded parties in formal adjudication . . .").

An examination of the procedures used by CARB, as alleged in the Complaint, reveals that the procedures used by CARB do not bear the indicia of a formal adjudicatory proceeding. The Complaint does not allege that CARB, in deciding on the Phase 2 regulations, conducted trial-like hearings, including cross-examination, rules of evidence, and burdens of proof. Instead, according to the Complaint, CARB conducted the Phase 2

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rulemaking pursuant to California's Administrative Procedure Act, which required CARB to issue a notice of proposed rulemaking, explain the basis and purpose of the regulations, provide an opportunity to comment, and conduct hearings. F. 17. See also Complaint at P17. The Complaint alleges that, in developing the RFG regulations, CARB provided notice of the proposed regulations, conferred in private meetings with various interested persons, held public workshops and hearings, solicited input from various industry groups and numerous companies, conducted lengthy hearings at which oral testimony was received, and collected written comments by interested parties. F. 17, 20, 21, 33 (Complaint at PP26, 35, 36, 47). See also F. 74, 75 (the Final Statement indicates the Board conducted a hearing and public workshop). In the Final Statement of Reasons for Rulemaking, CARB included all of the meaningful, relevant comments that it analyzed in formulating Phase 2 and its responses to these comments. F. 76, 77. As alleged in the Complaint, the processes used by CARB illustrate clearly that CARB's rulemaking was undertaken in a legislative, and not an adjudicative context.

**(iv) Authority invoked**

The Notice of Public Hearing states that CARB's regulatory action is proposed under that authority granted in sections 39600, 39601, 43013, 43018, and 43101 of the Health and Safety Code and *Western Oil and Gas Ass'n v. Orange County Air Pollution Control District*, 14 Cal. 3d 411, 121 Cal. Rprt. 249 (1975). F. 78 (Notice of Public Hearing, p. 8). These statutory provisions require CARB, inter alia, to consult with the public or private entities that would be impacted, prepare an economic analysis of impacts of the regulations, conduct workshops on the adoption of regulations, and submit a report of its findings to the legislature. F. 82-85 (Cal. Health & Safety Code § § 39601, 43013, 43018, 43101). These procedures are customary in rulemaking, but not in adjudication.

Further, the Notice of Public Hearing states and the statute requires that CARB's public hearing and adoption of regulations

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shall be conducted in accordance with the California Administrative Procedure Act (APA), Title 2, Division 3, Part 1, Chapter 3.5 of the Government Code. F. 86 (Notice of Public Hearing, p. 8; Cal. Health & Safety Code § 39601). Compliance with California APA procedures in the context of a rulemaking does not undercut the quasi-legislative character of the rulemaking. *Rivera v. Div. of Indus. Welfare*, 265 Cal. App. 2d 576, 586 (Cal. App. 1968); see also *Wilson v. Hidden Valley Muni. Water Dist.*, 256 Cal. App. 2d 271, 278 (Cal. App. 1967) ("the Legislature and administrators exercising quasi-legislative powers commonly resort to the hearing procedure to uncover, at least in part, the facts necessary to arrive at a sound and fair legislative decision"); *Joint Council of Interns and Residents v. Bd. of Supervisors of Los Angeles*, 210 Cal. App. 3d 1202, 1211 (Cal. App. 1989) (rejecting characterization of rulemaking as adjudicative based on the use of certain procedures because "the decisionmaking process under review here involved much more than the mechanical application of statutory criteria to existing fact"). Thus, even where an administrative decisionmaking process embodies "certain characteristics common to the judicial process," this does "not change the basically quasi-legislative nature of the subject proceedings." *Wilson*, 256 Cal. App. 2d at 279.

Furthermore, the chapter of the California APA that CARB was required to comply with was Chapter 3.5. F. 86. Chapter 3.5, entitled "Administrative Regulations and Rulemaking," states that "the provisions of this chapter are applicable to the exercise of any quasi-legislative power conferred by any statute . . ." F. 90 (Cal. Gov't Code § 11346(a)). CARB was not directed to comply with Chapter 4 ("Administrative Hearings"), Chapter 4.5 ("Administrative Adjudication: General Provisions"), or Chapter 5 ("Administrative Adjudication: Formal Hearing"). F. 95.

Although CARB is empowered to conduct adjudicative proceedings (see Cal. Code Regs. tit. 17, § § 60040-60053), the Notice of Public Hearing indicates that such procedures were not invoked in connection with the Phase 2 rulemaking. F. 78. Under sections 11370 et seq. of the California Government Code and

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Title 17 of the California Code of Regulations at sections 60040 to 60094, CARB's exercise of quasi-adjudicative powers is subject to the familiar strictures associated with adjudications. When it is conducting adjudications, CARB must provide notice, the hearing examiner controls what evidence may be admitted, oral testimony must be under oath, the parties may cross-examine adverse witnesses or offer rebuttal evidence if the hearing examiner deems it necessary to resolve disputed issues of material fact, California's rules of privilege apply, hearsay may not be used by itself to support a finding unless it falls under an exception to the hearsay rule, official notice may be taken, and affidavits are admissible. Cal. Code Regs. tit. 17, § § 60040-60053. CARB's "adjudication procedures" need not be considered since the Complaint does not allege that CARB followed these quasi-adjudicative procedures during its development of the Phase 2 RFG regulations and since the Notice of Public Hearing explicitly states that CARB's regulatory action was proposed, instead, under sections 39600, 39601, 43013, 43018, and 43101 of the Health and Safety Code. F. 78, 80.

It strains credulity to suggest that a "rulemaking," as it is referred to in the Complaint in at least 13 instances, was not a rulemaking in a legislative sense where the California statute governing CARB's rulemaking denominates it as administrative rulemaking and an exercise of quasi-legislative power. Nevertheless, as discussed above, an analysis of whether CARB was in a position to exercise policy discretion, whether the Phase 2 regulations affected people generally, in the future (as opposed to a determination of the specific rights of individuals), the procedures used by CARB, and the statutory authority under which CARB promulgated the regulations conclusively demonstrates that CARB was not acting in an adjudicatory manner, but in a legislative manner.

## **2. CARB was not wholly dependent on Respondent for information**

Complaint Counsel argues that, regardless of whether CARB's rulemaking was legislative or adjudicatory, Noerr-Pennington

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immunity does not apply where the decision making agency is dependent upon the petitioner for information. Opposition at 30. Complaint Counsel relies chiefly on Clipper Exxpress, which holds:

"adjudicatory procedures will not always ferret out misrepresentations. Administrative bodies and courts, however, rely on the information presented by the parties before them. They seldom, if ever, have the time or resources to conduct independent investigations."

Opposition at 30-31 (quoting Clipper Exxpress, 690 F.2d at 1262).

Clipper Exxpress involved a ratemaking proceeding before the Interstate Commerce Commission (ICC), wherein the plaintiff alleged that the defendants had attempted to influence ICC action by supplying fraudulent information to the ICC. The proceeding at issue was one in which the government agency adjudicated the entitlement of a particular party -- Clipper Exxpress -- to offer transport services at a particular rate. Clipper Exxpress, 690 F.2d at 1261. Thus, Clipper Exxpress does not compel a finding of no immunity under the facts alleged in the Complaint in the instant case.

In support of its argument that where the agency is dependent on facts known only to the petitioner, there is no immunity for fraud, Complaint Counsel also cites to *Whelan v. Abell*, 48 F.3d 1247, 1253-54 (D.C. Cir. 1995); *Woods*, 438 F.2d at 1295; and *De Loach v. Phillip Morris Cos.*, 2001 U.S. Dist. LEXIS 16909, \*44 (M.D.N.C. 2001). Opposition at 31-32. The facts alleged in the instant case are readily distinguishable from those cases relied upon by Complaint Counsel. In *Whelan*, the court held that *Noerr-Pennington* did not protect knowing misrepresentations made in an adjudicative context -- a letter of complaint to state securities administrators and to a federal court -- from claims of malicious prosecution, abuse of process, and tortious interference with prospective business advantage. 48 F.3d at 1249.

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In both *Woods* and *DeLoach*, the courts found that the deceptions at issue were not made during a policy making exercise, and thus were not immune. In *Woods*, plaintiffs alleged that entry of orders by the Texas Railroad Commission setting production allowables for plaintiffs' wells in specific fields had been based in part on false nomination forecasts and reports filed by defendants with the Texas Railroad Commission. 438 F.2d at 1292. The Court of Appeals discussed whether the Texas Railroad Commission was dependent on the defendants for the factual information in the context of determining whether defendants' conduct could be found to have become merged with the action of the state and thus exempt from antitrust liability under the state action doctrine. *Id.* at 1295. In its examination of whether defendants were exempt from antitrust liability under the Noerr-Pennington doctrine, the Court of Appeals focused on whether the "germination of the allowable formula was political" and thus protected, and found that where there was no attempt by defendants to influence the policies of the Texas Railroad Commission, there was no immunity.

In *De Loach*, the United States Department of Agriculture ("USDA") was tasked with determining the annual quota for certain tobacco by calculating using a statutory formula that factored in tobacco manufacturers' purchase intentions. 2001 U.S. Dist. LEXIS 16909, \*8-10. With the exception of the Secretary of Agriculture's ability to adjust the quota by plus or minus three percent from the statutory formula, the USDA had no discretion in determining the quota. *Id.* at \*10. Defendants' actions of intentionally submitting false purchase intentions to the USDA that resulted in lower quotas were not protected by Noerr-Pennington because the "submission of their purchase intentions in no way involved the policy-making process." *Id.* at \*44. "Rather, it was part of an administrative determination that relied upon [defendants'] truthfulness in calculating the annual quota." *Id.*

In *Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.*, 382 U.S. 172 (1965), the Supreme Court held that "the enforcement of a patent procured by fraud on the Patent

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Office may be violative of § 2 . . . provided the other elements necessary to a § 2 case are present." *Id.* at 174. As characterized by the Court of Appeals for the Third Circuit, the Patent Office was wholly dependent on the applicant for the facts. *Armstrong Surgical Center*, 185 F.3d at 164 n.8 (3d Cir. 1999). "While the Patent Office can determine the prior art from its own records, it effectively and necessarily delegates to the applicant the factual determinations underlying the issuance of a patent." *Id.* See also *Charles Pfizer & Co. v. Federal Trade Commission*, 401 F.2d 574, 579 (6th Cir. 1968) ("The Patent Office, not having testing facilities of its own, must rely upon information furnished by applicants and their attorneys. [Respondents], like all other applicants, stood before the Patent Office in a confidential relationship and owed the obligation of frank and truthful disclosure.").

The facts of this case are not at all like the facts at issue in the cases relied upon by Complaint Counsel holding that where an agency is dependent upon the petitioner for truthful information, Noerr-Pennington immunity does not apply. CARB's rulemaking was not a ratemaking procedure. CARB's rulemaking was not the mere application of a statutory formula to the facts presented. Respondent's alleged conduct was not the filing of a complaint before an adjudicatory body. Respondent's alleged conduct was not fraud on the Patent Office.

Instead, as set forth in the preceding section, CARB was vested with political discretion, set policy through its regulations, and was not acting in an adjudicatory manner. (Section V.B.1. *supra*). Section 43013 required CARB to consult with public or private entities that would be significantly impacted. F. 83. As alleged in the Complaint, CARB, in developing the RFG regulations, conferred in private meetings with various interested persons, held public workshops and hearings, solicited input from various industry groups and numerous companies, and collected written comments by interested parties. F. 17, 20, 21, 33 (Complaint at PP26, 35, 36, 47). The Notice of Public Hearing states that CARB staff was to conduct an independent cost analysis using the Process Industry Modeling System refinery



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model. F. 69. The Final Statement of Reasons for Rulemaking contains a summary of the comments the Board received on the Phase 2 RFG regulations during the formal rulemaking process and the Board's responses to the comments. F. 76 (Final Statement of Reasons for Rulemaking, p. 3). An attachment to the Final Statement of Reasons for Rulemaking shows that 51 entities, including automobile companies, assemblymen, business associations, chemical companies, environmental associations, forestry associations, labor unions, oil companies, petroleum associations, refiners' associations, and trucking associations, all provided comments to the Board during the formal rulemaking process. F. 77 (Final Statement of Reasons for Rulemaking, pp. A-1 - A-6). The text of these comments demonstrates that CARB was not solely dependent on Respondent for information. Moreover, the Complaint alleges that CARB "relied on industry to provide research and information." F. 16 (Complaint at P25).

Accordingly, because CARB was not wholly dependent on Respondent in its rulemaking proceeding, Noerr-Pennington applies.

**3. There is immunity even if CARB was unaware it was being asked to restrain trade**

Complaint Counsel asserts that there is no immunity where an agency is unaware that it is being asked to adopt or participate in a restraint of trade. Opposition at 14-15; Sur-reply at 7. Complaint Counsel further asserts that because CARB was unaware that it was being asked to adopt or participate in a restraint of trade and did not intend the consequences of its regulations, Respondent's actions do not constitute genuine petitioning activities and thus are not shielded by Noerr-Pennington. Opposition at 14-15; Sur-reply at 7.

Noerr protects "the right of the people to inform their representatives in government of their desires with respect to the passage or enforcement of laws," regardless of the petitioner's intent in doing so. Noerr, 365 U.S. at 139. "Petitioning" the

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government, as used in Noerr and its progeny, equates to advocating for or persuading the government to take some action. Noerr, 365 U.S. at 138 (petitioning is "solicitation of governmental action with respect to the passage and enforcement of laws"); Omni Outdoor Advertising, 499 U.S. at 379-80 (entities must be allowed to "seek anticompetitive action from the government").

Accepting the allegations of the Complaint as true, it is clear that Respondent engaged in petitioning conduct. E.g., F. 20 (Complaint at P35 (Respondent provided information to CARB for the purpose of obtaining competitive advantage)); F. 22 (Complaint at P37 (Respondent presented to CARB staff the results of its 5/14 project)); F. 32 (Complaint at P46 (Respondent submitted comments and presented testimony to CARB opposing CARB's proposal to grant small refiners a two-year exemption)); F. 34 (Complaint at P48 (Respondent submitted comments to CARB touting the predictive model as offering flexibility and furthering CARB's mandate of cost-effective regulations)). This communication of information to government regulators regarding Respondent's "desires with respect to the passage or enforcement of laws," is without question solicitation of governmental action.

Complaint Counsel asserts that Noerr and its progeny protect petitioning only if the government is "actually aware of the anticompetitive restraint it is imposing and takes state action nonetheless." Opposition at 14-15 (emphasis added). For support, Complaint Counsel cites to Areeda & Hovenkamp, at P209a and to *FTC v. Superior Ct. Trial Lawyers Ass'n* ("SCTLA"), 493 U.S. 411, 424-25 (1990). Neither of these cites support Complaint Counsel's proposition.

Section 209a of Areeda & Hovenkamp sets forth the general rule for the "commercial exception" to Noerr-Pennington. Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* P209a at 259 (2d ed. 2000). Within the context of the "general rule" that a private person dealing with the government as a buyer, seller, lessor, lessee, or franchisee has no greater antitrust privilege or immunity

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than in similar dealings with non-governmental parties, the Areeda treatise states, "a prerequisite for Noerr immunity is that the government actually know about the restraint being imposed. As a result, there is no immunity for secret price-fixing agreements directed at government purchasers . . ." *Id.* In this case, as alleged in the Complaint, CARB is not acting as a buyer, seller, lessor, lessee, or franchisee; nor are there allegations of secret price-fixing agreements directed at government purchasers. Thus, the commercial exception to Noerr-Pennington does not apply, and this quote, taken completely out of context, has no persuasive value.

The quote from SCTLTA upon which Complaint Counsel relies states: "but in the Noerr case the alleged restraint of trade was the intended consequence of public action; in this case the boycott was the means by which respondents sought to obtain favorable legislation." Reply at 15 n.7, quoting 493 U.S. 411, 424-25 (1990) (emphasis added). This quote has very little relation to the definition of "petitioning." SCTLTA does not hold that the legislature must have intended the consequences of its actions; rather, it compares the facts before it -- where the restraint of trade was the means by which respondents sought legislation (boycott) -- from the facts of Noerr -- where restraint of trade was the consequence of petitioners' action (legislation). SCTLTA, 493 U.S. at 424-25.

The quoted language in SCTLTA could not reasonably be construed to mean that Noerr requires the legislating agency to be aware of or intend the consequences of its regulations. In Noerr, the public and public officials were "deliberately deceived." Noerr, 365 U.S. at 145. "And that deception, reprehensible as it is, can be of no consequence so far as the Sherman Act is concerned." *Id.* The very concept of deception assumes that the deceived party does not know it is being deceived. See Black's Law Dictionary (defining "deception" as the act of deceit, and "deceit" as a deceptive misrepresentation used to deceive and trick another, who is ignorant of the true facts).

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Further, Omni Outdoor Advertising, makes clear that an analysis of the legislature's intent should not be undertaken. In discussing state action immunity, the Supreme Court wrote that an analysis into whether legislation was thought by the state actors to be in the public interest "would require the sort of deconstruction of the governmental process and probing of official 'intent' that we have consistently sought to avoid." 499 U.S. at 378. In further context of the state action immunity, the Omni Outdoor Advertising court held, "we reaffirm our rejection of any interpretation of the Sherman Act that would allow plaintiffs to look behind the actions of state sovereigns to base their claims on 'perceived conspiracies to restrain trade.'" *Id.* at 379. In discussing Noerr-Pennington immunity, the Supreme Court held:

The same factors which . . . make it impracticable or beyond the purpose of the antitrust laws to identify and invalidate lawmaking that has been infected by selfishly motivated agreement with private interests likewise make it impracticable or beyond that scope to identify and invalidate lobbying that has produced selfishly motivated agreement with public officials.

*Id.* at 383 (emphasis added). Thus, even where the antitrust violation alleged was that the petitioner conspired with city officials to harm a competitor, an analysis of the intent of the legislature was avoided. *Id.* at 368-69. See also *Areeda & Hovenkamp*, P202b at 158 ("To be sure, the legislature may be mistaken or unaware of the consequences of its actions . . . but the antitrust court may not reappraise the legislature's assessment of the public welfare . . . . If a statute excludes everyone but the monopolist from a market, the monopolist cannot itself be faulted.").

Complaint Counsel also relies on cases interpreting the state action immunity developed in *Parker v. Brown*, 317 U.S. 341 (1943) and its progeny for Complaint Counsel's argument that petitioning is protected only if the government agency is aware of the restraint of trade it is being asked to adopt. Sur-reply at 11.

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Parker and subsequent caselaw interpreting this doctrine explain that there must be conscious and deliberate efforts of the state to restrain competition in order for the state action immunity to apply. *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980) (Private anticompetitive activity is impliedly exempt from antitrust scrutiny under the state action doctrine only if: (1) the alleged anticompetitive conduct was taken pursuant to a clearly articulated and affirmatively expressed state policy to displace competition with state regulation; and (2) the state actively supervises the implementation of its policy.). This doctrine, with its necessary focus on "whether the anticompetitive scheme is the State's own," *FTC v. Ticor Title Ins. Co.*, 504 U.S. 621, 635 (1992), is in no way controlling in the instant case where the alleged anticompetitive scheme was undertaken, not by the state, but instead, by the petitioner.

Numerous cases have addressed both the Parker immunity and the Noerr-Pennington immunity. E.g., *Ticor Title Ins. Co. v. FTC*, 998 F.2d 1129 (3d Cir. 1993); *Boone*, 841 F.2d 886 (9th Cir. 1988); *Woods*, 438 F.2d at 1295; and *De Loach*, 2001 U.S. Dist. LEXIS 16909, \*44. In each of these cases, the courts, in analyzing the state action immunity, addressed whether the legislature or agency was aware of or intended the consequences of its actions. None of these cases addressed whether the legislature or agency was aware of or intended the consequences of its actions when analyzing the asserted Noerr-Pennington defense.

Respondent filed its motion to dismiss based on Noerr-Pennington immunity; its motion is not based on state action immunity. Thus, case law interpreting the state action doctrine has no bearing on this motion. Complaint Counsel has cited no cases holding that, for purposes of Noerr-Pennington immunity, the government agency must have known that it was being asked to enact a regulation that would restrain trade. Case law interpreting Noerr-Pennington allows deliberate deception in a legislative proceeding where the agency is not solely dependent on the petitioner for information. *Supra* V.B.2. Because Respondent's activities constitute petitioning genuinely undertaken to persuade

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CARB to enact regulations favorable to it and there is no requirement that the agency know what the effect of its legislation will be, Respondent's alleged conduct is protected by Noerr-Pennington.

### **C. Conduct Alleged in the Complaint Is Not Outside the Reach of Noerr-Pennington**

Noerr-Pennington applies only where the "restraint upon trade or monopolization is the result of valid governmental action, as opposed to private action . . ." 365 U.S. at 136. Complaint Counsel argues that the alleged monopolization, attempted monopolization, and restraint of trade in this case is not the result of governmental action, but is instead the result of private action. Specifically, Complaint Counsel argues that the alleged anticompetitive harm at issue flows not from CARB's Phase 2 regulations, but from Respondent's private business conduct in enforcing its patents. Opposition at 4, 18. On this basis, Complaint Counsel argues that Noerr-Pennington does not reach the conduct alleged in the Complaint.

In asserting that the conduct alleged in the Complaint is outside the Noerr-Pennington doctrine, Complaint Counsel argues, first, that this case resembles "sham" cases and *FTC v. Superior Court Trial Lawyers Ass'n* ("SCTLA"), 493 U.S. 411 (1990). Second, Complaint Counsel argues that because the alleged anticompetitive harm flows from the enforcement of patents, the harm in this case is analogous to the harm found to be anticompetitive in *Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.*, 382 U.S. 172 (1965).

#### **1. "Sham" exception and SCTLA**

The Supreme Court, in *Noerr*, recognized that antitrust petitioning immunity could be withheld in circumstances where petitioning activity "ostensibly directed toward influencing government action, is a mere sham to cover . . . an attempt to interfere directly with the business relationships of a competitor." 365 U.S. at 144. Subsequent decisions have clarified that the

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"sham" exception referred to in *Noerr* is applicable to situations in which persons use the governmental process, as opposed to its outcome, as an anticompetitive weapon. *California Motor Transport*, 404 U.S. at 510 (sham exception where complaint alleged one group of highway carriers sought to bar competitors from meaningful access to adjudicatory tribunals); *Omni Outdoor Advertising*, 499 U.S. at 381 (1991) (no sham exception where defendant set out to disrupt plaintiff's business relationships not through the process of lobbying, but through the ultimate product of that lobbying, the zoning ordinances).

The Complaint does not allege that Respondent attempted to gain monopoly through the use of CARB's process in adopting the Phase 2 RFG regulations. Instead, the Complaint alleges that Respondent sought to and did use the outcome of the government action -- the Phase 2 RFG regulations. F. 29 (Complaint at P44 (CARB Board adopted Phase 2 RFG regulations that set particular standards for the composition of low emissions, reformulated gasoline. Unocal's pending patent claims recited limits for five of the eight properties specified by the regulations.)); F. 30 (Complaint at P45 (CARB adopted Phase 2 RFG regulations that substantially overlapped with Respondent's patent claims.)). See also Complaint at P76 (Respondent "caused CARB to enact regulations that overlapped almost entirely with Unocal's pending patent rights.").

An effort that results in the adoption of the standards sought by petitioner into statutes and local ordinances "certainly cannot be characterized as a sham . . ." *Allied Tube*, 486 U.S. at 502; *Armstrong Surgical Center*, 185 F.3d at 158 (3rd Cir. 1999) ("The sham petitioning exception does not apply in a case like the one before us where the plaintiff has not alleged that the petitioning conduct was for any purpose other than obtaining favorable government action."). In the instant case, where the Complaint alleges Respondent used the outcome of the government action to its advantage, the sham exception does not apply.

In *SCTLA*, lawyers in private practice who served as court-appointed counsel in the District of Columbia organized a boycott

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in connection with their effort to force the city government to increase fees for court-appointed services. 493 U.S. at 414. Although this boycott otherwise constituted a classic restraint of trade, the lawyers argued that their conduct was protected under Noerr because the objective of the boycott was to obtain favorable legislation. *Id.* at 424. The Supreme Court rejected this argument finding that respondents' agreement to restrain trade was not outside the coverage of the Sherman Act simply because its objective was the enactment of favorable legislation. *Id.*

In SCTLTA, it did not matter that the result was favorable legislation; what mattered was that horizontal competitors engaged in a concerted refusal to deal and entered into an arrangement designed to obtain higher prices. In the instant case, for Noerr-Pennington purposes, it does matter that the result of Respondent's alleged misconduct is the adoption by CARB of Phase 2 regulations that substantially overlap Respondent's patents. See F. 29, 30. The Complaint alleges that Respondent "obtained unlawful market power through affirmative misrepresentations, materially false and misleading statements, and other bad-faith, deceptive conduct that caused CARB to enact regulations that overlapped almost entirely with Unocal's pending patent rights." Complaint at P76. Because the anticompetitive harm alleged in the Complaint arises from the adoption of regulations that substantially overlap Respondent's patents, the harm arises from governmental action and thus Noerr-Pennington applies.

## **2. Walker Process**

In Walker Process, the question presented was "whether the maintenance and enforcement of a patent obtained by fraud on the Patent Office may be the basis of an action under § 2 of the Sherman Act . . . ." Walker Process, 382 U.S. at 173. To the extent that some courts have held that Walker Process is not limited to fraud on the Patent Office, see *Clipper Express*, 690 F.2d at 1260-63 (relying on Walker Process in the context of a ratemaking proceeding); *Whelan*, 48 F.3d at 1255-58 (relying on Walker Process in the context of a complaint filed with state



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securities commissioner and a lawsuit filed in federal district court), those cases arose in a context in which the state action at issue was quasi-adjudicatory and dependent on the petitioner for factual information and thus, as set forth above in Section V.B.2. *supra*, are distinguishable from the instant case.

Complaint Counsel argues that this case is like *Walker Process* because the alleged competitive harm flows from private conduct - the defendant's efforts to enforce the patent - rather than from the governmental action itself. Opposition at 17. However, in *Walker Process*, the Supreme Court held that "proof that Food Machinery obtained the patent by knowingly and willfully misrepresenting facts to the Patent Office" would be sufficient to strip Food Machinery of its exemption from the antitrust laws. 382 U.S. at 177 (emphasis added). Thus, the focus was on the fraud on the Patent Office in the procurement of patents.

In *Walker Process*, there could be no harm from the enforcement of a patent if the Patent Office had never issued the patent. Here, there could be no harm from the enforcement of Respondent's patents if CARB had not enacted the Phase 2 regulations that substantially overlapped with CARB's patents. Complaint at P92 ("The extensive overlap between the CARB RFG regulations and the Unocal patent claims makes avoidance of Unocal patent claims technically and/or economically infeasible."); F. 62 (Complaint at P93) (Refiners in California invested billions of dollars in sunk capital investments in order to comply with the CARB Phase 2 RFG regulations.). Thus, it is not solely private conduct - Respondent's enforcement of its valid patents - that caused the anticompetitive harm alleged. Because the alleged harm stems from the cost of compliance with CARB's regulations that substantially overlap Respondent's patents, the restraint of trade is the result of valid governmental action and *Noerr-Pennington* applies.

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**D. Noerr-Pennington Immunity is Available in Actions Brought Under Section 5 of the FTC Act**

Complaint Counsel argues that "Noerr does not apply to actions brought under Section 5 of the FTC Act." Opposition at 33. As set forth below, while Noerr-Pennington was developed as an immunity to the Sherman Act, the underlying rationale for immunity is equally applicable in unfair competition cases brought under the FTC Act. Further, in later Supreme Court cases, discussed *infra*, Noerr-Pennington immunity has been extended more generally to antitrust cases and in other contexts. Moreover, Commission opinions and courts have applied the Noerr-Pennington doctrine to cases alleging violations of Section 5 of the FTC Act on numerous occasions.

In Noerr, the Supreme Court's "starting point" for consideration of the case was "that no violation of the [Sherman] Act can be predicated upon mere attempts to influence the passage or enforcement of laws." 365 U.S. at 136. Immunity from antitrust liability was based, in part, on the Constitutional right to "petition the Government for redress of grievances," U.S. Const. amend I, cl. 6. "The right of petition is one of the freedoms protected by the Bill of Rights, and we cannot, of course, lightly impute to Congress an intent to invade these freedoms." Noerr, 356 U.S. at 138.

The Supreme Court further held:

Insofar as the [Sherman] Act sets up a code of ethics at all, it is a code that condemns trade restraints, not political activity . . . . The proscriptions of the [Sherman] Act, tailored as they are for the business world, are not at all appropriate for application in the political arena. Congress has traditionally exercised extreme caution in legislating with respect to problems relating to the conduct of political activities, a caution which has been reflected in the decisions of this Court interpreting such legislation. All of this caution would go for naught if we

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permitted an extension of the Sherman Act to regulate activities of that nature simply because those activities have a commercial impact and involve conduct that can be termed unethical.

Id. at 140-41. The concerns that the Supreme Court had with Congress limiting the right to petition through the enactment of the Sherman Act must be of equal concern with respect to Congress limiting the right to petition through the enactment of the FTC Act.

Indeed, the Commission has argued as much in a brief filed with the Court of Appeals for the Ninth Circuit in *Rodgers v. Federal Trade Commission*, 492 F.2d 228 (9th Cir. 1974):

"The proscriptions of Section 5 of the FTC Act, as we view them, like the proscriptions of the Sherman Act, are tailored for the business world, not for the political arena . . . .

Even assuming a wrongful motive . . . and the willful use of distortion or deception, it is our view that actionable violation of Section 5 of the FTC Act is not indicated due to the overriding public interest in preservation of uninhibited communication in connection with political activity with legislative processes."

Id. at 230 (quoting Letter of Charles A. Tobin, Secretary, Federal Trade Commission, to William H. Rodgers, Jr., Jan. 26, 1971, in Brief of Appellant, Appendix at 10, 11-12). The Court of Appeals accepted the Commission's argument and upheld the Commission's reliance on Noerr to determine that action on the complaint was not warranted. *Rodgers*, 492 F.2d at 230.

The Noerr-Pennington doctrine has not been strictly limited to Sherman Act cases, but has been characterized by the Supreme Court as applying more broadly to "antitrust laws." See *Omni Outdoor Advertising*, 499 U.S. at 380 (citing *Noerr*, 365 U.S. at

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141). "Those who petition government are generally immune from antitrust liability." *Professional Real Estate Investors*, 508 U.S. at 56 (emphasis added). In *Professional Real Estate Investors*, the Supreme Court, including in its authority a case brought under Section 5 of the FTC Act, implied that Noerr is not strictly limited to Sherman Act cases. "Whether applying Noerr as [\*111] an antitrust doctrine or invoking it in other contexts, we have repeatedly reaffirmed that evidence of anticompetitive intent or purpose alone cannot transform otherwise legitimate activity into a sham." 504 U.S. at 59 (citing *SCTLA*, 493 U.S. at 424; *NAACP v. Claiborne Hardware Co.*, 458 U.S. 886, 913-14 (1982)).

It is appropriate to apply Noerr-Pennington, whether as an antitrust doctrine or "in another context," to the allegations of this Complaint. The very first allegation of the Complaint, describing the "Nature of the Case," illustrates that Respondent is charged with engaging in acts and practices that, if not shielded by Noerr-Pennington, could provide the basis for antitrust liability under Section 2 of the Sherman Act. 15 U.S.C. § 2 (monopolization; attempted monopolization).

Through a pattern of anticompetitive acts and practices that continues even today, Unocal has illegally monopolized, attempted to monopolize, and otherwise engaged in unfair methods of competition in both the technology market for the production and supply of CARB-compliant 'summer-time' RFG and the downstream CARB 'summer-time' RFG product market.

Complaint at P1. All five violations in the Complaint charge Respondent with "acts and practices [that] constitute unfair methods of competition in violation of Section 5 of the FTC Act." The Commission and courts routinely analyze causes of actions challenging unfair methods of competition through antitrust principles. *Atlantic Refining Co. v. FTC*, 381 U.S. 357, 369 (1965) ("When conduct does bear the characteristics of recognized antitrust violations it becomes suspect, and the

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Commission may properly look to cases applying those laws for guidance."); *In re American Med. Assoc.*, 94 F.T.C. 701, 994 (1979) ("It is instructive to look at cases construing the Sherman Act for initial guidance as to the reach of Section 5."). Thus, even though the doctrine was developed in cases alleging violations of the Sherman Act, it is appropriate and logical to apply the Noerr-Pennington doctrine of immunity from antitrust liability to a case alleging unfair methods of competition in violation of the FTC Act.

Complaint Counsel argues that the Supreme Court's decision in *BE & K Constr. Co. v. NLRB*, 536 U.S. 516 (2002) compels the conclusion that Noerr-Pennington does not apply to cases brought under the FTC Act. In *BE & K Constr.*, the Supreme Court declined to extend "antitrust immunity principles" to unsuccessful retaliatory lawsuits filed under the National Labor Relations Act. 536 U.S. at 525-33. Contrary to the situation in *BE & K*, in the instant case, "antitrust immunity principles" are appropriately applied in a case alleging causes of action that could also state a claim under Sections 1 and 2 of the Sherman Act.

Despite Complaint Counsel's assertion that "no court has held that Noerr's narrow exception to Sherman Act liability applies to Section 5 of the FTC Act," Sur-reply at 30, courts have analyzed the Noerr-Pennington defense in Section 5 cases. E.g., *Ticor Title Ins.*, 998 F.2d at 1138; *Rodgers*, 492 F.2d at 228-29 (accepting Commission argument that Noerr doctrine is applicable to FTC Act). Both the Commission and the Supreme Court applied the Noerr-Pennington doctrine to the alleged violations of Section 5 of the FTC Act in *In re Superior Court Trial Lawyers Ass'n*, 107 F.T.C. 510, 590 (1984), vacated by 856 F.2d 226, rev'd in part, and remanded by, 493 U.S. 411 (1990). The Commission stated, "if the respondents' activity had been limited to 'mere attempts to influence the passage of enforcement of laws,' *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. at 135, then the respondents would merit the protection of the First Amendment under Noerr and succeeding cases." 107 F.T.C. at 590. The Commission then held, "we think that Noerr and Pennington alone provide sufficient guidance for our conclusion

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that First Amendment immunity should not extend to the kind of conduct in which the respondents have engaged." *Id.* at 594.

The Supreme Court also utilized Noerr principles to determine whether there was immunity from antitrust liability in *FTC v. Superior Court Trial Lawyers*, 493 U.S. 411 (1990). Thus, though not explicit in holding that Noerr-Pennington applies to actions brought under the FTC Act, by application of the doctrine to the allegations of violations of the FTC Act, SCTLA makes clear that Noerr-Pennington immunity is fully available in FTC Act cases.

In numerous other opinions, the Commission has analyzed whether respondents have asserted valid Noerr-Pennington defenses to Section 5 causes of action. E.g., *In re Ticor Title Ins. Co.*, 112 F.T.C. 344, 460-64 (1989) (holding the Noerr defense inapplicable to the facts, but stating that if respondents had instead agreed on a political advocacy campaign to convince the state to adopt or change a ratemaking policy, such activity would be protected under Noerr-Pennington); *In re New England Motor Rate Bureau, Inc.*, 112 F.T.C. 200, 283-85 (1989) (the Noerr-Pennington doctrine "shields from antitrust scrutiny concerted efforts by competitors to petition government officials"); *In re Michigan State Med. Soc'y*, 101 F.T.C. 191, 296-301 (1983) (applying Noerr-Pennington to facts and holding that respondents' activities constituted illegal conduct that fell outside the protective shield of Noerr-Pennington). In none of these cases did the Commission hold that Noerr-Pennington defenses were not available to respondents in FTC Act cases. Indeed, Complaint Counsel has cited no cases so holding.

Because Supreme Court and Commission precedent establish that the Noerr-Pennington doctrine is a defense to antitrust liability and have applied the doctrine in Section 5 cases, Complaint Counsel's unsupported argument that Noerr-Pennington should not be available where the remedy sought is an order requiring Respondent to cease and desist from enforcing its patents, in other words, de facto invalidation of Respondent's patents, rather than the "chilling" treble damages allowed under the Sherman Act, does not withstand scrutiny. For the same

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reason, Complaint Counsel's argument that the "unitary nature" of the FTC Act precludes application of the Noerr-Pennington doctrine to cases brought under the FTC Act, also does not withstand scrutiny. Again, without citation, Complaint Counsel argues that because the FTC Act applies to the closely associated areas of "unfair methods of competition" and "unfair or deceptive practices," it would be incongruous to allow the Commission to prevent unfair or deceptive acts or practices to the full extent constitutionally permitted by the First Amendment, but prevent unfair methods of competition only to the extent permitted by antitrust principles. Opposition at 33-34. Complaint Counsel has cited no cases indicating that causes of action challenging unfair methods of competition are required to be analyzed by case law relating to causes of action challenging unfair and deceptive practices rather than antitrust law.

To hold that the Noerr-Pennington doctrine does not apply to Section 5 of the FTC Act, where the Commission has asserted to the contrary in another case, and where no other court or Commission opinion has so held, would be inappropriate and unfair. Accordingly, Noerr-Pennington immunity is fully available in this case alleging unfair methods of competition in violation of Section 5 of the FTC Act.

**E. Respondent's Conduct Before Private Industry Groups**

The Complaint alleges that Respondent participated in two private industry groups, the Auto/Oil Air Quality Improvement Research Program ("Auto/Oil Group") and the Western States Petroleum Association ("WSPA"), which conducted research on automobile emissions and reported their findings to the government. F. 38-40, 44 (Complaint at PP50-52, 56). The Complaint alleges that Respondent made statements to the Auto/Oil Group and to WSPA that were materially false and misleading in that they failed to disclose Unocal's proprietary interests in its emissions research results and Unocal's intention to enforce its intellectual property rights. F. 42, 46, 48 (Complaint at PP58, 59, 82); see also Complaint at P85. In its opposition to the motion to dismiss on Noerr-Pennington grounds, Complaint

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Counsel asserts that: (1) Respondent's misrepresentations to Auto/Oil Group and WSPA are not covered by any petitioning privilege; and (2) Respondent's misrepresentations to Auto/Oil Group and WSPA form an independent basis for liability. Opposition at 35-37.

To the extent that Respondent's statements to Auto/Oil Group and WSPA were part of Respondent's alleged scheme to induce CARB to act, as alleged in the Complaint, this conduct is political petitioning protected by Noerr-Pennington. To the extent that Respondent made statements to Auto/Oil Group and WSPA independent of its alleged scheme to induce CARB to act, these allegations involve substantial issues of patent law and, thus, do not state an independent cause of action over which the Commission has jurisdiction as alleged in the Complaint.

### **1. Indirect petitioning**

According to the allegations of the Complaint, Respondent made knowing and willful misrepresentations to the Auto/Oil Group and to WSPA and subverted the Auto/Oil Group's and WSPA's process of providing accurate and nonproprietary research data and information to CARB. F. 20 (Complaint at P35 (Unocal participated in industry groups that provided input into the CARB regulations)); Complaint at PP84, 89 (Unocal subverted the Auto/Oil Group's and WSPA's process of providing accurate and nonproprietary research data and information to CARB)). The Complaint does not allege that the Respondent prevented the Auto/Oil Group or WSPA from communicating with CARB.

Misrepresentations to third parties as a means of influencing the government's passage of laws fall within the bounds of Noerr-Pennington. In Noerr, the railroads' use of "the so-called third party technique," involved deception of the public, manufacture of bogus sources of reference, and distortion of public sources of information. Noerr, 365 U.S. at 140-42 (holding such conduct, "so far as the Sherman Act is concerned, legally irrelevant"). In Allied Tube, the Supreme Court held that a "claim of Noerr immunity



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cannot be dismissed on the ground that the conduct at issue involved no 'direct' petitioning of government officials, for Noerr itself immunized a form of 'indirect' petitioning." *Allied Tube*, 486 U.S. at 503.

To determine whether Noerr immunizes anticompetitive activity intended to influence the government requires an evaluation not only of its impact, but also of the context and nature of the activity. *Allied Tube*, 486 U.S. at 504. Here, it is clear from the allegations of the Complaint that Respondent's actions with respect to the Auto/Oil Group and WSPA were part of an alleged scheme to induce these third parties to influence CARB. F. 44 (Complaint at P56 (During the CARB Phase 2 RFG rulemaking proceedings, Unocal actively participated in WSPA, which actively participated in the CARB RFG rulemaking process; WSPA commissioned, and submitted to CARB, three cost studies in connection with the CARB Phase 2 RFG rulemaking.)); Complaint at P87 (Unocal participated in WSPA committees that discussed the potential cost implications of the CARB Phase 2 RFG regulations; Unocal knew that royalties were considered in a cost study commissioned by WSPA for submission to CARB)); Complaint at PP84, 89 (Respondent's deceptive conduct subverted Auto/Oil's and WSPA's process of providing accurate and nonproprietary research data and information to CARB.)); Complaint at P90 (But for Unocal's fraud, these participants in the rulemaking process would have taken actions including, but not limited to, advocating that CARB adopt regulations that minimized or avoided infringement on Unocal's patent claims, or advocating that CARB negotiate license terms substantially different from those that Unocal was later able to obtain.)).

This case is different from the context and nature of the private standard setting process evaluated in *Allied Tube*. There, where the anticompetitive harm was found to be a result of an implicit agreement by the private standard setting association's members not to trade in a certain type of electrical conduit, the Supreme Court held that the context and nature of the conduct was "more aptly characterized as commercial activity with a

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political impact." 486 U.S. at 507. While Allied Tube does state, as quoted by Complaint Counsel (Sur-reply at 25), "the mere fact that an anticompetitive activity is also intended to influence governmental action is not alone sufficient to render that activity immune from antitrust liability[,]" this quote must be put in context. It was only after finding that the anticompetitive conduct was commercial activity, the Supreme Court held, "at least outside the political context, the mere fact that an anticompetitive activity is also intended to influence governmental action is not alone sufficient to render that activity immune from antitrust liability." 486 U.S. at 507 (emphasis added). But in the instant case, where according to the Complaint, Respondent's conduct was part of its attempt to influence governmental action and where the anticompetitive harm results from CARB's adoption of Phase 2 RFG regulations that "substantially overlap[] with Unocal's concealed patent claims" (Complaint at P45), the "antitrust laws should not regulate political activities 'simply because those activities have a commercial impact.'" 486 U.S. at 507 (quoting Noerr, 356 U.S. at 141). Thus, because Respondent's alleged misconduct occurred within the political context, Noerr immunity extends to protect this conduct.

Nor is this case like California Motor Transport, where petitioners were alleged to have "instituted the proceedings and actions . . . with or without probable cause, and regardless of the merits of the cases." 404 U.S. at 512. The Supreme Court held that those actions served to deny plaintiffs free and unlimited access to administrative and judicial tribunals. California Motor Transport, 404 U.S. at 509, 511. In Omni Outdoor Advertising, the Supreme Court described California Motor Transport as limited to the "context in which the conspirators' participation in the governmental process was itself claimed to be a 'sham,' employed as a means of imposing cost and delay." Omni Outdoor Advertising, 499 U.S. at 381-82 (quoting California Motor Transport, 404 U.S. at 512). The Supreme Court, in Omni Outdoor Advertising, explained as follows:

Any lobbyist or applicant, in addition to getting himself heard, seeks by procedural and other means

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to get his opponent ignored. Policing the legitimate boundaries of such defensive strategies, when they are conducted in the context of a genuine attempt to influence governmental action, is not the role of the Sherman Act. In the present case, of course, any denial to Omni of "meaningful access to the appropriate city administrative and legislative fora" was achieved by COA in the course of an attempt to influence governmental action that, far from being a "sham," was if anything more in earnest than it should have been. If the denial was wrongful there may be other remedies, but as for the Sherman Act, the Noerr exemption applies.

Omni Outdoor Advertising, 499 U.S. at 382. In the instant case, where it is clear from the allegations of the Complaint that Respondent's alleged conduct with respect to the Auto/Oil Group and WSPA was part of a scheme to influence CARB, Respondent's conduct with respect to these third parties falls within Noerr's protection.

**2. Conduct directed at Auto/Oil Group and WSPA separate from conduct directed at CARB**

To the extent that the alleged misrepresentations made to the Auto/Oil Group and to WSPA were not part of Respondent's scheme to solicit favorable governmental action, the allegations of misconduct directed toward the Auto/Oil Group and WSPA, independent of the conduct directed toward CARB alleged in the Complaint, do not state an independent cause of action as a violation of Section 5 of the FTC Act over which the Commission has jurisdiction. Respondent, in its motion for dismissal of the Complaint for failure to make sufficient allegations that Respondent possesses or dangerously threatens to possess monopoly power ("Market Power Motion"), asserts that the Commission does not have jurisdiction to decide patent issues. The scope of Respondent's patents and whether or not third parties could have invented around these patents and whether any such newly created products or methods could have avoided

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infringement is called directly into question by the allegations of the Complaint regarding Respondent's conduct towards Auto/Oil Group and WSPA. Thus, in order to fairly and completely resolve the factual and legal allegations of the Complaint, an in depth analysis of substantial issues of patent law would be required.

**(i) Allegations relating to conduct separate from conduct directed at CARB**

After the conclusion that the steps that Respondent took, whether direct or indirect, to solicit CARB's adoption of the Phase 2 regulations were political petitioning conduct, immunized by Noerr-Pennington, the remaining allegations of the Complaint are as follows:

Throughout all of its communications and interactions with Auto/Oil prior to January 31, 1995, Unocal failed to disclose that it had pending patent rights, that its patent claims overlapped with the proposed RFG regulations, and that Unocal intended to charge royalties. Complaint at P83.

By deceptive conduct that included, but was not limited to, false and misleading statements concerning its proprietary interests in the results of its emissions research results, Unocal violated the letter and spirit of the Auto/Oil Agreement and breached its fiduciary duties to the other members of the Auto/Oil joint venture. Complaint at P84.

Throughout all of its communications and interactions with WSPA prior to January 31, 1995, Unocal failed to disclose that it had pending patent rights, that its patent claims overlapped with the proposed RFG regulations, and that Unocal intended to charge royalties. Complaint at P88.

By deceptive conduct that included, but was not limited to, false and misleading statements

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concerning its proprietary interests in the results of its emissions research results, Unocal breached its fiduciary duties to the other members of WSPA. Complaint at P89.

But for Unocal's fraud, these participants in the rulemaking process [Auto/Oil Group and WSPA] would have taken actions including, but not limited to . . . incorporating knowledge of Unocal's pending patent rights in their capital investment and refinery reconfiguration decisions to avoid and/or minimize potential infringement. Complaint at P90(c).

In its opposition to the Noerr-Pennington motion to dismiss, Complaint Counsel argues that even if CARB had enacted Phase 2 knowing that the regulations substantially overlapped with Respondent's patents, the oil companies could have avoided significant harm, had Respondent not duped them independently through its fraudulent, inequitable, and bad-faith business conduct. Opposition at 36.

**(ii) No independent basis for liability**

The allegations in the Complaint pertaining to Respondent's conduct towards Auto/Oil Group and WSPA, separate from its alleged scheme to influence CARB, (PP83, 84, 88, 89) do not establish a legally cognizable independent cause of action under Section 5 of the FTC Act over which the Commission has jurisdiction. The issue of whether or not Respondent had a fiduciary duty arising under Section 5 of the FTC Act towards WSPA or Auto/Oil Group or breached any such duty is not reached. As discussed in detail *infra*, there is no set of facts alleged in the Complaint that could establish that any antitrust injury or harm was caused from any breach of such duty without a thorough analysis of numerous substantial patent law issues.

CARB passed regulations substantially overlapping with Unocal's patents. F. 30, 53 (Complaint at PP45, 64). See also F. 29 (Complaint at P44) (Respondent's patent claims recite limits

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for five of the eight properties specified by the Phase 2 RFG regulations: T50, T90, olefins, aromatics, and RVP.). There is no set of facts alleged in the Complaint that, if established, would prove that anticompetitive injury and resulting harm to the Auto/Oil Group and WSPA resulted from the alleged misconduct directed at the Auto/Oil Group and WSPA, instead of from CARB's enactment of Phase 2 regulations and Respondent's subsequent enforcement of its patent rights. To the contrary, the Complaint alleges harm that resulted from compliance with the Phase 2 RFG regulations. F. 62 (Complaint at P93 (refiners invested billions of dollars in order to comply with the CARB Phase 2 RFG regulations. These refiners cannot produce significant volumes of non-infringing CARB-compliant gasoline without incurring substantial costs.)). See also Complaint at P92 ("extensive overlap between the CARB RFG regulations and the Unocal patent claims makes avoidance of the Unocal patent claims technically and/or economically infeasible"). Any alleged harm beyond that caused by CARB's regulations cannot be determined without knowing the scope of Respondent's patents, whether or not Auto/Oil Group and WSPA could have invented around these patents, and whether any such newly created products or methods could have avoided infringement. Accordingly, to find any other harm, as alleged, would require the substantial patent law analysis discussed herein and thus, logically, the issue of other harm can not be reached.

**(iii) Allegations raise substantial patent issues**

To analyze whether the allegations of the Complaint state an independent cause of action separate from the alleged violations stemming from Respondent's efforts to get CARB to adopt regulations favorable to Respondent would require a resolution of substantial patent issues. Complaint at PP83, 88 (Respondent failed to disclose that it had pending patent rights and that its patent claims overlapped with the proposed RFG regulations.); Complaint at PP84, 89 (Respondent made false and misleading statements concerning its proprietary interests.); Complaint at P90(c) (Auto/Oil Group and WSPA would have incorporated knowledge of Unocal's pending patent rights in their capital

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investment and refinery reconfiguration decisions to avoid and/or minimize potential infringement.) (Emphases added). To properly determine whether there is any set of facts that, if proven, could support these allegations would require an in depth and thorough analysis of what Respondent's "proprietary interests" were, which "proprietary interests" were and were not included in any patent, what was patented, what was not patented, the scope of Respondent's patents, the scope of any competitor's patents, whether any competitor products or methods exist or could be invented, whether any of the competitor products or methods that could be created or invented infringed, and whether refineries could be reconfigured so as to avoid or minimize infringement of Respondent's patents.

These are fundamental and substantial patent issues, as defined by the Supreme Court in *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800 (1988). There, the Supreme Court held that a case arises under federal patent law when the "plaintiff's right to relief necessarily depends on resolution of a substantial question of federal patent law, in that patent law is a necessary element of one of the well-pleaded claims." *Id.* at 808. Whether a claim "arises under" patent law "must be determined from what necessarily appears in the plaintiff's statement of his own claim in the bill or declaration, unaided by anything alleged in anticipation or avoidance of defenses which it is thought the defendant may interpose." *Christianson*, 486 U.S. at 809 (citations omitted) (claim did not arise under patent law where complaint only obliquely hinted at patent law issues). In the instant case, as discussed herein, allegations of the Complaint do more than obliquely hint at patent law issues. After a determination that Noerr-Pennington immunizes Respondent's conduct before CARB, what appears in the Complaint, particularly paragraph 90(c), -- third parties would have incorporated knowledge of Unocal's pending patent rights in their capital investment and refinery reconfiguration decisions to avoid and/or minimize potential infringement -- plainly alleges a claim under patent law in that patent law is a necessary element of the claims. There is no fair way to determine whether any "reconfiguration decisions" would "avoid and/or minimize

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potential infringement" without a determination of non-infringement. As discussed below, infringement and non-infringement are clearly fundamental and substantial patent issues.

**(iv) Federal courts decide substantial patent issues**

The determination of the scope of the federally created property right is a substantial question of federal patent law. *Hunter Douglas, Inc. v. Harmonic Design, Inc.*, 153 F.3d 1318, 1330 (Fed. Cir. 1998) (infringement is a substantial issue in the federal scheme for it determines what is the scope of the federally created property right), rev'd in part on other grounds, *Midwest Ind., Inc. v. Karavan Trailers, Inc.*, 175 F.3d 1356 (Fed. Cir. 1999). See also *U.S. Valves, Inc. v. Dray*, 190 F.3d 811, 814 (7th Cir. 1999) (the only way to determine whether a product is covered by the licensed patents is to apply substantive patent law). Where a court must "interpret the validity and scope of a particular patent," a claim arises under patent law. *Boggild & Dale v. Kenner Products*, 853 F.2d 465, 468 (6th Cir. 1988).

The authority to decide questions of patent law arises solely under 28 U.S.C. § 1338(a), which confers original jurisdiction over patent law questions upon the federal courts. The statute gives federal district courts original jurisdiction over "any civil action arising under any Act of Congress relating to patents," and further provides that "such jurisdiction shall be exclusive of the courts of the states in patent . . . cases." 28 U.S.C. § 1338(a). See also *Scherbatskoy v. Halliburton Co.*, 125 F.3d 288 (5th Cir. 1997) ("Section 1338(a) grants exclusive jurisdiction to the federal district courts in cases arising under the patent laws") (emphasis added).

Complaint Counsel argues that Section 1338 operates only to preclude state courts, not federal agencies, from asserting jurisdiction over cases arising under the patent laws. Market Power Opposition at 26. Complaint Counsel further argues that because the statute explicitly prohibits state court jurisdiction, "the canon of statutory interpretation of *expressio unis est*



## Initial Decision

exclusio alterius teaches that the mention of one thing (i.e., state courts) implies that Congress chose not to exclude agencies from hearing patent cases." Market Power Opposition at 27. Under this logic, one could infer, albeit not reasonably, that Congress chose not to exclude municipal courts, tax courts, the Court of Claims, etc. from hearing patent cases. Moreover, the Federal Circuit has held that this jurisdictional question arises not only in determining if state law claims are preempted, but also with respect to determining whether there is a conflict with other federal law. *Midwest Ind., Inc.*, 175 F.3d at 1357 (Federal Circuit will apply federal patent law and precedent "in determining whether patent law conflicts with other federal statutes or preempts state law causes of action."), rev'd in part on other grounds by *TraFFix Devices, Inc. v. Mktg. Displays, Inc.*, 532 U.S. 23 (2001). E.g., *Helfgott & Karas, P.C. v. Director of the United States Patent and Trademark Office*, 209 F.3d 1328, 1334 (Fed. Cir. 2000) (The question of whether the Commissioner of the Patent and Trademark Office has violated the Administrative Procedure Act raises a substantial question under the patent laws sufficient to vest jurisdiction with the district court based in part upon 28 U.S.C. 1338(a)).

**(v) Commission without jurisdiction as Complaint is alleged**

While the FTC may have jurisdiction over cases that "touch on patent law," as argued by Complaint Counsel, (Market Power Opposition at 4), the FTC has no jurisdiction over the allegations in this Complaint that depend on and require the resolution of substantial questions of federal patent law. In *Decker v. FTC*, 176 F.2d 461 (D.C. Cir. 1949), the FTC charged respondents with unfair and deceptive acts with regard to misrepresentations about the functions of respondent's product. Respondents asserted that the alleged misrepresentations were substantially like the statements that were included in the patent application, and thus respondents challenged the jurisdiction of the Commission on grounds that the proceedings were, in effect, an attack upon the patent itself. The Court of Appeals for the District of Columbia Circuit disagreed: "the proceedings before the FTC related only to

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advertising. They did not draw into question the validity of the patent grant. Hence the case is not one arising under the patent laws, cognizable only in district court." *Id.* at 463.

Here, unlike in *Decker*, a finding of liability based upon Respondent's conduct towards the Auto/Oil Group and WSPA can be made only upon a determination of what were Respondent's proprietary interests, what was patented, what was not patented, and whether third parties could have, in their capital investment and refinery reconfiguration decisions, avoided and/or minimized potential infringement, and whether any competing patents existed or would be valid and would not infringe. These issues draw into question the very scope of Respondent's patents and whether third parties can compete without infringing. Hence, unlike in *Decker*, the allegations here arise under the patent laws, cognizable only in federal district court. To be fair to all parties involved, a determination of the scope of Respondent's patents and any other competing, similar, or overlapping patents would be required. Due process demands that the issues raised in the allegations of the Complaint, entangled in numerous patent issues, be thoroughly and completely examined and resolved. Without such analysis and reference to federal patent law, any evidence presented would be speculative, incomplete, and not sufficient to fairly resolve the issues raised in this case.

The Federal Trade Commission is limited to the exercise of those specific powers granted to it by the Federal Trade Commission Act. *FTC v. Nat'l Lead Co.*, 352 U.S. 419, 428 (1957). Under the FTC Act, the Commission has jurisdiction to prevent unfair methods of competition and unfair or deceptive practices. 15 U.S.C. § 45. Nothing in either the language of the FTC Act or its legislative history contemplates that the Commission would exercise jurisdiction over substantial questions of federal patent law. No case was cited to, nor found, that held that the Commission has jurisdiction to decide causes of action arising under patent laws.

In *American Cyanamid*, the Commission issued a cease and desist order based on a finding that the respondent's inequitable

## Initial Decision

conduct before the Patent and Trademark Office constituted a violation of Section 5 of the FTC Act. *American Cyanamid*, 63 F.T.C. 1747, 1855-57 (1963), vac. on other grounds, 363 F.2d 757 (6th Cir. 1966), on rehearing, 72 F.T.C. 623 (1967), aff'd sub nom., *Charles Pfizer & Co. v. FTC*, 401 F.2d 574 (6th Cir. 1968). The Commission held that there is nothing within 28 U.S.C. § 1338(a) which would prevent the Commission from investigating methods of unfair competition before the Patent Office. 63 F.T.C. at 1857. On appeal to the Sixth Circuit, the Court of Appeals held that the Commission has jurisdiction to determine whether conduct before the Patent Office resulting in the issuance of a patent, and the subsequent use of the fruits of such conduct, may constitute a violation of Section 5 of the FTC Act. 363 F.2d at 771.

Unlike *American Cyanamid*, this Complaint does not challenge conduct before the Patent Office, where "Pfizer and Cyanamid, like all other applicants, stood before the Patent Office in a confidential relationship and owed the obligation of frank and truthful disclosure." *Pfizer*, 401 F.2d at 579. Unlike the allegations in the instant matter, *American Cyanamid* did not require an examination of scope and infringement issues. 363 F.2d at 769. Here, there are allegations requiring an examination of the scope of patents and infringement or avoidance thereof. Accordingly, if a fair and complete analysis of the allegations and violations of law is to be done, a resolution of the allegations in this Complaint goes far beyond what was required in *American Cyanamid*. Because questions of possible patent infringement and scope must be resolved in the instant case, these substantial questions of federal patent law vitiate jurisdiction under Section 5 of the FTC Act as this case is alleged.

Complaint Counsel also relies on *In re VISX, Inc.*, Docket No. 9286, 1999 WL 33577396, Initial Decision (filed May 27, 1999), and the Commission's recent proposed consent agreement in *Bristol-Myers Squibb* for the proposition that the Commission may examine antitrust considerations relating to patent law. *Market Power Opposition* at 24. To the extent that the Administrative Law Judge in *VISX* construed patent and patent

Initial Decision

issues in the initial decision, that initial decision was not appealed and was, in fact, dismissed. Subsequent to the issuance of that initial decision, complaint counsel filed a motion to dismiss the complaint in which complaint counsel asked the Commission to expressly state that the Commission does not adopt the initial decision. In re VISX, Inc., Docket No. 9286, (motion filed December 1, 1999) (available at [www.ftc.gov/os/adjpro/d9286/index.htm](http://www.ftc.gov/os/adjpro/d9286/index.htm)). By order of the Commission, dated February 7, 2001, the Commission dismissed the complaint. In addition, the Commission's recent proposed consent decree in Bristol-Meyers Squibb, relied upon by Complaint Counsel, provides no precedential value. "The circumstances surrounding . . . negotiated [consent decrees] are so different that they cannot be persuasively cited in a litigation context." E.I. du Pont, 366 U.S. at 330 n.12. Indeed, the consent decree itself acknowledges, "[a] consent order is for settlement purposes only and does not constitute an admission of a law violation." Bristol-Myers Squibb, Co., File Nos. 001 0221, 011 0046, and 021 0181 (F.T.C. March 7, 2003) (available at [www.ftc.gov/opa/2003/03/bms.htm](http://www.ftc.gov/opa/2003/03/bms.htm)).

**(vi) Complaint Counsel has burden of proof**

Complaint Counsel, as the party required to assert jurisdiction, bears the burden of proving subject matter jurisdiction. *Kokkonen*, 511 U.S. at 377; In re R.J. Reynolds Tobacco Co., Inc., 111 F.T.C. at 541, 549 n.17 (plaintiff bears burden of proving subject matter jurisdiction and failure to meet that burden requires dismissal of the proceeding). As this case is alleged in the Complaint, there is no set of facts that Complaint Counsel could prove to demonstrate that the Commission has jurisdiction to resolve these claims arising under patent law. An analysis of the conduct alleged in the Complaint that was directed at Auto/Oil Group and WSPA would require a resolution of substantial issues arising under patent law. Because the Commission does not have jurisdiction to adjudicate the scope of Respondent's patents and whether the third parties could compete with other products or methods without infringing on valid patents, the allegations of the

Initial Decision

Complaint with respect to Respondent's conduct towards Auto/Oil Group and WSPA are dismissed.

## **VI. CONCLUSION**

For the above stated reasons, Respondent's motion to dismiss the Complaint based upon immunity under Noerr-Pennington is **GRANTED IN PART** as to all violations alleged and all allegations of the Complaint, except the allegations of Respondent's conduct directed toward Auto/Oil Group and WSPA, independent of the conduct directed toward the CARB.

As stated above, the allegations of Respondent's conduct directed toward Auto/Oil Group and WSPA, independent of the conduct directed toward CARB, requires resolution of the substantial patent issues which are entangled in and raised by the allegations and violations of the Complaint. Respondent's motion to dismiss for failure to make sufficient allegations that Respondent possesses or dangerously threatens to possess monopoly power is **GRANTED IN PART** to the extent that the Commission lacks jurisdiction to decide the fundamental and substantial patent issues raised by the allegations of the Complaint. The remainder of Respondent's Market Power Motion is **DENIED WITHOUT PREJUDICE**.

As discussed in detail above, no allegations or violations of the Complaint remain and the Complaint in Docket 9305 is dismissed in its entirety.

## **VII. SUMMARY OF CONCLUSIONS OF LAW**

1. Respondent Union Oil Company of California ("Unocal") is a corporation, as "corporation" is defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44.

2. Respondent is engaged in commerce and affected commerce, as "commerce" is defined in Section 4 of the FTC Act, as amended, 15 U.S.C. § 44.

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3. Pursuant to Section 5 of the FTC Act, the FTC has jurisdiction over the subject matter of this proceeding, except as to the claims raised in the Complaint arising under patent law.

4. Official notice is taken of the statutes governing the California Air Resources Board ("CARB"), the Notice of Public Hearing through which CARB initiated the rulemaking, and the Final Statement of Reasons for Rulemaking, all of which are beyond dispute and have not been disputed.

5. Complaint Counsel bears the burden of showing that the Noerr-Pennington doctrine does not immunize Respondent's conduct alleged in the Complaint.

6. Complaint Counsel bears the burden of showing that the FTC has jurisdiction on all violations of law alleged in the Complaint.

7. Noerr-Pennington immunizes Respondent's efforts to induce CARB to adopt regulations on low emissions, reformulated gasoline ("RFG").

8. CARB's Phase 2 RFG rulemaking process was a legislative exercise.

9. CARB was not wholly dependent on the Respondent for information during the RFG rulemaking process.

10. Noerr-Pennington immunity exists even if CARB did not know that it was being asked to enact a regulation that would restrain trade.

11. The restraint of trade or monopolization alleged in the Complaint is the result of valid governmental action, CARB's adoption of Phase 2 regulations that substantially overlapped with Respondent's patent claims.

12. The sham petitioning exception does not apply in this case.

## Initial Decision

13. The Walker Process exception does not apply in this case.

14. The Noerr-Pennington doctrine provides immunity in this case alleging unfair methods of competition under Section 5 of the FTC Act.

15. To the extent that Respondent's alleged conduct towards Auto/Oil Group and WSPA were part of Respondent's scheme to induce CARB to act, it constitutes indirect petitioning protected by Noerr-Pennington.

16. There is no set of facts alleged in the Complaint that, if established, would prove that anticompetitive injury and resulting harm to the Auto/Oil Group and WSPA resulted from the alleged misconduct directed at the Auto/Oil Group and WSPA, instead of from CARB's enactment of Phase 2 regulations and Respondent's subsequent enforcement of its patent rights.

17. There is no set of facts alleged in the Complaint that could establish that any antitrust injury or harm was caused from any breach of a fiduciary duty without a thorough analysis of substantial patent law issues.

18. To determine whether there is any set of facts that, if proven, could support the allegations of conduct directed at Auto/Oil Group and WSPA separate from the alleged violations stemming from Respondent's efforts to get CARB to adopt regulations favorable to Respondent would require an in depth and thorough analysis of what Respondent's "proprietary interests" were, which "proprietary interests" were and were not included in any patent, what was patented, what was not patented, the scope of Respondent's patents, the scope of any competitor's patents, whether any competitor products or methods exist or could be invented, whether any of the competitor products or methods that could be created or invented infringed, and whether refineries could be reconfigured so as to avoid or minimize infringement of Respondent's patents.

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19. The scope of Respondent's patents, the scope of any competitor's patents, whether any of the competitor products or methods that could be created or invented infringed, and whether refineries could be reconfigured so as to avoid or minimize infringement of Respondent's patents are issues raised by the allegations of the Complaint and are substantial patent law issues.

20. Due process and fairness require that the issues raised in the allegations of the Complaint, entangled in numerous patent issues, be thoroughly and completely examined and resolved.

21. The FTC has no jurisdiction over the allegations in this Complaint in Docket 9305 that depend on the resolution of substantial questions of federal patent law.

22. Complaint Counsel can prove no set of facts in support of its Complaint in Docket 9305 that would entitle it to relief.

**ORDER**

For the reasons stated above,

IT IS ORDERED that Respondent's Motion to Dismiss the Complaint Based Upon Immunity Under Noerr-Pennington is GRANTED IN PART as to all violations alleged and all allegations of the Complaint, except the allegations of Respondent's conduct directed toward Auto/Oil Group and WSPA, independent of the conduct directed toward the CARB.

IT IS ORDERED that Respondent's Motion to [\*146] Dismiss the Complaint for Failure to Make Sufficient Allegations That Respondent Possesses or Dangerously Threatens to Possess Monopoly Power is GRANTED IN PART as to all violations alleged with respect to the allegations of Respondent's conduct directed toward Auto/Oil Group and WSPA, independent of the conduct directed toward CARB. The remainder of Respondent's Market Power Motion is DENIED WITHOUT PREJUDICE.



Initial Decision

IT IS ORDERED that all violations of the Complaint be, and hereby are, dismissed.

Complaint

IN THE MATTER OF

**ROBERT LEWIS, JAMES SOWDER, GERALD WEAR,  
AND JOEL R. YOSEPH, INDIVIDUALLY**

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

*Docket C-4111; File No. 0310155  
Complaint, July 23, 2004--Decision, July 23, 2004*

This consent order, among other things, prohibits four attorney Respondents -- who provide criminal defense services to indigents in Clark County, Washington -- from entering into or facilitating any agreement between or among any attorneys: (1) to negotiate with payors on any attorney's behalf; (2) to deal, to refuse to deal, or to threaten to refuse to deal with payors; (3) regarding the terms of dealing with any payor; or (4) not to deal individually with any payor. The order also prohibits the respondents from facilitating exchanges of information between attorneys concerning whether, or on what terms, to deal with a payor; from attempting to engage in, or inducing anyone to engage in, any action prohibited by the order.

*Participants*

For the Commission: *Joseph Lipinsky, Stuart Hirschfeld, Robert Schroeder, Charles A. Harwood, Michele Cerullo, and Roberta S. Baruch.*

For the Respondents: *Robert Lewis, James Sowder, Gerald Wear, and Robert Yoseph.*

**COMPLAINT**

Pursuant to the provisions of the Federal Trade Commission Act, as amended ("FTC Act"), 15 U.S.C. § 41 *et seq.*, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Robert Lewis, James Sowder, Gerald Wear, and Joel R. Yoseph, hereinafter collectively referred to as "Respondents," have violated Section 5 of the FTC Act, 15 U.S.C. § 45, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest,

## Complaint

hereby issues this Complaint stating its charges in that respect as follows:

**NATURE OF THE CASE**

1. This matter concerns Respondents' actions in organizing horizontal agreements, among 43 competing attorneys who constitute most of the attorneys who provide criminal defense services to indigents in the Clark County, Washington, area, to fix price and other terms charged to the government payor. In furtherance of their agreements, the Respondents organized a boycott against the payor of criminal indigent defense services for the Clark County area. The boycott culminated in a written agreement among the 43 competing attorneys titled "Indigent Defense Bar Consortium Contract." The agreement appointed the Respondents as the exclusive representatives, in negotiating the 2002 and 2003 Superior Court Felony Indigent Defense Contract: Homicide and Persistent Offender cases, for the 43 criminal indigent defense attorneys that were negotiating with the payor of criminal indigent defense services for the Clark County area. Respondents negotiated collectively agreed upon price and other contract terms with the payor, and Respondents and the other competing attorneys agreed to refuse to negotiate individually with the payor. This conduct raised the price of criminal indigent legal services in the Clark County area.

**RESPONDENTS**

2. Respondent Robert Lewis, an individual, is an attorney who represents indigent criminal defendants. His principal address is 430 NE Everett Street, Camas, WA 98607. He was one of four leaders and organizers of the boycott.

3. Respondent James Sowder, an individual, is an attorney who represents indigent criminal defendants. His principal address is 1600 Daniels, P.O. Box 27, Vancouver, WA 98666. He was one of four leaders and organizers of the boycott.

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4. Respondent Gerald Wear, an individual, is an attorney who represents indigent criminal defendants. His principal address is 207 East 19<sup>th</sup> Street, Vancouver, WA 98663. He was one of four leaders and organizers of the boycott.

5. Respondent Joel R. Yoseph, an individual, is an attorney who represents indigent criminal defendants. His principal address is 1305 Main Street, Vancouver, WA 98660. He was one of four leaders and organizers of the boycott.

6. Respondents' general business practices, including the acts and practices herein alleged, are in or affecting "commerce" as defined in the FTC Act, as amended, 15 U.S.C. § 44.

### **ALLEGATIONS OF VIOLATIONS**

7. Except to the extent that competition has been restrained as herein alleged, the Respondents and the other criminal indigent defense attorneys that participated in the boycott have been and are now in competition among themselves and with other attorneys in deciding independently whether and to what extent they will seek criminal indigent cases at fees offered by Clark County, as opposed to other legal work, and in obtaining appointments to represent indigent criminal defendants for homicide and persistent offender cases in the Superior Court of Clark County.

8. Near the end of 2001, Clark County started its biennial contract negotiations with the private attorneys that had provided criminal indigent defense services during the preceding contract period. Early in these negotiations, the Respondents presented the County with a document titled "Indigent Defense Bar Consortium Contract" (hereinafter "Consortium Contract") that was signed by 43 of the criminal indigent defense attorneys who had signed felony contracts with the County during the previous contract period.

## Complaint

9. The Consortium Contract appointed the Respondents as the group's exclusive contract negotiators. Moreover, it stated:

The 2002 contract for indigent defense services with Clark County Superior Court will be accepted on the condition it contains the following:

- a. All non-death penalty aggravated murders will be paid at the rate of \$65.00 per hour. The appointed attorney shall be guaranteed a minimum \$12,500.00. There will be a cap of \$50,000.00, subject to review by the assigned judge.
- b. Non-aggravated murders, including vehicular homicides, and persistent offender cases, shall be paid at the rate of \$55.00 per hour with a minimum guarantee of \$7,800.00 and a cap of \$30,000.00, subject to review by the assigned judge.
- c. Attempted murders, first degree manslaughter and second degree manslaughter shall be paid at the rate of \$50.00 per hour with a minimum guarantee of \$3,450.00, and a cap of \$15,000.00, subject to review by the assigned judge.
- d. Death penalty cases shall be paid at the rate of \$75.00 per hour with a minimum guarantee of \$15,000.00, and a cap of \$100,000.00 per attorney, subject to review by the assigned judge.

These fee demands were significantly higher than the fees the County paid in the previous year's contract and were also much higher than the County was offering in the current negotiations.

10. The Consortium Contract also included provisions to bind its signatories to its terms. In particular, it stated that "[t]he undersigned have agreed not to contract with Clark County for felony defense services in any manner inconsistent with the above and if such acts are taken, shall be subject to liability for attorney fees for any lawsuit or arbitration engaged in by the Consortium to

Complaint

uphold this agreement. This would include restraining orders and money damages."

11. In addition to the actions referenced in Paragraphs 8 through 10, Respondent James Sowder acted as a representative for many criminal indigent defense attorneys from 1990 to 2002 in contract negotiations with Clark County, where he negotiated prices and other competitively significant terms on behalf of competing criminal indigent defense attorneys and facilitated the competing criminal indigent defense attorneys' coordinated responses to contract offers.

**RESPONDENTS HAVE ENGAGED IN RESTRAINTS OF TRADE**

12. Respondents have acted to restrain competition by, among other things, organizing and acting as the exclusive representatives of the Consortium Contract and thereby facilitating, negotiating, entering into, and implementing agreements among competing criminal indigent defense attorneys on price and other competitively significant terms.

**RESPONDENTS' ACTIONS HAVE HAD SUBSTANTIAL ANTICOMPETITIVE EFFECTS**

13. Respondents' actions described in Paragraphs 8 through 12 of this Complaint have had, or have tended to have, the effect of restraining trade unreasonably and hindering competition in the provision of criminal indigent defense services in the Clark County area in the following ways, among others:

- a. price and other forms of competition among Respondents and the other signatories to the Consortium Contract were unreasonably restrained;
- b. prices for criminal indigent defense services for homicides, attempted homicides, and persistent offenders were increased; and

## Complaint

- c. Clark County and its taxpayers were deprived of the benefits of competition among criminal indigent defense attorneys.

14. The combination, conspiracy, acts, and practices described above constitute unfair methods of competition in violation of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45. Such combination, conspiracy, acts, and practices, or the effects thereof, are continuing and will continue or recur in the absence of the relief herein requested.

**WHEREFORE, THE PREMISES CONSIDERED,** the Federal Trade Commission on this twenty-third day of July, 2004, issues its Complaint against Respondents.

Decision and Order

## **DECISION AND ORDER**

The Federal Trade Commission ("Commission"), having initiated an investigation of certain acts and practices of Robert Lewis, James Sowder, Gerald Wear, and Joel R. Yoseph (hereinafter collectively referred to as "Respondents"), and Respondents having been furnished thereafter with a copy of the draft of Complaint that counsel for the Commission proposed to present to the Commission for its consideration and which, if issued, would charge Respondents with violations of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45; and

Respondents, their attorneys, and counsel for the Commission having thereafter executed an Agreement Containing Consent Order to Cease and Desist ("Consent Agreement"), containing an admission by Respondents of all the jurisdictional facts set forth in the aforesaid draft of Complaint, a statement that the signing of said Consent Agreement is for settlement purposes only and does not constitute an admission by Respondents that the law has been violated as alleged in such Complaint, or that the facts as alleged in such Complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission's Rules; and the Commission having thereafter considered the matter and having determined that it had reason to believe that Respondents have violated said Act, and that a Complaint should issue stating its charges in that respect, and having accepted the executed Consent Agreement and placed such Consent Agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, and having duly considered the comment received pursuant to Section 2.34 of its Rules, now in further conformity with the procedure described in Commission Rule 2.34, 16 C.F.R. § 2.34 (2003), the Commission hereby issues its Complaint, makes the following jurisdictional findings and issues the following Order:

1. Respondent Robert Lewis, an individual, is an attorney who represents indigent criminal defendants. His principal



## Decision and Order

address is 430 NE Everett Street, Camas, WA 98607.

2. Respondent James Sowder, an individual, is an attorney who represents indigent criminal defendants. His principal address is 1600 Daniels, P.O. Box 27, Vancouver, WA 98666.
3. Respondent Gerald Wear, an individual, is an attorney who represents indigent criminal defendants. His principal address is 207 East 19<sup>th</sup> Street, Vancouver, WA 98663.
4. Respondent Joel R. Yoseph, an individual, is an attorney who represents indigent criminal defendants. His principal address is 1305 Main Street, Vancouver, WA 98660.
5. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the Respondents, and the proceeding is in the public interest.

**ORDER****I.**

**IT IS ORDERED** that, as used in this Order, the following definitions shall apply:

- A. "Respondents" means Robert Lewis, James Sowder, Gerald Wear, and Joel R. Yoseph.
- B. "Payor" means any person or entity paying for indigent criminal defense services in the State of Washington.
- C. "Person" means both natural persons and artificial persons, including, but not limited to, corporations, unincorporated entities, and governments.

Decision and Order

- D. "Principal address" means either (1) primary business address, if there is a business address, or (2) primary residential address, if there is no business address.

**II.**

**IT IS FURTHER ORDERED** that Respondents, directly or indirectly, or through any corporate or other device, in connection with the provision of legal services in or affecting commerce, as "commerce" is defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44, cease and desist from:

- A. Entering into, adhering to, participating in, maintaining, organizing, implementing, enforcing, or otherwise facilitating any combination, conspiracy, agreement, or understanding between or among any attorneys:
1. To negotiate on behalf of any attorney with any Payor;
  2. To deal, refuse to deal, or threaten to refuse to deal with any Payor;
  3. Regarding any term, condition, or requirement upon which any attorney deals, or is willing to deal, with any Payor, including, but not limited to, price terms; or
  4. Not to deal individually with any Payor;
- B. Exchanging or facilitating in any manner the exchange or transfer of information among attorneys concerning any attorney's willingness to deal with a Payor, or the terms or conditions, including price terms, on which the attorney is willing to deal with a Payor;
- C. Attempting to engage in any action prohibited by Paragraph II.A or II.B above; and

## Decision and Order

- D. Encouraging, suggesting, advising, pressuring, inducing, or attempting to induce any person to engage in any action that would be prohibited by Paragraphs II.A through II.C above.

**PROVIDED, HOWEVER,** that, nothing in this Paragraph II shall prevent Respondents from:

- (i) Exercising rights under the First Amendment to the United States Constitution to petition any government body concerning legislation, rules or procedures;
- (ii) Providing information or views in a noncoercive manner to persons engaged in or responsible for the administration of any program to obtain legal services for persons eligible for appointed counsel.

**III.**

**IT IS FURTHER ORDERED** that Respondents shall:

- A. Within thirty (30) days after the date on which this Order becomes final:
  - 1. Send by first-class mail, with delivery confirmation, a copy of this Order and the Complaint to each attorney who signed the Indigent Defense Bar Consortium Contract; and
  - 2. Send by first-class mail, with delivery confirmation, a copy of this Order and the Complaint to each Payor that contracted with any Respondent for the provision of legal services to indigents; and

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- B. File verified written reports within sixty (60) days after the date this Order becomes final, annually thereafter for three (3) years on the anniversary of the date this Order becomes final, and at such other times as the Commission may by written notice require. Each report shall include:
1. A detailed description of the manner and form in which Respondents have complied and are complying with this Order;
  2. The name, address, and telephone number of each Payor with which Respondents have had any contact; and
  3. Copies of the delivery confirmations required by Paragraphs III.A.1 and III.A.2.

**IV.**

**IT IS FURTHER ORDERED** that each Respondent shall notify the Commission of any change in his principal address within twenty (20) days of such change.

**V.**

**IT IS FURTHER ORDERED** that, for the purpose of determining or securing compliance with this Order, Respondents shall permit any duly authorized representative of the Commission:

- A. Access, during office hours and in the presence of counsel, to inspect and copy all non-privileged books, ledgers, accounts, correspondence, memoranda, calendars, and other records and documents in their possession, or under their control, relating to any matter contained in this Order; and
- B. Upon ten (10) days' notice to Respondents, and in the presence of counsel, and without restraint or interference

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from Respondents, to interview Respondents or the employees of Respondents.

**VI.**

**IT IS FURTHER ORDERED** that this Order shall terminate on July 23, 2024.

Analysis

**Analysis of Agreement Containing Consent Order to Aid  
Public Comment**

The Federal Trade Commission has accepted, subject to final approval, an agreement containing a proposed consent order with Robert Lewis, James Sowder, Gerald Wear and Joel R. Yoseph. The Respondents are attorneys who provide criminal defense services to indigents in Clark County, Washington. The agreement settles charges that these parties violated Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, by orchestrating and implementing a conspiracy among 43 competing attorneys to fix prices and other terms charged for providing criminal defense services to indigents.

The proposed consent order has been placed on the public record for 30 days to receive comments from interested persons. Comments received during this period will become part of the public record. After 30 days, the Commission will review the agreement and the comments received and will decide whether it should withdraw from the agreement or make the proposed order final.

The purpose of this analysis is to facilitate public comment on the proposed order. The analysis is not intended to constitute an official interpretation of the agreement and proposed order or to modify their terms in any way. Further, the proposed consent order has been entered into for settlement purposes only and does not constitute an admission by any Respondent that said Respondent violated the law or that the facts alleged in the complaint (other than jurisdictional facts) are true.

**The Complaint**

The allegations of the complaint are summarized below.

In Clark County, Washington, criminal defense services for indigent defendants are provided by private attorneys working in individual practices or as members of small law firms, who work

## Analysis

under contract with Clark County. Those attorneys were and are separate and independent competitors of one another in all material respects.

Near the end of 2001, Clark County started its biennial contract negotiations with the attorneys who had provided criminal indigent defense services during the preceding contract period. Early in these negotiations, the Respondents presented the County with a document titled "Indigent Defense Bar Consortium Contract" (hereinafter "Consortium Contract") signed by 43 of the attorneys who had previously signed felony contracts with the County. In that document, the Respondents and their colleagues purported to form a "Consortium" and stated their intention to authorize the Consortium, as represented by the Respondents, to be the sole negotiator on behalf of all signatories. The document further stated the signatories' collective demand to alter the payment methodology and substantially increase the payment for all homicide, attempted homicide, persistent offender and death penalty cases. The signatories also stated their intention to refuse to accept any further such cases unless the County acceded to their demands, and authorized the Consortium to take legal action against any signatory who agreed to provide criminal defense services on terms inconsistent with those demanded by the Consortium.

After receiving the document from the Respondents, Clark County agreed to a new contract adopting the payment methodology demanded by the Consortium and substantially increasing reimbursement rates for all homicide, attempted homicide, persistent offender and death penalty cases. The Respondents, by orchestrating the formation of the Consortium and threatening the County with a refusal to deal, have violated Section 5 of the FTC Act.

**The Proposed Consent Order**

The proposed order is designed to remedy the illegal conduct charged in the complaint and prevent its recurrence. It is modeled

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after the remedy sought by the Commission and approved by the Supreme Court in *Federal Trade Commission v. Superior Court Trial Lawyers Association*, 493 U.S. 411 (1990), in which the Court held that a boycott among criminal indigent defense attorneys was a per se violation of the antitrust laws, despite the lawyers' claims that the boycott was a political act ostensibly designed to improve the quality of representation by increasing their reimbursement rates. The Court observed that "[n]o matter how altruistic the motives of respondents may have been, it is undisputed that their immediate objective was to increase the price that they would be paid for their services." 493 U.S. at 427.

The proposed order's specific provisions are as follows:

Paragraph II.A prohibits the Respondents from entering into or facilitating any agreement between or among any attorneys: (1) to negotiate with payors on any attorney's behalf; (2) to deal, to refuse to deal, or to threaten to refuse to deal with payors; (3) regarding the terms of dealing with any payor; or (4) not to deal individually with any payor.

Other parts of Paragraph II reinforce these general prohibitions. Paragraph II.B prohibits the Respondents from facilitating exchanges of information between attorneys concerning whether, or on what terms, to deal with a payor. Paragraph II.C bars attempts to engage in any action prohibited by Paragraph II.A or II.B; and Paragraph II.D proscribes inducing anyone to engage in any action prohibited by Paragraphs II.A through II.C.

Paragraph II contains a proviso clarifying that the order does not prohibit rights to petition government officials, as guaranteed by the First Amendment, nor does the order prohibit the Respondents from providing information or views to the County or its representatives.



## Analysis

Paragraphs III, IV and V impose various obligations on Respondents to report or provide access to information to the Commission to facilitate monitoring Respondents' compliance with the order.

The proposed order will expire in 20 years.

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IN THE MATTER OF

**SOUTH CAROLINA STATE BOARD OF DENTISTRY**

OPINION OF THE COMMISSION AND ORDER IN REGARD TO  
ALLEGED VIOLATIONS OF SEC. 5 OF THE  
FEDERAL TRADE COMMISSION ACT

*Docket 9311; File No. 0210128*

*Complaint, September 12, 2003--Opinion and Order, July 28, 2004*

In a unanimous Opinion, the Commission addressed a motion filed by Respondent South Carolina State Board of Dentistry to dismiss the administrative complaint in this matter on the ground that its actions were protected by the state action doctrine. The Commission concluded that an emergency regulation issued by the Board – which required dental preexaminations in school settings – appeared to contravene state law, and therefore determined that dismissing the complaint on state action grounds would be inappropriate. In particular, the Commission concluded that – as a subordinate state regulatory entity – the Board was not automatically entitled to protection from antitrust liability because its actions were not those of the state as sovereign. The Commission also determined that the Board had failed to show that its emergency rule was issued pursuant to a clearly articulated state policy. In the accompanying Order, the Commission retained jurisdiction over the matter, and remanded it to an administrative law judge for further findings concerning whether the Board is likely to reimpose the dental preexamination requirement, in order to address the Board’s separate argument that the complaint should be dismissed on grounds of mootness.

*Participants*

For the Commission: *Michael B. Kades, Andrew S. Ginsburg, Garth W. Huston, K. Shane Woods, John T. Delacourt, Jeffrey Brennan, Robert J. Schroeder, Charles A. Harwood, D. Bruce Hoffman, Mark N. Hertzendorf, and Charissa P. Wellford.*

For the Respondent: *Lynne W. Rogers, General Counsel, South Carolina Department of Labor, Licensing & Regulation, and William H. Davidson, II, Andrew F. Lindemann, and Kenneth P. Woodington, Davidson, Morrison and Lindemann P.A.*

Commission Opinion

**OPINION AND ORDER OF THE COMMISSION**

By Thompson, Commissioner, For A Unanimous Commission:

**I. INTRODUCTION**

This case presents the important question of whether the South Carolina State Board of Dentistry (“Respondent” or “the Board”) violated federal antitrust law by enacting a regulation that contravened legislation designed to improve access to dental care for South Carolina’s most vulnerable citizens -- children of low-income families. The Board is the regulatory authority for dentists and dental hygienists in South Carolina and this case is before the Federal Trade Commission on the Board’s Motion to Dismiss the Complaint. As required by law, we accept the factual allegations in the Complaint as true for purposes of ruling on the Board’s motion. Unless otherwise noted, all statements of fact in this opinion are based directly on the Complaint.

More than 40 percent of children in South Carolina are Medicaid-eligible and, in the early 1990s, only 12 percent of those received preventive dental care. According to the South Carolina Administrative Law Judge’s Report, this problem is especially acute in rural areas. In 1988, the South Carolina legislature sought to remedy this problem by amending the state dental law to permit dental hygienists to provide preventive dental care to children in schools. However, the amended law did not significantly improve preventive dental care in schools, principally because it required a dentist to examine each student before performing the services. In 2000, the state legislature again amended its law to make it easier for dental hygienists to provide oral health care in schools. The amendments removed the requirement that “a supervising dentist [examine] the patient no more than 45 days before the [hygienist’s] treatment,” and added the requirement that the hygienist work “under general supervision.” The Governor of South Carolina stated that the 2000 law “remove[d] a regulation that hindered access to dental care.”

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Following the 2000 amendments, in July 2001, the Board enacted an emergency temporary regulation that reinstated the preexamination requirement. As a result, thousands fewer children in South Carolina received preventive dental care in the latter half of 2001 than in the first half of that year. In 2003, the South Carolina legislature amended the law to state expressly that the dental examination requirements applicable in some settings do not apply to hygienists' work in public health settings. In March 2003, the Board restated its position that a dentist must see a patient and provide a treatment plan before a hygienist provides care. Thereafter, the Commission issued a complaint to enjoin the Board from requiring a dental preexamination in school settings.

The Board asserts two arguments in support of its Motion to Dismiss. The first raises the legal issue of whether the state action doctrine protects the Board's conduct from antitrust liability. We cannot conclude that the state action doctrine protects the Board's reinstatement of the preexamination requirement because the Board's actions appear to directly conflict with a specific legislative mandate. Accordingly, we deny Respondent's Motion to Dismiss the Complaint on this ground.

The Board's second argument, that changes to South Carolina law have rendered the case moot, raises a question of disputed fact that we cannot resolve given the record at this early stage of the proceedings. In light of the narrow scope of this factual question, however, the Commission has decided to retain jurisdiction at this time and to refer this matter to the administrative law judge for a limited inquiry on the issue of whether there is a reasonable likelihood that the challenged conduct will recur. If, after this inquiry, we decide that the case is moot, the Commission can dismiss the Complaint. Absent such a determination, this matter will proceed to an administrative trial on the merits.

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## II. PROCEDURAL BACKGROUND

On September 12, 2003, the Commission issued an administrative complaint against the Board, alleging that the Board violated Section 5 of the Federal Trade Commission Act by “restrain[ing] competition in the provision of preventive dental care services by unreasonably restricting the delivery of dental cleanings, sealants, and topical fluoride treatments in school settings by licensed dental hygienists.” Compl. ¶ 1. Specifically, the Complaint points to the Board’s July 2001 adoption of an “emergency regulation” that allegedly reimposed a requirement that dentists preexamine patients before dental hygienists provide treatment in school settings. *Id.* ¶ 25. The Complaint asserts that the Board’s action “deprive[d] thousands of school children -- particularly economically disadvantaged children -- of the benefits of preventive oral health care services.” *Id.* ¶ 1. The Complaint also alleges that, despite subsequent actions by the state legislature, the Board presents a current threat to the delivery of preventive dental services in South Carolina. *Id.* ¶ 38.

The Commission has retained adjudicative responsibility for this matter pursuant to Rule 3.42 of the Commission’s Rules of Practice, 16 C.F.R. § 3.42 (2004). The Board filed its Motion to Dismiss the Complaint on October 21, 2003, and the Commission heard oral argument on the motion on January 13, 2004.

## III. STANDARD OF REVIEW

For purposes of this review, the Commission regards the Board’s motion as a motion to dismiss for failure to state a claim and applies the standard used by federal courts under Fed. R. Civ. P. 12(b)(6). *See, e.g., Schering-Plough Corp.*, 2001 FTC LEXIS 198, at \*10-13 (Oct. 31, 2001). This is a high standard that requires the Respondent to show that Complaint Counsel can prove no set of facts that would entitle them to relief. *Id.* at \*12 (*citing McLain v. Real Estate Bd. of New Orleans, Inc.*, 444 U.S. 232, 246 (1980)). In evaluating whether a complaint withstands a motion to dismiss, the Commission must accept as true all of the

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complaint's well-pled factual allegations and must construe all inferences in the light most favorable to Complaint Counsel. *See, e.g., Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974); *TK-7 Corp. and Moshe Tal*, 1989 FTC LEXIS 32, at \*3 (May 3, 1989). Moreover, the Commission should not dismiss the complaint if the motion, or Complaint Counsel's opposition to the same, raises disputed issues of material fact. *Schering-Plough Corp.*, 2001 FTC LEXIS 198, at \*12.

#### **IV. FACTUAL ALLEGATIONS AND STATUTORY FRAMEWORK**

Set forth below are the relevant facts alleged in the Complaint, together with the pertinent South Carolina statutes, regulations and any additional material properly presented for our consideration.

##### **A. Dental Hygienists and the Board**

In South Carolina, dental hygienists are "licensed health care professionals who specialize in providing preventive oral health services . . . includ[ing] cleaning teeth, taking x-rays, . . . providing fluoride treatments, and applying dental sealants." Compl. ¶ 11; *see also* S.C. Code Ann. § 40-15-80 (2003). Dental hygienists "practice in collaboration with a supervising dentist or under the direction of the South Carolina Department of Health and Environmental Control's public health dentist." Compl. ¶ 12; *see also* S.C. Code Ann. §§ 40-15-85; 40-15-102 ; 40-15-110.

The Board is South Carolina's regulatory authority for dentists and dental hygienists, Compl. ¶¶ 7, 9; S.C. Code Ann. § 40-15-10, and "is composed of seven dentists, one dental hygienist, and one public member." Compl. ¶ 5; *see also* S.C. Code Ann. § 40-15-20. Licensed dentists elect six of the Board's dentists, while licensed hygienists elect the Board's sole hygienist. § 40-15-20. The Governor appoints one dentist member and the public "lay" member and may "reject" any elected members based on their "unfitness," in which case additional nominees may be elected in

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the same manner. *Id.* Dentists that serve as members of the Board “continue to engage in the business of providing dental services for a fee.” Compl. ¶ 6.

**B. Statutory Framework**1. 1988 to 2000

Children in South Carolina, especially those from low-income families, have suffered from oral health problems due to inadequate access to preventive dental care. Compl. ¶ 14. The need for preventive dental care for underprivileged children is partly due to the unavailability of dentists and is especially acute in rural areas. Pub. Hr’g Report of the Admin. Law Judge, *In re: Proposed Regulation*, Doc. No. 2644, Docket No. 01-ALJ-11-0348-RH, at 17-18 (S.C. A.L.J. Feb. 11, 2002) (RX-10) (“ALJ Report”). In 1988, the South Carolina General Assembly amended the state law relating to dentists, dental hygienists and dental technicians (referred to herein as the “Dental Practice Act” or the “DPA”) to authorize, subject to certain restrictions, dental hygienists to provide various oral health services in public settings, including schools. Compl. ¶ 15; 1988 S.C. Act No. 439. Section § 40-15-80 of this legislation authorized hygienists to apply topical fluoride and to perform oral screenings in a school setting “without the presence of a dentist on the premises.” S.C. Code Ann. § 40-15-80(B)(1999).

Additionally, this law permitted dental hygienists to apply sealants and oral prophylaxis in a school setting upon satisfaction of the following conditions: (1) the student had written permission from a parent or guardian; (2) the treatments were authorized by a licensed dentist; (3) the student was not an active patient of another dentist; and (4) the authorizing dentist had examined the student and given written authorization within 45 days before application of the sealant or oral prophylaxis. Compl. ¶ 18; § 40-15-80(C)(1)-(3) (1999). The Complaint alleges that, despite this authorization, the 1988 law “did not significantly increase the

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delivery of dental hygienists' services in school settings." Compl. ¶ 15.

2. The 2000 Dental Practice Act Amendments

In 2000, South Carolina increased Medicaid reimbursement for dental services. Compl. ¶ 16. The legislature also "amended its statutes to make it easier for dental hygienists to deliver preventive dental care services in school settings." Compl. ¶ 18; *see also* 2000 S.C. Act No. 298. For example, Section 40-15-80(B) of the DPA, as amended in 2000, permitted dental hygienists to apply sealants, topical fluoride, and oral prophylaxis<sup>1</sup> in a school setting, provided they had "written permission" from the student's parent or guardian and that such treatment by the dental hygienist was done "under general supervision." *See also* Compl. ¶ 19. The amended DPA defined "general supervision" to require that either a licensed dentist or a state public health dentist "has authorized the procedures to be performed but does not require that a dentist be present when the procedures are performed." S.C. Code Ann. § 40-15-85(B) (2000).<sup>2</sup> The

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<sup>1</sup> Oral prophylaxis is defined as "the removal of any and all hard and soft deposits, accretions, toxins, and stain from any natural or restored surfaces of teeth or prosthetic devices by scaling and polishing as a preventive measure for the control of local irritational factors." § 40-15-85(3) (2003).

<sup>2</sup> In contrast, a hygienist in a private office setting required "direct supervision" by a dentist that included that the dentist "personally diagnoses the condition to be treated . . ." § 40-15-85(A) (2000). The 2000 amendments also clarified that the DPA was "not intended to establish independent dental hygiene practice," § 40-15-80(F) (2000), and required dental hygienists in public health settings to have professional liability insurance, § 40-15-80(G) (2000). Further, the 2000 law permitted dental hygienists "employed within the public health system" to provide "primary preventive care" services "under the direction and



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amended statute did not include, or indeed make any reference to, the 45-day dentist preexamination requirement set forth in the prior version of § 40-15-80(C)(3). Compl. ¶ 19; *see* S.C. Code Ann. § 40-15-80(B) (2000).

The Complaint asserts that the 2000 amendments prevented the Board from requiring “a dentist examination as a condition of a dental hygienist’s providing preventive services in a school setting.” Compl. ¶ 19; *see also infra* at 24-27. In signing the 2000 amendments, the South Carolina Governor’s office stated that the “new law removes a regulation that hindered access to dental care” and noted that doing so would “allow[] dental hygienists to offer preventive dental care in places such as schools . . . [where] [d]entists rarely practice full-time.” Compl. ¶ 20; State of S.C., Office of the Governor, *New Law Makes Children’s Dental Care More Accessible* (May 26, 2000) (press release) (cited in Resp. Ex. (“RX”)-4 (ex. 7)).

Following enactment of the 2000 amendments, Health Promotion Specialists (“HPS”), an organization composed of dental hygienists that contracted with supervising dentists, began using dental hygienists to provide preventive dental care on-site to children in South Carolina schools. Compl. ¶ 22. By July 2001, HPS had screened over 19,000 children and had provided services to over 4,000, of whom almost 3,000 were Medicaid-eligible. Compl. ¶ 23.

### 3. The Board’s 2001 Emergency Regulation and Subsequent Actions

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control of the State Director of Public Health Dentistry but [did] not require that the director be present when authorized services are provided. If a licensed dentist is available, an examination and diagnosis must be made by him before a sealant is placed on a tooth.” § 40-15-110 (2000).

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On July 13, 2001, the Board promulgated emergency regulation 39-18 (the “Emergency Regulation”) to “clarify the type of authorization” required for dental hygienists to administer care in school settings under Section 40-15-85(B) of the amended DPA. 25-7 S.C. Reg. 79; Compl. ¶ 25. The Emergency Regulation needed only the approval of the Board, a majority of whose members were dentists with a financial interest in reimposing the preexamination requirement. Compl. ¶ 26; § 40-15-20.

Through the Emergency Regulation, the Board interpreted the general supervision standard of Section 40-15-85(B) as it applied to dental hygienists and specified that this standard required a licensed dentist to examine clinically each patient and actually determine the need for any treatment “not more than forty-five (45) days prior to the date the dental hygienist is to perform the procedure for the patient.” 25-7 S.C. Reg. 79, 39-18(A); Compl. ¶ 25. The Complaint alleges that the Board’s Emergency Regulation “re-imposed the same examination requirement that the General Assembly removed in 2000: that a supervising dentist had to examine the patient no more than 45 days prior to treatment.” Compl. ¶ 25. The Complaint further alleges that this action “reduce[d] substantially the number of children (particularly economically disadvantaged children) who received preventive dental care.” Compl. ¶ 28.

In 2001, HPS challenged the Emergency Regulation in state court. The state court denied HPS’s motion for a temporary restraining order because HPS had not exhausted its administrative remedies, and because the court agreed with the Board that the Emergency Regulation reasonably clarified the term “general supervision” in the 2000 amendments to include dental preexaminations. *Health Promotion Specialists, LLC v. South Carolina Bd. of Dentistry*, No. 01-CP-40-3148 (S.C.C.P. County of Richland Aug. 24, 2001). However, the state appellate court affirmed the decision solely on the exhaustion grounds. *Health Promotion Specialists, LLC v. South Carolina Bd. of Dentistry*, No. 2003-UP-232 (S.C. Ct. App. Mar. 26, 2003).

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In August 2001, the Board published a proposed permanent regulation that was substantially identical to the Emergency Regulation. Compl. ¶ 30; ALJ Report at 2-4. As required by state law, a South Carolina administrative law judge (“ALJ”) held a public hearing to determine whether the proposed permanent regulation was “a reasonable exercise of the Board’s authority.” Compl. ¶ 31; ALJ Report at 2, 17. The state ALJ’s determination would guide the General Assembly in determining whether to effectuate the proposed permanent regulation. *Id.* In February 2002, the ALJ issued his conclusion that “the Board’s proposed permanent regulation was unreasonable and contravened state policy to the extent it reinstated the dentist preexamination requirement that the legislature had eliminated in 2000.” Compl. ¶ 32; *see also* ALJ Report at 17-18. The ALJ held that the state legislature intended through the 2000 amendments to delete the preexamination requirement in order “to increase access to preventive oral health care for low-income children.” Compl. ¶ 33; *see also* ALJ Report at 17-18.

The Board did not submit the proposed permanent regulation to the General Assembly for review, and the permanent regulation did not take effect. Compl. ¶ 34. In accordance with South Carolina state law, the Emergency Regulation terminated in January 2002, 180 days after adoption. Compl. ¶ 26. Following the Emergency Regulation’s termination, several firms, including HPS, resumed providing preventive dental care to thousands of school children in South Carolina. Compl. ¶¶ 35-36.

#### 4. 2003 DPA Amendments

In May 2003, the General Assembly again amended the DPA, altering the supervision requirements for dental hygienists operating in certain settings and specifically referencing their authority to provide preventive dental care in certain public health settings without a requirement for preexamination by a dentist. The new S.C. Code Ann. § 40-15-110 (A)(10) (2003), expressly provides that “[n]othing in this chapter may be construed to prevent . . . a licensed dental hygienist employed within or

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contracted through the public health system from providing . . . primary preventive care that is reversible.” This section further states that the services that may be provided in a public health setting include “oral prophylaxis, application of topical fluoride including varnish, and the application of dental sealants.” *Id.* Although such services “are to be performed under the direction of” a specified state official or his designee, the new section does not require a dentist’s presence and there is no reference to a preexamination requirement. *Id.*<sup>3</sup>

5. The Board’s March 2003 Meeting and the October 2003 Resolution

In March 2003, two months before the General Assembly enacted the 2003 amendments, the Board met to consider the statutory revisions. The Complaint alleges that at this meeting, the Board “maintained that *in all settings where a dental hygienist provides treatment -- whether public health or private practice -- a licensed dentist has to see the patient and provide a treatment plan.*” Compl. ¶ 38 (emphasis added); *see also* S.C. Bd. of Dentistry, Mins. from Conference Call, 4 (Mar. 6, 2003) (RX-13 (attach. B)).

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<sup>3</sup> The 2003 statute retains the basic definition of “general supervision” (§ 40-15-85(2)), but expands the range of settings in which it may apply -- including, *e.g.*, private office settings. Another new provision, § 40-15-102, further defines the services that may be performed under “general supervision” in a private office and in some school settings and imposes further “restrictions” on the provision of those services in those settings. §§ 40-15-102(B)-(D). Such restrictions relate principally to examination by a dentist. § 40-15-102(C). Nevertheless, consistent with § 40-15-110’s express allowance of hygienist services in public health settings, such settings are specifically exempted from the additional restrictions of § 40-15-102. *See* § 40-15-102(D).

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On October 16, 2003, following the Commission's issuance of the Complaint in this matter, the Board issued a resolution (the "Resolution") stating that preexaminations of a patient were *not* required as a precondition to a dental hygienist's working in a public health setting, and that the Board would not seek any change to that policy. *See* RX-13 (attach. A).

**V. MATERIALS BEFORE THE COMMISSION**

The Commission is limited in what it may consider to resolve a motion to dismiss for failure to state a claim. In addition to the complaint, the Commission may consider documents attached to or referenced in the complaint whose authenticity is unchallenged, as well as matters of official or judicial notice that are "not subject to reasonable dispute," without converting the motion to one for summary judgment. *United States v. Ritchie*, 342 F.3d 903, 908-09 (9<sup>th</sup> Cir. 2003) (citing Fed. R. Evid. 201(b)); *In re K-Tel Int'l, Inc. Secs. Litig.*, 300 F.3d 881, 889 (8<sup>th</sup> Cir. 2002) (in addition to pleadings, the court may consider "materials 'embraced by the pleadings' and materials that are part of the public record") (citation omitted); *Pryor v. NCAA*, 288 F.3d 548, 559-60 (3d Cir. 2002). Matters of official notice include those contained in public records, such as judicial decisions, statutes, regulations, and "records and reports of administrative bodies." *Ritchie*, 342 F.3d at 909 (citation omitted).

Here, state statutes, regulations, court decisions, and other official government records material to the issues are properly referenced in the Complaint and/or are properly the subject of judicial notice.<sup>4</sup> The Commission may also consider material

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<sup>4</sup> These materials include: the 2000 amendments to the South Carolina DPA (RX-2); the 2003 amendments to the DPA (RX-12); the Board's Emergency Regulation 39-18 and proposed permanent regulation 39-18 (RX-3 (ex. B)); the Office of the Governor's 2000 press release (RX-4 (ex. 7)); the order in *Health Promotion Specialists, LLC v. South Carolina Bd. of*

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reflecting an industry's understanding or definition of technical or scientific terms at the time legislation is enacted as possible indicia of the legislature's understanding of the term. *See Order of Ry. Conductors of America v. Swan*, 329 U.S. 520, 525 (1947). Thus, we may consider the American Dental Association's ("ADA") Comprehensive Policy Statement on Dental Auxiliaries in effect in 2000, RX-3 (ex. C, attach.), which includes the ADA's various standards for supervision of dental auxiliaries.

In addition to these submissions, the Board has made a number of factual assertions in its briefs and has referenced several documents, including affidavits, letters, brochures, and Internet websites, that discuss factual issues that the Complaint does not reference and that are not appropriate subjects of judicial notice.<sup>5</sup> The Board explains that it submitted some of these materials to provide "background information," while the rest were "submitted not for the truth of the matters asserted therein," but for some

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*Dentistry, supra* (RX-8); the ALJ Report (RX-10); and the minutes of the Board's March 6, 2003, conference call (RX-13 (attach. B)). Additionally, the Board has proffered its October 16, 2003 Resolution (RX-13 (attach. A)). This post-complaint document relates to the Board's mootness defense, and the Commission can judicially notice such a document as an official government record. However, we will not give the document any particular weight at this time, much less resolve the Board's mootness defense on the basis of this one submission. We consider this document only in the context of our discussion in Part VI.B., *infra*, referring the case to the FTC administrative law judge for more complete discovery relating to the mootness issue.

<sup>5</sup> Complaint Counsel specifically object to the following documents attached to the Board's motion to dismiss: RX-1 (and attachments A, B and C); RX-3 (and attached exhibit A and a portion of exhibit C); RX-4 (and attached exhibits 2 and 6); and RX-5, RX-6 and RX-7. Compl. Counsel's Opp'n to Resp't Mot. to Dismiss, App. A.

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other undisclosed purpose. *See* Resp.'s Reply Mem. in Support of Mot. to Dismiss ("Reply"), Appendix A. Although the Commission always has discretion to consider extra-pleading material and to convert a motion to dismiss to one for summary judgment, *see, e.g., Poole v. County of Otero*, 271 F.3d 955, 957 n.2 (10<sup>th</sup> Cir. 2001); 5A Charles Alan Wright & Arthur R. Miller, *Federal Practice & Procedure* § 1366 (2d ed. 1990 & Supp. 2004), we decline to do so here. We believe that it would be inappropriate to consider the Board's proffered limited evidence at this stage. The Board's factual material is not comprehensive and can best be described as "scanty, incomplete, or inconclusive" and unlikely "to facilitate the disposition of the action" at this stage. Wright & Miller, § 1366, at 493 and 676 n.16.1. Permitting selective evidence at this stage would also unfairly prejudice Complaint Counsel, who have not yet had an opportunity to conduct discovery or respond to the proffered evidence. The Board may instead submit any relevant material -- whether it relates to the case's general "background," the Board's mootness defense, or some other relevant issue -- following discovery at the summary judgment stage or at trial.<sup>6</sup>

**VI. CONCLUSIONS OF LAW****A. Whether the State Action Doctrine Applies to the Board's Actions**

The Board asserts that the challenged acts were those of the State of South Carolina and, as such, are exempt from federal antitrust liability under the state action doctrine. First, the Board claims that its status as an agency of the state of South Carolina necessarily or "*ipso facto*" makes its actions those of the state.

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<sup>6</sup> The mere fact that the Commission perused the materials submitted by the Board to determine whether to consider them does not automatically convert the Board's Motion to Dismiss into one for summary judgment. *See Homart Dev. Co. v. Sigman*, 868 F.2d 1556, 1561-62 (11<sup>th</sup> Cir. 1989).

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Alternatively, the Board argues that it is covered by the state action doctrine because it acted pursuant to a “clearly articulated” state policy to displace competition. The Board also argues that, even if it erred by adopting the Emergency Regulation, such error did not deprive it of state action protection. We are unpersuaded by these arguments and therefore deny the Motion to Dismiss on this ground.

1. The State Action Doctrine

It is well-settled that the state action doctrine protects a state government, acting as sovereign, from liability under the federal antitrust laws. The Supreme Court first articulated this doctrine in *Parker v. Brown*, 317 U.S. 341 (1943), where the Court upheld California’s Agricultural Prorate Act against a Sherman Act challenge. Although the legislation at issue clearly restricted competition among California’s agricultural commodities growers, the Court concluded that the Sherman Act did not restrain the state, acting through its legislature, from undertaking anticompetitive actions. The Court based its holding on the recognition that, under a dual system of government, the state is “sovereign, save only as Congress may constitutionally subtract from [its] authority,” and the Court would not lightly infer Congressional intention to “nullify a state’s control over its officers and agents.” *Id.* at 351. Where the Sherman Act was silent and gave “no hint that it was intended to restrain state action or official action directed by a state,” the Court refused to read such intent into the act. *Id.*

Subsequent Supreme Court case law has confirmed and elaborated on the state’s ability to restrain competition. In *Hoover v. Ronwin*, the Supreme Court explained that *Parker* imparts automatic, or *ipso facto*, protection from antitrust liability to state legislative acts. *Hoover v. Ronwin*, 466 U.S. 558, 567-68 (1984) (“when a state legislature adopts legislation, its actions constitute those of the State . . . and *ipso facto* are exempt from the operation of the antitrust laws”) (citation omitted). The Court has also extended this *ipso facto* treatment to a state’s supreme



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court when the court acts in a legislative, rather than in a judicial, capacity. *Id.* at 568 (citing *Bates v. State Bar of Arizona*, 433 U.S. 350, 360 (1977)). See also *Southern Motor Carriers Rate Conference, Inc. v. United States*, 471 U.S. 48, 63 (1985) (“*Parker* immunity is available only when the challenged activity is undertaken pursuant to a clearly articulated policy of the State itself, such as a policy approved by a state legislature . . . or a State Supreme Court . . . .”) (citations omitted).

Where the actor is neither the state legislature nor the supreme court, but is instead a political subdivision of a state or a private party ostensibly acting pursuant to state authorization, the Court has applied a more rigorous analysis to determine whether the entity is excluded from the federal antitrust laws. In such cases, the Court has held that the party is not *ipso facto* entitled to state action protection; rather, the party must demonstrate that it acted pursuant to a “clearly articulated and affirmatively expressed” state policy to displace competition in favor of regulation and that the state actively supervised the actions. *Cal. Retail Liquor Dealers Ass’n v. Midcal Alum., Inc.*, 445 U.S. 97, 105 (1980) (citations omitted). *Midcal*’s analytical framework provides guidance as to when state action protection is applicable to private parties as well as to nonsovereign state entities regulating private parties. See, e.g., *Southern Motor Carriers*, 471 U.S. at 57-66 (applying standard); *FTC v. Ticor Title Ins. Co.*, 504 U.S. 621, 631-40 (1992) (applying *Midcal* analysis to state-licensed title insurance rate bureaus).

## 2. The Board Is Not *Ipsa Facto* Protected by *Parker* and Its Progeny

The Board is undoubtedly a state regulatory agency with broad powers to supervise the fields of dentistry and dental hygiene in South Carolina.<sup>7</sup> As discussed above, however, the Supreme

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<sup>7</sup> “The practice of dentistry and dental hygiene . . . shall be under the supervision of [the Board].” S.C. Code Ann. §

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Court has accorded *ipso facto* state action status only to state legislatures or supreme courts. The Court has not decided whether a state Governor may ever be sovereign for state action purposes. See *Hoover*, 466 U.S. at 568 n.17. However, it has indicated that “state agencies” regulating private parties are not *ipso facto* excluded from antitrust scrutiny. See *Southern Motor Carriers*, 471 U.S. at 57 (“[t]he circumstances in which *Parker* immunity is available to private parties, and to state agencies or officials regulating the conduct of private parties, are defined most specifically by our decision in [*Midcal*],” applying its two-part test) (emphasis added). For those “nonsovereign state representative[s],” [c]loser analysis is required . . . to ensure that the anticompetitive conduct of the State’s representative was contemplated by the State.” *Hoover*, 466 U.S. at 568-69.

Despite this clear precedent limiting the application of *ipso facto* state action coverage, the Board maintains that its actions are automatically exempt from federal antitrust law because of its status as a state agency. The Board points to the fact that it is a body created by state statute, S.C. Code Ann. § 40-15-10 *et seq.*, whose members are appointed and removed by the Governor, § 40-15-20, and are required by state law to hold regular meetings, and whose financial and employment matters are regulated by the Director of the Department of Labor, Licensing and Regulation. § 40-1-50(D). Mem. in Support of Mot. to Dismiss at 24-25. The Commission, however, concludes that the Board is not sufficiently sovereign to be necessarily exempt from the antitrust laws.

The Board relies on several cases holding that state executive departments may be entitled to *ipso facto* protection in the same

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40-15-10. Section 40-15-40 authorizes the Board to “adopt rules and regulations not inconsistent with this chapter for its own organization and for the practice of dentistry and dental hygiene . . . and for carrying out the provisions of this chapter, and [to] amend, modify and repeal any rules and regulations from time to time.”

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manner as a state legislature or supreme court. *See, e.g., Neo Gen Screening, Inc. v. New England Newborn Screening Program*, 187 F.3d 24, 28-29 (1<sup>st</sup> Cir. 1999) (regarding “full fledged” state executive departments); *Charley’s Taxi Radio Dispatch Corp. v. SIDA of Hawaii, Inc.*, 810 F.2d 869, 875-76 (9<sup>th</sup> Cir. 1987) (state executive agency *ipso facto* exempt); *Deak-Perera Hawaii, Inc. v. Dept. of Transp.*, 745 F.2d 1281 (9<sup>th</sup> Cir. 1984) (same). Some courts and commentators would limit this exception to the Governor’s office, 1 Phillip E. Areeda and Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and their Application* ¶ 224, at 405 (2d ed. 2000), or to the Governor himself and not other executive branch agencies. *See, e.g.,* William H. Page, *Interest Groups, Antitrust, and State Regulation: Parker v. Brown in the Economic Theory of Legislation*, 1987 Duke L.J. 618, 637 n.113 (1987). We need not, however, determine whether state executives or departments are ever *ipso facto* covered by the state action doctrine because that issue is not before us. Instead, the Board is best characterized as a “subordinate” state special purpose instrumentality or industry regulatory body.

Further, courts have long rejected extending *ipso facto* state action treatment to such governmental entities because they lack sufficient attributes of state sovereignty. *See, e.g., Southern Motor Carriers*, 471 U.S. at 62-63 (state Public Service Commissions that set intrastate motor common carriers’ rates, “[a]cting alone,” are not sovereign and cannot immunize private anticompetitive conduct); *Goldfarb v. Virginia State Bar*, 421 U.S. 773, 790-92 (1975) (state bar association, which was a state agency for certain purposes, was not the “State” under the *Parker* doctrine); *Cine 42<sup>nd</sup> Street Theater Corp. v. Nederlander Org., Inc.*, 790 F.2d 1032, 1044 (2<sup>d</sup> Cir. 1986) (state Urban Development Corporation, created by statute and designated a “governmental agency” and a “political subdivision,” was not “sovereign” for *Parker* purposes). Declining to treat such non-elected governmental entities as equivalent to the state itself comports fully with the policies of the state action doctrine because such entities lack the political accountability to formulate

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state competition policy. *See, e.g.*, William H. Page & John E. Lopatka, *State Regulation in the Shadow of Antitrust: FTC v. Ticor Title Insurance Co.*, 3 Sup. Ct. Econ. Rev. 189, 205-07 (1993) (state action protection based on “political legitimacy” of state entity).

Courts have also consistently declined to afford *ipso facto* state action status to state licensing or regulatory boards that are composed at least in part of members of the regulated industry. *See Earles v. State Bd. of Certified Pub. Accountants of Louisiana*, 139 F.3d 1033, 1040-41 (5<sup>th</sup> Cir. 1998) (state licensing board consisting of private accountants not the “state,” and its actions “subjected to greater scrutiny” under the *Midcal* clear articulation analysis); *FTC v. Monahan*, 832 F.2d 688, 689-90 (1<sup>st</sup> Cir. 1987) (Breyer, J.) (state pharmacy board, consisting of private pharmacists, is a “subordinate governmental unit” and therefore undeserving of *ipso facto* state action status); *Massachusetts Bd. of Registration in Optometry*, 110 F.T.C. 549, 612-13 (1988) (state optometric licensing board not entitled to *ipso facto* state action treatment). In fact, the Supreme Court has noted that, other than the legal profession, it was unaware of “any trade or other profession in which the licensing of its members is determined directly by the sovereign itself . . . .” *Hoover*, 466 U.S. at 580 n.34.<sup>8</sup>

For these reasons, we reject the Board’s contention that it is entitled to *ipso facto* state action treatment and turn to whether the Board’s challenged action -- enacting the Emergency Regulation that required dental preexaminations -- was taken pursuant to a “clearly articulated” state legislative policy.

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<sup>8</sup> Moreover, the Board’s reliance on other cases, *see, e.g., Neuwirth v. Louisiana State Bd. of Dentistry*, 845 F.2d 553, 556 (5<sup>th</sup> Cir. 1988), is misplaced because state action treatment is not dependent on Eleventh Amendment standards, and, in any event, the Eleventh Amendment is not a bar to suit such as this one brought by the federal government.

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### 3. The Board's Emergency Regulation Does Not Satisfy the Clear Articulation Test

As discussed above, the Supreme Court in *Midcal* articulated the test for determining whether the actions of a private party or a nonsovereign state entity like the Board are exempt from antitrust law under the state action doctrine. This test requires, first, that the challenged conduct proceed from a “clearly articulated and affirmatively expressed” state policy to *displace* competition and, second, that the state “actively supervise[ ]” the conduct. *Midcal*, 445 U.S. at 105 (citations omitted). These two elements together address the economic and federalism concerns underlying the state action doctrine by “reconcil[ing] the interests of the states in adopting noncompetitive policies with the strong national policy favoring competition,” *Areeda & Hovenkamp*, *supra*, ¶ 221, at 374, and by ensuring that the antitrust laws will be displaced only where there is a “a deliberate and intended state policy.” *Ticor Title Ins. Co.*, 504 U.S. at 636. This principle also ensures that the state entity is held politically accountable for its anticompetitive policies.

In *Midcal*, the Court reviewed a California wine pricing system that required all wine producers and wholesalers in the state to file fair trade contracts or price schedules with the state. *Midcal*, 445 U.S. at 99. The California system specifically barred any state-licensed wine merchant from selling wine to a retailer at a price below the scheduled price. Because the “legislative policy is forthrightly stated and clear in its purpose to permit resale price maintenance,” *id.* at 105, the Court held that the pricing system satisfied the clear articulation test.<sup>9</sup>

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<sup>9</sup> The *Midcal* Court held, however, that the state pricing scheme did not satisfy the “active supervision” requirement and affirmed the California state court ruling that the scheme violated the Sherman Act. *Id.* The “active supervision” test requires that “the State has exercised sufficient independent judgment and control so that the details of the [restraint] have

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A line of post-*Midcal* cases more fully defines the parameters of the clear articulation standard. In *Community Communications Co., Inc. v. City of Boulder*, 455 U.S. 40 (1982), the Court held that the City of Boulder's moratorium on cable television expansions did not meet the clear articulation standard, even though Colorado's constitution vested municipalities with extensive powers of self-government in local and municipal matters. The Court found that despite the state's broad grant of power to localities, Colorado's position was "one of mere *neutrality*" with respect to the challenged conduct. *Boulder*, 455 U.S. at 55 (emphasis in the original). Consequently, the Court refused to find that "the general grant of power to enact ordinances necessarily implies

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been established as a product of deliberate state intervention, not simply by agreement among private parties." *Ticor Title Ins. Co.*, 504 U.S. at 634-35.

The Board argues that the active supervision test does not apply to any governmental entity. The Supreme Court has held that municipalities, unlike private parties, are not subject to the active supervision requirement and are protected by the state action doctrine if they are acting pursuant to a clearly articulated state policy. *Town of Hallie v. City of Eau Claire*, 471 U.S. 34, 46-47 (1985). The Court indicated in dicta that "it is likely that active state supervision would also not be required" when the relevant actor is a "state agency," but declined to resolve the issue. *Id.* at 46 n.10. Thus, the role of active supervision for the myriad varieties of governmental and quasi-governmental entities, including state regulatory boards, remains unclear. See FTC, Office of Policy Planning, Report of the State Action Task Force 15-19, 37-40, 55-56 (Sept. 2003) ("FTC Staff Report"). Because our analysis of the clear articulation requirement provides sufficient reason to deny the Board's motion to dismiss, we need not address whether active supervision is required under these circumstances.

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state authorization to enact specific anticompetitive ordinances.” *Id.* at 56.

By contrast, the Court in *Southern Motor Carriers* analyzed a Mississippi statute that authorized a state commission to regulate common carriers. In directing the commission to establish “just and reasonable” rates for intrastate transportation of commodities, the legislature clearly articulated “that intrastate rates would be determined by a regulatory agency, rather than by the market.” *Southern Motor Carriers*, 471 U.S. at 63-64 (citation omitted). The Court found that the challenged rate-setting program followed a clearly articulated policy to displace competition, even though the details of the rate-setting were under the agency’s discretion. In doing so, the Court stated that the clear articulation test does not require “express authorization for every action that an agency might find necessary to effectuate state policy.” *Id.* at 64.

Within the clear articulation parameters set forth in *Boulder* and *Southern Motor Carriers*, the Court has described factors relevant to determining whether a nonsovereign entity’s anticompetitive conduct follows a clear state policy. In *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 370-73 (1991), for example, the Court held that a city council’s ordinance restricting “the size, location, and spacing of billboards” met the clear articulation standard because the anticompetitive effects of such zoning restrictions were a “foreseeable result” of the statutes authorizing the city to regulate the use and construction of structures on city land. This test was satisfied because “[t]he very purpose of zoning regulation is to displace unfettered business freedom in a manner that regularly has the effect of preventing normal acts of competition, particularly on the part of new entrants.” 499 U.S. at 373. The Court also found foreseeability a useful tool in determining clear articulation in *Town of Hallie*, 471 U.S. at 41-42, where state law specifically authorized Wisconsin cities to delineate the area

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within which they would provide certain sewage services.<sup>10</sup> Unincorporated townships located next to the City of Eau Claire alleged that the city had “used its monopoly over sewage treatment to gain an unlawful monopoly over the provision of sewage collection and transportation services.” *Id.* at 37. The Court rejected this contention and concluded that “the statutes clearly contemplate that a city may engage in anticompetitive conduct. Such conduct is a foreseeable result of empowering the City to refuse to serve unannexed areas.” *Id.* at 42.<sup>11</sup>

Based on these post-*Midcal* cases, we can conclude that, while clear articulation does not require a state entity to show “express authorization” for every specific anticompetitive act, *Southern Motors Carriers*, 471 U.S. at 64, it does anticipate that the anticompetitive action will have a significant nexus to, or degree of “foreseeability” stemming from, an identifiable state policy. *City of Columbia*, 499 U.S. at 373. “Foreseeability” in this context, however, must be restricted to only those regulatory schemes in which the anticompetitive conduct would “ordinarily

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<sup>10</sup> *Southern Motor Carriers* -- decided the same day as *Town of Hallie* -- did not apply the foreseeability analysis, indicating that such analysis, while relevant, is not always necessary to determine clear articulation.

<sup>11</sup> Two pre-*Midcal* cases that denied state action treatment also provide insight into the clear articulation analysis. See *Goldfarb*, 421 U.S. at 790-92 (denying state action exemption because, although lawyers were subject to ethical codes issued by the state Supreme Court, the state court did not require or approve of state bar opinions placing minimum fee schedules for title searches); *Cantor v. Detroit Edison Co.*, 428 U.S. 579, 584-85 (1976) (denying state action exemption for a public utility that distributed free light bulbs as part of a light bulb exchange program, despite state’s approval of utility’s tariff that included the exchange program, where, at most, state policy was “neutral” with respect to the program).



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or routinely result” from the authorizing legislation in order to ensure that there was a deliberate and intended state policy. See FTC Staff Report 33-34. In any event, a state’s “general grant of power” to a political subdivision, without more, is insufficient for purposes of clear articulation under the state action doctrine. *Boulder*, 455 U.S. at 56.<sup>12</sup>

Here, the Board contends that its enactment of the Emergency Regulation satisfies the *Midcal* test, arguing that “[w]hen a state regulatory board has been given comprehensive authority to regulate a profession, such broad grant of authority has been held sufficient to satisfy the ‘clear articulation’ requirement for state action immunity.” Mem. in Support of Mot. to Dismiss at 33 (citing *Earles*, *supra*). The Board further asserts that its enactment of the Emergency Regulation was the “foreseeable result” of South Carolina’s grant of “comprehensive power to regulate both the practice of dentistry and the auxiliary practice of dental hygiene.” *Id.* We do not agree that the Board has established grounds for dismissal based on these assertions.

It is undisputed that South Carolina’s statutory regime gives the Board broad general authority to regulate the fields of dentistry and dental hygiene. See, e.g., S.C. Code Ann. §§ 40-15-10; 40-15-40 (2003). South Carolina law also vests the Board with authority to regulate many specific aspects of dentistry and dental hygiene

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<sup>12</sup> Certain lower courts have confused general authority to regulate with a state policy to displace competition. See, e.g., *Earles*, 139 F.3d at 1042; *Sandy River Nursing Care v. Aetna Casualty*, 985 F.2d 1138 (1<sup>st</sup> Cir. 1993). Other courts have made this distinction, analyzing whether the state intended to displace competition concerning the particular conduct at issue in addition to whether the governmental body was provided regulatory authority. See, e.g., *Cost Management Servs., Inc. v. Washington Natural Gas Co.*, 99 F.3d 937 (9<sup>th</sup> Cir. 1996); *Yeager’s Fuel, Inc. v. Pennsylvania Power & Light Co.*, 22 F.3d 1260, 1267-68 (3<sup>d</sup> Cir. 1994); see also *Areeda & Hovenkamp*, *supra*, ¶ 225, at 437.

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in the state, including licensing, specialization, advertising, and disciplining improper conduct.<sup>13</sup> This comprehensive legislative scheme necessarily allows the Board to displace competition in the provision of dentistry and dental hygiene services. For example, it is certainly an ordinary and foreseeable consequence of such a scheme that the Board will limit those practices to persons with adequate training and upon successful examination and will bar lay persons from such practices, even though doing so clearly limits in some sense “competition” for dental services.

Nevertheless, it cannot similarly be shown that the particular conduct alleged to be improper here -- imposition of the preexamination requirement by the Board in its Emergency Regulation -- was the foreseeable result of the DPA as amended in 2000. Prior to 2000, dental hygienists in South Carolina could apply sealants and oral prophylaxis in school settings only if four specific requirements were met: written parental permission; authorization from a licensed dentist; that the student not be the active patient of another dentist; and preexamination by the authorizing dentist within 45 days of treatment. S.C. Code Ann. § 40-15-80(C) (1999); Compl. ¶ 18. In 2000, the General Assembly amended the law to permit such treatment only with written parental permission and under the “general supervision” of a dentist. S.C. Code Ann. § 40-15-80(B) (2000); Compl. ¶ 19. “General supervision,” in turn, required only that a dentist “has authorized the procedures to be performed but [did] not require

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<sup>13</sup> For example, the DPA requires that a license can be issued only after examination, §§ 40-15-100, 40-15-140; provides various grounds to discipline dentists and dental hygienists, §§ 40-15-190(A), 40-15-140; regulates the manner in which dentists may advertise, § 40-15-130; imposes additional requirements on dentists who want to specialize in areas of practice, § 40-15-220; and requires that only dentists may control the use of dental equipment in a dental office and that dentists retain control over the selection of a course of treatment of a patient. § 40-15-135.

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that a dentist be present when the procedures are performed.” S.C. Code Ann. § 40-15-85(B)(2000). Whatever room these amendments left for regulation by the Board, the one thing that is clear is that the General Assembly sought “to make it easier for dental hygienists to deliver preventive dental care services in school settings,” Compl. ¶ 18, by deleting the 45-day preexamination requirement.

By removing this specific impediment to the ability of dental hygienists to provide preventive treatment in schools, South Carolina’s legislature has recast the boundaries between two sets of regulated professionals -- the dentists and the hygienists -- in order to promote rather than displace competition between them in the provision of these services. This result is evidenced by the statement of the South Carolina’s Governor’s Office that the 2000 amendments “remove[d] a regulation that hindered access to dental care” and would “allow[] dental hygienists to offer preventive dental care in places such as schools . . . [where] [d]entists rarely practice full-time.” State of S.C., Office of the Governor, *New Law Makes Children’s Dental Care More Accessible*, RX-4 (ex.7).

The Board’s primary basis for asserting that it reimposed the 45-day preexamination requirement pursuant to a “clearly articulated” state policy is the statute’s “general supervision” standard that requires a dentist’s authorization, § 40-15-85(B) (2000). As noted above, however, the “general supervision” provision does not, on its face, impose a requirement of prior examination by a dentist, much less “clearly articulate” a state policy that hygienists’ ability to offer preventive dental services in school settings was to be subject to such a restriction. In parsing the General Assembly’s 2000 enactment, we of course read the statute as “a symmetrical and coherent regulatory scheme” and “an harmonious whole.” *See, e.g., FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000) (citations omitted). We find it relevant that while the 2000 enactment added the “general supervision” requirement, it simultaneously and expressly eliminated the preexamination requirement that existed

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previously. Applying the “commonplace of statutory construction that the specific governs the general,” *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992), we can only conclude that the “general supervision” requirement does not authorize reimposition of the preexamination requirement that the Assembly had just eliminated.<sup>14</sup>

The Board attempts to bolster its argument by referring to widely-available industry standards issued by the ADA as they existed in 2000, on the apparent supposition that the South Carolina legislature intended to use the term “general supervision” in conformity with those standards. As a general matter, the courts have recognized that the state action doctrine “involves a question of law, generally an issue of statutory construction.”

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<sup>14</sup> Moreover, any consideration of the 2003 amendments -- although of minimal value in interpreting the prior enactment, *see* 2A Norman J. Singer, *Statutes and Statutory Construction* § 48:20, at 488-89 (6<sup>th</sup> ed. 2000) -- would only reinforce our view of the meaning of “general supervision” in both versions of the statute. While the legislature essentially left the definition of “general supervision” unchanged in 2003 (§ 40-15-85(2)), it addressed the issue of the need for dentist examination by imposing *additional* requirements for the provision of services under “general supervision” in certain settings. *See* § 40-15-102(C). Such additional requirements would be unnecessary if, as the Board supposed, the “general supervision” requirement itself mandated prior examination by a dentist. Moreover, the 2003 statute also specifically provided for the provision of certain hygienist services in public health settings without any preexamination requirement, *see* §§ 40-15-102(D), 40-15-110(10), while leaving in place the overall requirement that services provided in school settings be subject to “general supervision” (§ 40-15-80(B)). Again, the clear inference to be drawn from this combination of provisions is that the South Carolina legislature has not understood “general supervision” to encompass a prior examination requirement.

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*Euster v. Eagle Downs Racing Ass'n*, 677 F.2d 992, 997 (3<sup>d</sup> Cir. 1982); see *Telecor Communs., Inc. v. Southwestern Bell Tel. Co.*, 305 F.3d 1124, 1139 (10<sup>th</sup> Cir. 2002), *cert. denied*, 538 U.S. 1031 (2003); *Trigen-Oklahoma City Energy Corp. v. Okla. Gas & Elec. Co.*, 244 F.3d 1220, 1225 (10<sup>th</sup> Cir.), *cert. denied*, 534 U.S. 993 (2001). Nevertheless, as discussed above, in limited circumstances it is appropriate, even in addressing the meaning of a statutory enactment, to look to extrinsic sources that may have a bearing on the way in which the legislature used a particular term. See pp. 11-12, *supra*. The Board's reliance on the ADA's use of the term "general supervision," however, cannot overcome the statutory analysis set forth above, because there is no reason to conclude that the South Carolina legislature adopted the ADA's "general supervision" standard. Indeed, all indications are to the contrary. While the ADA's definition of that term specifically requires that the dentist "has personally diagnosed the condition to be treated," *ADA Comprehensive Policy on Dental Auxiliaries* (attached to RX-3 (ex. C)), S.C. Code Ann. § 40-15-85(B) (2000) strikingly omits this language from its provision defining "general supervision." By contrast, when the South Carolina legislature has intended to adopt an ADA definition *in toto*, it has done so expressly, as in its nearly verbatim incorporation of the ADA's definition of "direct supervision." Compare, e.g., S.C. Code Ann. § 40-15-85(A) (2000) with RX-3 (ex. C at 8).<sup>15</sup>

The Board has not shown that its enactment of the Emergency Regulation reimposing the 45-day preexamination requirement was the foreseeable result of the 2000 amendments. See *Telecor Communs.*, 305 F.3d at 1139-40 (state action protection did not apply to private party defendant because its activities, rather than expressly permitted by a state policy, were contrary to the state's policy of fostering competition in the pay phone market). On the

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<sup>15</sup> Indeed, certain provisions in the DPA (concerning the licensing of dental specialties) specifically refer to ADA standards or requirements. See, e.g., S.C. Code Ann. §§ 40-15-220, 40-15-250, 40-15-260 (2003).

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contrary, the Board's regulation appears to be in direct conflict with the South Carolina statute and inconsistent with the policy ideals behind the state action doctrine: that federalism permits the state as sovereign to displace the national policy of open competition with regulation, but only if such anticompetitive intent is clearly shown. In this way, federal antitrust policy will not be "unnecessarily and inappropriately subordinated to state policy." *Bates*, 433 U.S. at 362.

The Board's reliance on case law concluding that a state licensing board's broad grant of regulatory power necessarily contemplates certain anticompetitive conduct, *see, e.g., Earles*, 139 F.3d at 1042, is misplaced and does not cure the basic defect in its argument. Although the Board continued to have general authority over the practice of dentistry and dental hygiene, the 2000 amendments facially eliminated the preexamination requirement. We therefore cannot conclude that the Board's Emergency Regulation reinstating such a requirement was an action pursuant to a clearly articulated state policy to displace competition. Instead, the South Carolina legislature's specific direction to permit dental hygienists to provide preventive dental care in schools without preexaminations represents a discrete, pro-competitive "carve-out" from the Board's general authority over the practice of dentistry and dental hygiene. *See, e.g., Cost Management Servs.*, 99 F.3d at 942-43 (fact that state had displaced competition in the market for sale of natural gas with a regulatory structure did not provide a state action exemption for off-tariff pricing).

Finally, we also disagree with the Board's argument that the 2000 amendments maintained the state's "clearly articulated" policy to require dental preexaminations because the 2000 law removed only the requirement that a dentist be physically present when a hygienist performs certain services in schools. Mem. in Support of Mot. to Dismiss at 27-28. It is far from clear, however, whether a dentist was required to be physically present in school settings prior to 2000: the pre-2000 law made no reference to a physical presence requirement in the provision specifically

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governing the application of sealants and oral prophylaxis in school settings, § 40-15-80(C) (1999), and the law expressly permitted oral screenings and the application of topical fluoride “without the presence of a dentist on the premises.” § 40-15-80(B) (1999). If the aim of the 2000 statute was to delete the physical presence requirement, one would have expected such a requirement to be clearly shown in the pre-2000 law, such as by including it in its list of other requirements for the application of sealants and oral prophylaxis -- *e.g.*, parental consent, dentist preexamination -- set forth in Section 40-15-80(C). Further, the Board’s interpretation of the 2000 law would create anomalous conditions, such as requiring preexaminations under the “general supervision” provision for fluoride treatments in school settings even though no such requirement existed before 2000.

Contrary to the Board’s arguments, the plain language of the 2000 amendments indicates that the state General Assembly intended to allow dental hygienists to perform certain preventive dental treatments in schools without a prior dental examination. After all, the Assembly deleted specific language that had imposed a preexamination requirement. Moreover, as shown above, the Board has failed to show that the “general supervision” language provides a basis for its actions. In light of the 2000 statutory amendments, we cannot agree with the Board’s argument that its Emergency Regulation was “clearly articulated” by state policy.<sup>16</sup>

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<sup>16</sup> The Board asserts that the state court finding that the 2000 amendments required a dental preexamination, *see Health Promotion Specialists, supra*, constitutes an interpretation of state law that binds the Commission. We reject this argument. Although the Commission may consider state trial court interpretations of state law, we -- like federal courts -- are not bound by such interpretations. *See, e.g., King v. Order of United Commercial Travelers*, 333 U.S. 153, 159-62 (1948). This rule is particularly applicable where the state decision was based, in part, on the argument (now abandoned by the Board) that the 2000 law

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4. The Board's 2001 Emergency Regulation That Contravened South Carolina's Legislative Policy Was More Than a Mere "Error" of State Administrative Law

The Board also argues that, even if it erred in interpreting the 2000 amendments, its promulgation of the Emergency Regulation did not so far exceed the bounds of its statutory authority to regulate as to constitute the kind of "egregious level of error" necessary to lose its state action protection. Mem. in Support of Mot. to Dismiss at 28-31; Reply at 12-19. To support its argument, the Board relies on a statement in *City of Columbia* that, under the state action doctrine, "it is necessary to adopt a concept of authority broader than what is applied to determine the legality of the [political subdivision's] action under state law." *City of Columbia*, 499 U.S. at 372. Thus, a political subdivision would still be entitled to state action protection if it "possess[ed] the power to engage in the challenged conduct" through delegated statutory authority, even if its actual implementation of this authority were substantively or procedurally defective. *Id.* (citation omitted).

This argument is based upon a fundamental misreading of the cited *City of Columbia* passage. There the Court distinguished carefully between, on the one hand, the basic "authority to regulate" and, on the other hand, the specific authority "to suppress competition." *Id.* With respect to the former, the Court recognized that the authority of state bodies had to be read broadly, lest *any* state law error in the defendant's actions render those actions "unauthorized," and thus subject to antitrust attack. The Court rejected a rule that would thus "transform[] . . . state administrative review into a federal antitrust job." *Id.* (quoting *Areeda & Hovemkamp*, *Antitrust Law* ¶ 212.3b (Supp. 1989)). With respect to the authority to suppress competition, however, the Court emphasized the necessity of a clearly articulated state

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effected no substantive change in the law.



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policy that authorizes the political subdivision to engage in anticompetitive conduct.

The Board's argument in the present case ignores this distinction and would eviscerate the "clear articulation" standard. Complaint Counsel have not argued that the 2001 Emergency Regulation was simply "unauthorized" under state law, in the sense of being procedurally defective or substantively incorrect in a manner that is not directly related to competitive concerns. Rather, Complaint Counsel challenge the Emergency Regulation because it is *contrary* to a specific directive of the state legislature -- one that placed an express limitation on how far the Board was permitted to go in suppressing competition. If an action of this sort could be written off as a "mere error" of state law, such a theory would swallow the clear articulation rule. An action of a subordinate state entity that ignores an express legislative limitation of this sort must fall outside the state action exemption.

##### 5. State Action Holding

Based on the above analysis, we cannot conclude that the Board's enactment of the 2001 Emergency Regulation was protected state action. We have no reason to conclude that the Board's actions are those of the state as sovereign, so as to be *ipso facto* exempt state action. Nor can we conclude that the Board acted pursuant to a clearly articulated policy of the South Carolina legislature to displace competition. On the contrary, its actions appear to have contravened the clear legislative intent in the 2000 amendments to eliminate the preexamination requirement. Finally, the apparent flaw in the Board's actions is not a mere error of state administrative law, but relates directly to the limitations the state legislature has imposed on the Board's authority to restrict competition.

For all these reasons, we deny the Board's Motion to Dismiss on state action grounds. In so doing, we do not foreclose entirely further proceedings on the state action issue. Although the fundamental principles of statutory construction discussed above

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negate rather than support the defense in this situation, it remains conceivable, for reasons discussed previously, that the Board could adduce additional materials relevant to the interpretation of the 2000 statute. *See* pp. 11-12, 26-27, *supra*.<sup>17</sup> We leave any further consideration of this issue, along with other issues on the merits, to be addressed in such future administrative proceedings as may be necessary in the event we find a live controversy, after the limited inquiry described below regarding possible mootness.

**B. Whether This Case Is Moot**

The issue of whether this case is moot raises a question of disputed fact that the Commission cannot properly resolve on Respondent's Motion to Dismiss. For the reasons set forth below, however, we refer this matter to the administrative law judge for limited discovery on the issue of whether the challenged conduct is likely to recur.

1. Respondent's Mootness Claim

The Board asserts that the Commission should dismiss this case as moot because the 2003 amendments to the DPA, combined with the Emergency Regulation's expiration and the Board's actions since 2002, now ensure that hygienists are not subject to the dentist preexamination requirement and preclude the Board from engaging in the challenged conduct. In addition, the Board argues that, even if the matter is not technically moot, the

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<sup>17</sup> As emphasized above, any such inquiry must be narrow, in light of the legal nature of the issues of statutory interpretation to be addressed. In particular, post-enactment statements, particularly those from nonofficial sources (such as from the South Carolina Dental Hygiene Association website, RX-5), are not to be considered in the course of interpreting a statute. Singer, *supra* note 14, §§ 48:11, 48:20, at 456-62, 488-89.

## Commission Opinion

Commission should still dismiss the Complaint because there is no need for the relief contemplated by the Complaint.

## 2. Mootness Claims and Analysis

To prove that a case is moot, the moving party must show more than just that the challenged conduct has ceased; rather, the movant must establish that there is no reasonable expectation that the conduct could recur. *See United States v. W.T. Grant Co.*, 345 U.S. 629, 632 (1953) (“voluntary cessation of allegedly illegal conduct does not deprive the tribunal of power to hear and determine the case, *i.e.*, does not make the case moot”). Where the respondent contends that it will not repeat prior conduct, it bears a heavy burden to establish that a proceeding is moot. *See The Coca-Cola Co.*, 117 F.T.C. 795, 917 (1994).

In order to meet this burden, the Board primarily relies upon the changes to the statutory framework in South Carolina. The Board specifically cites the 2003 amendments to the DPA, which it contends now prevent it from imposing a dentist preexamination requirement on hygienists offering treatment in public settings. It also cites the expiration of the Emergency Regulation, which the Board has not attempted to revive. The Board relies on several cases, *e.g.*, *Native Village of Noatak v. Blatchford*, 38 F.3d 1505, 1510 (9<sup>th</sup> Cir. 1994), finding cases moot where allegedly discriminatory or unconstitutional state statutes were repealed. However, this case does not involve the repeal of a challenged law and the 2003 amendments did not change some area of the 2000 law that formed the basis of the Complaint. Instead, the Complaint alleges violative conduct by the Board under the 2000 law -- conduct that would similarly violate the 2003 law. Moreover, the Complaint alleges facts that suggest that the Board may again engage in the type of conduct the Complaint challenges. *See* Compl. ¶ 38. Accordingly, we cannot find this action moot at this time.

Commission Opinion

The Complaint alleges that the Board met in March 2003 and considered the proposed revisions to the DPA that the General Assembly thereafter enacted. Under the heading “The Current Threat to the Delivery of Preventive Dental Services in South Carolina,” Paragraph 38 of the Complaint alleges that the Board “maintained that in all settings where a dental hygienist provides treatment -- whether public health or private practice -- *a licensed dentist has to see the patient and provide a treatment plan*” (emphasis added). *See also* S.C. Bd. of Dentistry, Mins. From Conference Call (RX-13 (attach. B at 4)).

In ruling on a motion to dismiss, the Commission must accept all well-pled factual allegations as true and must construe all inferences in Complaint Counsel’s favor. *See supra* Section III. We therefore accept as true that the Board met to discuss what would become the 2003 amendments and interpreted these statutory revisions to require a preexamination by a dentist in all settings before a dental hygienist can provide treatment. The Board similarly found a preexamination requirement in the 2000 amendments, which led it to enact the Emergency Regulation. Paragraph 38 thus raises the inference that the Board will once again restrict, through some emergency enactment or other action, the ability of dental hygienists to provide treatment in school settings. In other words, the Complaint alleges facts that would clearly justify the Commission in ordering relief.

The Board’s October 16, 2003, Resolution (RX-13 (attach. A)) does not alter the inference that the Board may engage in the challenged conduct in the future. First, we note that the Board did not adopt the Resolution until after the Commission had issued the Complaint, and the Board could abandon the Resolution at any time. More important, to the extent that the Resolution offers an explanation or context for Paragraph 38 of the Complaint, we find that it simply raises a question of disputed fact that the Commission cannot resolve in a motion to dismiss. *See, e.g., Schering-Plough Corp.*, 2001 FTC LEXIS 198 (Oct. 31, 2001).

## Commission Opinion

Finally, the Board argues that there is no need for relief even if the matter is not “technically” moot. Motion to Dismiss at 22. We reject this argument. Because Paragraph 38 of the Complaint suggests that the Board will again engage in actions similar to those challenged, we find that the Complaint sets forth grounds for injunctive relief to address such actions. We thus decline to dismiss the Complaint on such grounds at this stage of these proceedings. *See FTC v. Citigroup Inc.*, 239 F. Supp. 2d 1302, 1306 (N.D. Ga. 2001) (denying Rule 12(b)(6) motion to dismiss and stating that an injunction may be issued if a violation is ongoing or likely to recur).

### 3. Mootness Holding

Accepting, as we must, all of the Complaint’s factual allegations and construing all inferences in the light most favorable to Complaint Counsel, we find that the Board has not met its burden of establishing that Complaint Counsel can prove no set of facts that would entitle them to relief. Accordingly, this case does not appear to be moot or otherwise subject to dismissal for failure to state a claim. However, our conclusion regarding mootness is based primarily on the factual allegations and inferences raised by Paragraph 38 of the Complaint, which raises the relatively narrow issue of whether there is a meaningful chance for recurrence of the challenged conduct.

During oral argument on this Motion, Respondent’s counsel agreed to engage in limited discovery to assist the Commission in resolving the mootness issue. *South Carolina State Bd. of Dentistry*, Oral Argument on Mot. to Dismiss, Hr’g Tr. 71, 75-76 (Jan. 13, 2004). We find this suggestion helpful. Thus, based upon each party’s interest in avoiding a potentially unnecessary trial, we exercise our discretion to refer this matter to the administrative law judge for limited discovery for ninety (90) days and an initial assessment of the likelihood that the Board may engage in future unlawful conduct under the 2003 statute. In particular, the Commission requests that the administrative law judge make findings of fact and resolve the context and

Commission Opinion

significance of the Board's March 2003 meeting and the Board's October 2003 Resolution. We leave to the administrative law judge's discretion whether to hold a hearing or to request a briefing to assist the Commission in resolving the Board's mootness defense. Apart from this limited referral, we retain jurisdiction over this matter.

**VII. CONCLUSION**

For all the reasons stated above, the Commission denies the Board's Motion to Dismiss on state action grounds. Further, we will retain jurisdiction over this case and hold in abeyance the Board's Motion to Dismiss on mootness grounds. We refer the matter to the administrative law judge to conduct limited discovery and to make findings of fact and an initial decision regarding the Board's mootness defense.

Order

**ORDER DENYING MOTION TO DISMISS ON STATE  
ACTION GROUNDS, HOLDING IN ABEYANCE MOTION  
TO DISMISS ON MOOTNESS GROUNDS, RETAINING  
JURISDICTION, AND REFERRING MOOTNESS ISSUES  
TO AN ADMINISTRATIVE LAW JUDGE**

Respondent South Carolina State Board of Dentistry has filed a Motion to Dismiss the Complaint in this matter, based on two grounds. First, Respondent argues that the acts that are the subject of the Complaint are exempt from federal antitrust liability under the state action doctrine. Second, Respondent argues that this case is moot because it has discontinued the challenged acts and because those acts are now barred by the 2003 amendments to state law.

The Commission has considered the Motion to Dismiss, as well as Respondent's and Complaint Counsel's briefs and oral arguments in support of and in opposition to the Motion to Dismiss. For the reasons stated in the accompanying Opinion, the Commission has determined: to deny Respondent's Motion to Dismiss on state action grounds; to hold in abeyance Respondent's Motion to Dismiss on mootness grounds; to retain jurisdiction; and to refer the mootness issues raised by Respondent's Motion to Dismiss to Chief Administrative Law Judge Stephen J. McGuire or his designee to conduct a limited inquiry and the preparation of an initial decision on the issue of whether there is a reasonable likelihood that the conduct challenged by the Complaint will recur. Accordingly,

**IT IS ORDERED THAT** Respondent's Motion to Dismiss on state action grounds be, and it hereby is, denied;

**IT IS FURTHER ORDERED THAT** Respondent's Motion to Dismiss on mootness grounds be, and it hereby is, held in abeyance;

Order

**IT IS FURTHER ORDERED THAT** the Commission shall retain jurisdiction of this matter, pursuant to Commission Rule 3.42(a), 16 C.F.R. § 3.42(a); and

**IT IS FURTHER ORDERED THAT** the mootness issues raised by Respondent's Motion to Dismiss be, and they hereby are, referred to Chief Administrative Law Judge Stephen J. McGuire or his designee for further proceedings in accordance with the accompanying Opinion, including in particular (1) the conduct of limited discovery, for a period not to exceed ninety (90) days from the date of issuance of this Order; and (2) the preparation of findings of fact and an initial decision addressing the likelihood that the Respondent may engage in future unlawful conduct under the 2003 South Carolina statute. For purposes of this proceeding, the deadline for filing the initial decision shall be determined and if necessary extended as prescribed by Commission Rule 3.51(a), 16 C.F.R. § 3.51(a), except that the deadline shall in no event be any earlier than January 31, 2005.



Complaint

**COMPLAINT**

Pursuant to the provisions of the Federal Trade Commission Act, as amended, 15 U.S.C. § 41, *et seq.*, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that the South Carolina State Board of Dentistry violated Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues this Complaint stating its charges in that respect as follows:

**STATEMENT OF THE CASE**

1. Respondent South Carolina State Board of Dentistry (“the Board”), which consists almost entirely of practicing dentists, restrained competition in the provision of preventive dental care services by unreasonably restricting the delivery of dental cleanings, sealants, and topical fluoride treatments in school settings by licensed dental hygienists. Although the South Carolina General Assembly passed legislation in 2000 eliminating a statutory requirement that a dentist examine each child before a hygienist may perform cleanings or apply sealants in school settings, the Board in 2001 re-imposed the very examination requirement that the legislature had eliminated, and extended it to the application of topical fluoride in school settings as well. The effect of the Board’s action was to deprive thousands of school children—particularly economically disadvantaged children—of the benefits of preventive oral health care services. The Board’s anticompetitive action, undertaken by self-interested industry participants with economic interests at stake, was contrary to state policy and was not reasonably related to any countervailing efficiencies or other benefits sufficient to justify its harmful effects on competition and consumers.

Complaint

**RESPONDENT**

2. The Board is organized, exists, and transacts business under and by virtue of the laws of South Carolina, with its principal office at Synergy Business Park, Kingstree Building, 110 Centerview Dr., Columbia, South Carolina 29210.

3. The Board was created by the South Carolina legislature to supervise the practice of dentistry and dental hygiene.

4. By virtue of the Board's make-up, the licensed dentists of South Carolina regulate both themselves and dental hygienists.

5. The Board is composed of seven dentists, one dental hygienist, and one public member. The licensed dentists in South Carolina elect six of the dentist members for approval by the governor, and the dental-hygienist member is elected by licensed dental hygienists in South Carolina for approval by the governor. The governor of South Carolina appoints one of the dentist members and the public member.

6. While serving their membership terms, dentist members of the Board may, and do, continue to engage in the business of providing dental services for a fee. Except to the extent that competition has been restrained as alleged below, and depending on their geographic location, licensed dentists in South Carolina compete with each other and with dentist members of the Board.

7. The Board is the sole licensing authority for dentists and dental hygienists in South Carolina. It is generally unlawful for an individual to practice or to offer to practice dentistry or dental hygiene in South Carolina unless he or she holds a current license to practice.

8. The Board is authorized by South Carolina law to take disciplinary action against any licensee who violates any rule or regulation promulgated by the Board. Disciplinary action by the

## Complaint

Board may include the suspension or revocation of a license, or other limitations or restrictions on a licensee.

**JURISDICTION**

9. The Board is a state regulatory body and is a “person” within the meaning of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45.

10. Substantial sums of money flow into South Carolina from the federal government and other out-of-state payers for the purchase of preventive dental care services. The acts and practices of the Board, including the acts and practices alleged herein, have been or are in or affecting “commerce” within the meaning of Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

**PREVENTIVE DENTAL SERVICES IN SOUTH  
CAROLINA**

11. Dental hygienists are licensed health care professionals who specialize in providing preventive oral health services. Such services include cleaning teeth, taking x-rays, providing nutrition and dietary counseling, providing fluoride treatments, and applying dental sealants. Dental hygienists are also trained to detect signs of oral disease and to educate patients on maintaining optimal oral health.

12. There are over 2,200 dental hygienists licensed to practice in South Carolina. Dental hygienists in South Carolina practice in collaboration with a supervising dentist or under the direction of the South Carolina Department of Health and Environmental Control’s public health dentist.

13. Firms owned by dental hygienists working in collaboration with a dentist (either supervised by a private dentist or working at the direction of South Carolina’s public health dentist) can

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compete with dentists for the provision of preventive dental care services.

14. Many children in South Carolina suffer from oral health problems because they do not receive preventive dental care, particularly children in low-income families. Over 400,000 children – more than 40 percent of children in South Carolina – are Medicaid-eligible. In the early 1990s, only 12 percent of Medicaid-eligible children received preventive dental care services.

15. In 1988, the South Carolina General Assembly enacted a law specifically authorizing dental hygienists to provide preventive services in schools. That law, however, required that hygienists could provide cleanings and apply dental sealants only if a dentist had examined the child's teeth within the previous 45 days. The 1988 law did not significantly increase the delivery of dental hygienists' services in school settings.

16. In 2000, South Carolina substantially increased Medicaid reimbursement for dental services. With federal matching funds, about \$79 million became available annually for Medicaid-eligible dental services.

17. After Medicaid payment levels for dental care services increased, the number of South Carolina dentists participating in South Carolina's Medicaid-Dental program increased about one-third. More than 900 of the over 1,500 licensed dentists licensed in South Carolina now participate in the state's Medicaid-Dental program.

Complaint

**SOUTH CAROLINA GENERAL ASSEMBLY REMOVES A  
BARRIER TO THE PROVISION OF PREVENTIVE  
DENTAL CARE IN SCHOOLS**

18. In 2000, the South Carolina General Assembly amended its statutes to make it easier for dental hygienists to deliver preventive dental care services in school settings. Prior to the 2000 amendments, South Carolina statutes provided that a dental hygienist could provide cleanings and sealants in a school setting only if:

- (1) a supervising dentist examined the patient no more than 45 days before the treatment;
- (2) a supervising dentist provided written authorization for the procedures;
- (3) the patient was not an active patient of another dentist; and
- (4) the patient's parents provided written permission for the treatment.

19. The 2000 amendments removed these requirements, except the requirement for parental consent. The 2000 amendments provided instead that a dental hygienist could apply topical fluoride and perform the application of sealants and oral prophylaxis "under general supervision." S.C. Acts § 40-15-80(B) (2000). General supervision "means that a licensed dentist or the South Carolina Department of Health and Environmental Control's public health dentist has authorized the procedures to be performed but does not require that a dentist be present when the procedures are performed." S.C. Acts § 40-15-85 (2000). By virtue of the 2000 amendments, the Board could not require a dentist examination as a condition of a dental hygienist's providing preventive services in a school setting.

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20. Upon signing the 2000 amendments, South Carolina's governor announced: "This new law removes a regulation that hindered access to dental care."

21. The 2000 amendments embodied a policy to remove artificial barriers to the provision of oral preventive health care by dental hygienists to school children.

22. Health Promotion Specialists ("HPS") is a firm owned by a dental hygienist that provides preventive dental services to South Carolina children. HPS employs dental hygienists to provide those services and contracts with dentists to supervise the hygienists.

23. In January 2001, HPS began providing cleanings, sealants, topical fluoride treatments, and other preventive dental services on-site to children in South Carolina schools. By July 2001, HPS had screened over 19,000 children, and provided preventive services (cleanings, sealants, and topical fluoride treatments) to over 4,000 children, including nearly 3,000 Medicaid-eligible children. Because HPS's services were provided in schools, they were more convenient for the families of the children served. Dentists in traditional office practices risked losing patients to HPS.

24. Because a tremendous unmet need for preventive dental care remained, HPS expected to treat more than twice as many students in the fall semester of 2001 as it had in the spring semester. Relying on this forecast, HPS more than doubled the number of hygienists it employed.

### **BOARD CONDUCT**

25. The Board has restrained competition in the provision of preventive dental care services by combining or conspiring with its members or others, or by acting as a combination of its members or others, to restrict unreasonably the ability of dental hygienists to deliver preventive services in school settings. In

## Complaint

particular, on July 12, 2001, the Board adopted an emergency regulation governing dental hygienist practice in school settings that re-imposed the same examination requirement that the General Assembly removed in 2000: that a supervising dentist had to examine the patient no more than 45 days prior to treatment.

26. For the regulation to become effective, it required the approval only of the Board, a majority of which consists of practicing dentists elected by the licensed dentists of South Carolina. No financially disinterested state actor approved the regulation before or while it was in effect. Under state law, the regulation terminated after 180 days.

27. The emergency regulation conflicted directly with the policy articulated by the General Assembly, by re-imposing the precise barriers to dental hygienists' providing preventive services to school children that the legislature had just removed.

28. The effect of the emergency regulation was to reduce substantially the number of children (particularly economically disadvantaged children) who received preventive dental care. During the latter half of 2001, the period when the emergency regulation was in effect, HPS screened fewer than 6,000 children, about 13,000 fewer than it had screened during the first half of 2001. The emergency regulation also limited HPS's ability to provide preventive dental care; as a result, the regulation deprived thousands of South Carolina children of preventive dental care.

29. The Board's requirement that a dentist examine each child before a dental hygienist provides a cleaning, sealant, or fluoride treatment in school settings was not reasonably related to any efficiencies or other benefits sufficient to justify its harmful effect on competition and consumers.

Complaint

**STATE ADMINISTRATIVE REVIEW FINDS  
IMPOSITION OF THE DENTIST PRE-EXAMINATION  
REQUIREMENT IN SCHOOL SETTINGS CONTRARY TO  
THE 2000 AMENDMENTS**

30. In August 2001, the Board published a proposed permanent regulation substantially identical to the emergency regulation, which by law would lapse in January 2002.

31. Pursuant to South Carolina law, an administrative law judge was required, after a public hearing, to determine whether the proposed permanent regulation was a reasonable exercise of the Board's authority. The administrative law judge's report, along with the proposed regulation, had to be forwarded to the General Assembly for review in order for the permanent regulation to become effective.

32. In February 2002, the presiding administrative law judge issued a report that concluded that the Board's proposed permanent regulation was unreasonable and contravened state policy to the extent it reinstated the dentist pre-examination requirement that the legislature had eliminated in 2000.

33. The administrative law judge found that deletion of the statutory pre-examination requirement reflected a state policy adopted by the South Carolina legislature during its 2000 session to increase access to preventive oral health care for low-income children. The administrative law judge recommended that the Board delete the pre-examination requirement from its proposal before forwarding it to the legislature.

34. After issuance of the administrative law judge's report, the Board did not submit its proposed permanent regulation to the General Assembly for review. As a result, the proposed regulation did not take effect.



Complaint

**THE CURRENT THREAT TO THE DELIVERY OF  
PREVENTIVE DENTAL SERVICES IN SOUTH  
CAROLINA**

35. After the emergency regulation lapsed, at least three firms, including HPS, provided preventive dental care in schools pursuant to contracts with the Department of Health and Environmental Control. Under the contracts, these firms provided cleanings, fluoride treatments, and sealants, under standing orders, without a mandatory pre-examination by a dentist.

36. During the latter part of 2002, HPS provided preventive dental care treatments to nearly 10,700 school children, 6,000 more than during the same period in 2001, when the Board's emergency regulation was in effect.

37. In May 2003, the South Carolina General Assembly enacted legislation that expressly provides that dentist examination requirements applicable in some settings do not apply to dental hygienists' provision of preventive oral health care services, including cleanings, sealants and topical fluoride, when they are working in public health settings under the direction of the Department of Health and Environmental Control.

38. Nonetheless, when the Board in March 2003 considered the statutory revisions that the General Assembly later enacted, it maintained that in all settings where a dental hygienist provides treatment – whether public health or private practice – a licensed dentist has to see the patient and provide a treatment plan.

**ANTICOMPETITIVE EFFECTS**

39. The Board's acts and practices have had the effect of restraining competition unreasonably and injuring consumers in the following ways, among others:

Complaint

- A. hindering competition in the delivery of cleaning, sealant, topical fluoride, and other preventive dental services to school-aged children in South Carolina; and
- B. depriving thousands of school children—particularly economically disadvantaged school children—of the benefits of preventive oral health care.

**VIOLATION**

40. The combination, conspiracy, acts and practices described above constitute unfair methods of competition in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. Such combination, conspiracy, acts, and practices, or the effects thereof, are continuing and will continue or recur in the absence of the relief herein requested.

**NOTICE**

Notice is hereby given to the Respondent that the fourteenth day of January, 2004, at 10:00 a.m., or such later date as determined by the Commission or by an Administrative Law Judge of the Commission, is hereby fixed as the time and Federal Trade Commission offices, 600 Pennsylvania Ave., N.W., Washington, D.C. 20580, as the place when and where a hearing will be had on the charges set forth in this Complaint, at which time and place you will have the right under the FTC Act to appear and show cause why an order should not be entered requiring you to cease and desist from the violations of law charged in the Complaint.

Pending further order of the Commission, the Commission will retain adjudicative responsibility for this matter. *See* § 3.42(a) of the Commission's Rules of Practice for Adjudicative Proceedings. Pursuant to § 3.12 of those Rules, the Commission hereby allows you until 30 days from the date of service of this Complaint upon you to file either an answer or a dispositive motion. If you file a dispositive motion within that time, your time for filing an answer

## Complaint

is extended until 10 days after service of the Commission's order on such motion. If you do not file a dispositive motion within that time, you must file an answer.

An answer in which the allegations of the Complaint are contested shall contain a concise statement of the facts constituting each ground of defense; and specific admission, denial, or explanation of each fact alleged in the Complaint or, if you are without knowledge thereof, a statement to that effect. Allegations of the Complaint not thus answered shall be deemed to have been admitted.

If you elect not to contest the allegations of fact set forth in the Complaint, the answer shall consist of a statement that you admit all of the material facts to be true. Such an answer shall constitute a waiver of hearings as to the facts alleged in the Complaint and, together with the Complaint, will provide a record basis on which the Administrative Law Judge shall file an initial decision containing appropriate findings and conclusions and an appropriate order disposing of the proceeding. In such answer, you may, however, reserve the right to submit proposed findings and conclusions under § 3.46 of the Commission's Rules of Practice for Adjudicative Proceedings and the right to appeal the initial decision to the Commission under §3.52 of said Rules.

Failure to answer within the time above provided shall be deemed to constitute a waiver of your right to appear and contest the allegations of the Complaint and shall authorize the Administrative Law Judge, without further notice to you, to find the facts to be as alleged in the Complaint and to enter an initial decision containing such findings, appropriate conclusions, and order.

The Commission or the Administrative Law Judge will schedule an initial prehearing scheduling conference to be held not later than 14 days after an answer is filed by Respondent. Unless otherwise directed by the Commission or the Administrative Law Judge, the scheduling conference and further

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proceedings will take place at the Federal Trade Commission, 600 Pennsylvania Avenue, N.W., Room 532, Washington, D.C. 20580. Rule 3.21(a) requires a meeting of the parties' counsel as early as practicable before the prehearing scheduling conference, and Rule 3.31(b) obligates counsel for each party, within 5 days of receiving a respondent's answer, to make certain initial disclosures without awaiting a formal discovery request.

**NOTICE OF CONTEMPLATED RELIEF**

Should the Commission conclude from the record developed in an adjudicative proceeding in this matter that the Board is in violation of Section 5 of the Federal Trade Commission Act, as alleged in the Complaint, the Commission may order such relief as is supported by the record and is necessary and appropriate, including, but not limited to, an order that requires the following:

1. The Board shall cease and desist from, either directly or indirectly, requiring that a dentist conduct an examination of a patient as a condition of a dental hygienist who is working in a public health setting pursuant to S.C. Code Ann. § 40-15-110(A)(10), or any recodification thereof, performing oral prophylaxis or applying sealants or topical fluoride to that patient, unless the examination requirement is adopted by the South Carolina General Assembly after the date that the order becomes final.
2. The Board shall mail a copy of the Complaint, order, and an explanatory notice to each Board member; each officer, director, representative, agent, and employee of the Board; each person licensed to practice dentistry or dental hygiene in South Carolina; and the superintendent of each school district in South Carolina.
3. The Board shall take such other measures that are appropriate to correct or remedy, or prevent the recurrence of, the anticompetitive practices in which it engaged.

## Complaint

**WHEREFORE, THE PREMISES CONSIDERED,** the Federal Trade Commission on this twelfth day of September, 2003, issues its Complaint against Respondent South Carolina State Board of Dentistry.

By the Commission.

Donald S. Clark  
Secretary

SEAL

Complaint

IN THE MATTER OF

**SOUTHEASTERN NEW MEXICO  
PHYSICIANS IPA, INC., ET AL.**

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

*Docket C-4113; File No. 0310134  
Complaint, August 5, 2004--Decision, August 5, 2004*

This consent order, among other things, prohibits Respondent Southeastern New Mexico Physicians IPA, Inc. ("SENM") -- an independent practice association with 68 physician members -- and two of its non-physician employees, also respondents, from entering into or facilitating any agreement between or among any physicians (1) to negotiate with payors on behalf of any physician; (2) to deal, not to deal, or threaten not to deal with payors; (3) on what terms to deal with any payor; or (4) not to deal individually with any payor, or to deal with any payor only through an arrangement involving the respondents. The order also prohibits the respondents from facilitating exchanges of information between physicians concerning whether, or on what terms, to contract with a payor, and from attempting to engage, or inducing anyone to engage in, any action prohibited by the order. In addition, the order prohibits the individual respondents, for three years, from negotiating with any payor on behalf of SENM or any SENM member, and to notify the Commission before entering into any arrangement to act as a messenger, or as an agent on behalf of any physicians, with payors regarding contracts.

*Participants*

For the Commission: *Steve Vieux, Patrick English, David Pender, Jeffrey W. Brennan, Anne R. Schenof, Daniel P. Ducore, Louis Silvia and Luke Froeb.*

For the Respondents: *Andrew S. Gordon.*

**COMPLAINT**

Pursuant to the provisions of the Federal Trade Commission Act, as amended, 15 U.S.C. § 41 *et seq.*, and by virtue of the authority vested in it by said Act, the Federal Trade Commission ("Commission"), having reason to believe that Southeastern New Mexico Physicians IPA, Inc. ("SENM"), Barbara Gomez, and

## Complaint

Lonnie Ray, hereinafter referred to as “Respondents,” have violated Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues this Complaint stating its charges in that respect as follows:

**NATURE OF THE CASE**

1. This matter concerns horizontal agreements among competing physicians in the Roswell, New Mexico, area, to fix prices charged to health care plans and other third-party payors (“payors”), and to refuse to deal with payors except on collectively agreed upon terms. These physicians constitute most of the physicians in the Roswell area. They orchestrated these price-fixing agreements and refusals to deal through SENM and its non-physician employees, Barbara Gomez and Lonnie Ray, and their conduct raised the price of physician services in the Roswell area.

**RESPONDENTS**

2. SENM is a not-for-profit corporation, organized, existing, and doing business under and by virtue of the laws of the State of New Mexico, with its principal address at 500 North Main Street, Suite 618, Roswell, NM 88201.

3 Barbara Gomez and Lonnie Ray are individuals who negotiate payor contracts on behalf of SENM’s physician members. Their principal address is 500 North Main Street, Suite 618, Roswell, NM 88201.

**THE FTC HAS JURISDICTION OVER RESPONDENTS**

4. At all times relevant to this Complaint, SENM has been engaged in the business of contracting with payors, on behalf of its physician members, for the provision of health care services to persons for a fee.

Complaint

5. SENM was founded by, is controlled by, and carries on business for the pecuniary benefit of its physician members. Accordingly, SENM is a corporation within the meaning of Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

6. Except to the extent that competition has been restrained as alleged herein, SENM physician members have been, and are now, in competition with each other for the provision of physician services in the Roswell area for a fee.

7. Respondents' general business practices, including the acts and practices herein alleged, are in or affecting "commerce" as defined in the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

**OVERVIEW OF MARKET AND PHYSICIAN  
COMPETITION**

8. SENM is an independent practice association ("IPA") with approximately 68 physician members, all of whom are licensed to practice allopathic or osteopathic medicine in the State of New Mexico, and engaged in the business of providing physician services to patients in the Roswell area. Approximately 73% of the physicians who independently practice in the Roswell area are members of SENM. To be competitively marketable in the Roswell area, a payor's health insurance plan must include in its physician network a large number of primary care physicians and specialists who practice in that area.

9. Roswell is in southeastern New Mexico. The closest major cities to Roswell are El Paso, Texas, approximately 200 miles to the southwest; Lubbock, Texas, approximately 260 miles to the east; Albuquerque, the largest city in New Mexico, approximately 200 miles to the northwest; and Santa Fe, the state capital and second largest city in the state, approximately 190 miles to the northwest.



## Complaint

10. Physicians often contract with payors to establish the terms and conditions, including price terms, under which the physicians will render services to the payors' subscribers. Physicians entering into such contracts often agree to lower compensation to obtain access to additional patients made available by the payors' relationship with insureds. These contracts may reduce payors' costs and enable them to lower the price of insurance, and thereby result in lower medical care costs for subscribers to the payors' health insurance plans.

11. Absent agreements among competing physicians on the terms, including price, on which they will provide services to enrollees in payors' health care plans, competing physicians decide individually whether to enter into payor contracts to provide services to their subscribers or enrollees, and what prices they will accept pursuant to such contracts.

12. Medicare's Resource Based Relative Value System ("RBRVS") is a system used by the United States Centers for Medicare and Medicaid Services to determine the amount to pay physicians for the services they render to Medicare patients. The RBRVS approach provides a method to determine fees for specific services. In general, payors in the Roswell area make contract offers to individual physicians or groups at a price level specified as some percentage of the RBRVS fee for a particular year (*e.g.*, "110% of 2003 RBRVS").

13. Competing physicians sometimes use a "messenger" to facilitate the establishment of contracts between themselves and payors in ways that do not constitute or facilitate an unlawful agreement on prices and other competitively significant terms. Such a messenger may not, however, consistent with a competitive model, negotiate prices and other competitively significant terms on behalf of the participating physicians, or facilitate the physicians' coordinated responses to contract offers by, for example, electing not to convey a payor's offer to them based on the messenger's opinion on the appropriateness, or lack thereof, of the offer.

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**RESPONDENTS NEGOTIATED PAYOR CONTRACTS  
FOR SENM PHYSICIAN MEMBERS**

14. SENM's physician members each pay \$500 annual membership dues. A physician member becomes eligible to participate in SENM's contracts by entering into a "Physician Agreement" with the organization. SENM's representatives, Respondents Gomez and Ray, negotiate one single-signature contract with each payor, signed by SENM's president, on behalf of all of SENM's physician members. The contracts include a uniform fee schedule that applies to the entire general membership.

15. SENM's Managed Care Contract Committee ("Contract Committee") is responsible for evaluating, on behalf of SENM's physician members, contracts and contracting opportunities with payors. According to one SENM document, the Contract Committee's goal is to convince members "to agree . . . to handle managed care as a group." The Contract Committee reports to SENM's Board of Directors ("SENM Board").

16. Another Contract Committee function is to "arrange for external negotiation resources." SENM has contracted with payors through Ms. Gomez and Ms. Ray. Ms. Gomez and Ms. Ray were once employees of a consulting firm that negotiated contracts for SENM. After that firm exited the business in 2001, Ms. Gomez and Ms. Ray became SENM employees and continued to negotiate payor contracts for SENM.

17. Ms. Gomez and Ms. Ray, with the assistance of the SENM Board and Contract Committee, developed and periodically updated an IPA fee schedule that, according to Contract Committee minutes, was "used to negotiate contracts" with payors. The IPA fee schedule – which the SENM Board must approve – lists the minimum prices at which SENM will accept a payor contract offer.

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18. In developing the IPA fee schedule, SENM surveyed its members on the minimum price levels they would accept. To aid physicians in making this decision, SENM informed them of the prices they were paid for their most common medical procedures under preexisting, SENM-negotiated payor contracts. All such contracts contained prices that the physicians had fixed and jointly demanded through SENM. Many SENM physician members used these fixed prices to determine the minimum price levels they would accept through SENM negotiations with payors.

19. Ms. Ray reported to the Contract Committee that the SENM physicians “expected fees that were far beyond any amount that most payors would be willing to accept.” According to Contract Committee minutes, members nonetheless “agreed that she should make every effort to obtain the desired reimbursement or as close as possible.”

20. Ms. Gomez and Ms. Ray negotiate with payors on the prices and other contract terms pursuant to which SENM members will provide medical care to subscribers of payors’ health plans, and report to the SENM Board and Contract Committee on developments in payor negotiations. The Contract Committee must approve any negotiated contract, at which point it then submits the contract to the SENM Board for approval. The SENM Board, once it approves a contract, presents the contract to the individual members and recommends that they approve it. If a majority of the general membership approves the contract, then SENM’s president signs the contract on the organization’s behalf. Thereafter, SENM’s members decide whether to opt into or out of the contract. Members routinely opted into contracts jointly negotiated on their behalf in this manner.

21. SENM’s physician members agreed with each other and with SENM that they would not deal individually, or through any other organization, with any payor with which SENM was attempting to negotiate, or had signed, a contract jointly on behalf of SENM’s members. SENM’s members often refused payor offers made to them individually, hindering payors’ efforts to

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establish competitive physician networks in the Roswell area. Due to SENM's large share of Roswell area physicians, payors have repeatedly acceded to Respondents' price demands for all SENM members.

22. Reflecting SENM's mission as a contracting entity for its members' joint benefit, minutes from a SENM general membership meeting, under the heading "President's Report," state: "Solidarity of IPA – Reinforced the importance that the bargaining strength of the overall organization rests with the solidarity of its membership." When a payor attempted to negotiate individual contracts with SENM's physician members, it was repeatedly rebuffed.

23. In a November 1998 letter to one payor, a SENM representative stated that SENM members had agreed on prices they should receive for physician services, would forward that fee schedule to the payor the next day, and would not deal with that payor unless it "meets or exceeds" those prices. The letter added that SENM would not accept a contract offer "if any single fee is less than what has been approved by the general membership."

24. Prices for physician services in New Mexico typically range from approximately 120% to 140% of RBRVS, for most procedures. Through collective negotiations and threatened refusals to deal, Respondent SENM has contracted for much higher prices than the New Mexico average, including prices as high as 250% of RBRVS for some procedures.

### **HEALTHSMART PREFERRED CARE**

25. Healthsmart Preferred Care, Inc. ("Healthsmart"), is a health plan doing business in the Roswell area. In July 1997, Healthsmart and SENM, on its members' collective behalf, first entered into a contract. In March 1998, SENM demanded to negotiate a new contract. During these negotiations, SENM, through Ms. Gomez and Ms. Ray, collectively demanded higher fees from Healthsmart. SENM insisted on fees that were, on

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average, more than 15% above Healthsmart's fee schedule with comparable IPAs in the region.

26. By April 1999, Healthsmart and SENM had not agreed on new price terms. Ms. Ray, on behalf of SENM, terminated contract discussions with Healthsmart. SENM's refusal to deal forced Healthsmart to stop doing business in the Roswell area, because it had no other alternatives for a viable physician network in the area.

27. In 2001, Healthsmart and SENM resumed contract negotiations. Healthsmart, in response to SENM's consistently high price demands, proposed prices well above 130% of RBRVS, but SENM responded that those rates still were not high enough. Healthsmart approached individual SENM physicians directly, to try to establish a provider network without including SENM, but the physicians repeatedly told the payor that they would deal only through SENM. In December 2001, Healthsmart, having no reasonable alternative for a marketable health plan in the Roswell area, came to terms with SENM by meeting its price demands. The contract's prices were, depending on procedure, as much as 50% or more above Healthsmart's offer, and believed to be the highest in the region.

**PRESBYTERIAN HEALTH PLAN**

28. Presbyterian Health Plan, Inc. ("Presbyterian"), is a payor doing business in the Roswell area. In 1996, Presbyterian and SENM entered into the first contract between them. Under the contract, Presbyterian met SENM's call for prices that were substantially higher than New Mexico averages – reaching as high as 200% of current-year RBRVS for some procedures. In May 2001, SENM started to negotiate, collectively on its members' behalf, with Presbyterian over price and other terms in a new contract. Presbyterian proposed prices ranging from approximately 100% to 145% of 2001 RBRVS. In August of that year, Ms. Gomez, on behalf of SENM and its physician members, rejected Presbyterian's offer and told the payor that SENM

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insisted on prices in the range of 150% to 225% of RBRVS. In November 2001, Presbyterian agreed to prices that closely matched Ms. Gomez's and SENM's terms, and SENM signed a contract with the payor in December of that year.

**BEECH STREET**

29. Beech Street Corporation ("Beech Street") is a health plan doing business in the Roswell area. In 1997, SENM entered into a contract with Beech Street, under which Beech Street agreed to pay SENM physician members according to the fee schedule that SENM developed on its members' behalf.

30. SENM and Beech Street most recently renegotiated their contract in 2001. In November 2001, Ms. Gomez transmitted to Beech Street what she characterized as SENM's "IPA fee requirement." It contained prices for various medical procedures ranging from more than 150% to more than 220% of RBRVS. Beech Street responded that it "conducted an analysis and compared the rates to other rural areas and [felt] these rates are extremely high," and sent a counteroffer more in line with prices in other rural areas.

31. In December 2001, Ms. Gomez rejected Beech Street's counteroffer without transmitting it to individual SENM members for their unilateral acceptance or rejection. She told Beech Street that its counteroffer was too low for many specialists, and that "[t]he IPA represents all of [its] members and [has] been known to reject a contract if a proposal is not good for the majority." Ms. Gomez then sent to Beech Street what she called SENM's "final offer," which contained prices nearly identical to those that Beech Street had found to be "extremely high" the previous month. In July 2002, having no reasonable alternative for a marketable health plan in the Roswell area, Beech Street agreed to contract terms containing prices closely reflecting SENM's demand, ranging from more than 140% to 200% of 2001 RBRVS.

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**OTHER PAYORS**

32. SENM has orchestrated collective negotiations with other payors that do business, or attempted to do business, in the Roswell area, including Blue Cross and Blue Shield of New Mexico, Lovelace Sandia Health System, and Omni Networks, Inc. Ms. Gomez and Ms. Ray, with the assistance of the SENM Board and Contract Committee, negotiated with these payors on price, making proposals and counterproposals, as well as accepting or rejecting offers without transmitting them to physician members for their individual acceptance or rejection. SENM's members collectively accepted or rejected these payor contracts, and refused to deal with these payors individually. Due to SENM's dominant market position in the Roswell area, such coercive tactics have been highly successful. SENM has been able to extract high prices from these payors relative to what the payors pay other physicians in New Mexico.

**RESPONDENTS' PRICE-FIXING IS NOT JUSTIFIED**

33. Respondents' joint negotiation of fees and other competitively significant contract terms has not been, and is not, reasonably related to any efficiency-enhancing integration.

**RESPONDENTS' ACTIONS HAVE HAD SUBSTANTIAL ANTICOMPETITIVE EFFECTS**

34. Respondents' actions described in Paragraphs 14 through 32 of this Complaint have had, or have tended to have, the effect of restraining trade unreasonably and hindering competition in the provision of physician services in the Roswell area in the following ways, among others:

1. price and other forms of competition among physician members of SENM were unreasonably restrained;
2. prices for physician services were increased; and

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3. health plans, employers, and individual consumers were deprived of the benefits of competition among physicians.

**VIOLATION OF THE FEDERAL TRADE COMMISSION  
ACT**

35. The combination, conspiracy, acts, and practices described above constitute unfair methods of competition in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. Such combination, conspiracy, acts, and practices, or the effects thereof, are continuing and will continue or recur in the absence of the relief herein requested.

**WHEREFORE, THE PREMISES CONSIDERED,** the Federal Trade Commission on this fifth day of August, 2004, issues its Complaint against Respondents SENM, Barbara Gomez, and Lonnie Ray.



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**DECISION AND ORDER**

The Federal Trade Commission (“Commission”), having initiated an investigation of certain acts and practices of the Southeastern New Mexico Physicians IPA, Inc. (“SENM”), Barbara Gomez, and Lonnie Ray, hereinafter sometimes referred to as “Respondents,” and Respondents having been furnished thereafter with a copy of the draft of Complaint that counsel for the Commission proposed to present to the Commission for its consideration and which, if issued, would charge Respondents with violations of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45; and

Respondents, their attorney, and counsel for the Commission having thereafter executed an Agreement Containing Consent Order to Cease and Desist (“Consent Agreement”), containing an admission by Respondents of all the jurisdictional facts set forth in the aforesaid draft of Complaint, a statement that the signing of said Consent Agreement is for settlement purposes only and does not constitute an admission by Respondents that the law has been violated as alleged in such Complaint, or that the facts as alleged in such Complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission’s Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that Respondents have violated the said Act, and that a Complaint should issue stating its charges in that respect, and having accepted the executed Consent Agreement and placed such Consent Agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, and having carefully considered the comments received from interested persons, now in further conformity with the procedure described in Commission Rule 2.34, 16 C.F.R. § 2.34, the Commission hereby issues its Complaint, makes the following jurisdictional findings and issues the following Order:

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1. Respondent Southeastern New Mexico Physicians IPA, Inc., is a not-for-profit corporation, organized, existing, and doing business under and by virtue of the laws of the State of New Mexico, with its principal address at 500 North Main Street, Suite 618, Roswell, NM 88201.
2. Respondent Barbara Gomez's principal address is 500 North Main Street, Suite 618, Roswell, NM 88201.
3. Respondent Lonnie Ray's principal address is 500 North Main Street, Suite 618, Roswell, NM 88201.
4. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of Respondents, and this proceeding is in the public interest.

**ORDER**

**I.**

**IT IS ORDERED** that, as used in this Order, the following definitions shall apply:

- A. "Respondent SENM" means Southeastern New Mexico Physicians IPA, Inc., its officers, directors, employees, agents, attorneys, representatives, successors, and assigns; and the subsidiaries, divisions, groups, and affiliates controlled by Southeastern New Mexico Physicians IPA, Inc., and the respective officers, directors, employees, agents, attorneys, representatives, successors, and assigns of each.
- B. "Respondent Gomez" means Barbara Gomez.
- C. "Respondent Ray" means Lonnie Ray.
- D. "Respondents" means Respondent SENM, Respondent Gomez, and Respondent Ray.

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- E. “Medical group practice” means a bona fide, integrated firm in which physicians practice medicine together as partners, shareholders, owners, members, or employees, or in which only one physician practices medicine.
- F. “Participate” in an entity means (1) to be a partner, shareholder, owner, member, or employee of such entity, or (2) to provide services, agree to provide services, or offer to provide services, to a payor through such entity. This definition also applies to all tenses and forms of the word “participate,” including, but not limited to, “participating,” “participated,” and “participation.”
- G. “Payor” means any person that pays, or arranges for the payment, for all or any part of any physician services for itself or for any other person. “Payor” includes any person that develops, leases, or sells access to networks of physicians.
- H. “Person” means both natural persons and artificial persons, including, but not limited to, corporations, unincorporated entities, and governments.
- I. “Physician” means a doctor of allopathic medicine (“M.D.”) or a doctor of osteopathic medicine (“D.O.”).
- J. “Preexisting contract” means a contract that was in effect on the date of the receipt by a payor, that is a party to such contract, of notice sent by Respondent SENM, pursuant to Paragraph V.A.3 of this Order, of such payor’s right to terminate such contract.
- K. “Principal address” means either (1) primary business address, if there is a business address, or (2) primary residential address, if there is no business address.

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- L. “Qualified clinically-integrated joint arrangement” means an arrangement to provide physician services in which:
1. all physicians that participate in the arrangement participate in active and ongoing programs of the arrangement to evaluate and modify the practice patterns of, and create a high degree of interdependence and cooperation among, the physicians who participate in the arrangement, in order to control costs and ensure the quality of services provided through the arrangement; and
  2. any agreement concerning price or other terms or conditions of dealing entered into by or within the arrangement is reasonably necessary to obtain significant efficiencies through the joint arrangement.
- M. “Qualified risk-sharing joint arrangement” means an arrangement to provide physician services in which:
1. all physicians who participate in the arrangement share substantial financial risk through their participation in the arrangement and thereby create incentives for the physicians who participate jointly to control costs and improve quality by managing the provision of physician services, such as risk-sharing involving:
    - a. the provision of physician services for a capitated rate from payors;
    - b. the provision of physician services for a predetermined percentage of premium or revenue from payors;
    - c. the use of significant financial incentives (*e.g.*, substantial withholds) for physicians who participate to achieve, as a group, specified cost-containment goals; or
    - d. the provision of a complex or extended course of treatment that requires the substantial coordination of

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- care by physicians in different specialties offering a complementary mix of services, for a fixed, predetermined price, where the costs of that course of treatment for any individual patient can vary greatly due to the individual patient's condition, the choice, complexity, or length of treatment, or other factors; and
2. any agreement concerning price or other terms or conditions of dealing entered into by or within the arrangement is reasonably necessary to obtain significant efficiencies through the joint arrangement.

**II.**

**IT IS FURTHER ORDERED** that Respondents, directly or indirectly, or through any corporate or other device, in connection with the provision of physician services in or affecting commerce, as "commerce" is defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44, cease and desist from:

- A. Entering into, adhering to, participating in, maintaining, organizing, implementing, enforcing, or otherwise facilitating any combination, conspiracy, agreement, or understanding between or among any physicians:
  1. to negotiate on behalf of any physician with any payor,
  2. to deal, refuse to deal, or threaten to refuse to deal with any payor,
  3. regarding any term, condition, or requirement upon which any physician deals, or is willing to deal, with any payor, including, but not limited to, price terms, or
  4. not to deal individually with any payor, or not to deal with any payor through any arrangement other than Respondent SENM;

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- B. Exchanging or facilitating in any manner the exchange or transfer of information among physicians concerning any physician's willingness to deal with a payor, or the terms or conditions, including price terms, on which the physician is willing to deal;
- C. Attempting to engage in any action prohibited by Paragraph II.A or II.B, above; and
- D. Encouraging, suggesting, advising, pressuring, inducing, or attempting to induce any person to engage in any action that would be prohibited by Paragraphs II.A through II.C above.

**PROVIDED, HOWEVER**, that nothing in Paragraph II of this Order shall prohibit any agreement involving or conduct by:

- (i) Respondent Gomez or Respondent Ray, subject to the provisions of Paragraph IV below, that is reasonably necessary to form, participate in, or take any action in furtherance of a qualified risk-sharing joint arrangement or qualified clinically-integrated joint arrangement, or that solely involves physicians in the same medical group practice; or
- (ii) Respondent SENM that is reasonably necessary to form, participate in, or take any action in furtherance of a qualified risk-sharing joint arrangement or qualified clinically-integrated joint arrangement, so long as the arrangement does not restrict the ability, or facilitate the refusal, of physicians who participate in it to deal with payors on an individual basis or through any other arrangement.

**III.**

**IT IS FURTHER ORDERED** that Respondent Gomez and Respondent Ray, for three (3) years after the date that this Order becomes final, directly or indirectly, or through any corporate or

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other device, in connection with the provision of physician services in or affecting commerce, as “commerce” is defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44, cease and desist from:

- A. Negotiating with any payor on behalf of Respondent SENM or on behalf of any physician who participates or has participated in Respondent SENM, notwithstanding whether such conduct also is prohibited by Paragraph II of this Order; and
- B. Advising any physician who participates, or has participated, in SENM to accept or reject any term, condition, or requirement of dealing with any payor, notwithstanding whether such conduct also is prohibited by Paragraph II of this Order.

**IV.**

**IT IS FURTHER ORDERED** that, for three (3) years from the date this Order becomes final, Respondents shall notify the Secretary of the Commission in writing (“Notification”) at least sixty (60) days prior to entering into any arrangement with any physicians under which Respondents would act as a messenger, or as an agent on behalf of those physicians, with payors regarding contracts. The Notification shall include the identity of each proposed physician participant; the proposed geographic area in which the proposed arrangement will operate; a copy of any proposed physician participation agreement; a description of the proposed arrangement’s purpose and function; a description of any resulting efficiencies expected to be obtained through the arrangement; and a description of procedures to be implemented to limit possible anticompetitive effects, such as those prohibited by this Order. Notification is not required for Respondents’ subsequent acts as a messenger pursuant to an arrangement for which this Notification has been given. Receipt by the Commission from Respondents of any Notification, pursuant to this Paragraph IV, is not to be construed as a determination by the

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Commission that any action described in such Notification does or does not violate this Order or any law enforced by the Commission.

V.

**IT IS FURTHER ORDERED** that Respondent SENM shall:

- A. Within thirty (30) days after the date on which this Order becomes final, send by first-class mail, return receipt requested, a copy of this Order and the Complaint to:
  1. each physician who participates, or has participated, in Respondent SENM since January 1, 2000;
  2. each officer, director, manager, and employee of Respondent SENM; and
  3. the chief executive officer of each payor with which Respondent SENM has a record of having been in contact since January 1, 2000, regarding contracting for the provision of physician services, and include in such mailing the notice specified in Appendix A to this Order;
- B. Terminate, without penalty or charge, and in compliance with any applicable laws, any preexisting contract with any payor for the provision of physician services, at the earlier of: (1) receipt by Respondent SENM of a written request from a payor to terminate such contract, or (2) the earliest termination or renewal date (including any automatic renewal date) of such contract; *provided, however*, a preexisting contract may extend beyond any such termination or renewal date no later than one (1) year after the date on which the Order becomes final if, prior to such termination or renewal date, (a) the payor submits to Respondent SENM a written request to extend such contract to a specific date no later than one (1) year after the date this Order becomes final, and (b) Respondent SENM has



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determined not to exercise any right to terminate; *provided further*, that any payor making such request to extend a contract retains the right, pursuant to part (1) of Paragraph V.B of this Order, to terminate the contract at any time;

- C. Within ten (10) days after receiving a written request from a payor, pursuant to Paragraph V.B(1) of this Order, distribute, by first-class mail, return receipt requested, a copy of that request to each physician participating in Respondent SENM as of the date Respondent SENM receives such request;
- D. For a period of three (3) years after the date this Order becomes final:
  - 1. distribute by first-class mail, return receipt requested, a copy of this Order and the Complaint to:
    - a. each physician who begins participating in Respondent SENM, and who did not previously receive a copy of this Order and the Complaint from Respondent SENM, within thirty (30) days of the time that such participation begins;
    - b. each payor that contracts with Respondent SENM for the provision of physician services, and that did not previously receive a copy of this Order and the Complaint from Respondent SENM, within thirty (30) days of the time that such payor enters into such contract;
    - c. each person who becomes an officer, director, manager, or employee of Respondent SENM, and who did not previously receive a copy of this Order and the Complaint from Respondent SENM, within thirty (30) days of the time that he or she assumes such responsibility with Respondent SENM; and

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2. annually publish a copy of this Order and the Complaint in an official annual report or newsletter sent to all physicians who participate in Respondent SENM, with such prominence as is given to regularly featured articles;
- E. File a verified written report within sixty (60) days after the date this Order becomes final, annually thereafter for three (3) years on the anniversary of the date this Order becomes final, and at such other times as the Commission may by written notice require. Each such report shall include:
1. a detailed description of the manner and form in which Respondent SENM has complied and is complying with this Order; and
  2. copies of the return receipts required by Paragraphs V.A, V.C, and V.D of this Order; and
- F. Notify the Commission at least thirty (30) days prior to any proposed change in Respondent SENM, such as dissolution, assignment, sale resulting in the emergence of a successor company or corporation, the creation or dissolution of subsidiaries, or any other change in Respondent SENM that may affect compliance obligations arising out of this Order.

**VI.**

**IT IS FURTHER ORDERED** that, if Respondent SENM fails to comply with all or any portion of Paragraph V.A or Paragraph V.D.1.b of this Order within sixty (60) days of the times set forth in the paragraph, then Respondent Ray shall, within thirty (30) days thereafter, comply with those portions of Paragraphs V.A and V.D.1.b of this Order with which Respondent SENM did not comply.

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**VII.**

**IT IS FURTHER ORDERED** that, within thirty (30) days after the date on which this Order becomes final, Respondent Gomez and Respondent Ray shall send a copy of this Order and the Complaint by first-class mail, return receipt requested:

- A. To each physician who participates, or has participated, in a physician group represented by Respondent Gomez or Respondent Ray since August 1, 2001; and
- B. To each payor with which Respondent Gomez or Respondent Ray has dealt since August 1, 2001, for the purpose of contracting, or seeking to contract, while representing or advising any physician or group of physicians relating to contracting with such payor for the provision of physician services.

**PROVIDED, HOWEVER,** that Respondent Gomez and Respondent Ray are not required to send a copy of this Order and the Complaint to any physician who has participated in Respondent SENM or any payor that has been in contact with Respondent SENM and that received a copy of this Order and the Complaint from Respondent SENM, pursuant to Paragraph V.A.1 and Paragraph V.A.3 of this Order.

**VIII.**

**IT IS FURTHER ORDERED** that Respondent Gomez and Respondent Ray shall:

- A. For three (3) years after the date this Order becomes final, distribute a copy of this Order and the Complaint by first-class mail, return receipt requested:
  - 1. to all physicians that Respondent Gomez or Respondent Ray represents relating to contracting, or seeking to contract, with payors for the provision of physician

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services, or that Respondent Gomez or Respondent Ray advises relating to providing payors with physician services, within (30) days of the time that Respondent Gomez or Respondent Ray begins providing such representation or advice; and

2. to each payor with which Respondent Gomez or Respondent Ray deals for the purpose of contracting, or seeking to contract, pursuant to any arrangement to represent or advise any physician, relating to contracting with such payor for the provision of physician services, within thirty (30) days of such dealing; *provided, however*, that Respondent Gomez and Respondent Ray are not required to send a copy of this Order and the Complaint to any physician who begins participating in Respondent SENM or any payor that contracts with Respondent SENM for the provision of physician services and that received a copy of this Order and the Complaint from Respondent SENM, pursuant to Paragraph V.D.1.a or Paragraph V.D.1.b of this Order; and

B. File verified written reports within sixty (60) days after the date this Order becomes final, annually thereafter for three (3) years on the anniversary of the date this Order becomes final, and at such other times as the Commission may by written notice require. Each report shall include:

1. a detailed description of the manner and form in which Respondent Gomez or Respondent Ray has complied and is complying with this Order; and
2. copies of the return receipts required by Paragraphs VII and VIII.A.

**IX.**

**IT IS FURTHER ORDERED** that each Respondent shall notify the Commission of any change in her or its respective

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principal address within twenty (20) days of such change in address.

**X.**

**IT IS FURTHER ORDERED** that, for the purpose of determining or securing compliance with this Order, each Respondent shall permit any duly authorized representative of the Commission:

- A. Access, during office hours and in the presence of counsel, to inspect and copy all books, ledgers, accounts, correspondence, memoranda, calendars, and other records and documents in her or its possession, or under her or its control, relating to any matter contained in this Order; and
- B. Upon five (5) days' notice to such Respondent, and in the presence of counsel, and without restraint or interference from her or it, to interview such Respondent or employees of such Respondent.

**XI.**

**IT IS FURTHER ORDERED** that this Order shall terminate on August 5, 2024.

Analysis

**Analysis of Agreement Containing Consent Order to Aid  
Public Comment**

The Federal Trade Commission has accepted, subject to final approval, an agreement containing a proposed consent order with the Southeastern New Mexico Physicians IPA, Inc. (SENM), and two of its non-physician employees. The agreement settles charges that these parties violated Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, by orchestrating and implementing agreements among members of SENM to fix prices and other terms on which they would deal with health plans, and to refuse to deal with such purchasers except on collectively-determined terms. The proposed consent order has been placed on the public record for 30 days to receive comments from interested persons. Comments received during this period will become part of the public record. After 30 days, the Commission will review the agreement and the comments received, and will decide whether it should withdraw from the agreement or make the proposed order final.

The purpose of this analysis is to facilitate public comment on the proposed order. The analysis is not intended to constitute an official interpretation of the agreement and proposed order, or to modify their terms in any way. Further, the proposed consent order has been entered into for settlement purposes only and does not constitute an admission by any respondent that said respondent violated the law or that the facts alleged in the complaint (other than jurisdictional facts) are true.

**The Complaint**

The allegations of the complaint are summarized below.

SENM is an independent practice association (IPA) with 68 physician members. SENM's members represent 73% percent of all physicians independently practicing (that is, those not employed by area hospitals) in and around Roswell, New Mexico, which is located in southeastern New Mexico.

## Analysis

SENM members refuse to deal with health plans on an individual basis. Instead, two SENM employees, Barbara Gomez and Lonnie Ray, negotiate price and other contract terms with health plans that desire to contract with SENM members.

Contracts that Ms. Gomez and Ms. Ray negotiate for SENM with health plans are presented to SENM's Managed Care Contract Committee for approval, then to SENM's Board of Directors. After SENM's Board approves it, a contract is presented to the general membership, which votes on whether SENM should accept the contract. If a majority of SENM members vote to accept, SENM's president signs the contract. Following this process, respondents have orchestrated collective agreements on fees and other terms of dealing with health plans, have carried out collective negotiations with health plans, and have orchestrated refusals to deal and threats to refuse to deal with health plans that resisted respondents' desired terms. Although SENM purported to operate as a "messenger" -- that is, an arrangement that does not facilitate horizontal agreements on price -- it engaged in various actions that reflected or orchestrated such agreements.<sup>1</sup>

Respondents have succeeded in forcing numerous health plans to raise fees paid to SENM members, and thereby raised the cost of medical care in the Roswell area. SENM engaged in no efficiency-enhancing integration sufficient to justify respondents' joint negotiation of fees. By orchestrating agreements among SENM members to deal only on collectively-determined terms,

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<sup>1</sup> Some arrangements can facilitate contracting between physicians and payors without fostering an agreement among competing physicians on fees or fee-related terms. One such approach, sometimes referred to as a "messenger model" arrangement, is described in the 1996 Statements of Antitrust Enforcement Policy in Health Care jointly issued by the Federal Trade Commission and U.S. Department of Justice at 125. See <http://www.ftc.gov/reports/hlth3s.htm#8>.

Analysis

and actual or threatened refusals to deal with health plans that would not meet those terms, respondents have violated Section 5 of the FTC Act.

### **The Proposed Consent Order**

The proposed order is designed to remedy the illegal conduct charged in the complaint and prevent its recurrence. It is similar to recent consent orders that the Commission has issued to settle charges that physician groups engaged in unlawful agreements to raise fees they receive from health plans. The order also includes temporary “fencing-in” relief to ensure that the alleged unlawful conduct by respondents does not continue.

The proposed order’s specific provisions are as follows:

Paragraph II.A prohibits respondents from entering into or facilitating any agreement between or among any physicians: (1) to negotiate with payors on any physician’s behalf; (2) to deal, not to deal, or threaten not to deal with payors; (3) on what terms to deal with any payor; or (4) not to deal individually with any payor, or to deal with any payor only through an arrangement involving the respondents.

Other parts of Paragraph II reinforce these general prohibitions. Paragraph II.B prohibits the respondents from facilitating exchanges of information between physicians concerning whether, or on what terms, to contract with a payor. Paragraph II.C bars attempts to engage in any action prohibited by Paragraph II.A or II.B, and Paragraph II.D proscribes inducing anyone to engage in any action prohibited by Paragraphs II.A through II.C.

As in other Commission orders addressing providers’ collective bargaining with health care purchasers, certain kinds of agreements are excluded from the general bar on joint negotiations. First, respondents would not be precluded from engaging in conduct that is reasonably necessary to form or



## Analysis

participate in legitimate joint contracting arrangements among competing physicians, whether a “qualified risk-sharing joint arrangement” or a “qualified clinically-integrated joint arrangement.” The arrangement, however, must not facilitate the refusal of, or restrict, physicians from contracting with payors outside of the arrangement.

As defined in the proposed order, a “qualified risk-sharing joint arrangement” possesses two key characteristics. First, all physician participants must share substantial financial risk through the arrangement, such that the arrangement creates incentives for the physician participants jointly to control costs and improve quality by managing the provision of services. Second, any agreement concerning reimbursement or other terms or conditions of dealing must be reasonably necessary to obtain significant efficiencies through the joint arrangement.

A “qualified clinically-integrated joint arrangement,” on the other hand, need not involve any sharing of financial risk. Instead, as defined in the proposed order, physician participants must participate in active and ongoing programs to evaluate and modify their clinical practice patterns in order to control costs and ensure the quality of services provided, and the arrangement must create a high degree of interdependence and cooperation among physicians. As with qualified risk-sharing arrangements, any agreement concerning price or other terms of dealing must be reasonably necessary to achieve the efficiency goals of the joint arrangement.

Also, because the order is intended to reach agreements among horizontal competitors, Paragraph II would not bar agreements that only involve physicians who are part of the same medical group practice (defined in Paragraph I.E).

Paragraph III, for a period of three years, bars Ms. Gomez and Ms. Ray from negotiating with any payor on behalf of SENM or any SENM member, and from advising any SENM member to accept or reject any term, condition, or requirement of dealing

Analysis

with any payor. This temporary “fencing-in” relief is included to ensure that the alleged unlawful conduct by these respondents does not continue.

Paragraph IV, for three years, requires respondents to notify the Commission before entering into any arrangement to act as a messenger, or as an agent on behalf of any physicians, with payors regarding contracts. Paragraph IV sets out the information necessary to make the notification complete.

Paragraph V, which applies only to SENM, requires SENM to distribute the complaint and order to all physicians who have participated in SENM, and to payors that negotiated contracts with SENM or indicated an interest in contracting with SENM. Paragraph V.B requires SENM, at any payor’s request and without penalty, or within one year after the Order is made final, to terminate its current contracts with respect to providing physician services. Paragraph V.C requires SENM to distribute payor requests for contract termination to all physicians who participate in SENM. Paragraph V.D.1.b requires SENM to distribute the complaint and order to any payors that negotiate contracts with SENM in the next three years.

In the event that SENM fails to comply with the requirements of Paragraph V.A or Paragraph V.D.1.b, Paragraph VI would require Ms. Ray to do so.

Paragraphs VII and VIII generally require Ms. Gomez and Ms. Ray to distribute the complaint and order to physicians who have participated in any group that has been represented by Ms. Gomez or Ms. Ray since August 1, 2001, and to each payor with which Ms. Gomez or Ms. Ray has dealt since August 1, 2001, for the purpose of contracting.

## Analysis

Paragraphs V.E, V.F, VIII.B, IX, and X of the proposed order impose various obligations on respondents to report or provide access to information to the Commission to facilitate monitoring respondents' compliance with the order.

The proposed order will expire in 20 years.

Complaint

IN THE MATTER OF

**ITRON, INC. AND SCHLUMBERGER  
ELECTRICITY, INC.**

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 7 OF THE CLAYTON ACT AND SEC. 5 OF THE FEDERAL TRADE  
COMMISSION ACT

*Docket C-4114; File No. 0310201  
Complaint, August 5, 2004--Decision, August 5, 2004*

This consent order addresses the acquisition by Respondent Itron, Inc. -- the leading supplier of mobile radio frequency ("RF") automatic meter reading ("AMR") systems, which gather electricity consumption information from meters and then broadcast the data to electric utilities -- of Respondent Schlumberger Electricity, Inc. and other assets. The order, among other things, requires the respondents to grant a royalty-free, perpetual and irrevocable license to their mobile RF AMR technology, and related assets, to Hunt Technologies, Inc. The order also requires the respondents to provide Hunt with technical assistance and, for three years, with any updates to the covered technology that they may produce.

*Participants*

For the Commission: *Matthew J. Reilly, Randall A. Long, Sean G. Dillon, Stephanie C. Bovee, Stephanie A. Parks, Sylvia M. Brooks, Richard A. Levy, Jessica Yarnall, Michael R. Moiseyev, Eric D. Rohlck, Jennifer Lee, Daniel P. Ducore, Malcolm B. Coate, Jeffrey Fischer and Mark Frankena.*

For the Respondent: *Benjamin S. Sharp, Perkins Coie, LLP, John A. Herfort, Gibson, Dunn & Crutcher LLP, and Lawrence Fullerton, Sidley, Austin, Brown & Wood, LLP.*

**COMPLAINT**

Pursuant to the Clayton Act and the Federal Trade Commission Act, and its authority thereunder, the Federal Trade Commission ("Commission"), having reason to believe that Respondent Itron, Inc. ("Itron"), a corporation subject to the jurisdiction of the Commission, has agreed to acquire Respondent Schlumberger

## Complaint

Electricity, Inc. (“Schlumberger Electricity”) a corporation subject to the jurisdiction of the Commission, in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, and it appearing to the Commission that a proceeding in respect thereof would be in the public interest, hereby issues its Complaint, stating its charges as follows:

**I. RESPONDENTS**

1. Respondent Itron is a corporation organized, existing, and doing business under and by virtue of the laws of the state of Washington, with its office and principal place of business located at 2818 N. Sullivan Rd., Spokane, WA 99216.

2. Respondent Schlumberger Electricity is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 313-B North Highway 11, West Union, South Carolina 29696.

3. Itron and Schlumberger Electricity are, among other things, engaged in the research development, manufacture and sale of automatic meter reading (“AMR”) systems for electric utilities, including, but not limited to mobile radio frequency (“RF”) AMR systems for electric utilities. Mobile RF AMR systems allow electric utilities to automatically and remotely obtain energy consumption data from an electricity meter.

4. Respondents are, and at all times relevant herein have been, engaged in commerce, as “commerce” is defined in Section 1 of the Clayton Act as amended, 15 U.S.C. §12, and are corporations whose business is in or affects commerce, as “commerce” is defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

**II. THE PROPOSED ACQUISITION**

Complaint

5. Itron and Schlumberger Electricity (and affiliates of Schlumberger Electricity) entered into a stock and asset purchase agreement dated July 16, 2003 (the “Purchase Agreement”) whereby Itron agreed to acquire Schlumberger Electricity and 51 percent of the shares of Walsin Schlumberger Electricity Measurement Corporation (a Taiwan corporation), and certain foreign assets of Schlumberger Canada Limited, Schlumberger Distribucion S.A. de C.V., Schlumberger Servicios S.A. de C.V., and Axalto S.A. (formerly Schlumberger Systemes S.A.), all owned indirectly by Schlumberger Limited, in a cash transaction for approximately \$255 million (the “Acquisition”).

### **III. THE RELEVANT MARKET**

6. For the purposes of this Complaint, the relevant line of commerce in which to analyze the effects of the Acquisition is the research, development, manufacture, and sale of mobile RF AMR systems for electric utilities.

7. For the purposes of this Complaint, the United States is the relevant geographic area in which to analyze the effects of the Acquisition in the relevant line of commerce.

### **IV. THE STRUCTURE OF THE MARKET**

8. Itron and Schlumberger Electricity are, by a large margin, the two largest suppliers in the United States of mobile RF AMR systems for electric utilities. Consequently, the U.S. market for mobile RF AMR systems for electric utilities is highly concentrated whether measured by the Herfindal-Hirschman Index or two-firm or four-firm concentration ratios.

9. Itron and Schlumberger Electricity are actual competitors in the relevant market.

Complaint

**V. ENTRY CONDITIONS**

10. New entry into the relevant market is a difficult process because of, among other things, the time and cost associated with researching and developing a mobile RF AMR system for electric utilities, the lengthy period necessary to attain customer acceptance with electric utilities, and the exclusionary effect of proprietary communication protocols utilized by Itron and Schlumberger Electricity.

11. New entry into the relevant market sufficient to deter or counteract the anticompetitive effects described in Paragraph 13 would not occur in a timely manner because it would take over two years to enter and achieve a significant market impact.

12. Expansion by smaller competitors in the relevant market sufficient to deter or counteract the anticompetitive effects described in Paragraph 13 is unlikely to occur in a timely manner because of, among other things, the lengthy period necessary to attain sufficient customer acceptance with electric utilities and the inability of smaller competitors to sell a mobile RF AMR system for electric utilities that is interoperable with the proprietary communication protocols utilized by Itron and Schlumberger Electricity.

**VI. EFFECTS OF THE ACQUISITION**

13. The effects of the Acquisition, if consummated, may be to substantially lessen competition and to tend to create a monopoly in the relevant markets in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the FTC Act, as amended, 15 U.S.C. § 45, in the following ways, among others:

- a. by eliminating actual, direct, and substantial competition between Itron and Schlumberger Electricity in the U.S. market for mobile RF AMR systems for electric utilities;
- b. by increasing the likelihood that Itron will unilaterally

Complaint

exercise market power in the U.S. market for mobile RF AMR systems for electric utilities;

c. by reducing incentives to improve service or product quality or to pursue further innovation in the U.S. market for mobile RF AMR systems for electric utilities; and

d. by increasing the likelihood that electric utilities would be forced to pay higher prices for mobile RF AMR systems.

**VII. VIOLATIONS CHARGED**

14. The Purchase Agreement described in Paragraph 5 constitutes a violation of Section 5 of the FTC Act, as amended, 15 U.S.C. § 45.

15. The Acquisition described in Paragraph 5, if consummated, would constitute a violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the FTC Act, as amended, 15 U.S.C. § 45.

WHEREFORE, THE PREMISES CONSIDERED, the Federal Trade Commission on this fifth day of August, 2004, issues its Complaint against said Respondents.



Decision and Order

**DECISION AND ORDER**

The Federal Trade Commission (“Commission”), having initiated an investigation of the proposed Acquisition by Respondent Itron, Inc. (“Itron”) of Schlumberger Electricity, Inc. (“Schlumberger”), hereinafter referred to as “Respondents,” and 51% of the shares of Walsin Schlumberger Electricity Measurement Corporation (a Taiwan corporation), and certain foreign assets of Schlumberger Canada Limited, Schlumberger Distribucion S.A. de C.V., Schlumberger Servicios S.A. de C.V., and Axalto S.A. (formerly Schlumberger Systemes S.A.), all owned indirectly by Schlumberger Limited, and Respondents having been furnished thereafter with a copy of a draft of Complaint that the Bureau of Competition proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge Respondents with violations of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45; and

Respondents, their attorneys, and counsel for the Commission having thereafter executed an Agreement Containing Consent Orders (“Consent Agreement”), containing an admission by Respondents of all the jurisdictional facts set forth in the aforesaid draft of Complaint, a statement that the signing of said Consent Agreement is for settlement purposes only and does not constitute an admission by Respondents that the law has been violated as alleged in such Complaint, or that the facts as alleged in such Complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission’s Rules; and

The Commission, having thereafter considered the matter and having determined that it had reason to believe that Respondents have violated the said Acts, and that a Complaint should issue stating its charges in that respect, and having accepted the executed Consent Agreement and placed such Consent Agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, and having

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duly considered the comments received from interested persons pursuant to section 2.34 of its Rules, now in further conformity with the procedure described in Commission Rule 2.34, 16 C.F.R. § 2.34, the Commission hereby makes the following jurisdictional findings and issues the following Decision and Order (“Order”):

1. Respondent Itron, Inc. is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Washington, with its office and principal place of business located at 2818 North Sullivan Road, Spokane, Washington 99216.

2. Respondent Schlumberger Electricity, Inc., is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 313-B North Highway 11, West Union, South Carolina 29696.

3. Hunt Technologies, Inc. is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Minnesota, with its office and principal place of business located at 6436 Country Road II, Pequot Lakes, Minnesota, 56472.

4. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of Respondents, and the proceeding is in the public interest.

**ORDER**

**I.**

**IT IS ORDERED** that, as used in this Order, the following definitions shall apply:

- A. “Itron” means Itron, Inc., its directors, officers, employees, agents, representatives, predecessors, successors, and assigns; its joint ventures, subsidiaries, divisions, groups and affiliates controlled by Itron, Inc., and the respective directors, officers, employees, agents,

## Decision and Order

representatives, predecessors, successors, and assigns of each.

- B. “Schlumberger” means Schlumberger Electricity, Inc., its directors, officers, employees, agents, representatives, successors, and assigns; its joint ventures, subsidiaries, divisions, groups and affiliates controlled by Schlumberger Electricity, Inc., and the respective directors, officers, employees, agents, representatives, predecessors, successors, and assigns of each.
- C. “Hunt” means Hunt Technologies, Inc., its directors, officers, employees, agents, representatives, predecessors, successors, and assigns; its joint ventures, subsidiaries, divisions, groups and affiliates controlled by Hunt Technologies, Inc., and the respective directors, officers, employees, agents, representatives, predecessors, successors, and assigns of each.
- D. “Acquirer” means either Hunt Technologies, Inc. or any other entity that receives the prior approval of the Commission to acquire the RF AMR Assets pursuant to Paragraphs II. and III. of this Order.
- E. “Acquisition” means the proposed acquisition by Itron of Schlumberger Electricity, Inc., 51% of the shares of Walsin Schlumberger Electricity Measurement Corporation (a Taiwan corporation), and certain foreign assets of Schlumberger Canada Limited, Schlumberger Distribucion S.A. de C.V., Schlumberger Servicios S.A. de C.V., and Axalto S.A. (formerly Schlumberger Systemes S.A.), all owned indirectly by Schlumberger Limited, by means of a Purchase Agreement, dated July 16, 2003, and all amendments thereto.
- F. “AMR” means automatic meter reading.

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- G. “Closing Date” means the date on which Respondents (or a Divestiture Trustee) and an Acquirer close on a transaction to license the RF AMR Assets as required by Paragraphs II.B. and III.B. of this Order.
- H. “Commission” means the Federal Trade Commission.
- I. “Confidential Business Information” means all information that is not in the public domain related to research, development, manufacture, marketing, commercialization, distribution, importation, cost, pricing, supply, sales, sales support, or the use of particular assets.
- J. “Copyrights” means any copyrights, mask works, and other copyrightable works whether registered or unregistered.
- K. “DAP” means DAP Technologies, a corporation organized, existing, and doing business under and by virtue of the laws of Canada. Within the United States, its office and principal place of business is located at 5525 West Cypress Street, Suite 205, Tampa, Florida, 33607. DAP Technologies is a subsidiary of Neptune Technology Group, Inc.
- L. “Effective Date” means the date the Acquisition is consummated.
- M. “Electric ERT” means Itron’s transmitter within the family of Series 41 or 45ES-1, 45ER-1, 45EN-1 transmitters in electromechanical or solid state configuration that is installed on or within an electricity meter and sends a consumption reading using RF waves to a remote RF AMR Receiving Device.
- N. “Electricity Meter” means any current or future electricity measuring meters manufactured for sale exclusively in the United States, Canada or Mexico or used by any electric utility located in the United States, Canada or Mexico.

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- O. “Elster” means Elster Electricity, LLC, a corporation organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 208 S. Rogers Lane, Raleigh, North Carolina 27610.
- P. “ERT” means Itron’s Encoder-Receiver-Transmitter.
- Q. “GE” means General Electric, a corporation organized, existing, and doing business under and by virtue of the laws of the State of New York, with its office and principal place of business located at 41 Woodford Avenue, Plainville, CT 06062.
- R. “Governmental Entity” means any Federal, state, local or non-U.S. government or any court, legislature, governmental agency or governmental commission or any judicial or regulatory authority of any government.
- S. “Hunt License and Supply Agreement” means the license agreement entered into between Hunt and Itron, dated on or before the date this Order becomes final, as well as all amendments, exhibits, attachments, agreements, and schedules thereto, related to the RF AMR Assets to be conveyed to accomplish the requirements of this Order. The Hunt License and Supply Agreement is attached to this Order as non-public Appendix A.
- T. “Landis + Gyr” means Landis + Gyr, Inc., a corporation organized, existing, and doing business under and by virtue of the laws of Delaware, with its office and principal place of business located at 2800 Duncan Road, Lafayette, Ind. 47904-5012.
- U. “Licensing Agreement” means either the Hunt License and Supply Agreement or any other agreement that receives the prior approval of the Commission between

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Respondents and an Acquirer (or between the Divestiture Trustee and an Acquirer), as well as all amendments, exhibits, attachments, agreements, and schedules thereto, related to the licensing of the RF AMR Assets.

- V. “Meter Manufacturer” means a company that manufactures residential Electricity Meters, including, but not limited to, Elster, GE, Landis + Gyr, and Sensus, and their successors.
- W. “Neptune” means Neptune Technology Group, Inc., a corporation organized, existing, and doing business under and by virtue of the laws of the State of Alabama, with its office and principal place of business located at 1600 Alabama Highway 229, Tallassee, Alabama, 36078.
- X. “Patents” means any and all United States patents, patent applications, continuations, continuations-in-part, divisionals, reissues, and reexaminations thereof.
- Y. “Person” means any natural person, partnership, association, or corporate or governmental organization or entity.
- Z. “R-300” means Schlumberger’s transmitter known as the R-300 in electromechanical or solid state configuration that is installed on or within an electricity meter and sends a consumption reading using RF waves and using only Itron’s protocol to a remote RF AMR Receiving Device.
- AA. “Respondents” means Itron and Schlumberger, individually and collectively.
- BB. “RF” means radio frequency.
- CC. “RF AMR Assets” includes the following:

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1. The RF AMR Electric Endpoint Intellectual Property;  
and
  2. The RF AMR Mobile Receiving Device Intellectual Property.
- DD. “RF AMR Electric Endpoint” means the Electric ERT and the R-300.
- EE. “RF AMR Electric Endpoint Intellectual Property” means all intellectual property owned or licensed by Respondents to use, make, distribute, offer for sale, promote, advertise, sell, import or export, or have used, made, distributed, offered for sale, promoted, advertised, sold, imported or exported RF AMR Electric Endpoints, including but not limited to, Software, inventions, technology, formulations, specifications, Patents, patent applications, Trade Secrets, Copyrights, know-how, research materials, technical information, designs, drawings, manufacturing information, integration information, testing and quality control data related to RF AMR Electric Endpoints including, but not limited to, (i) all algorithms, circuits, documentation, tools, data, communication protocols; and (ii) all such technology that relates to ANSI standards applicable to either the Electric ERT or the R-300, and including further, without limitation:
1. the Electric ERT and R-300 Trademarks; and
  2. the following RF AMR Electric Endpoint related documentation:
    - a. Reference designs;
    - b. Assembly documentation;
    - c. Approved supplier lists;

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- d. Complete bill of material information;
  - e. Printed circuit board build data;
  - f. Functional test design information to enable testers to be built and operated;
  - g. Laser tune operational specifications and design requirements;
  - h. In circuit test specifications and design requirements;
  - i. Manufacturing process information;
  - j. Control and design information as related to serial numbers;
  - k. Product acceptance criteria; and
  - l. Quality metrics.
- FF. “RF AMR Mobile Receiving Device” means a handheld or vehicle transportable data collection unit, including, but not limited to, a handheld or laptop computer, used to remotely gather electricity, gas, or water consumption data from an RF AMR Electric Endpoint or water or gas ERT using only Itron’s protocols.
- GG. “RF AMR Mobile Receiving Device Intellectual Property” means the Itron application programming interfaces and protocols that enable an RF AMR Mobile Receiving Device to remotely gather electricity, gas, or water consumption data from an RF AMR Electric Endpoint or water or gas ERT.
- HH. “RF AMR Receiving Device” means any technology used for remotely receiving electricity, gas, or water consumption data transmitted via RF technology.



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- II. “Sensus” means Sensus Metering Systems, Inc., a corporation organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 8609 Six Forks Road, Raleigh, North Carolina 27615.
- JJ. “Software” means all computer software and firmware (in source code and object code forms) owned, licensed or used by, or developed for, Respondents for the radio transmission of data from a meter to an RF AMR Mobile Receiving Device, including all upgrades, enhancements or new releases of such software, and all tools, documentation, commentaries, flow-charts, data or other materials used in the development, maintenance and support of such software.
- KK. “Trademarks” means any trademarks, trade names, service marks, logos, and other source-identifying symbols or devices, and any combination thereof and variations thereof, whether registered or unregistered.
- LL. “Trade Secrets” means any proprietary inventions, discoveries, improvements, know-how, works-in-progress, processes, designs, concepts, and ideas that are: (i) not generally known and not readily ascertainable by proper means; and (ii) maintained by Respondents as proprietary and confidential.

**II.****IT IS FURTHER ORDERED** that:

- A. Within ten (10) days after the Effective Date, Respondents shall grant a royalty-free, perpetual, irrevocable, transferable (subject to the specific terms in the Hunt License and Supply Agreement), non-exclusive (subject to the specific terms in the Hunt License and Supply

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Agreement) license to the RF AMR Electric Endpoint Intellectual Property, in good faith, to Hunt pursuant to and in accordance with the Hunt License and Supply Agreement (which agreement shall not vary or contradict, or be construed to vary or contradict, the terms of this Order, it being understood that nothing in this Order shall be construed to reduce any rights or benefits of Hunt or to reduce any obligations of Respondents under such agreements), and such agreement, if approved by the Commission as the Licensing Agreement for the RF AMR Electric Endpoint Intellectual Property, is incorporated by reference into this Order and made a part hereof as non-public Appendix A.

- B. If, at the time the Commission determines to make this Order final, the Commission notifies Respondents that Hunt is not an acceptable acquirer of the RF AMR Electric Endpoint Intellectual Property or that the manner in which the licensing was accomplished is not acceptable, then, after receipt of such written notification:
1. Respondents shall immediately notify Hunt of the notice received from the Commission and shall as soon as practicable effect the rescission of the Hunt License and Supply Agreement; and
  2. Respondents shall, within six (6) months from the date this Order becomes final, grant an irrevocable, non-exclusive, perpetual, transferable, royalty-free license to the RF AMR Electric Endpoint Intellectual Property, at no minimum price, to an acquirer that receives the prior approval of the Commission and in a manner that receives the prior approval of the Commission.
- C. Any Licensing Agreement that has been approved by the Commission between Respondents and an Acquirer of the RF AMR Electric Endpoint Intellectual Property shall be deemed incorporated into this Order, and any failure by

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Respondents to comply with any term of such Licensing Agreement shall constitute a failure to comply with this Order.

- D. Pending licensing of the RF AMR Electric Endpoint Intellectual Property, Respondents shall take such actions as are necessary to maintain the viability and marketability of the RF AMR Electric Endpoint Intellectual Property and to prevent the destruction, removal, wasting, deterioration, or impairment of any of the RF AMR Electric Endpoint Intellectual Property.
- E. Respondents shall:
1. Within fifteen (15) days after the Closing Date, deliver to the Acquirer, at Respondents' expense
    - a. A copy of all RF AMR Electric Endpoint Intellectual Property relating to the Electric ERTs in its control as it exists as of the Closing Date including, but not limited to, copies of all plans, drawings, designs, specifications, schematics, source code compilers, reports, studies, data, component sources, and test equipment information relating to the Electric ERT; and
    - b. A list of Respondents' customers who have purchased Electric ERTs within the five (5) years prior to the Effective Date.
  2. Within ninety (90) days after the Closing Date, deliver to the Acquirer, at Respondents' expense, a copy of all RF AMR Electric Endpoint Intellectual Property relating to the R-300 in its control as it exists as of the Closing Date including, but not limited to, copies of all plans,

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drawings, designs, specifications, schematics, source code compilers, reports, studies, data, component sources, and test equipment information relating to the R-300.

3. For a period of three (3) years after the Closing Date, provide the Acquirer with:
  - a. updates to the RF AMR Electric Endpoint Intellectual Property that are being incorporated and made for sale to customers at least ninety (90) days in advance of such updates being made available to customers; and
  - b. at the Acquirer's request, technical assistance in connection with those updates.
  
- F. At the Acquirer's request, the Respondents shall enter into an agreement with the Acquirer in which Respondents shall manufacture and deliver, in a timely manner and under reasonable terms and conditions, approved by the Commission, a supply of RF AMR Electric Endpoints for a period of time sufficient to allow the Acquirer to manufacture RF AMR Electric Endpoints independently of Respondents.
  1. If Hunt is approved as the Acquirer and the Hunt License and Supply Agreement is approved as the Licensing Agreement, the supply of RF AMR Electric Endpoints shall be pursuant to this Order and the terms of the Hunt License and Supply Agreement, which is non-public Appendix A to this Order.
  2. During the term of agreement provided for in this Paragraph II.F., Respondents may enter in an agreement with one or more of the Acquirer's customers whereby the Respondents shall provide a warranty for an RF AMR Electric Endpoint that it manufactures for the Acquirer and which is supplied to customers of the

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Acquirer. Such warranty agreement shall be in substantially the form set forth in the “Hunt Customer License and Warranty Agreement” attached as an Exhibit to the Hunt License and Supply Agreement.

*PROVIDED, HOWEVER*, that such warranty agreement shall not extend beyond fourteen (14) months after the date such RF AMR Electric Endpoint is shipped to the customer. *PROVIDED FURTHER, HOWEVER*, any information supplied by the Acquirer or the Acquirer’s customers as part of such warranty agreement to Respondents shall be kept confidential and separate from those persons at Respondents involved in the sale and marketing of RF AMR Electric Endpoints; and Respondents shall take all steps necessary to prevent all such persons from obtaining or obtaining access to such information.

- G. Respondents shall make available, at the Acquirer’s request, technical assistance to the Acquirer to assist in the manufacture and sale of RF AMR Electric Endpoints. For a period not to exceed 18 months following the Closing Date, Respondents’ obligation to make such assistance available shall include, among other things:
1. advice to enable the Acquirer to obtain all necessary permits, consents, and approvals from any Governmental Entity to sell the RF AMR Electric Endpoints; and
  2. personnel, assistance, and training, at an Itron facility to manufacture the RF AMR Electric Endpoints, including but not limited to, technical assistance relating to the process technology, quality assurance, quality control, and sales training. Respondents shall continue providing such assistance and training until the Acquirer is reasonably satisfied that it can manufacture and sell the RF AMR Electric Endpoints in substantially the same manner and quality employed or achieved by or on behalf of Respondents. Respondents shall provide such

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assistance to the Acquirer in a timely manner. Pursuant to this Paragraph II.G., Respondents shall make available 200 hours of such assistance without cost to the Acquirer. *PROVIDED, HOWEVER*, Respondents' obligation to make available technical assistance pursuant to this Paragraph II.G. shall not extend more than three (3) months beyond the ending of Respondents' supplying RF AMR Electric Endpoints to the Acquirer pursuant to any supply agreement approved under this Order.

H. Respondents shall not:

1. Restrict in any way the use of Confidential Business Information related to the RF AMR Electric Endpoints by the Acquirer's employees who were at any time employed by Respondents and involved in the research, development, manufacturing, distribution, sale, or marketing of the RF AMR Electric Endpoints; and
  2. Use or disclose, directly or indirectly, any of the Acquirer's Confidential Business Information (other than as necessary to comply with the requirements of this Order) related to the research, development, manufacturing, marketing, or sale of the RF AMR Electric Endpoints.
- I. The purpose of the licensing and transfer of the RF AMR Electric Endpoint Intellectual Property is to ensure the continued use of the RF AMR Electronic Endpoints in the same business in which the RF AMR Electronic Endpoints were engaged at the time of the announcement of the Acquisition, and to remedy the lessening of competition resulting from the Acquisition as alleged in the Commission's Complaint.

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**III.****IT IS FURTHER ORDERED** that:

- A. At the written request of the Acquirer and within ten (10) days of such request, Respondents shall grant a royalty-free, perpetual, irrevocable, transferable (subject to the specific terms in the Hunt License and Supply Agreement), non-exclusive (subject to the specific terms in the Hunt License and Supply Agreement) license to the RF AMR Mobile Receiving Device Intellectual Property, in good faith, to Hunt pursuant to and in accordance with the Hunt License and Supply Agreement (which agreement shall not vary or contradict, or be construed to vary or contradict, the terms of this Order, it being understood that nothing in this Order shall be construed to reduce any rights or benefits of Hunt or to reduce any obligations of Respondents under such agreements), and such agreement, if approved by the Commission as the Licensing Agreement for the RF AMR Mobile Receiving Device Intellectual Property is incorporated by reference into this Order and made a part hereof as non-public Appendix A.
- B. If, at the time the Commission determines to make this Order final, the Commission notifies Respondents that Hunt is not an acceptable acquirer of the RF AMR Mobile Receiving Device Intellectual Property or that the manner in which the licensing was accomplished is not acceptable, then, after receipt of such written notification:
1. Respondents shall immediately notify Hunt of the notice received from the Commission and shall as soon as practicable effect the rescission of the Hunt License and Supply Agreement;
  2. Respondents shall, within six (6) months from the date this Order becomes final, grant an irrevocable, non-

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exclusive, perpetual, transferable, royalty-free license to the RF AMR Mobile Receiving Device Intellectual Property, at no minimum price, to the acquirer of the RF AMR Electric Endpoint Intellectual Property pursuant to Paragraph II.B.2., and in a manner that receives the prior approval of the Commission.

- C. Any Licensing Agreement that has been approved by the Commission between Respondents and an Acquirer of the RF AMR Mobile Receiving Device Intellectual Property shall be deemed incorporated into this Order, and any failure by Respondents to comply with any term of such Licensing Agreement shall constitute a failure to comply with this Order.
- D. Pending licensing of the RF AMR Mobile Receiving Device Intellectual Property, Respondents shall take such actions as are necessary to maintain the viability and marketability of the RF AMR Mobile Receiving Device Intellectual Property and to prevent the destruction, removal, wasting, deterioration, or impairment of any of the RF AMR Mobile Receiving Device Intellectual Property.
- E. Respondents shall:
  - 1. Within fifteen (15) days after the license is granted pursuant to Paragraph III.A. of this Order, deliver to the Acquirer, at the Respondents' expense, a copy of the RF AMR Mobile Receiving Device Intellectual Property, including, but not limited to, all public and non-public information that is necessary for the RF AMR Mobile Receiving Device Intellectual Property; and



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2. Respondents shall make no changes to its RF AMR Mobile Receiving Device or its RF AMR Electric Endpoints which would have the effect of materially diminishing the ability of the Acquirer's RF AMR Electric Endpoint radio frequency signals to be read by its RF AMR Mobile Receiving Device.
- F. At the Acquirer's option, Respondents shall sell RF AMR Mobile Receiving Devices and any related products to the Acquirer at the actual price it generally charges its distributors.
1. For any RF AMR Mobile Receiving Device sold pursuant to this Paragraph III.F., Respondents may enter in an agreement with one or more of the Acquirer's customers whereby the Respondents shall provide a warranty for an RF AMR Mobile Receiving Device that it manufactures and supplies to such customer on behalf of the Acquirer. Such warranty agreement shall be in substantially the form set forth in the "Hunt Customer License and Warranty Agreement" attached as an Exhibit to the Hunt License and Supply Agreement.
  2. For any RF AMR Mobile Receiving Device sold pursuant to this Paragraph III.F., Respondents may enter into an agreement with the Acquirer whereby the Respondents shall provide a warranty for an RF AMR Mobile Receiving Device that it manufactures and supplies to the Acquirer for the Acquirer's own use. Such warranty agreement shall be in substantially the form set forth in the "Hunt Software License and Warranty Agreement" attached as an Exhibit to the Hunt License and Supply Agreement.
- G. Respondents shall not:
1. Restrict in any way the use of Confidential Business Information related to the RF AMR Mobile Receiving

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Devices by the Acquirer's employees who were at any time employed by Respondents and involved in the research, development, manufacturing, distribution, sale, or marketing of the RF AMR Mobile Receiving Devices;  
or

2. Use or disclose, directly or indirectly, any of the Acquirer's Confidential Business Information (other than as necessary to comply with the requirements of this Order) related to the research, development, manufacturing, marketing, or sale of the RF AMR Mobile Receiving Devices.
- H. Within ten (10) days after the Effective Date, Respondents shall assign, without any charge for the act of assignment, all rights and obligations of the agreement dated April 17, 1995, between Respondent Itron and Schlumberger Industries, Inc., Electricity Division and Schlumberger Industries Electricity Division of Schlumberger Canada Limited ("1995 Agreement") either (i) to DAP and Neptune, or, (ii) if DAP and Neptune decline the assignment, within sixty (60) days after the Effective Date, to another manufacturer of RF AMR Receiving Devices.
1. The assigned rights shall include, among other things, all rights as are granted in the 1995 Agreement relating to meter reading systems that have the capability to read data transmitted from an Electric ERT and an R-300. *PROVIDED, HOWEVER*, the Respondents are not required by this Paragraph to assign the rights to make an Electric ERT or R-300 or the rights to the production of an Electric ERT or R-300.
  2. The Respondents shall submit a copy of the assignment to Commission staff prior to the assignment to DAP and Neptune.

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3. If Respondents assign the 1995 Agreement to a person other than DAP and Neptune, Respondents shall make such assignment only to a manufacturer of RF AMR Receiving Devices that receives the prior approval of the Commission, and only in a manner that receives the prior approval of the Commission.
  4. In the event Respondents fail within sixty (60) days after the Effective Date to assign the contract rights as required in this Paragraph III.H., the Commission may appoint a trustee, in a manner similar to that described in Paragraph V. of this Order, to make such an assignment.
- I. The purpose of the licensing and transfer of the RF AMR Mobile Receiving Device Intellectual Property is to ensure the continued use of the RF AMR Mobile Receiving Devices in the same business in which the RF AMR Mobile Receiving Devices were engaged at the time of the announcement of the Acquisition, to maintain the number of entities engaged at the time of the announcement of the Acquisition selling RF AMR Mobile Receiving Devices, and to remedy the lessening of competition resulting from the Acquisition as alleged in the Commission's Complaint.

**IV.****IT IS FURTHER ORDERED** that:

- A. At any time after Respondents sign the Consent Agreement in this matter, the Commission may appoint one or more Interim Monitors to assure that Respondents expeditiously comply with all of their obligations and perform all of their responsibilities as required by this Order and the Licensing Agreement.
- B. The Commission shall select the Interim Monitor, subject to the consent of Respondents, which consent shall not be unreasonably withheld. If neither Respondent has opposed,

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in writing, including the reasons for opposing, the selection of a proposed Interim Monitor within ten (10) days after notice by the staff of the Commission to Respondents of the identity of any proposed Interim Monitor, Respondents shall be deemed to have consented to the selection of the proposed Interim Monitor.

- C. Not later than ten (10) days after appointment of the Interim Monitor, Respondents shall execute an agreement that, subject to the prior approval of the Commission, confers on the Interim Monitor all the rights and powers necessary to permit the Interim Monitor to monitor Respondents' compliance with the relevant terms of the Order and the Licensing Agreement in a manner consistent with the purposes of the Order.
- D. If one or more Interim Monitors are appointed pursuant to this Paragraph IV., Respondents shall consent to the following terms and conditions regarding the powers, duties, authorities, and responsibilities of each Interim Monitor:
  - 1. The Interim Monitor shall have the power and authority to monitor the Respondents' compliance with the terms of the licensing and interim supply terms of the Order and the Licensing Agreement, and shall exercise such power and authority and carry out the duties and responsibilities of the Interim Monitor in a manner consistent with the purposes of the Order and in consultation with the Commission.
  - 2. The Interim Monitor shall act in a fiduciary capacity for the benefit of the Commission.
  - 3. The Interim Monitor shall serve until the later of:
    - a. the completion by Respondents of the licensing of all relevant assets required to be assigned, granted,

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licensed, divested, transferred, delivered, or otherwise conveyed pursuant to this Order in a manner that fully satisfies the requirements of the Order and notification by Respondents to the Interim Monitor that the Acquirer is fully capable of producing or having produced an RF AMR Electric Endpoint independently of Respondents; or

- b. the completion by Respondents of the last obligation of any agreement entered into between Respondents and an Acquirer pursuant to Paragraphs II.F. and II.G. of this Order.
4. Subject to any demonstrated legally recognized privilege, the Interim Monitor shall have full and complete access to Respondents' personnel, books, documents, records kept in the normal course of business, facilities and technical information, and such other relevant information as the Interim Monitor may reasonably request, related to Respondents' compliance with their obligations under the Order, including, but not limited to, their obligations related to the RF AMR Assets. Respondents shall cooperate with any reasonable request of the Interim Monitor and shall take no action to interfere with or impede the Interim Monitor's ability to monitor Respondents' compliance with the Order.
5. The Interim Monitor shall serve, without bond or other security, at the expense of Respondents on such reasonable and customary terms and conditions as the Commission may set. The Interim Monitor shall have authority to employ, at the expense of the Respondents, such consultants, accountants, attorneys and other representatives and assistants as are reasonably necessary to carry out the Interim Monitor's duties and responsibilities. The Interim Monitor shall account for all expenses incurred, including fees for services rendered, subject to the approval of the Commission.

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6. Respondents shall indemnify the Interim Monitor and hold the Interim Monitor harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Interim Monitor's duties, including all reasonable fees of counsel and other reasonable expenses incurred in connection with the preparations for, or defense of, any claim, whether or not resulting in any liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from misfeasance, gross negligence, willful or wanton acts, or bad faith by the Interim Monitor.
  7. Respondents shall report to the Interim Monitor in accordance with the requirements of this Order and/or as otherwise provided in any agreement approved by the Commission. The Interim Monitor shall evaluate the reports submitted to the Interim Monitor by Respondents, and any reports submitted by the Acquirer with respect to the performance of its or Respondents' obligations under the Order or the Licensing Agreement. Within one (1) month from the date the Interim Monitor receives these reports, the Interim Monitor shall report in writing to the Commission concerning performance by Respondents of its obligations under the Order.
  8. Respondents may require the Interim Monitor and each of the Interim Monitor's consultants, accountants, attorneys, and other representatives and assistants to sign a customary confidentiality agreement; *PROVIDED, HOWEVER*, such agreement shall not restrict the Interim Monitor from providing any information to the Commission.
- E. The Commission may, among other things, require the Interim Monitor and each of the Interim Monitor's consultants, accountants, attorneys, and other

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representatives and assistants to sign an appropriate confidentiality agreement relating to Commission materials and information received in connection with the performance of the Interim Monitor's duties.

- F. If the Commission determines that the Interim Monitor has ceased to act or failed to act diligently, the Commission may appoint a substitute Interim Monitor in the same manner as provided in this Paragraph IV.
- G. The Commission may on its own initiative, or at the request of the Interim Monitor, issue such additional orders or directions as may be necessary or appropriate to assure compliance with the requirements of the Order.
- H. An Interim Monitor appointed pursuant to this Order may be the same person appointed as a Divestiture Trustee pursuant to the relevant provisions of this Order.

**V.****IT IS FURTHER ORDERED** that:

- A. If Respondents have not licensed the RF AMR Assets as required by Paragraphs II. and III. of this Order, the Commission may appoint a Divestiture Trustee to license the RF AMR Assets in a manner that satisfies the requirements of Paragraphs II. and III. In the event that the Commission or the Attorney General brings an action pursuant to § 5(*l*) of the Federal Trade Commission Act, 15 U.S.C. § 45(*l*), or any other statute enforced by the Commission, Respondents shall consent to the appointment of a Divestiture Trustee in such action to license the relevant assets in accordance with the terms of this Order. Neither the appointment of a Divestiture Trustee nor a decision not to appoint a Divestiture Trustee under this Paragraph shall preclude the Commission or the Attorney General from seeking civil penalties or any other

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relief available to it, including a court-appointed Divestiture Trustee, pursuant to § 5(l) of the Federal Trade Commission Act, or any other statute enforced by the Commission, for any failure by the Respondents to comply with this Order.

- B. The Commission shall select the Divestiture Trustee, subject to the consent of Respondents, which consent shall not be unreasonably withheld. The Divestiture Trustee shall be a person with experience and expertise in acquisitions and divestitures. If Respondents have not opposed, in writing, including the reasons for opposing, the selection of any proposed Divestiture Trustee within ten (10) days after notice by the staff of the Commission to Respondents of the identity of any proposed Divestiture Trustee, Respondents shall be deemed to have consented to the selection of the proposed Divestiture Trustee.
- C. Within ten (10) days after appointment of a Divestiture Trustee, Respondents shall execute a trust agreement that, subject to the prior approval of the Commission, transfers to the Divestiture Trustee all rights and powers necessary to permit the Divestiture Trustee to effect the relevant licensing or transfer required by the Order.
- D. If a Divestiture Trustee is appointed by the Commission or a court pursuant to this Order, Respondents shall consent to the following terms and conditions regarding the Divestiture Trustee's powers, duties, authority, and responsibilities:
  - 1. Subject to the prior approval of the Commission, the Divestiture Trustee shall have the exclusive power and authority to assign, grant, license, divest, transfer, deliver or otherwise convey the RF AMR Assets that are required by this Order to be assigned, granted, licensed, divested, transferred, delivered or otherwise conveyed.



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2. The Divestiture Trustee shall have twelve (12) months from the date the Commission approves the trust agreement described herein to accomplish the licensing, which shall be subject to the prior approval of the Commission. If, however, at the end of the twelve (12) month period, the Divestiture Trustee has submitted a licensing plan or believes that the licensing can be achieved within a reasonable time, the licensing period may be extended by the Commission; *PROVIDED, HOWEVER*, the Commission may extend the licensing period only two (2) times.
3. Subject to any demonstrated legally recognized privilege, the Divestiture Trustee shall have full and complete access to the personnel, books, records, and facilities related to the relevant assets that are required to be assigned, granted, licensed, divested, delivered or otherwise conveyed by this Order and to any other relevant information, as the Divestiture Trustee may request. Respondents shall develop such financial or other information as the Divestiture Trustee may request and shall cooperate with the Divestiture Trustee. Respondents shall take no action to interfere with or impede the Divestiture Trustee's accomplishment of the licensing. Any delays in licensing caused by Respondents shall extend the time for licensing under this Paragraph V. in an amount equal to the delay, as determined by the Commission or, for a court-appointed Divestiture Trustee, by the court.
4. The Divestiture Trustee shall use commercially reasonable best efforts to negotiate the most favorable price and terms available in each contract that is submitted to the Commission, subject to Respondents' absolute and unconditional obligation to license expeditiously and at no minimum price. The licensing shall be made in the manner and to an Acquirer as required by this Order; *PROVIDED, HOWEVER*, if the

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Divestiture Trustee receives bona fide offers from more than one acquiring entity, and if the Commission determines to approve more than one such acquiring entity, the Divestiture Trustee shall divest to the acquiring entity selected by Respondents from among those approved by the Commission; *PROVIDED FURTHER, HOWEVER*, that Respondents shall select such entity within five (5) days of receiving notification of the Commission's approval.

5. The Divestiture Trustee shall serve, without bond or other security, at the cost and expense of Respondents, on such reasonable and customary terms and conditions as the Commission or a court may set. The Divestiture Trustee shall have the authority to employ, at the cost and expense of Respondents, such consultants, accountants, attorneys, investment bankers, business brokers, appraisers, and other representatives and assistants as are necessary to carry out the Divestiture Trustee's duties and responsibilities. The Divestiture Trustee shall account for all monies derived from the licensing and all expenses incurred. After approval by the Commission and, in the case of a court-appointed Divestiture Trustee, by the court, of the account of the Divestiture Trustee, including fees for the Divestiture Trustee's services, all remaining monies shall be paid at the direction of the Respondents, and the Divestiture Trustee's power shall be terminated. The compensation of the Divestiture Trustee shall be based at least in significant part on a commission arrangement contingent on the licensing of all of the relevant assets that are required to be licensed by this Order.
6. Respondents shall indemnify the Divestiture Trustee and hold the Divestiture Trustee harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Divestiture Trustee's duties, including all reasonable fees of counsel

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and other expenses incurred in connection with the preparation for, or defense of, any claim, whether or not resulting in any liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from misfeasance, gross negligence, willful or wanton acts, or bad faith by the Divestiture Trustee.

7. The Divestiture Trustee shall have no obligation or authority to operate or maintain the relevant assets required to be licensed by this Order.
  8. The Divestiture Trustee shall report in writing to Respondents and to the Commission every sixty (60) days concerning the Divestiture Trustee's efforts to accomplish the divestiture.
  9. Respondents may require the Divestiture Trustee and each of the Divestiture Trustee's consultants, accountants, attorneys, and other representatives and assistants to sign a customary confidentiality agreement; *PROVIDED, HOWEVER*, such agreement shall not restrict the Divestiture Trustee from providing any information to the Commission.
- E. If the Commission determines that a Divestiture Trustee has ceased to act or failed to act diligently, the Commission may appoint a substitute Divestiture Trustee in the same manner as provided in this Paragraph V.
- F. The Commission or, in the case of a court-appointed Divestiture Trustee, the court, may on its own initiative or at the request of the Divestiture Trustee issue such additional orders or directions as may be necessary or appropriate to accomplish the licensing required by this Order.

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- G. The Divestiture Trustee appointed pursuant to this Paragraph may be the same Person appointed as Interim Monitor pursuant to the relevant provisions of this Order.

**VI.**

**IT IS FURTHER ORDERED** that if Hunt licenses the RF AMR Assets pursuant to Paragraphs II. and III. of this Order, Hunt shall not, for a period of five (5) years from the date this Order becomes final, sell or otherwise convey, directly or indirectly, all or substantially all of the RF AMR Assets (excluding transactions in the ordinary course of business, such as sales of inventory to customers) to any Meter Manufacturer without sixty (60) days prior notice to the Commission. Such notice shall contain the proposed agreement with all attachments and documents that would be responsive to Item 4©) of the Premerger Notification and Report Form under the Hart-Scott-Rodino Premerger Notification Act, Section 7A of the Clayton Act, 15 U.S.C. § 18a, and Rules, 16 C.F.R. § 801-803, relating to the proposed transaction. The Bureau of Competition may request additional information and documents related to the proposed transaction and may allow the transaction to consummate before the sixty-day time period has run. *PROVIDED, HOWEVER*, that prior notification shall not be required by this paragraph for a transaction for which notification is required to be made, and has been made, pursuant to Section 7A of the Clayton Act, 15 U.S.C. § 18a.

**VII.**

**IT IS FURTHER ORDERED** that:

- A. If Hunt is approved as the Acquirer pursuant to Paragraph II.A., then beginning thirty (30) days after the date this Order becomes final, and every sixty (60) days thereafter until Respondents have completed their supply and technical assistance obligations under Paragraphs II.F. and II.G. of this Order, Respondents shall submit to the

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Commission a verified written report setting forth in detail the manner and form in which they intend to comply, are complying, and have complied with the terms of the entire Order. Respondents shall submit at the same time a copy of their reports concerning compliance with this Order to the Interim Monitor, if any Interim Monitor has been appointed.

- B. If Hunt is not approved as the Acquirer pursuant to Paragraph II.A., then beginning thirty (30) days after the date this Order becomes final, and every thirty (30) days thereafter until Respondents have licensed the RF AMR Assets pursuant to Paragraphs II.B. and III.B. and have completed their supply and technical assistance obligations under Paragraphs II.F. and II.G. of this Order, Respondents shall submit to the Commission a verified written report setting forth in detail the manner and form in which they intend to comply, are complying, and have complied with the terms of the entire Order. Respondents shall submit at the same time a copy of their reports concerning compliance with this Order to the Interim Monitor, if any Interim Monitor has been appointed. Respondents shall include in their reports, among other things that are required from time to time, a full description of the efforts being made to comply with this Order, including a description of all substantive contacts or negotiations related to the licensing of the relevant assets and the identity of all parties contacted. Respondents shall include in these reports copies of all written and electronic communications to and from such parties, all internal memoranda, and all reports and recommendations concerning the completion of such obligations.
- C. Beginning twelve (12) months after the date this Order becomes final, and annually thereafter on the anniversary of the date this Order becomes final, for the next four years, Respondents shall submit to the Commission

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verified written reports setting forth in detail the manner and form in which they are complying and have complied with this Order.

**VIII.**

**IT IS FURTHER ORDERED** that Respondents shall notify the Commission at least thirty (30) days prior to any proposed (1) dissolution of the Respondents, (2) acquisition, merger or consolidation of Respondents, or (3) any other change in the Respondents that may affect compliance obligations arising out of the order, including but not limited to assignment, the creation or dissolution of subsidiaries, or any other change in Respondents.

**IX.**

**IT IS FURTHER ORDERED** that, for the purpose of determining or securing compliance with this Order, and subject to any legally recognized privilege, and upon written request with reasonable notice to Respondents, Respondents shall permit any duly authorized representative of the Commission:

- A. Access, during office hours of Respondents and in the presence of counsel, to all facilities and access to inspect and copy all books, ledgers, accounts, correspondence, memoranda, and all other records and documents in the possession or under the control of Respondents related to compliance with this Order; and
- B. Upon five (5) days' notice to Respondents and without restraint or interference from Respondents, to interview officers, directors, or employees of Respondents, who may have counsel present, regarding such matters.

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**X.**

**IT IS FURTHER ORDERED** that this Order shall terminate on August 5, 2014.

By the Commission, Commissioner Harbour recused.

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NONPUBLIC APPENDIX A

[Redacted from Public Record Version]



Analysis

**Analysis of Agreement Containing Consent Orders to Aid  
Public Comment****I. Introduction**

The Federal Trade Commission has accepted, subject to final approval, an Agreement Containing Consent Orders (“Consent Agreement”) from Itron, Inc. and Schlumberger Electricity, Inc. The purpose of the Consent Agreement is to remedy the anticompetitive effects of Itron’s acquisition of Schlumberger Electricity. Under the terms of the Consent Agreement, Itron is required to grant a royalty-free, perpetual and irrevocable license to Hunt Technologies, Inc. for Itron’s mobile radio frequency (“RF”) automatic meter reading (“AMR”) technology for electric utilities, as well as components of Schlumberger Electricity’s mobile RF AMR technology for electric utilities.

The proposed Consent Agreement has been placed on the public record for thirty days to solicit comments from interested persons. Comments received during this period will become part of the public record. After thirty days, the Commission will again review the proposed Consent Agreement and the comments received, and will decide whether it should withdraw from the proposed Consent Agreement or make it final.

Pursuant to a stock and asset purchase agreement dated July 16, 2003, Itron agreed to acquire Schlumberger Electricity and 51 percent of the shares of Walsin Schlumberger Electricity Measurement Corporation (a Taiwan corporation), and certain foreign assets of Schlumberger Canada Limited, Schlumberger Distribucion S.A. de C.V., Schlumberger Servicios S.A. de C.V., and Axalto S.A. (formerly Schlumberger Systemes S.A.), all owned indirectly by Schlumberger Limited, in a cash transaction for approximately \$255 million (“Proposed Acquisition”). The Commission’s Complaint alleges that the Proposed Acquisition, if consummated, would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, by substantially

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lessening competition in the United States market for the research, development, manufacture, and sale of mobile RF AMR systems for electric utilities.

## II. The Parties

Headquartered in Spokane, Washington, Itron is the leading supplier of mobile RF AMR systems to electric utilities in the United States. Itron's mobile RF AMR system is based upon encoder-receiver-transmitter ("ERT") technology and related communication protocols. The Itron ERT is electronic circuitry that gathers consumption information from an electricity meter and then broadcasts the data via radio frequency, using a specific communication protocol, known as the ERT protocol. To gather this data stream, Itron supplies handheld and vehicle-transportable receivers, also known as drive-by data collectors. The ERT is sold as either a retrofit for existing electromechanical electricity meters, or is integrated into newly manufactured electromechanical and solid state meters. Itron also supplies mobile RF AMR systems to water and natural gas utilities. In each of these areas, Itron is a leading mobile RF AMR systems supplier. Itron is also active in other lines of business serving the utility sector, including handheld computers for manual meter reading, as well as specialized software systems for billing systems, route management, and line design.

Schlumberger Electricity is a wholly owned subsidiary of Schlumberger Limited, a leading provider of oilfield services. With its headquarters in Oconee, South Carolina, Schlumberger Electricity is the leading supplier of residential electricity meters in the United States, and the second largest supplier of mobile RF AMR systems in the United States. Presently, Schlumberger Electricity's mobile RF AMR is based on the R300, which is integrated into Schlumberger Electricity's meters. Schlumberger Electricity also sells handheld and drive-by data collectors through a partnership with Neptune Technology Group, Inc.. The Neptune/Schlumberger mobile RF AMR receivers are capable of gathering data from the Itron ERT and the Schlumberger R300.

## Analysis

As the result of a license arrangement, Itron's and Schlumberger Electricity's mobile RF AMR systems utilize the same technology and proprietary communication protocols. Hence, products produced by Itron and Schlumberger are fully interoperable. Electric utilities, therefore, can utilize a combination of Itron and Schlumberger mobile RF AMR components, i.e., endpoints and receiving devices, within the same system. No other company manufactures a mobile RF AMR system that is interoperable with the mobile RF AMR systems manufactured by Itron or Schlumberger.

### III. Mobile RF AMR Systems

Electric utilities utilize mobile RF AMR systems to automatically and remotely gather consumption data from residential electricity meters and certain electricity meters used by smaller commercial enterprises. A mobile RF AMR system consists of two principle components: (1) an endpoint, which is electronic circuitry integrated into an electricity meter that records and broadcasts consumption data, and (2) a mobile receiving device, which can be handheld or vehicle-transportable, to gather the data signal.

Mobile RF AMR systems allow consumption data from electricity meters to be read automatically and remotely, eliminating the need for a utility to send a meter reader to manually inspect each individual meter. Manual meter reading is labor-intensive and time-consuming, requiring the meter reader to physically access and visually inspect each electricity meter. Further, many meters are hard to access. Consequently, manual meter reading requires the effort of a substantial workforce of meter readers. By deploying a mobile RF AMR system, an electric utility can reduce its labor costs significantly. Additional cost savings are obtained by eliminating other problems endemic to manual meter reading, such as transcription errors, unread meters, and theft of service. As a result of these benefits, electric utilities are unlikely to alter their mobile RF AMR purchases relative to manual meter reading even if the price of mobile RF

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AMR systems increased by five to ten percent. Likewise, in response to a small but significant increase in mobile RF AMR prices, customers are unlikely to utilize other, non-mobile AMR technologies as they entail different technical requirements and are substantially more expensive.

The United States is the appropriate geographic market for mobile RF AMR systems in which to analyze the competitive effects of the Proposed Acquisition. There are not now, nor have there ever been, any imports of mobile RF AMR systems. Companies cannot compete from abroad for two primary reasons. First, electric utilities will not purchase mobile RF AMR systems from companies that do not have a substantial presence and track record in the United States. This is due to the importance of timely and effective service and support, as well as a strong “buy American” sentiment. Second, there are no significant foreign companies that produce mobile RF AMR systems.

The United States market for mobile RF AMR systems is highly concentrated. Itron and Schlumberger Electricity are the two largest suppliers of mobile RF AMR systems to electric utilities in the United States, and combined would account for over 99 percent of the market. There are three other firms in the market that together have a market share of less than one-half of one percent. Additionally, because Itron and Schlumberger Electricity are the only two mobile RF AMR suppliers with access to the proprietary ERT technology, the industry standard, they are especially close competitors, and the direct competition between Itron and Schlumberger Electricity has benefitted consumers significantly in the form of lower prices, improved service and greater innovation. Absent Commission action, Itron’s acquisition of Schlumberger Electricity raises serious antitrust concerns.

Finally, sufficient new entry into the United States mobile RF AMR market is unlikely to occur in a timely manner as there are significant impediments to entry and expansion. A new entrant would need to devote significant time and expense to researching

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and developing a product. Second, a new entrant must undertake the lengthy and costly process of establishing a track record of performance and reliability for its product, which is critical to utility customers because they rely on the quality and accuracy of AMR systems in order to properly bill their customers. Further, a new entrant would not have access to the intellectual property necessary to sell a mobile RF AMR system that is compatible with the substantial installed base of systems produced by Itron and Schlumberger Electricity, which would significantly limit the available sales opportunities.

#### **IV. The Consent Agreement**

The Consent Agreement effectively remedies the Proposed Acquisition's anticompetitive effects in the U.S. market for the research, development, manufacture, and sale of mobile RF AMR systems by requiring Itron to grant a royalty-free license to its mobile RF AMR technology. Pursuant to the Consent Agreement, a package of assets referred to in the Consent Agreement as the RF AMR Assets, will be licensed to Hunt. The RF AMR Assets provide Hunt with all the technology and rights necessary to manufacture and sell a mobile RF AMR system, including endpoints and receivers, that is entirely interoperable with Itron's mobile RF AMR system. Should Itron fail to accomplish the divestiture within the time and in the manner required by the Consent Agreement, the Commission may appoint a trustee to divest the RF AMR Assets subject to Commission approval. The trustee will have the exclusive power and authority to accomplish the divestiture within twelve (12) months of being appointed, subject to any necessary extensions by the Commission.

The Commission is satisfied that Hunt is a well-qualified acquirer of the divested assets. Hunt is a private corporation headquartered in Pequot Lakes, Minnesota, that researches, develops, manufactures, and sells powerline carrier ("PLC") systems to electric utilities. PLC systems are a type of AMR technology used primarily for rural service areas. PLC systems

Analysis

are therefore complementary to mobile RF AMR systems, which are utilized primarily in areas of low population concentration. Therefore, Hunt does not pose separate competitive issues as the acquirer of the license to the RF AMR assets. Due to its involvement in the electric utility industry, Hunt has the resources, related expertise and capabilities to ensure that it will become an effective competitor in the market for mobile RF AMR systems for electric utilities.

Until Hunt has made the necessary manufacturing arrangements, Hunt will procure Electric RF Endpoints from Itron at terms that will allow Hunt to aggressively compete with Itron immediately upon the closing of the transaction. Under a separate supply agreement, Hunt may also procure mobile RF AMR receivers from Itron under terms that would enable Hunt to compete effectively with Itron. To provide mobile RF AMR receivers, however, Hunt may choose to partner with Neptune, as did Schlumberger Electricity. To ensure that Hunt retains the ability to partner with Neptune for mobile RF AMR receiving devices and to allow Neptune to continue to make sales for its own account, the proposed consent agreement requires Itron to assign all of Schlumberger Electricity's mobile RF AMR receiving device rights to Neptune.

The Consent Agreement contains several further provisions designed to help ensure that the divestiture of the mobile RF AMR Assets is successful. First, to assist Hunt in the manufacture and sale of the Hunt mobile RF AMR system, Itron will provide technical assistance to Hunt, including 200 hours of technical assistance at no cost to Hunt. Second, Itron must provide Hunt with any updates to ERT technology for a period of three years. Finally, the Decision and Order allows the Commission to appoint an Interim Monitor, if necessary, to ensure that Itron complies with all of its obligations and performs all of its responsibilities as required by the Consent Agreement.

## Analysis

The purpose of this analysis is to facilitate public comment on the Consent Agreement, and is not intended to constitute an official interpretation of the proposed Decision and Order or the Order to Maintain Assets, or to modify their terms in any way.

Complaint

IN THE MATTER OF

**JONATHAN BARASH**

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

*Docket C-4115; File No. 0423002*

*Complaint, August 13, 2004--Decision, August 13, 2004*

This consent order, among other things, requires Respondent Jonathan Barash – who collaborated with others in the marketing of a purported children’s weight loss product called “Pedia Loss,” and a purported female libido enhancer called “Fabulously Feminine” -- to possess and rely on competent and reliable scientific evidence to support claims that Pedia Loss or any other covered product or service causes weight loss, suppresses appetite, increases fat burning, or slows carbohydrate absorption; causes weight loss in overweight or obese children ages 6 and over; or causes weight loss by suppressing appetite, increasing fat burning, or slowing carbohydrate absorption, when taken by overweight or obese children ages 6 and over, and to support claims that Fabulously Feminine or any other covered product or service will increase a woman’s libido, sexual desire, or sexual satisfaction. The order also requires the respondent to possess and rely on competent and reliable scientific evidence to support benefits, performance, or efficacy claims for any dietary supplement, food, drug, or device, and for any health-related service or program promoting weight loss or sexual enhancement. In addition, the order prohibits the respondent from misrepresenting the existence, contents, validity, results, conclusions, or interpretations of any test or studies.

*Participants*

For the Commission: *Janet M. Evans, Sydney Knight, Richard Cleland, Mary Engle, Susan Braman, and Jesse Leary.*

For the Respondent: *Debra Bass and Antonio C. Martinez, Martinez Bass & Associates.*

**COMPLAINT**

The Federal Trade Commission, having reason to believe that Jonathan Barash (hereinafter "Respondent") has violated the provisions of the Federal Trade Commission Act, and it appearing



## Complaint

to the Commission that this proceeding is in the public interest, alleges:

1. Dynamic Health of Florida, LLC (“Dynamic Health”), a respondent in Docket No. 9317 (hereinafter “Docket 9317 Respondent”), is a Florida limited liability company with offices located at 1455 North Park Dr., Weston, Florida.
2. Chhabra Group, LLC (“Chhabra Group”), a respondent in Docket No. 9317 (hereinafter “Docket 9317 Respondent”), is a Florida limited liability company located at 1455 North Park Dr., Weston, Florida.
3. DBS Laboratories, LLC (“DBS Laboratories”), a respondent in Docket No. 9317 (hereinafter “Docket 9317 Respondent”), is a Florida limited liability company with offices located at 1485 North Park Dr., Weston, Florida.
4. Vineet K. Chhabra a/k/a Vincent K. Chhabra, a Respondent in Docket No. 9317 (hereinafter “Docket 9317 Respondent”), is an officer of Dynamic Health and Chhabra Group. Individually, or in concert with others, he has formulated, directed, participated in, or controlled the acts or practices of Dynamic Health and Chhabra Group, including the acts and practices alleged in this complaint. His principal office or place of business is 1455 North Park Dr., Weston, Florida.
5. Respondent Jonathan Barash (hereinafter “Respondent”) is an owner and officer of DBS Laboratories, LLC and has participated in its day to day operations. Individually, or in concert with others, he has formulated, directed, participated in, or controlled the acts or practices of DBS Laboratories LLC, including the acts or practices challenged in the complaint. His principal office or place of business is 6599 NW 97th Drive, Parkland, Florida 33076.
6. The Docket 9317 Respondents and Respondent have advertised, labeled, offered for sale, sold, and distributed products

Complaint

to the public, including Pedia Loss, a weight loss supplement, and Fabulously Feminine, a female sexual enhancement supplement. Pedia Loss and Fabulously Feminine are either a “food” or a “drug” within the meaning of Sections 12 and 15 of the Federal Trade Commission Act, 15 U.S.C. §§ 52 and 55.

7. The acts and practices of the Docket 9317 Respondents and Respondent alleged in this complaint have been in or affecting commerce, as "commerce" is defined in Section 4 of the Federal Trade Commission Act.

**PEDIA LOSS**

8. The Docket 9317 Respondents and Respondent have disseminated or caused to be disseminated advertisements for Pedia Loss through various Internet websites, including [www.pedialoss.com](http://www.pedialoss.com), [www.dynamichealthproducts.com](http://www.dynamichealthproducts.com), and [www.dbslabs.com](http://www.dbslabs.com), as well as print advertising in Cosmopolitan magazine. According to the product labels, Pedia Loss contains, among other ingredients, fructose, inulin, glutamine, lecithin, citric acid, and hydroxycitric acid (HCA). Advertisements for Pedia Loss products include, but are not necessarily limited to, the attached Exhibits A through C. The advertisements contain the following statements, among others:

a. **Pedia Loss**

\* \* \*

Child obesity is a growing problem in North America. Pedia Loss is an appetite suppressant for children 6 years and older. Allow children to enjoy their favorite foods without gaining weight. This revolutionary new formula slows the absorption of carbohydrates, allowing more to be burned for energy and less to be stored as fat. This highly effective and natural dietary supplement comes in berry-flavored chewable tablets

## Complaint

for easy consumption. In conjunction with a proper diet and exercise program, Pedia Loss can keep your child from becoming a statistic.

Please consult your healthcare provider before giving Pedia Loss to your child.

\* \* \*

This synergistic formula was designed to aide in a child's glucose metabolism. Since many of their favorite foods are rich in carbohydrates but very low in dietary fiber, their digestive tracts and insulin never function properly. Now with Pedia Loss children can still enjoy their favorite food but with the help of Inulin their bodies with [sic] slow down the absorption of carbohydrate, allowing more to be burned for energy and less to be stored as fat, and give a great source of soluble fiber. In addition to this highly advanced ingredient, we have included supplemental amounts of both glutamine and FOS, which have both been proven to drastically improve intestinal health. Finally this product contains a highly effective compound called HCA. This compound has been shown to safely burn fat without any form of stimulants.

(Exhibit A: web page from [www.dynamichealthproducts.com](http://www.dynamichealthproducts.com))

- b. Pedia Loss is highly effective for children 6 years of age and older. Children can still enjoy their favorite food in moderation while slowing the absorption of carbohydrates, allowing more to be burned for energy and less to be stored as fat. For best results use in conjunction with an exercise program and a low fat low calorie diet. Please consult your healthcare provider before giving this product for your child.

(Exhibit B: product label)

Complaint

c. **Child Obesity**

an american [sic] reality

According to the Centers for Disease Control and Prevention, childhood obesity is a growing problem in the U.S., with one in ten pre-schoolers considered clinically obese. Pedia Loss addresses this growing health care issue in children 6 years of age and older. Children can still enjoy their favorite foods in moderation, while slowing the absorption of carbohydrates. The use of Pedia Loss enables more carbs to be burned for energy and less to be stored as fat. This highly effective and natural dietary supplement comes in berry-flavored chewable tablets that will appeal to children. Best of all is the feeling of strength and confidence they'll experience by overcoming childhood weight problems. . . .

(Exhibit C: ad in Cosmopolitan Magazine)

9. Through the means described in Paragraph 8, the Docket 9317 Respondents and Respondent have represented, expressly or by implication, that:

- a. Pedia Loss causes weight loss in overweight or obese children ages 6 and over, and
- b. When taken by overweight or obese children ages 6 and over, Pedia Loss causes weight loss by suppressing appetite, increasing fat burning, and slowing carbohydrate absorption.

10. Through the means described in Paragraph 8, the Docket 9317 Respondents and Respondent have represented, expressly or by implication, that they possessed and relied upon a reasonable

## Complaint

basis that substantiated the representations set forth in Paragraph 9, at the time the representations were made.

11. In truth and in fact, the Docket 9317 Respondents and Respondent did not possess and rely upon a reasonable basis that substantiated the representations set forth in Paragraph 9, at the time the representations were made. Therefore, the representation set forth in Paragraph 10 was, and is, false or misleading.

**FABULOUSLY FEMININE**

12. The Docket 9317 Respondents and Respondent have disseminated or caused to be disseminated advertisements for Fabulously Feminine through various Internet websites, including [www.usaprescription.com](http://www.usaprescription.com), [www.dbslabs.com](http://www.dbslabs.com), and [www.medprescribe.com](http://www.medprescribe.com), as well as print ads in various newspaper publications. According to the product labels, Fabulously Feminine contains L-arginine, ginseng, damiana leaf, ginkgo biloba leaf, and horny goat weed, among other ingredients. Advertisements for Fabulously Feminine products include, but are not necessarily limited to, the attached Exhibits D through F. The advertisements contain the following statements, among others:

**a. Fabulously Feminine**

Do you crave more from sexual intimacy? Rev up your sex drive with FABULOUSLY FEMININE. All-natural FABULOUSLY FEMININE can help you build the stamina you need to make your sexual experiences more intense and lasting. . . It's all a matter of stimulating blood flow and increasing sensitivity, and FABULOUSLY FEMININE'S herbal and amino acid formula accomplishes this naturally, yet powerfully. . . .

\* \* \*

**PRODUCT INFORMATION**

Complaint

Fabulously Feminine is a safe, natural way to enhance sexual desire, satisfaction and enjoyment. The ingredients in Fabulously Feminine, when taken daily with a multivitamin, have been shown in a double-blind, placebo-controlled Stanford University study to enhance satisfaction with sex life, the level of sexual desire and frequency of sexual encounters.

It is estimated that 43% of women experience a loss of sexual vitality at some time in their lives. External factors such as stress and fatigue may contribute to the decline in sexual interest. . . .

(Exhibit D : web page from [www.usaprescription.com](http://www.usaprescription.com))

- b. It is not unusual for men and women, young or old, to lose desire, arousal and overall satisfaction in the bedroom. Let **DBS Laboratories** give you the fuel you need to re-kindle the fire inside you.

LIBIDO ENHANCER

**FABULOUSLY  
FEMININE**

Dietary Supplement

Millions of women are dealing with the same issues you are. Put your confidence and your relationship in the hands of **Fabulously Feminine** – The safe, natural way to enhance sexual desire, satisfaction and enjoyment. A special libido enhancing formula designed specifically for women, **Fabulously Feminine** contains a proprietary blend of traditional libido enhancing herbs. Not being in the mood for sex is often times the result of poor stimulation; lack of energy, and hormonal imbalance. This product was specially formulated to address these issues. These all-natural ingredients are known to stimulate blood

## Complaint

flow and increase sensitivity, making this product one of the most potent available on the market.

(Exhibit E: National Examiner newspaper ad)

## c. LIBIDO ENHANCER

**FABULOUSLY™**

**FEMININE**

Dietary Supplement

\* \* \*

A scientific formula designed especially for women, **Fabulously Feminine** contains a proprietary blend of clinically proven ingredients for libido health. Not being in the mood for sex is oftentimes the result of poor stimulation, lack of energy, and hormonal imbalance. This product has been formulated to address these issues. . . .

(Exhibit F: National Enquirer newspaper ad)

13. Through the means described in Paragraph 12, the Docket 9317 Respondents and Respondent have represented, expressly or by implication, that clinical testing proves that Fabulously Feminine enhances a woman's satisfaction with her sex life and level of sexual desire.

14. In truth and in fact, clinical testing does not prove that Fabulously Feminine enhances a woman's satisfaction with her sex life and level of sexual desire. Therefore, the representation set forth in Paragraph 13 was, and is, false or misleading.

15. Through the means described in Paragraph 12, the Docket 9317 Respondents and Respondent have represented, expressly or by implication, that Fabulously Feminine will increase a woman's libido, sexual desire, and sexual satisfaction by stimulating blood flow and increasing sensitivity.

Complaint

16. Through the means described in Paragraph 12, the Docket 9317 Respondents and Respondent have represented, expressly or by implication, that they possessed and relied upon a reasonable basis that substantiated the representation set forth in Paragraph 15, at the time the representation was made.

17. In truth and in fact, the Docket 9317 Respondents and Respondent did not possess and rely upon a reasonable basis that substantiated the representation set forth in Paragraph 15, at the time the representation was made. Therefore, the representation set forth in Paragraph 16 was, and is, false or misleading.

18. The acts and practices of the Docket 9317 Respondents and Respondent as alleged in this complaint constitute unfair or deceptive acts or practices in or affecting commerce in violation of Sections 5(a) and 12 of the Federal Trade Commission Act.

THEREFORE, the Federal Trade Commission this thirteenth day of August, 2004, has issued this complaint against Respondent.



DynamicHealthProducts.com

Apimin-AM  
Apimin-PM  
Carb-Crusher  
Fat-Fighter  
Pedia Loss  
Thermo-Loss

Ovulte

Reflux Balance

Arginine-Plus  
Fabulously Feminine  
Masculine Male

Health Boost 60  
Health Boost 120

Sleep-PM

Subscribe to o

## Pedia Loss



[View Supplement Facts](#)

**Get to my Shopping Bag**

Child obesity is a growing problem in North America. Pedia Loss is an appetite suppressant for children 6 years and older. Allow children to enjoy their favorite foods without gaining weight. This revolutionary new formula slows the absorption of carbohydrates, allowing more to be burned for energy and less to be stored as fat. This highly effective and natural dietary supplement comes in berry-flavored chewable tablets for easy consumption. In conjunction with a proper diet and exercise program, Pedia Loss can keep your child from becoming a statistic.

Please consult your healthcare provider before giving Pedia Loss to your child.

To understand the difference between Dynamic Health weight loss products click here.

**\$69.99**

1 **BUY NOW**

### Pedia Loss is safe and effective for children of all ages

This synergistic formula was designed to aide in a child's glucose metabolism. Since many of their favorite foods are rich in carbohydrates but very low in dietary fiber, their digestive tracts and insulin never function properly. Now with Pedia Loss children can still enjoy their favorite food but with the help of Inulin their bodies with slow down the absorption of carbohydrate, allowing more to be burned for energy and less to be stored as fat, and give a great source of soluble fiber. In addition to this highly advanced ingredient, we have included supplemental amounts of both glutamine and FOS, which have both been proven to drastically improve intestinal health. Finally this product contains a highly effective compound called HCA. This compound has been shown to safely burn fat without any form of stimulants.

**Inulin** is a polysaccharide derived from the Jerusalem artichoke and Dahlia tuber. It is formed by linking 30 fructose monomer units together in a long chain. A natural fiber, it helps to moderate blood sugar levels in the body. Not only can inulin analog help avoid "sugar rushes and crashes" commonly experienced, but it may also help reduce sugar craving, a frequent source of calories. Inulin analog is not absorbed by the digestive tract and therefore contributes no extra calories while improving energy levels.

### DIRECTIONS

#### Suggested Use:

**Children ages 6-10:** Two (2) tablets twice a day, 15 minutes before lunch & dinner.  
**Children ages 11-16:** Three (3) tablets twice a day, 15 minutes before lunch & dinner.  
Consume with 6-8 ounces of water, juice or other liquid.

As with all dietary supplements if you are pregnant or nursing or taking medication consult your health care professional before taking this product.

**Storage:** Store in a cool dry place. Keep out of reach of children. Do not use if seal is broken.

### FACTS



Exhibit A

Customer Care Specialist: 800-268-9554  
Available 24 hours a day, 7 days a week.



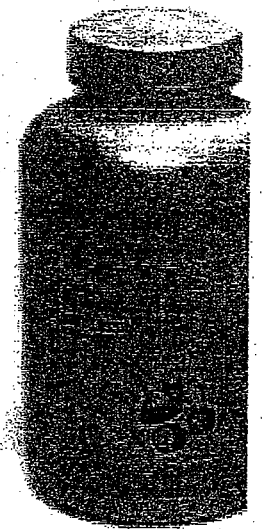
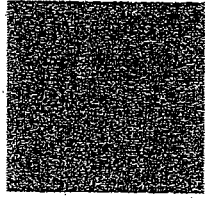
HOME ABOUT PEDIA LOSS ORDER NOW SUPPLEMENT FACTS DIRECTIONS FOR USE FAQ CONTACT

## Pedia Loss

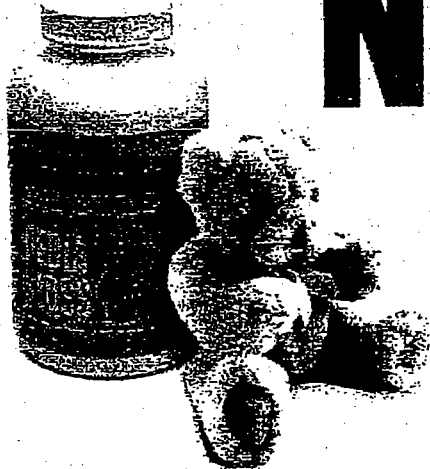
Pedia Loss is highly effective for children 6 years of age and older. Children can still enjoy their favorite food in moderation while slowing the absorption of carbohydrates, allowing more to be burned for energy and less to be stored as fat. For best results use in conjunction with an exercise program and a low fat low calorie diet. Please consult your healthcare provider before giving this product to your child.

\$69.99

Quantity



# what's NEW!



## Childhood Obesity an american reality

According to the Centers for Disease Control and Prevention, childhood obesity is a growing problem in the U.S., with one in ten pre-schoolers considered clinically obese. Pedia Loss addresses this growing health care issue in children 6 years of age and older. Children can still enjoy their favorite foods in moderation, while slowing the absorption of carbohydrates. The use of Pedia Loss enables more carbs to be burned for energy and less to be stored as fat. This highly effective and natural dietary supplement comes in berry-flavored chewable tablets that will appeal to children. Best of all is the feeling of strength and confidence they'll experience by overcoming childhood weight problems. A health care provider should be consulted before using Pedia Loss.

For more info about PediaLoss  
call: 1.800.304.6103 or visit: [www.PediaLoss.com](http://www.PediaLoss.com)

The latest trends in natural products

## SPICE IT UP! Add condiment to your sex life

### Fabulously Feminine



Designed to build stamina and enhance the libido, Fabulously Feminine can help women feel more confident in their sexual encounters. Its

herbal and amino acid formula, which is comprised of all-natural ingredients like Ginseng and Ginkgo, works to stimulate blood flow, increase sensitivity and prolong the sexual experience. According to The Journal of the American Medical Association, 40 percent of women experience sexual problems the most common being lack of desire. For women who are having difficulty with close encounters, this product can be taken prior to any intimate situation.

For more info about FABULOUSLY FEMININE and MASCULINE MALE  
call: 1.800.305.0028 or visit: [www.dynamichealthproducts.com](http://www.dynamichealthproducts.com)

SAPRESCRIPTION.COM

International orders click here >>



Customer Care: 800.310.88  
24 Hours a Day, 7 Days a Week

Your shopping bag: 0 items : \$0.00 [CHECKOUT](#)

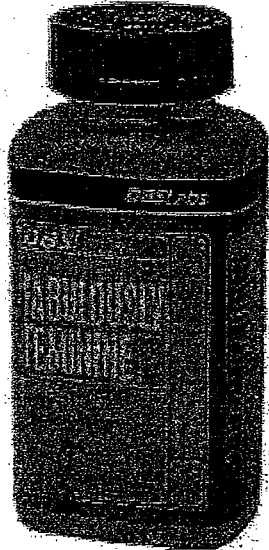
[HOME](#) [PRESCRIPTION](#) [SUPPLEMENTS](#) [TEST KITS](#) [PRODUCT LIST](#) [COMPANY INFO](#) [AFFILIATE](#)

[WEIGHT LOSS](#) [WOMEN'S HEALTH](#) [MEN'S HEALTH](#) [SEXUAL HEALTH](#) [SKIN & HAIR](#) [WELLNESS](#) [ALLERGY & SINUS](#) [GASTROHEALTH](#)

SEARCH



## Fabulously Feminine



### ADD ITEM TO MY SHOPPING BAG

Do you crave more from sexual intimacy? Rev up your sex drive with FABULOUSLY FEMININE. All-natural FABULOUSLY FEMININE can help you build the stamina you need to make your sexual experiences more intense and lasting. Discover a passionate confidence that may have been forgotten or not yet explored and revel in fresh sensations that will take passion to a new level for you and your partner. It's all a matter of stimulating blood flow and increasing sensitivity, and FABULOUSLY FEMININE's herbal and amino acid formula accomplishes this naturally, yet powerfully. Boost your desire for intimacy and get the most out of your sexual experiences with FABULOUSLY FEMININE.

**FABULOUSLY FEMININE** ~~\$69.99~~ \$39.95    
90 CAPSULES

**FREE** ON ORDERS OVER \$75.00 **FREE** ON ORDERS OVER \$75.00

### Non-Prescription All-Natural Health Product From DBS Labs

[View Supplement Facts](#)



This product has been made at a Good Manufacturing Practices certified laboratory. To read more about it click here

### PRODUCT INFORMATION

Change Size Font

Fabulously Feminine is a safe, natural way to enhance sexual desire, satisfaction and enjoyment. The ingredients in Fabulously Feminine, when taken daily with a multivitamin, have been shown in a double-blind, placebo-controlled Stanford University study to enhance satisfaction with sex life, the level of sexual desire and frequency of sexual encounters.

It is estimated that 43% of women experience a loss of sexual vitality at some time in their lives. External factors such as stress and fatigue may contribute to the decline in sexual interest. Also, as we age, physical and psychological changes may impact sexual desire, satisfaction and enjoyment. Nutritional supplementation with the ingredients in Fabulously Feminine and a multivitamin appears to have a positive effect on a woman's health, overall sexual fitness and satisfaction.

A special libido enhancing formula designed specifically for women. Fabulously Feminine contains a proprietary blend of traditional libido enhancing herbs. Not being in the mood for sex is often times the result of poor stimulation; lack of energy, and hormonal

SIGN UP FOR SPECIALS

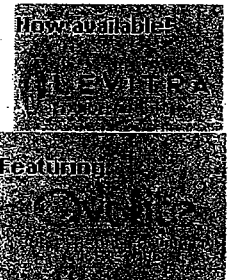



**ORDERS OVER \$79.00 WILL RECEIVE**

ORDER STATUS

COMPANY INFO

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- [FAQs](#)
- [Contact Us](#)
- [Privacy Policy](#)
- [Safe Shopping Guarantee](#)
- [Resources](#)



[Safe Shopping Guarantee](#)

### PRESCRIPTION

- [Weight Loss](#)
- [Allergies & Sinus](#)
- [Gastro Health](#)
- [Men's Health](#)
- [Muscle Relaxants](#)
- [Pain Relief](#)
- [Quit Smoking](#)
- [Sexual Health](#)
- [Skin & Hair Care](#)
- [Women's Health](#)
- [Alcohol](#)
- [Anti-Aging](#)
- [Anxiety](#)
- [Complexion](#)
- [Constipation](#)
- [Contraception](#)
- [Depression](#)
- [Diuretic](#)
- [Ear Infection](#)
- [Flu](#)
- [Fungal Infection](#)
- [Gout](#)
- [Hair & Scalp](#)
- [Hemorrhoids](#)
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- [Insomnia](#)
- [Motion Sickness](#)
- [Nails](#)
- [Parasites](#)
- [Perspiration](#)
- [Rashes | Sores](#)
- [Seizures](#)
- [Vomiting](#)

### SUPPLEMENTS

- [Weight Loss](#)
- [Cold & Flu Formulas](#)

**Exhibit D**

I **Just**  
want better  
**SEX...**



It is not unusual for men and women, young or old, to lose desire, arousal and overall satisfaction in the bedroom. Let *DBS Laboratories* give you the fuel you need to re-kindle the fire inside you.



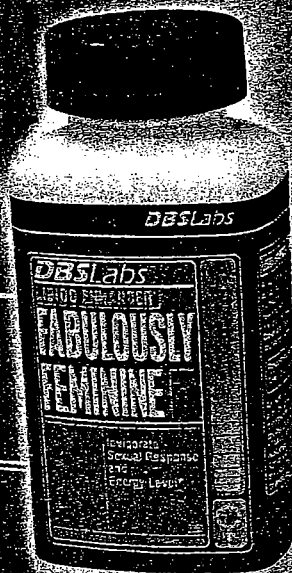
LIBIDO ENHANCER

# FABULOUSLY FEMININE

Dietary Supplement

Millions of women are dealing with the same issues you are. Put your confidence and your relationship in the hands of Fabulously Feminine - The safe, natural way to enhance sexual desire, satisfaction and enjoyment. A special libido enhancing formula designed specifically for women. Fabulously Feminine contains a proprietary blend of traditional libido enhancing herbs. Not being in the mood for sex is often times the result of poor stimulation, lack of energy, and hormonal imbalance. This product was specially formulated to address these issues. These all-natural ingredients are known to stimulate blood flow and increase sensitivity, making this product one of the most potent available on the market.

# Your Desire Unleashed!



It is not unusual for women, young or old, to lose desire, arousal and overall satisfaction in the bedroom. Let **DBS Laboratories** give you the fuel you need to re-kindle the fire inside you.

When low libido begins to interfere with your relationship, measures must be taken. In the past little focus had been directed towards female sexual issues. You have the tools – now let **Fabulously Feminine** help you use them better and longer.

LIBIDO ENHANCER  
**FABULOUSLY™  
FEMININE**

A scientific formula designed especially for a women, **Fabulously Feminine** contains a proprietary blend of clinically proven ingredients for libido health. Not being in the mood for sex is often times the result of poor stimulation; lack of energy, and hormonal imbalance. This product has been formulated to address these issues. **Fabulously Feminine's** natural ingredients stimulate blood flow and increase sensitivity, making this product extremely potent. Let **DBS Labs** show you the natural way to enhance sexual desire, satisfaction and enjoyment!

NATIONAL ENQUIRER

DBS Labs invites you to explore our wide-range of cutting edge, natural supplements. Our product discovery. DBS Labs prides itself on a meticulous process to ensure our products have come to

Exhibit F

Decision and Order

**DECISION AND ORDER**

The Federal Trade Commission having initiated an investigation of certain acts and practices of respondent Jonathan Barash (“respondent”) named in the caption hereof, and the respondent having been furnished thereafter with a copy of a draft of complaint which the Bureau of Consumer Protection proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge respondent with violation of the Federal Trade Commission Act; and

The respondent, his attorneys, and counsel for Federal Trade Commission having thereafter executed an agreement containing a consent order, an admission by the respondent of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondent that the law has been violated as alleged in such complaint, or that the facts as alleged in such complaint, other than jurisdictional facts, are true and waivers and other provisions as required by the Commission’s Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that the respondent has violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of thirty (30) days, now in further conformity with the procedure prescribed in § 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent Jonathan Barash is a minority owner and officer of DBS Laboratories, LLC and has participated in its day to day operations. Individually, or in concert with others, he has formulated, directed, participated in, or controlled the acts or practices of DBS Laboratories LLC, including the acts or



Decision and Order

practices challenged in the complaint. His principal office or place of business is 6599 NW 97th Drive, Parkland, Florida 33076.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and the proceeding is in the public interest.

**ORDER**

**DEFINITIONS**

For purposes of this order, the following definitions shall apply:

- A. Unless otherwise specified, “respondent” shall mean Jonathan Barash individually and as an officer of DBS Laboratories, LLC, and his agents, representatives, and employees.
- B. “Competent and reliable scientific evidence” shall mean tests, analyses, research, studies, or other evidence based on the expertise of professionals in the relevant area, that has been conducted and evaluated in an objective manner by persons qualified to do so, using procedures generally accepted in the profession to yield accurate and reliable results.
- C. “Pedia Loss” shall mean “Pedia Loss Dietary Supplement” and any other product containing one or more of the ingredients in the current product that is marketed for weight loss or control.
- D. “Fabulously Feminine” shall mean “Fabulously Feminine Dietary Supplement” and any other product containing one or more of the ingredients in the current product that is marketed for sexual enhancement.
- E. “Food,” “drug,” and “device” shall mean as “food,” “drug,” and “device” are defined in Section 15 of the Federal Trade



## Decision and Order

Commission Act, 15 U.S.C. § 55.

F. “Covered product or service” shall mean any dietary supplement, food, drug, or device, and any health-related service or program promoting weight loss or sexual enhancement.

G. “Commerce” shall mean as defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44.

H. “Endorsement” shall mean as defined in 16 C.F.R. § 255.0(b).

I. The term “including” in this order shall mean “without limitation.”

J. The terms “and” and “or” in this order shall be construed conjunctively or disjunctively as necessary, to make the applicable phrase or sentence inclusive rather than exclusive.

**I.****IT IS ORDERED** that:

A. Respondent, directly or through any corporation, subsidiary, division, or other device, in connection with the manufacturing, labeling, advertising, promotion, offering for sale, sale, or distribution of Pedia Loss or any other covered product or service, shall not make any representation, in any manner, expressly or by implication, including through the use of endorsements or the product name, that:

1. Such product or service causes weight loss, suppresses appetite, increases fat burning, or slows carbohydrate absorption;
2. Such product or service causes weight loss in overweight or obese children ages 6 and over; or

Decision and Order

3. Such product or service, when taken by overweight or obese children ages 6 and over, suppresses appetite, increases fat burning, or slows carbohydrate absorption,

unless, at the time the representation is made, respondent possesses and relies upon competent and reliable scientific evidence that substantiates the representation; and

B. Respondent, directly or through any corporation, subsidiary, division, or other device, in connection with the manufacturing, labeling, advertising, promotion, offering for sale, sale, or distribution of Fabulously Feminine or any other covered product or service, shall not make any representation, in any manner, expressly or by implication, including through the use of endorsements or the product name, that such product or service will increase a woman's libido, sexual desire, or sexual satisfaction, unless, at the time the representation is made, respondent possesses and relies upon competent and reliable scientific evidence that substantiates the representation.

**II.**

**IT IS FURTHER ORDERED** that respondent, directly or through any corporation, subsidiary, division, or other device, in connection with the manufacturing, labeling, advertising, promotion, offering for sale, sale, or distribution of any covered product or service, in or affecting commerce, shall not make any representation, in any manner, expressly or by implication, including through the use of endorsements or the product name, about the benefits, performance, or efficacy of such product or service, unless, at the time the representation is made, respondent possesses and relies upon competent and reliable scientific evidence that substantiates the representation.

**III.**

**IT IS FURTHER ORDERED** that respondent, directly or through any corporation, subsidiary, division, or other device, in

## Decision and Order

connection with the manufacturing, labeling, advertising, promotion, offering for sale, sale, or distribution of any covered product or service, in or affecting commerce, shall not misrepresent, in any manner, directly or by implication, the existence, contents, validity, results, conclusions, or interpretations of any test or study.

**IV.**

**IT IS FURTHER ORDERED** that:

A. Nothing in this order shall prohibit respondent from making any representation for any drug that is permitted in labeling for such drug under any tentative final or final standard promulgated by the Food and Drug Administration, or under any new drug application approved by the Food and Drug Administration; and

B. Nothing in this order shall prohibit respondent from making any representation for any product that is specifically permitted in labeling for such product by regulations promulgated by the Food and Drug Administration pursuant to the Nutrition Labeling and Education Act of 1990.

**V.**

**IT IS FURTHER ORDERED** that respondent Jonathan Barash shall, for a period of three (3) years after the last date of dissemination of any representation covered by this order, maintain and upon request make available for inspection and copying:

- A. All advertisements and promotional materials containing the representation;
- B. All materials that were relied upon in disseminating the representation; and

Decision and Order

- C. All tests, reports, studies, surveys, demonstrations, or other evidence in their possession or control that contradict, qualify, or call into question the representation, or the basis relied upon for the representation, including complaints and other communications with consumers or with governmental or consumer protection organizations.

**VI.**

**IT IS FURTHER ORDERED** that respondent Jonathan Barash shall deliver a copy of this order to all current and future principals, officers, directors, and managers, and to all current and future employees, agents, and representatives having responsibilities with respect to the subject matter of this order, and shall secure from each person a signed and dated statement acknowledging receipt of the order. Respondent shall deliver this order to current personnel within thirty (30) days after the date of service of this order, and to future personnel within thirty (30) days after the person assumes such position or responsibilities.

**VII.**

**IT IS FURTHER ORDERED** that respondent Jonathan Barash, for a period of three (3) years after the date of issuance of this order, shall notify the Commission of the discontinuance of his current business or employment, or of his affiliation with any new business or employment. The notice shall include respondent's new business address and telephone number and a description of the nature of the business or employment and his duties and responsibilities. All notices required by this Part shall be sent by certified mail to the Associate Director, Division of Enforcement, Bureau of Consumer Protection, Federal Trade Commission, 600 Pennsylvania Avenue, N.W., Washington, D.C. 20580. Attention: In the Matter of Dynamic Health of Florida, LLC.

Decision and Order

**VIII.**

**IT IS FURTHER ORDERED** that respondent Jonathan Barash shall, within sixty (60) days after service of this order, and at such other times as the Federal Trade Commission may require, file with the Commission a report, in writing, setting forth in detail the manner and form in which he has complied with this order.

**IX.**

This order will terminate on August 13, 2024, or twenty (20) years from the most recent date that the United States or the Federal Trade Commission files a complaint (with or without an accompanying consent decree) in federal court alleging any violation of the order, whichever comes later; provided, however, that the filing of such a complaint will not affect the duration of:

- A. Any Part in this order that terminates in less than twenty (20) years;
- B. This order's application to any respondent that is not named as a defendant in such complaint; and
- C. This order if such complaint is filed after the order has terminated pursuant to this Part.

Provided, further, that if such complaint is dismissed or a federal court rules that the respondent did not violate any provision of the order, and the dismissal or ruling is either not appealed or upheld on appeal, then the order will terminate according to this Part as though the complaint had never been filed, except that the order will not terminate between the date such complaint is filed and the later of the deadline for appealing such dismissal or ruling and the date such dismissal or ruling is upheld on appeal.

Analysis

**Analysis of Proposed Consent Order to Aid Public Comment**

The Federal Trade Commission has accepted, subject to final approval, an agreement containing a consent order from Jonathan Barash (“proposed respondent”). Proposed respondent collaborated with others in the marketing of a purported children’s weight loss product called “Pedia Loss,” and a purported female libido enhancer called “Fabulously Feminine.”

The proposed consent order has been placed on the public record for thirty (30) days for reception of comments by interested persons. Comments received during this period will become part of the public record. After thirty (30) days, the Commission will review the agreement in light of any comments received and will decide whether it should withdraw from the agreement and take other appropriate action or make final the agreement's proposed order.

The Commission's complaint charges that advertising for Pedia Loss made unsubstantiated claims that (1) Pedia Loss causes weight loss in overweight or obese children ages 6 and over, and (2) when taken by overweight or obese children ages 6 and over, Pedia Loss causes weight loss by suppressing appetite, increasing fat burning, and slowing carbohydrate absorption. The Commission’s complaint also charges that advertising for Fabulously Feminine falsely represented that clinical testing proves that Fabulously Feminine enhances a woman’s satisfaction with her sex life and level of sexual desire. In addition, the complaint challenges the unsubstantiated claim that Fabulously Feminine will increase a woman’s libido, sexual desire, and sexual satisfaction by stimulating blood flow and increasing sensitivity.

Part I A of the proposed order pertains to Pedia Loss. It requires that proposed respondent possess and rely on competent and reliable scientific evidence to support claims that Pedia Loss or any other covered product or service causes weight loss, suppresses appetite, increases fat burning, or slows carbohydrate

## Analysis

absorption; causes weight loss in overweight or obese children ages 6 and over; or causes weight loss by suppressing appetite, increasing fat burning, or slowing carbohydrate absorption, when taken by overweight or obese children ages 6 and over. Part IB of the order pertains to Fabulously Feminine. It requires that proposed respondent possess and rely on competent and reliable scientific evidence to support claims that Fabulously Feminine or any other covered product or service will increase a woman's libido, sexual desire, or sexual satisfaction.

Part II of the proposed order requires that proposed respondent possess and rely on competent and reliable scientific evidence to support benefits, performance, or efficacy claims for covered products or services defined as any dietary supplement, food, drug, or device, and any health-related service or program promoting weight loss or sexual enhancement.

Part III of the proposed order prohibits proposed respondent from misrepresenting the existence, contents, validity, results, conclusions, or interpretations of any test or studies. Part IV of the proposed order permits proposed respondents to make certain claims for drugs or dietary supplements that are permitted in labeling under laws and/or regulations administered by the U.S. Food and Drug Administration.

The remainder of the proposed order contains standard requirements that proposed respondent maintain advertising and any materials relied upon as substantiation for any representation covered by substantiation requirements under the order; distribute copies of the order to certain company officials and employees; and file one or more reports detailing their compliance with the order. Part IX of the proposed order is a provision whereby the order, absent certain circumstances, terminates twenty years from the date of issuance.

Analysis

The purpose of this analysis is to facilitate public comment on the proposed order, and is not intended to constitute an official interpretation of the agreement and proposed order or to modify in any way their terms.



Complaint

## IN THE MATTER OF

## NUTRAMAX LABORATORIES, INC.

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 5 AND SEC. 12 OF THE FEDERAL TRADE COMMISSION ACT*Docket C-4116; File No. 0323052  
Complaint, August 27, 2004--Decision, August 27, 2004*

This consent order, among other things, requires Respondent Nutramax Laboratories, Inc., to possess competent and reliable scientific evidence substantiating any claims that Senior Moment -- a dietary supplement containing cerebral phospholipids and docosahexaenoic acid (DHA) -- or any substantially similar product prevents memory loss or restores lost memory function. The order also requires the respondent to possess competent and reliable scientific evidence substantiating any claims -- whether conveyed directly, or by implication through the use of the product name -- about the benefits, performance or efficacy of any food, drug, dietary supplement, device or service sold for human use or consumption for cognitive functions or processes, or the treatment, cure, mitigation, alleviation of the symptoms, prevention, or reduction in the risk of any related disease or disorder. In addition, the order prohibits the respondent from misrepresenting the existence, contents, validity, results, conclusions, or interpretations of any test or study, in connection with the marketing or sale of any product or program for human cognitive function or processes.

*Participants*

For the Commission: *Shira D. Modell, Michael Ostheimer, Heather Hipsley, and Mary K. Engle.*

For the Respondent: *Michael Oliver, Bowie & Jensen, and Charles E. Buffon, Covington & Burling*

**COMPLAINT**

The Federal Trade Commission, having reason to believe that Nutramax Laboratories, Inc., a corporation, (“respondent”), has violated the provisions of the Federal Trade Commission Act, and it appearing to the Commission that this proceeding is in the public interest, alleges:

Complaint

1. Respondent Nutramax Laboratories, Inc. is a Maryland corporation with its principal office or place of business at 2208 Lakeside Boulevard, Edgewood, MD 21040.
2. Respondent has advertised, labeled, offered for sale, sold, and distributed the dietary supplement Senior Moment. According to the package label, Senior Moment contains cerebral phospholipids and docosahexaenoic acid (DHA).
3. Senior Moment is a “food” or “drug” within the meaning of Sections 12 and 15 of the Federal Trade Commission Act.
4. The acts and practices of respondent alleged in this complaint has been in or affecting commerce, as “commerce” is defined in Section 4 of the Federal Trade Commission Act.
5. Respondent has disseminated or has caused to be disseminated advertisements for Senior Moment, including but not limited to the attached Exhibits A through F. These advertisements contain the following statements:

A. (Exhibit A: Television advertisement)

Opening	An envelope reading: “Happy Belated Birthday”
Visual:	
Accompanying	“I’m worried about her. She’s starting to
Voice Over:	forget things.”
Visual:	Mother & daughter having lunch at restaurant, birthday card is on the table (the mother’s voice provided the preceding voice-over)
Daughter:	“I can’t seem to remember anything these days.”
Mother:	“Oh Kathy, even younger adults forget things. Dad and I take this.”
Daughter:	“Senior Moment. I’m not a senior”
Mother:	“It’s for adults of all ages.”
Daughter:	“This isn’t one of the trendy herbal kind of . . .”

## Complaint

- Mother: “No, no, no. This is a nutritional supplement just for the brain. It helps us remember. And it’s safe.”
- Daughter: “Well, thanks mom. With Senior Moment, I won’t miss your birthday next year.”

## B. (Exhibit B: Radio advertisement)

Dr. Anna Marie: I’m sure this has happened to you. You try to recall a name and it’s right there on the tip of your tongue, but you just can’t remember it. As we get older, our memory seems to play tricks on us more and more. I’m Dr. Anna Marie. I’ve been a television medical reporter for over ten years, and I have exciting news about a new nutritional supplement specially formulated to enhance memory in adults of all ages. Don’t laugh, the name of the product is Senior Moment. It’s a serious product with a name that’s easy to remember. It’s not one of those trendy herbal products. Senior moment is truly the next generation in memory support. Senior Moment contains two brain-specific nutrients to help overcome mild memory loss. And what I like best? Senior moment is from the makers of CosaminDS, so you know it’s a safe, quality supplement. Don’t forget, try Senior Moment. Even the name is easy to remember.

## C. (Exhibit C: Print advertisement)

## NEW MEMORY ENHANCING SUPPLEMENT

“You don’t have to be a senior  
to need SENIOR MOMENT!”

THE NEXT GENERATION IN MEMORY  
ENHANCEMENT\*

- ❖ Advanced formula -  
Not an herbal product -  
NO GINGKO
- ❖ Helps overcome mild

Complaint

memory loss\*

- ❖ Contains a proprietary blend of brain specific nutrients
- ❖ For adults of all ages

. . .

\*These statements have not been evaluated by the Food & Drug Administration.

This product is not intended to diagnose, treat, cure or prevent any disease.

D. (Exhibit D: Press Release)

**Nutramax Laboratories Compiles Studies Affirming Efficacy of Senior Moment**

Edgewood, MD (May 16, 2002) - **Nutramax Laboratories** announced that it is reaffirming the efficacy of its **Senior Moment** product, a dietary supplement containing a proprietary blend of brain-specific nutrients shown to enhance memory, by making available a booklet of studies related to the product. . . .

The booklet, **CLINICAL AND SCIENTIFIC STUDIES SUPPORTING THE USE OF SENIOR MOMENT FOR MEMORY**, contains a summary of studies conducted to show that DHA and Cerebral Phospholipids, the two ingredients that comprise Senior Moment, have been proven to enhance memory.

E. (Exhibit E: Package label)

“You don’t have to be a senior to need Senior Moment”

**SENIOR  
MOMENT**  
Dietary Supplement

Complaint

FOR  
ADULTS OF  
ALL AGESADVANCED MEMORY  
ENHANCING FORMULA

- Contains a proprietary blend of brain-specific nutrients
- Helps overcome mild memory loss\*

\*These statements have not been evaluated by the Food & Drug Administration.

This product is not intended to diagnose, treat, cure or prevent any disease.

F. (Exhibit F: Package insert)

SENIOR MOMENT  
ADVANCED MEMORY ENHANCING\*  
DIETARY SUPPLEMENT**What is Senior Moment?**

Senior Moment is a liquid filled capsule containing cerebral phospholipids and docosahexaenoic acid (DHA) taken once a day to help maintain memory function or taken more frequently, according to the directions provided, to help enhance memory function.\* Senior Moment is rich in the same phospholipids in the same combination as found in your brain.

...

**How did this happen?**

Aging, stress, heredity, and diet can lead to brain cell membranes becoming rigid and less permeable. This change in cell membrane structure decreases the efficiency of brain function and memory. . . .

Complaint

**How can Senior Moment Help?**

Scientific research indicates that supplementation with the brain-specific phospholipids and DHA found in Senior Moment can compensate for aging, stress, and diet-related deficits in these phospholipids. Senior Moment is specifically designed to restore these deficits.\*

...

To maintain memory function, take 1 or 2 capsules daily, preferably in the morning.

To enhance memory function, intake can vary depending on individual needs and may be increased up to 6 capsules daily.

...

\*These statements have not been evaluated by the Food & Drug Administration.

This product is not intended to diagnose, treat, cure or prevent any disease.

6. Through the means described in Paragraph 5, respondent has represented, expressly or by implication, that:
  - (a) Senior Moment prevents memory loss in adults of all ages.
  - (b) Senior Moment restores lost memory function in adults of all ages.
7. Through the means described in Paragraph 5, respondent has represented, expressly or by implication, that it possessed and relied upon a reasonable basis that substantiated the representations set forth in Paragraph 6, at the time the representations were made.
8. In truth and in fact, respondent did not possess and rely upon a reasonable basis that substantiated the representations set forth in Paragraph 6, at the time the representations were made.

## Complaint

Therefore, the representation set forth in Paragraph 7 was, and is, false or misleading.

9. Through the means described in Paragraph 5, respondent has represented, expressly or by implication, that scientific studies prove that Senior Moment restores lost memory function in adults of all ages.

10. In truth and in fact, scientific studies do not prove that Senior Moment restores lost memory function in adults of all ages. Therefore, the representation set forth in Paragraph 9 was, and is, false or misleading.

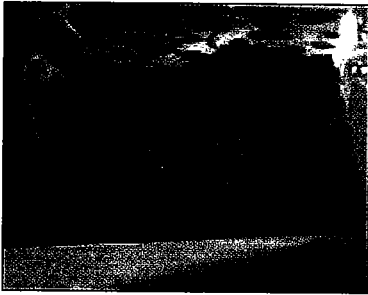
11. The acts and practices of respondent as alleged in this complaint constitute unfair or deceptive acts or practices, and the making of false advertisements, in or affecting commerce in violation of Sections 5(a) and 12 of the Federal Trade Commission Act.

IN WITNESS WHEREOF, the Federal Trade Commission has caused its complaint to be signed by its Secretary and its official seal to be hereto affixed at Washington, D.C. this twenty-seventh day of August, 2004.



**PRODUCT** Senior Moment  
**MARKET** San Francisco, CA  
**PROGRAM** Eyewitness News At Noon  
**CODE #** 030200530  
**TITLE** Daughter Is Losing Memory/Costco

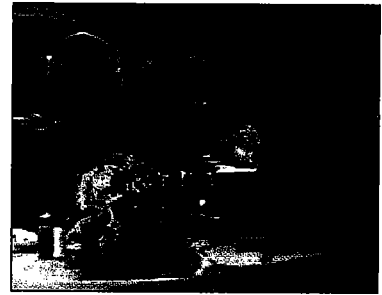
**LENGTH** 30  
**STATION** KPIX  
**DATE** 02/04/2003  
**TIME** 12:10 PM  
**REV OF #** 020407303



FEMALE (VO): I'm worried about her. She's starting to forget things.



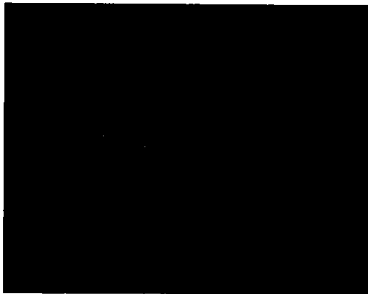
(MUSIC IN) (SFX: RESTAURANT IN)  
 KATHY: I can't seem to remember anything these days.



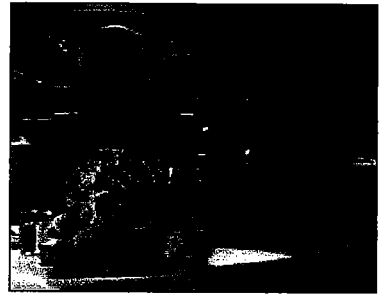
WOMAN: Oh, Kathy. Even younger adults forget things.



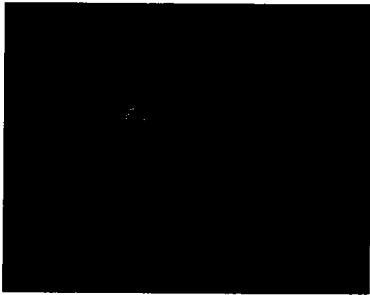
Dad and I take this. KATHY: Senior Moment?



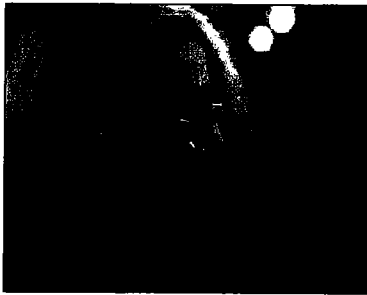
I'm not a senior.



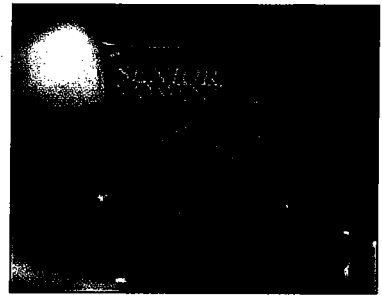
WOMAN: It's for adults of all ages.



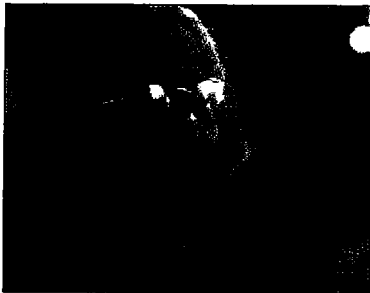
KATHY: This isn't one of those trendy, herbal kind of--



WOMAN: No, no, no. This is a nutritional supplement just for the brain.



It helps us remember



and it's safe.



KATHY: Well, thanks, Mom.



With Senior Moment, I won't miss your birthday next year. WOMAN: Oh.  
 (SFX/MUSIC OUT)

Exhibit A

**VIDEO ALSO AVAILABLE**

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330 West 42nd Street, New York, NY 10036 T 212 736 2010





## TRANSCRIPT

**DATE:** SEPTEMBER 2, 2002  
**TIME:** 6:34AM  
**STATION:** WTOP-FM  
**LOCATION:** WASHINGTON, D.C.  
**PRODUCT:** SENIOR MOMENT / WALGREENS  
**LENGTH:** :60  
**CODE:** 0209-01597C

**TITLE:** DR. ANNA MARIE; REPORTER; WEB

DR. ANNA MARIE: I'm sure this has happened to you. You try to recall a name and it's right there on the tip of your tongue, but you just can't remember it. As we get older, our memory seems to play tricks on us more and more. I'm Dr. Anna Marie. I've been a television medical reporter for over ten years, and I have exciting news about a new nutritional supplement specially formulated to enhance memory in adults of all ages. Don't laugh, the name of the product is Senior Moment. It's a serious product with a name that's easy to remember. It's not one of those trendy herbal products. Senior Moment is truly the next generation in memory support. Senior Moment contains two brain-specific nutrients to help overcome mild memory loss. And what I like best? Senior Moment is from the makers of Cosamin DS, so you know it's a safe quality supplement. Don't forget, try Senior Moment. Even the name is easy to remember.

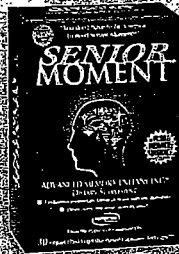
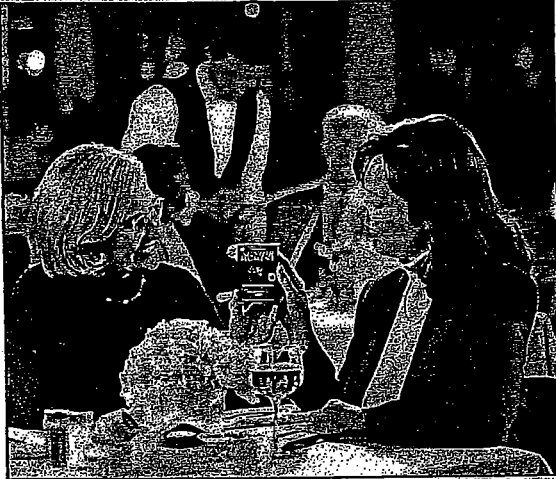
MALE ANNCR: Available at leading discount, drug and grocery stores. For more information, visit [SeniorMoment.com](http://SeniorMoment.com). That's SeniorMoment.com.

###

Exhibit B

# NEW MEMORY ENHANCING SUPPLEMENT

## "You don't have to be a senior to need Senior Moment!"



### THE NEXT GENERATION IN MEMORY ENHANCEMENT\*

- ◆ Advanced formula—  
Not an herbal product—  
NO GINKGO
- ◆ Helps overcome mild memory loss
- ◆ Contains a proprietary blend of brain-specific nutrients
- ◆ For adults of all ages

From Nutramax Laboratories<sup>®</sup>  
the makers of  
#1 Doctor Recommended Brand<sup>†</sup>  
Glucosamine/Chondroitin Sulfate  
Joint Health Supplement

### COSAMIN<sup>®</sup> DS



112 Tablets, 500 mg/500 mg

\* Based on a survey conducted by Consumer Reports of 1,000  
consumers' opinions and recommendations in June, 2000.  
† Based on a survey of 10,000 consumers in 1999  
and 2000 conducted by Consumer Reports.



NUTRAMAX LABORATORIES, INC.  
1-800-925-5187 • [senior-moment.com](http://senior-moment.com) • [cosamin.com](http://cosamin.com)

\*These statements have not been evaluated by the Food & Drug Administration. This product is not intended to diagnose, treat, cure or prevent any disease.

FOR IMMEDIATE RELEASE



**Media Contact:**

Megan Arts, 410-902-5036  
marts@mgpr.com

## Nutramax Laboratories Compiles Studies Affirming Efficacy of Senior Moment®

EDGEWOOD, Md. (May 16, 2002) – Nutramax Laboratories today announced that it is reaffirming the efficacy of its Senior Moment® product, a dietary supplement containing a proprietary blend of brain-specific nutrients shown to enhance memory, by making available a booklet of studies related to the product. Nutramax Laboratories is also the maker of CosaminDS, the No. 1 doctor-recommended glucosamine/chondroitin sulfate joint supplement\*.

The booklet, **CLINICAL AND SCIENTIFIC STUDIES SUPPORTING THE USE OF SENIOR MOMENT® FOR MEMORY**, contains a summary of studies conducted to show that DHA and Cerebral Phospholipids, the two ingredients that comprise *Senior Moment*, have been proven to enhance memory. Nutramax lead researcher Chuck Filburn, PhD, who is the author of the fall 2000 *Journal of the American Nutraceutical Association* article that originally reviewed the studies, compiled the booklet.

The Cerebral Phospholipids and DHA unique to *Senior Moment* have been extensively tested in clinical and scientific studies for their effects on cognition and biochemical aspect of brain function. These studies have been published in such distinguished medical journals as:

- *Journal of the American College of Nutrition*
- *Journal of Neurochemistry*
- *American Journal of Clinical Nutrition*
- *Journal of Lipid Research*
- *Neurology*
- *Neurobiology of Aging*

“The Nutramax family stands behind the research that has gone into the development of all of our products,” said pharmacist Robert W. Henderson, president and CEO of Nutramax Laboratories. “We feel that to truly tell the whole Senior Moment story, people have to know the research behind it.”

The booklet is available free of charge to all interested parties including the news media, consumer groups and private individuals. To obtain a copy, please call 1-410-776-4000.

Nutramax Laboratories, based in Edgewood, Md., develops, manufactures and markets nutraceuticals for humans and companion animals. For more information about Senior Moment, visit [www.senior-moment.com](http://www.senior-moment.com).

\* Source: Survey conducted by *Orthopedics Today* of 1,000 Orthopedic Surgeons and Rheumatologists in April 2000 relating to glucosamine/chondroitin brands.

# # #

"You don't have to be a senior  
to need Senior Moment®"

# SENIOR MOMENT®

DIETARY SUPPLEMENT



FOR  
ADULTS OF  
ALL AGES

ADVANCED MEMORY  
ENHANCING\* FORMULA

- Contains a proprietary blend  
of brain-specific nutrients
- Helps overcome mild memory loss\*



From the makers of Cosamin® DS

75 Liquid-filled  
Vegetable-based Capsules  
(Indicaps™)

## RECOMMENDATION:

To maintain normal memory function\*, take 1 capsule daily.

For severe memory loss, consult your physician.

For complete product and dosage information, see package insert.

While there are no known interactions or side effects with Senior Moment®, if you have any condition that requires medical attention, you should always consult your physician before taking any drug or dietary supplement.

KEEP OUT OF REACH OF CHILDREN. KEEP IN A COOL, DRY PLACE.

## Supplement Facts

Serving Size 1 Capsule

	Amount Per Capsule	
▲ Cerebral Phospholipids (from standardized porcine extract)	50mg	†
Docosahexaenoic Acid (DHA) (from standardized algal oil extract)	40mg	†

† Daily Value Not Established

Other ingredients: Sunflower oil, hydroxypropylmethylcellulose, ascorbyl palmitate, tocopherols, water, propylene glycol, titanium dioxide color, FD&C Red #3, FD&C Yellow #5, and FD&C Blue #1  
Algal oil\* from Martek Biosciences Corp.

\* These statements have not been evaluated by the Food & Drug Administration. This product is not intended to diagnose, treat, cure or prevent any disease.



NUTRAMAX LABORATORIES®, INC. EDGEWOOD, MARYLAND 21040  
senior-moment.com • 1-800-925-5187

# SENIOR MOMENT®

Exhibit F

ADVANCED MEMORY ENHANCING\*  
DIETARY SUPPLEMENT



## What is *Senior Moment*?

*Senior Moment* is a liquid-filled capsule containing cerebral phospholipids and docosahexaenoic acid (DHA) taken once a day to help maintain memory function or taken more frequently, according to the directions provided, to help enhance memory function.\* *Senior Moment* is rich in the same phospholipids in the same combination as found in your brain.

## What are phospholipids and DHA?

Phospholipids are fats that are essential to the healthy structure of cell membranes in the brain. *Senior Moment* contains the same combination of phospholipids found in optimally functioning brains. DHA is an essential fatty acid present in brain phospholipids. It enhances the benefit of the cerebral phospholipids found in *Senior Moment*. Additionally, DHA provides further protection against the breakdown of the brain's cellular structure and supports optimal memory function.

## Why can't I remember things the way I used to?

There are many reasons why you may not remember things as well as you used to. This may be caused by aging, stress, and deficiencies in your diet. Young nerve and brain cell membranes are fluid and permeable, allowing chemical messengers and impulses to easily interact with the cells. This dynamic flow is responsible for efficient brain and memory function. Nutrients called phospholipids are important in maintaining the cell membrane structure required for this activity. Cell membranes require specific types of phospholipids in specific combinations. Nerve cells require a unique combination of phospholipids to maintain optimum nerve, brain, and memory performance.

## How did this happen?

Aging, stress, and diet can lead to brain cell membranes becoming rigid and less permeable. This change in cell membrane structure decreases the efficiency of brain function and memory. This process is accelerated by a diet lacking in the specific phospholipids and fatty acids necessary to keep the brain's chemical messengers and impulses working at their highest level.

## How can *Senior Moment* help?

Scientific research indicates that supplementation with the brain-specific phospholipids and DHA found in *Senior Moment* can compensate for aging, stress, and diet-related deficits in these phospholipids. *Senior Moment* is specifically designed to restore these deficits.\*

## How is *Senior Moment* different from other supplements that are supposed to help memory loss?

Phospholipids from vegetable sources, including soy and several other dietary supplements, lack the specific compounds critical in regulating brain transmissions and function. Younger individuals may be able to convert the compounds from other sources into specific membrane structures the brain requires. However, older individuals benefit most when these compounds are provided directly in the supplement.

\*These statements have not been evaluated by the Food & Drug Administration. This product is not intended to diagnose, treat, cure or prevent any disease.

## Exhibit F

Unlike some dietary supplements that claim to increase circulation in the brain, *Senior Moment* actually supplies specific nutrients (phospholipids and DHA) the brain requires for optimal memory function. The components of cerebral phospholipids and DHA found in *Senior Moment* are capable of passing through the brain's protective barrier. There, these compounds enter the brain and become incorporated into the cell membrane, thus helping brain cell activity and performance.\*

### Why is *Senior Moment* in a liquid-filled capsule?

Liquid-filled capsules represent a state-of-the-art technology in the dietary supplement industry. A tamper evident seal locks the capsule together. This prevents the leakage of liquid and oxidative damage to the active ingredients in *Senior Moment*. Nutramax Laboratories®, Inc. follows the manufacturing and quality control standards developed by the pharmaceutical industry.

### Directions for Use:

- To help maintain memory function, take 1 or 2 capsules daily, preferably in the morning.
- To help enhance memory function, intake can vary depending on individual needs and may be increased up to 6 capsules daily.
- For severe memory loss, consult your physician.
- *Senior Moment* should be taken during the day; if taken prior to bedtime it may increase mental awareness and interfere with sleep in certain individuals.
- Research on the components indicates *Senior Moment* should be taken on a continual daily basis for maximum effect.

*Developed by the makers of Cosamin® DS,  
the #1 Doctor Recommended brand of Glucosamine/Chondroitin Sulfate*  
(Source: April 2000 survey by *Orthopedics Today* of 1,000 orthopedic surgeons and rheumatologists relating to glucosamine/chondroitin sulfate brands.)

Questions? Contact Nutramax Laboratories®, Inc. at 1-800-925-5187 or check the website:  
[www.senior-moment.com](http://www.senior-moment.com) or [www.nutramaxlabs.com](http://www.nutramaxlabs.com).



2208 Lakeside Boulevard • Edgewood, Maryland 21040  
1-800-925-5187 1-410-776-4000

\*These statements have not been evaluated by the Food & Drug Administration. This product is not intended to diagnose, treat, cure or prevent any disease.

Decision and Order

**DECISION AND ORDER**

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondent named in the caption hereof, and the respondent having been furnished thereafter with a copy of a draft of complaint which the Bureau of Consumer Protection proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge the respondent with violation of the Federal Trade Commission Act; and

The respondent, its attorneys, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondent of all the jurisdictional facts set forth in the aforesaid draft complaint, a statement that the signing of the agreement is for settlement purposes only and does not constitute an admission by the respondent that the law has been violated as alleged in such complaint, or that the facts as alleged in such complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that the respondent has violated the Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of thirty (30) days, now in further conformity with the procedure prescribed in § 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings, and enters the following order:

1. Respondent Nutramax Laboratories, Inc., is a Maryland corporation with its principal office or place of business at 2208 Lakeside Boulevard, Edgewood, MD 21040.

Decision and Order

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and the proceeding is in the public interest.

**ORDER**

**DEFINITIONS**

For purposes of this order, the following definitions shall apply:

1. “Competent and reliable scientific evidence” shall mean tests, analyses, research, studies, or other evidence based on the expertise of professionals in the relevant area, that has been conducted and evaluated in an objective manner by persons qualified to do so, using procedures generally accepted in the profession to yield accurate and reliable results.
2. Unless otherwise specified, “respondent” shall mean Nutramax Laboratories, Inc., a corporation, its successors and assigns, and the officers, agents, representatives, and employees of each of the above, including, without limitation, any successor to, assignee of, lessee of or licensee of the Senior Moment trademark or the Senior Moment or any substantially similar product, under that trademarked name or any other name.
3. “Commerce” shall mean as defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44.
4. “Endorsement” shall mean as defined in 16 C.F.R. § 255.0.
5. “Substantially similar product” shall mean any ingestible dietary supplement for human consumption with respect to cognitive functions or processes that contains the following ingredients: cerebral phospholipids or docosahexaenoic acid.
6. “Cognitive functions or processes” include all aspects of perception, thinking, reasoning and remembering, including, but



## Decision and Order

not limited to, memory, learning, concentration, abstract thinking, language, visuospatial perception, and higher executive functions (planning, organizing and sequencing), but do not include emotional or mental states, including but not limited to, mood, nervousness, sadness, anxiety or depression.

**I.**

IT IS ORDERED that respondent, directly or through any corporation, subsidiary, division, or other device, in connection with the labeling, advertising, promotion, offering for sale, sale, or distribution of Senior Moment or any substantially similar product, in or affecting commerce, shall not make any representation, in any manner, expressly or by implication, including through the use of endorsements or the product name:

- A. That the product or service prevents memory loss; or
- B. That the product or service restores lost memory function;

unless, at the time the representation is made, respondent possesses and relies upon competent and reliable scientific evidence that substantiates the representation.

**II.**

IT IS FURTHER ORDERED that respondent, directly or through any corporation, subsidiary, division, or other device, in connection with the labeling, advertising, promotion, offering for sale, sale, or distribution of Senior Moment or any food, drug, dietary supplement, device, or service, as “food” and “drug,” are defined in Section 15 of the Federal Trade Commission Act, in or affecting commerce, shall not make any representation, in any manner, expressly or by implication, including through the use of endorsements or the product name, about the benefits, performance or efficacy of such product or service for cognitive functions or processes, or the treatment, cure, mitigation, alleviation of the symptoms, prevention, or reduction in the risk of

Decision and Order

any disease or disorder related thereto, unless, at the time the representation is made, respondent possesses and relies upon competent and reliable scientific evidence that substantiates the representation. PROVIDED, however, that this Paragraph shall apply only to products or services labeled, advertised, promoted, offered for sale, sold for use or distributed for consumption by or use on humans.

**III.**

IT IS FURTHER ORDERED that respondent, directly or through any partnership, corporation, subsidiary, division, or other device, in connection with the labeling, advertising, promotion, offering for sale, sale, or distribution of any product or program for human cognitive functions or processes, in or affecting commerce, shall not misrepresent, in any manner, directly or by implication, the existence, contents, validity, results, conclusions, or interpretations of any test or study.

**IV.**

Nothing in this order shall prohibit respondent from making any representation for any product that is specifically permitted in labeling for such product by regulations promulgated by the Food and Drug Administration pursuant to the Nutrition Labeling and Education Act of 1990.

**V.**

IT IS FURTHER ORDERED that respondent Nutramax Laboratories, Inc., and its successors and assigns, shall, for five (5) years after the last date of dissemination of any representation covered by this order, maintain and upon request make available to the Federal Trade Commission for inspection and copying:

- A. All advertisements and promotional materials containing the representation including videotape recordings of all such broadcast advertisements;

## Decision and Order

- B. All materials that were relied upon in disseminating the representation; and
- C. All tests, reports, studies, surveys, demonstrations or other evidence in their possession or control that contradict, qualify, or call into question the representation, or the basis relied upon for the representation, including complaints and other communications with consumers or with governmental or consumer protection organizations.

**VI.**

IT IS FURTHER ORDERED that respondent Nutramax Laboratories, Inc., and its successors and assigns, shall deliver a copy of this order to all current and future principals, officers, directors, and managers, and to all current and future employees, agents, and representatives having managerial responsibilities with respect to the subject matter of this order, and shall secure from each such person a signed and dated statement acknowledging receipt of the order. Respondent shall deliver this order to current personnel within thirty (30) days after the date of service of this order, and to future personnel within thirty (30) days after the person assumes such position or responsibilities.

**VII.**

IT IS FURTHER ORDERED that respondent Nutramax Laboratories, Inc., and its successors and assigns, shall notify the Commission at least thirty (30) days prior to any proposed change in its corporate structure that may affect compliance obligations arising under this order, including but not limited to a dissolution, assignment, sale, merger, or other action that would result in the emergence of a successor corporation; the creation or dissolution of a subsidiary, parent, or affiliate that engages in any acts or practices subject to this order; the proposed filing of a bankruptcy petition; or a change in the corporate name or address. Provided, however, that, with respect to any proposed change in the corporation about which respondent learns less than thirty (30)

Decision and Order

days prior to the date such action is to take place, respondent shall notify the Commission as soon as is practicable after obtaining such knowledge. All notices required by this Part shall be sent by certified mail to the Associate Director, Division of Enforcement, Bureau of Consumer Protection, Federal Trade Commission, 600 Pennsylvania Avenue, NW, Washington, D.C. 20580.

**VIII.**

IT IS FURTHER ORDERED that respondent Nutramax Laboratories, Inc., and its successors and assigns, shall, within sixty (60) days from the date of service of this order, and at such other times as the Federal Trade Commission may require, file with the Commission a report, in writing, setting forth in detail the manner and form in which they have complied with this order.

**IX.**

This order will terminate on August 27, 2024, or twenty (20) years from the most recent date that the United States or the Federal Trade Commission files a complaint (with or without an accompanying consent decree) in federal court alleging any violation of the order, whichever comes later; provided, however, that the filing of such a complaint will not affect the duration of:

- A. Any Part in this order that terminates in less than twenty (20) years;
- B. This order's application to any respondent that is not named as a defendant in such complaint; and
- C. This order if such complaint is filed after the order has terminated pursuant to this Part.

Provided further, that if such complaint is dismissed or a federal court rules that the respondent did not violate any provision of the order, and the dismissal or ruling is either not appealed or upheld on appeal, then the order will terminate according to this Part as

## Decision and Order

though the complaint had never been filed, except that the order will not terminate between the date such complaint is filed and the later of the deadline for appealing such dismissal or ruling and the date such dismissal or ruling is upheld on appeal.

Analysis

**Analysis of Proposed Consent Order to Aid Public Comment**

The Federal Trade Commission has accepted, subject to final approval, an agreement containing a consent order from Nutramax Laboratories, Inc. (“Nutramax”).

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

This matter involves the advertising and promotion of Senior Moment, a dietary supplement containing cerebral phospholipids and docosahexaenoic acid (DHA). According to the FTC complaint, Nutramax represented that Senior Moment prevents memory loss and restores lost memory function in adults of all ages. The complaint alleges that the company failed to have substantiation for these claims. It further alleges that Nutramax falsely represented that scientific studies prove that Senior Moment restores lost memory function in adults of all ages.

The proposed consent order contains provisions designed to prevent Nutramax from engaging in similar acts and practices in the future.

Part I of the order requires Nutramax to have competent and reliable scientific evidence substantiating any claims that Senior Moment or any substantially similar product prevents memory loss or restores lost memory function.

Part II requires Nutramax to have competent and reliable scientific evidence substantiating any claims about the benefits, performance or efficacy of any food, drug, dietary supplement, device or service sold for human use or consumption for cognitive functions or processes, or the treatment, cure, mitigation,

## Analysis

alleviation of the symptoms, prevention, or reduction in the risk of any related disease or disorder. Although the order does not prohibit the trade name “Senior Moment,” it does require the respondent to have competent and reliable scientific evidence to substantiate any covered claims conveyed directly or by implication through the use of the product name.

Part III prohibits any misrepresentation of the existence, contents, validity, results, conclusions, or interpretations of any test or study, in connection with the marketing or sale of any product or program for human cognitive function or processes.

Part IV permits any representation for any product that is permitted in labeling for such product pursuant to regulations promulgated by FDA pursuant to the Nutrition Labeling and Education Act of 1990.

Parts V through VIII of the order require Nutramax to keep copies of relevant advertisements and materials substantiating claims made in the advertisements; to provide copies of the order to certain of its personnel; to notify the Commission of changes in corporate structure; and to file compliance reports with the Commission. Part IX provides that the order will terminate after twenty (20) years under certain circumstances.

The purpose of this analysis is to facilitate public comment on the proposed order, and it is not intended to constitute an official interpretation of the agreement and proposed order or to modify in any way their terms.

Complaint

IN THE MATTER OF

**PRINCE LIONHEART, INC.**

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 5 AND SEC. 12 OF THE FEDERAL TRADE COMMISSION ACT

*Docket C-4117; File No. 0323245*

*Complaint, September 1, 2004--Decision, September 1, 2004*

This consent order, among other things, prohibits Respondents Prince Lionheart, Inc., and its president, Thomas E. McConnell, from representing that the "Love Bug" -- an electronic mosquito repellent device -- or any substantially similar product, (1) repels mosquitoes from a baby or any person; (2) is an effective alternative to the use of chemical products formulated to repel mosquitoes; or (3) protects babies or other persons against contracting the West Nile virus, unless the representation is true and the respondents possess competent and reliable scientific evidence that substantiates the representation. The order also prohibits unsubstantiated representations about the benefits, performance, or efficacy of any consumer electronic product. In addition, the order requires the respondents to send a letter, with a copy of the order, to any catalog company or other wholesale or retail seller to which respondents have sold the "Love Bug" since January 1, 2002.

*Participants*

For the Commission: *Carol Jennings, Robert M. Frisby, Elaine Kolish, Susan Braman and Jesse Leary.*

For the Respondents: *Thomas E. McConnell, pro se.*

**COMPLAINT**

The Federal Trade Commission, having reason to believe that Prince Lionheart, Inc., a corporation, and Thomas E. McConnell, individually and as President of the corporation ("respondents"), have violated the provisions of the Federal Trade Commission Act, and it appearing to the Commission that this proceeding is in the public interest, alleges:



## Complaint

1. Respondent Prince Lionheart, Inc., is a California corporation with its principal office or place of business at 2421 South Westgate Road, Santa Maria, California 93455.
2. Respondent Thomas E. McConnell is President of the corporation. Individually or in concert with others, he formulates, directs, or controls the policies, acts, or practices of the corporation, including the acts or practices alleged in this complaint. His principal office or place of business is the same as that of Prince Lionheart, Inc.
3. The acts and practices of respondents alleged in this complaint have been in or affecting commerce, as “commerce” is defined in Section 4 of the Federal Trade Commission Act.
4. Respondents have manufactured, advertised, labeled, offered for sale, sold, and distributed to the public an Electronic Mosquito Repeller called the “Love Bug.”
5. Respondents have disseminated or have caused to be disseminated advertisements for the Electronic Mosquito Repeller or “Love Bug,” including but not necessarily limited to the attached Exhibits A and B. These advertisements contain the following statements:

A. **“Electronic Mosquito Repeller**

Helps protect your Baby from WEST NILE VIRUS! Repels mosquitoes effectively without the mess of costly sprays or lotions, and without potential danger to infants. The Electronic Mosquito Repeller emits a safe, barely audible tone that emulates the sound of a dragonfly’s wing beat – the mosquito’s mortal enemy! Clips to strollers, playpens, carriers, car seats and more!”

[<http://www.princelionheart.com>, 8/26/03, Exhibit A]

Complaint

**B. “LOVE BUG  
KEEPS MOSQUITOES AWAY FROM BABY!**

- Love Bug repels mosquitoes by electronically duplicating the wingbeat of the dragonfly – the mosquito’s mortal enemy!
- The safe, low-level tone is barely audible to humans, but mosquitoes hear it loud and clear and run for cover.
- Clip Love Bug to a stroller or playyard and watch the mosquitoes scatter! Effective within a 20 - 30 foot radius.
- Love bug emits a safe, barely audible tone that emulates the sound of a dragonfly’s wingbeat (mosquitoes HATE dragonflies!).
- Love Bug is as effective as costly sprays or lotions but without the mess and potential danger to infants with skin sensitive to strong chemicals.”  
[product package, Exhibit B]

6. Through the means described in Paragraph 5, respondents have represented, expressly or by implication, that:

- A. The Electronic Mosquito Repeller or “Love Bug” effectively repels mosquitoes from a baby.
- B. The Electronic Mosquito Repeller or “Love Bug” is an effective alternative to the use of chemical products formulated to repel mosquitoes.
- C. Use of the Electronic Mosquito Repeller or “Love Bug” protects babies against contracting the West Nile virus.

7. In truth and in fact:

## Complaint

- A. The Electronic Mosquito Repeller or “Love Bug” does not effectively repel mosquitoes from a baby.
- B. The Electronic Mosquito Repeller or “Love Bug” is not an effective alternative to the use of chemical products formulated to repel mosquitoes.
- C. Use of the Electronic Mosquito Repeller or “Love Bug” does not protect babies against contracting the West Nile virus.

Therefore, the representations set forth in Paragraph 6 were, and are, false or misleading.

8. Through the means described in Paragraph 5, respondents have represented, expressly or by implication, that they possessed and relied upon a reasonable basis that substantiated the representations set forth in Paragraph 6, at the time the representations were made.

9. In truth and in fact, respondents did not possess and rely upon a reasonable basis that substantiated the representations set forth in Paragraph 6, at the time the representations were made. Therefore, the representation set forth in Paragraph 8 was, and is, false or misleading.

10. The acts and practices of respondents as alleged in this complaint constitute unfair or deceptive acts or practices, and the making of false advertisements, in or affecting commerce in violation of Sections 5(a) and 12 of the Federal Trade Commission Act.

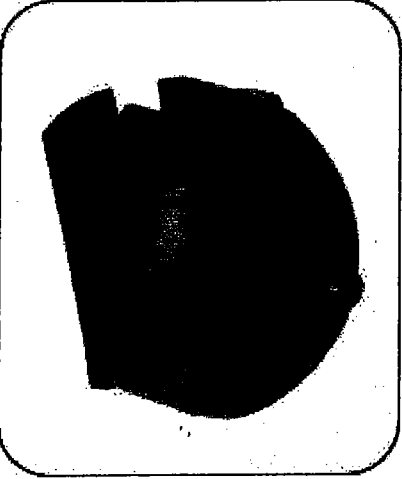

THEREFORE, the Federal Trade Commission this first day of September, 2004, has issued this complaint against respondents.

**Safety**

- #0095 Cushiony Fireplace Guard™
- #0098 Jumbo Edge Guard™
- #0097 Jumbo Corner Guard™
- #0070 Table Edge Guard™
- #0071 Cushiony Corner Guards™
- #0089 Stove Guard™
- #5205 Crib Rail Teether™
- #6701 Electronic Mosquito Repeller

Style #6701

## Electronic Mosquito Repeller

**CHILD PROOF HOME**

Helps protect your Baby from WEST NILE VIRUS! Repels mosquitoes effectively without the mess of costly sprays or lotions, and without potential danger to infants. The Electronic Mosquito Repeller emits a safe, barely audible tone that emulates the sound of a dragonfly's wing beat - the mosquito's mortal enemy! Clips to strollers, playpens, carriers, car seats and more!



Last

What's New | Store Finder | Parenting | About Us | Shop Online  
Contact Us | Registration | Press | Home

*Exhibit A*

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PRINCE  
LIONHEART®



STYLE 6701



13  
buybuy BABY  
\$11.99 EACH™

# LOVE BUG

**KEEPS MOSQUITOES AWAY FROM BABY!**



■ Love Bug repels mosquitoes by electronically duplicating the wingbeat of the dragonfly - the mosquito's mortal enemy!



■ The safe, low-level tone is barely audible to humans, but mosquitoes hear it loud and clear and run for cover.



■ Clip Love Bug to a stroller or playyard and watch the mosquitoes scatter! Effective within a 20 - 30 foot radius.

*9v Battery required (not incl.)*

Exhibit B



PRINCE  
LIONHEART.

STYLE 6701

# LOVE BUG™

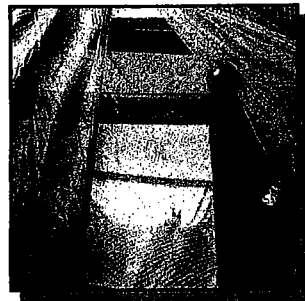
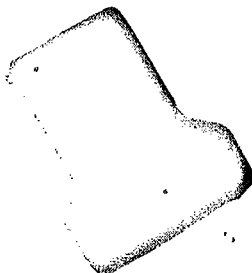
**KEEPS MOSQUITOES AWAY FROM BABY!**

■ Love Bug emits a safe, barely audible tone that emulates the sound of a dragonfly's wingbeat (mosquitoes HATE dragonflies!).

■ Love Bug is as effective as costly sprays or lotions but without the mess and potential danger to infants with skin sensitive to strong chemicals.

■ Effective within a 20 - 30 foot radius! The effectiveness of this product varies in individual situations.

**Directions:** Loosen screw on bottom of Love Bug and connect 9v battery to battery clip. Reposition cover and tighten screw. Flip switch and watch the mosquitoes stampede! Flashing RED LIGHT reminds you that Love Bug is functioning.



**Caution:** Love Bug is not a toy. Please keep out of the reach of small children.

© 1992 PRINCE LIONHEART, INC.  
2421 S. Westgate Rd.  
Santa Maria, CA 93455 USA

Made to PRINCE LIONHEART'S  
specifications in China



0 49345 06701 9

Decision and Order

## **DECISION AND ORDER**

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondents named in the caption hereof, and the respondents having been furnished thereafter with a copy of a draft complaint which the Bureau of Consumer Protection proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge respondent with violations of Section 5(a) of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45(a); and

The respondents and counsel for the Commission having thereafter executed an agreement containing a consent order, and admission by the respondent of all the jurisdictional facts set forth in the draft complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by respondents that the law has been violated as alleged in such complaint, or that the facts as alleged in such complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that the respondents violated the said Act, and that a complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, and having duly considered the comment filed thereafter from an interested person, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings, and enters the following order:

1. Respondent Prince Lionheart, Inc., is a California corporation with its principal office or place of business at 2421 South Westgate Road, Santa Maria, California 93455.



## Decision and Order

2. Respondent Thomas E. McConnell is President of the corporation. Individually or in concert with others, he formulates, directs, or controls the policies, acts, or practices of the corporation. His principal office or place of business is the same as that of Prince Lionheart, Inc.
3. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondents, and the proceeding is in the public interest.

**ORDER**

## DEFINITIONS

For purposes of this order, the following definitions shall apply:

1. "Competent and reliable scientific evidence" shall mean tests, analyses, research, studies, or other evidence based on the expertise of professionals in the relevant area, that have been conducted and evaluated in an objective manner by persons qualified to do so, using procedures generally accepted in the profession to yield accurate and reliable results.
2. Unless otherwise specified, "respondents" shall mean Prince Lionheart, Inc., a corporation, its successors and assigns and its officers; Thomas E. McConnell, individually and as President of the corporation; and each of the above's agents, representatives, and employees.
3. "Commerce" shall mean as defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44.

## I.

IT IS ORDERED that respondents, directly or through any corporation, subsidiary, division, or other device, in connection with the manufacturing, labeling, advertising, promotion, offering

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for sale, sale, or distribution of the Electronic Mosquito Repeller or “Love Bug,” or any substantially similar product, in or affecting commerce, shall not make any representation, in any manner, expressly or by implication, that:

- A. such product repels mosquitoes from a baby or any person;
- B. such product is an effective alternative to the use of chemical products formulated to repel mosquitoes; or
- C. use of such product protects babies or other persons against contracting the West Nile virus,

unless the representation is true and, at the time it is made, respondents possess and rely upon competent and reliable scientific evidence that substantiates the representation. For purposes of this Part, “substantially similar product” shall mean any product that uses or purports to use sonic or ultrasonic technology to repel mosquitoes from the user.

II.

IT IS FURTHER ORDERED that respondents, directly or through any corporation, subsidiary, division, or other device, in connection with the manufacturing, labeling, advertising, promotion, offering for sale, sale, or distribution of any consumer electronic product, in or affecting commerce, shall not make any representation, in any manner, expressly or by implication, about the benefits, performance, or efficacy of such product, unless, at the time the representation is made, respondents possess and rely upon competent and reliable evidence, which when appropriate must be competent and reliable scientific evidence, that substantiates the representation.

III.

IT IS FURTHER ORDERED that respondent Prince

## Decision and Order

Lionheart, Inc., and its successors and assigns, and respondent Thomas E. McConnell shall, within thirty (30) days after the date of service of this order, send, by first class certified mail, return receipt requested, to each catalog company or other wholesale or retail seller to which respondents have sold the “Love Bug” since January 1, 2002, a copy of this order together with the notice attached as Attachment A.

## IV.

IT IS FURTHER ORDERED that respondent Prince Lionheart, Inc., and its successors and assigns, and respondent Thomas E. McConnell shall, for three (3) years after the last date of dissemination of any representation covered by this order, maintain and upon request make available to the Federal Trade Commission for inspection and copying:

- A. All advertisements and promotional materials containing the representation;
- B. All materials that were relied upon in disseminating the representation; and
- C. All tests, reports, studies, surveys, demonstrations, or other evidence in their possession or control that contradict, qualify, or call into question the representation, or the basis relied upon for the representation, including complaints and other communications with consumers or with governmental or consumer protection organizations.

## V.

IT IS FURTHER ORDERED that respondent Prince Lionheart, Inc., and its successors and assigns, and respondent Thomas E. McConnell shall, within thirty (30) days after the date of service of this order, deliver a copy of this order to all principals, officers, directors, and managers, and to all employees, agents, and representatives having responsibilities with respect to

Decision and Order

the subject matter of this order, and shall secure from each such person a signed and dated statement acknowledging receipt of the order. Respondents shall retain the signed, dated statements acknowledging receipt of the order for a period of three (3) years and upon request make them available to the Federal Trade Commission for inspection and copying.

VI.

IT IS FURTHER ORDERED that respondent Prince Lionheart, Inc., and its successors and assigns, shall notify the Commission at least thirty (30) days prior to any change in the corporation that may affect compliance obligations arising under this order, including but not limited to a dissolution, assignment, sale, merger, or other action that would result in the emergence of a successor corporation; the creation or dissolution of a subsidiary, parent, or affiliate that engages in any acts or practices subject to this order; the proposed filing of a bankruptcy petition; or a change in the corporate name or address. *Provided, however,* that, with respect to any proposed change in the corporation about which respondent learns less than thirty (30) days prior to the date such action is to take place, respondent shall notify the Commission as soon as is practicable after obtaining such knowledge. All notices required by this Part shall be sent by certified mail to the Associate Director, Division of Enforcement, Bureau of Consumer Protection, Federal Trade Commission, Washington, D.C. 20580.

VII.

IT IS FURTHER ORDERED that respondent Thomas E. McConnell, for a period of five (5) years after the date of issuance of this order, shall notify the Commission of the discontinuance of his current business or employment, or of his affiliation with any new business or employment. The notice shall include the respondent's new business address and telephone number and a description of the nature of the business or employment and his duties and responsibilities. All notices required by this Part shall

## Decision and Order

be sent by certified mail to the Associate Director, Division of Enforcement, Bureau of Consumer Protection, Federal Trade Commission, Washington, D.C. 20580.

## VIII.

IT IS FURTHER ORDERED that respondent Prince Lionheart, Inc., and its successors and assigns, and respondent Thomas E. McConnell shall, within sixty (60) days after the date of service of this order, and at such other times as the Federal Trade Commission may require, file with the Commission a report, in writing, setting forth in detail the manner and form in which they have complied with this order. This report shall include a list of the names and addresses of respondents' customers who received the notice set forth in Attachment A, as required by Part III of this order.

## IX.

This order will terminate on September 1, 2024, or twenty (20) years from the most recent date that the United States or the Federal Trade Commission files a complaint (with or without an accompanying consent decree) in federal court alleging any violation of the order, whichever comes later; *provided, however*, that the filing of such a complaint will not affect the duration of:

- A. Any Part in this order that terminates in less than twenty (20) years;
- B. This order's application to any respondent that is not named as a defendant in such complaint; and
- C. This order if such complaint is filed after the order has terminated pursuant to this Part.

*Provided, further*, that if such complaint is dismissed or a federal court rules that the respondent did not violate any provision of the

Decision and Order

order, and the dismissal or ruling is either not appealed or upheld on appeal, then the order will terminate according to this Part as though the complaint had never been filed, except that the order will not terminate between the date such complaint is filed and the later of the deadline for appealing such dismissal or ruling and the date such dismissal or ruling is upheld on appeal.

Decision and Order

**ATTACHMENT A**

[insert date]

Dear Prince Lionheart Customer,

This letter is to inform you that Prince Lionheart, Inc., recently settled a dispute with the Federal Trade Commission regarding advertising for our Electronic Mosquito Repeller, known as the “Love Bug.” The FTC complaint alleged that certain claims for this product are false and that we do not have a reasonable basis to substantiate the claims. Under the terms of the Stipulated Final Order that we have agreed to, we can no longer represent that:

- A. this product repels mosquitoes from a baby or any person;
- B. this product is an effective alternative to the use of chemical products formulated to repel mosquitoes; or
- C. use of this product protects babies or other persons against contracting the West Nile virus,

unless we can establish that the representation is true and supported by competent and reliable scientific evidence. Accordingly, we must instruct you to stop using advertising or promotional materials that make any of the representations prohibited by the settlement.

Sincerely yours,

Thomas E. McConnell  
President  
Prince Lionheart, Inc.

Analysis

**Analysis of Proposed Consent Order to Aid Public Comment**

The Federal Trade Commission has accepted, subject to final approval, an agreement to a proposed consent order by respondents Prince Lionheart, Inc., and Thomas E. McConnell, individually and as President of the corporation.

The proposed consent order has been placed on the public record for thirty (30) days for reception of comments by interested persons. Comments received during this period will become part of the public record. After thirty (30) days, the Commission will again review the agreement and the comments received and will decide whether it should withdraw from the agreement and take other appropriate action or make final the agreement's proposed order.

This matter concerns practices related to the advertising, offering for sale, sale, and distribution of an electronic mosquito repellent device called the "Love Bug." The Commission's complaint charged that respondents violated the Federal Trade Commission Act, 15 U.S.C. § 41 *et seq.*, by making representations that were false and for which they lacked a reasonable basis of substantiation. These representations concerned the following: the ability of the "Love Bug" to repel mosquitoes from a baby; the effectiveness of the "Love Bug" as an alternative to the use of chemical products formulated to repel mosquitoes; and the ability of the "Love Bug" to protect babies against contracting the West Nile virus.

Part I of the proposed order prohibits any representation that the "Love Bug," or any substantially similar product, (A) repels mosquitoes from a baby or any person; (B) is an effective alternative to the use of chemical products formulated to repel mosquitoes; or (C) protects babies or other persons against contracting the West Nile virus, unless the representation is true and respondents possess competent and reliable scientific evidence that substantiates the representation. For purposes of this part, a "substantially similar product" means any product that



## Analysis

uses or purports to use sonic or ultrasonic technology to repel mosquitoes from the user.

Part II of the proposed order prohibits unsubstantiated representations about the benefits, performance, or efficacy of any consumer electronic product.

Part III of the proposed order requires the respondents to send a letter (Attachment A to the consent agreement), with a copy of the order, to any catalog company or other wholesale or retail seller to which respondents have sold the “Love Bug” since January 1, 2002.

Part IV of the proposed order is a record keeping provision that requires the respondents to maintain certain records for three (3) years after the last date of dissemination of any representation covered by the order. These records include: (1) all advertisements and promotional materials containing the representation; (2) all materials relied upon in disseminating the representation; and (3) all evidence in respondents’ possession or control that contradicts, qualifies, or calls into question the representation or the basis for it.

Part V of the proposed order requires distribution of the order to principals, officers, directors, and managers, and to employees, agents, and representatives having responsibilities with respect to the subject matter of the order.

Part VI of the proposed order requires that the Commission be notified of any change in the corporation that might affect compliance obligations under the order. Part VII of the proposed order requires that for a period of five (5) years, the individual respondent notify the Commission of the discontinuance of his current business or employment or of his affiliation with any new business or employment.

Part VIII of the proposed order requires the respondents to file a compliance report with the Commission.

Analysis

Part IX of the proposed order states that, absent certain circumstance, the order will terminate twenty (20) years from the date it is issued.

The purpose of this analysis is to facilitate public comment on the proposed consent order. It is not intended to constitute an official interpretation of the agreement and proposed order or to modify their terms in any way.

Complaint

IN THE MATTER OF

**KFC CORPORATION**CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 5 AND SEC. 12 OF THE FEDERAL TRADE COMMISSION ACT*Docket C-4118; File No. 0423033**Complaint, September 9, 2004--Decision, September 9, 2004*

This consent order, among other things, prohibits Respondent KFC Corporation from representing that eating KFC fried chicken is better for a consumer's health than eating a Burger King Whopper, or that eating KFC fried chicken is compatible with "low carbohydrate" weight loss programs, unless the representation is true and, at the time it is made, the respondent possesses and relies upon competent and reliable evidence – which in certain specified cases must be competent and reliable scientific evidence – that substantiates the representation. The order also prohibits the respondent from making certain representations about the absolute or comparative amount of fat, cholesterol, sodium, calories or any other nutrient in any food it sells that contains chicken; about the compatibility of such food with any weight loss program; or about the health benefits of such food, unless the representation is true and, at the time it is made, the respondent possesses and relies upon competent and reliable evidence – which in certain specified cases must be competent and reliable scientific evidence – that substantiates the representation. In addition, the order provides that representations conveying nutrient content or health claims that the Food and Drug Administration has by regulation defined for labeling purposes will be evaluated using the same nutrient thresholds that the FDA has established for those claims.

*Participants*

For the Commission: *Shira Modell, Michelle Rusk, Heather Hipsley, Mary K. Engle and Carolyn Cox.*

For the Respondent: *James H. Sneed, McDermott, Will & Emery.*

**COMPLAINT**

The Federal Trade Commission, having reason to believe that KFC Corporation, a corporation, ("respondent"), has violated the provisions of the Federal Trade Commission Act, and it appearing

Complaint

to the Commission that this proceeding is in the public interest, alleges:

1. Respondent KFC Corporation (“KFCC”) is a Delaware corporation with its principal office or place of business at 1441 Gardiner Lane, Louisville, Kentucky 40213-1914.
2. Respondent has advertised, labeled, offered for sale, sold, and distributed food products to the public, including fried chicken sold under the “KFC” name.
3. Fried chicken is a “food” within the meaning of Sections 12 and 15 of the Federal Trade Commission Act.
4. The acts and practices of respondent alleged in this complaint have been in or affecting commerce, as “commerce” is defined in Section 4 of the Federal Trade Commission Act.
5. Respondent has disseminated or has caused to be disseminated advertising and promotional materials for its fried chicken, including but not limited to the attached Exhibits A and B. These advertisements and promotional materials contain the following statements:

A. (Exhibit A: Television advertisement)

Visual: A man watching a football game on television while his wife arrives at home carrying a shopping bag.

Husband: Hey, honey.

Wife: Hey. Remember how we talked about eating better. Well, it starts today!

Fine Print Superscript: A balanced diet and exercise are necessary for good health.

## Complaint

Visual: Wife puts a bucket of KFC chicken down in front of husband.

Announcer: The secret's out. Two Original Recipe chicken breasts have less fat than a BK Whopper. Or go skinless for just 3 grams of fat per piece.

Fine Print Superscript: Comparing edible portions. 2 Original Recipe breasts 38 g fat, Whopper 43 g fat. . . .

Visual: **2 KFC BREASTS  
LESS FAT  
THAN 1 WHOPPER**

\*\*\*

Announcer: And now, get a 12-piece bucket of kitchen-fresh chicken for just \$9.99.

Fine Print Superscript: Not a low sodium, low cholesterol food. 12-piece bucket also contains legs, thighs and wings. . . .

Husband: You know, I'm doing this for you.

Wife: Hmm.

Announcer: For a fresh way to eat better, you've gotta KFC what's cookin'!

B. (Exhibit B: Television advertisement)

Visual: A man is sitting on the tailgate of a truck with his back to the camera. Another man walks by, then backs up as he recognizes him.

Man: Jack? Is that you? Man, you look fantastic! What the heck you been doing!?

Complaint

Jack: Eatin' chicken.

Fine Print Superscript: A balanced diet and exercise are necessary for good health.

Visual: Jack takes a bite of fried chicken. Next to him on the tailgate is a KFC box containing at least one other piece of chicken.

Announcer: The secret's out. One Original Recipe chicken breast has just 11 grams of carbs and packs 40 grams of protein. So if you're watching carbs and going high-protein, go KFC.

Visual: **11GRAMS OF CARBS**  
**40 GRAMS OF PROTEIN**

Fine Print Superscript: Not a low fat, low sodium, low cholesterol food. 12-piece bucket also contains legs, thighs and wings. . . .

Announcer: And now, get a 12-piece bucket of kitchen-fresh chicken for just \$9.99.

\*\*\*

Man: Chicken?

Jack: Chicken.

Announcer: For a fresh way to eat better, you gotta KFC what's cookin'!

6. Through the means described in Paragraph 5, respondent has represented, expressly or by implication, that eating KFC fried chicken, specifically two Original Recipe fried chicken breasts, is better for a consumer's health than eating a Burger King Whopper.

## Complaint

7. In truth and in fact, eating KFC fried chicken, specifically two Original Recipe fried chicken breasts, is not better for a consumer's health than eating a Burger King Whopper. While compared to Burger King's Whopper, two KFC Original Recipe fried chicken breasts have slightly less total fat (38 g. v. 43 g.) and saturated fat (12 g. v. 13 g.), they have more trans fat (3.5 g. vs. 1 g.), more cholesterol (290 mg. v. 85 mg.), more sodium (2300 mg. vs. 980 mg.), and more calories (760 v. 710). Therefore, the representation set forth in Paragraph 6 was, and is, false or misleading.

8. Through the means described in Paragraph 5, respondent has represented, expressly or by implication, that eating KFC fried chicken is compatible with "low carbohydrate" weight loss programs.

9. In truth and in fact, eating KFC fried chicken is not compatible with "low carbohydrate" weight loss programs. "Low carbohydrate" weight loss programs such as the Atkins Diet and the South Beach Diet advise against eating breaded, fried foods. Therefore, the representation set forth in Paragraph 8 was, and is, false or misleading.

10. The acts and practices of respondent as alleged in this complaint constitute unfair or deceptive acts or practices, and the making of false advertisements, in or affecting commerce in violation of Sections 5(a) and 12 of the Federal Trade Commission Act.

IN WITNESS WHEREOF, the Federal Trade Commission has caused its complaint to be signed by its Secretary and its official seal to be hereto affixed at Washington, D.C. this ninth day of September, 2004.



**PRODUCT** KFC Original Recipe Chicken  
**MARKET** Boston, MA  
**PROGRAM** News  
**CODE #** 031008316  
**TITLE** Starting Today They're Eating Better

**LENGTH** 30  
**STATION** WBZ  
**DATE** 10/27/2003  
**TIME** 05:57 AM



(SFX: TV/BALL GAME)



MAN: Hey, honey. WOMAN: Hey. Remember how we talked about eating better?



(SFX)



Well, it starts today.



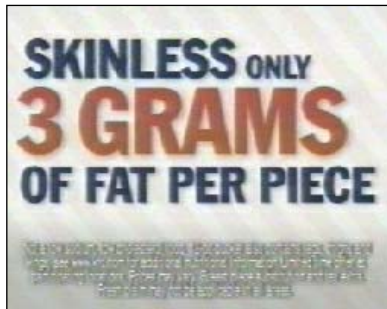
(SFX PAUSES) (MUSIC IN) MALE ANNCR: The secret's out,



two Original Recipe Chicken breasts have



less fat than a BK Whopper. Or go skinless for just



three grams of fat per piece.



And now, get a 12-piece bucket of kitchen fresh chicken for just 9.99. (MUSIC PAUSES)



(SFX RESUMES) MAN: You know, I'm doing this for you.



WOMAN: Hmm. (SFX OUT) (MUSIC RESUMES) ANNCR: For a fresh way to eat better,



you've gotta KFC what's cookin'. (MUSIC OUT)

**ALSO AVAILABLE ON VIDEO CASSETTE**





**PRODUCT** KFC Original Recipe Chicken  
**MARKET** Boston, MA  
**PROGRAM** News  
**CODE #** 031008294  
**TITLE** Jack's Been Eating Chicken

**LENGTH** 30  
**STATION** WHDH  
**DATE** 10/27/2003  
**TIME** 06:23 AM



(SFX: BIRDS IN) MAN: Jack,



is that you?



Man, you look fantastic. What the heck you've been doing?



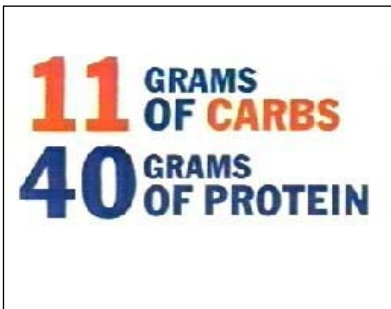
JACK: Eating chicken. (MUSIC IN)



MALE ANNCR: The secret's out.



One Original Recipe Chicken Breast



has just 11 grams of carbs and packs 40 grams of protein.



So, if you're watching carbs and going high protein, go KFC.



And now, get a 12-piece bucket of kitchen-fresh chicken for just 9.99.



MAN: Chicken?



JACK: Chicken.



ANNCR: For a fresh way to eat better, you gotta KFC What's Cookin'. (MUSIC/ OUT)

**ALSO AVAILABLE ON VIDEO CASSETTE**

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330 West 42nd Street, New York, NY 10036 T 212 736 2010

Decision and Order

## **DECISION AND ORDER**

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondent named in the caption hereof, and the respondent having been furnished thereafter with a copy of a draft of complaint which the Bureau of Consumer Protection proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge the respondent with violation of the Federal Trade Commission Act; and

The respondent, its attorneys, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the respondent of all the jurisdictional facts set forth in the aforesaid draft complaint, a statement that the signing of the agreement is for settlement purposes only and does not constitute an admission by the respondent that the law has been violated as alleged in such complaint, or that the facts as alleged in such complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that the respondent has violated the Act, and that a complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, and having duly considered the comments filed thereafter from interested persons, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings, and enters the following order:

1. Respondent KFC Corporation (“KFCC”) is a Delaware corporation with its principal office or place of business at 1441 Gardiner Lane, Louisville, Kentucky 40213-1914.

## Decision and Order

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondent, and the proceeding is in the public interest.

**ORDER****DEFINITIONS**

For purposes of this order, the following definitions shall apply:

1. “Competent and reliable scientific evidence” shall mean tests, analyses, research, studies, or other evidence based on the expertise of professionals in the relevant area, that has been conducted and evaluated in an objective manner by persons qualified to do so, using procedures generally accepted in the profession to yield accurate and reliable results.
2. Unless otherwise specified, “respondent” shall mean KFC Corporation, its successors and assigns, and its officers, agents, representatives, and employees.
3. “Commerce” shall mean as defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44.
4. “Endorsement” shall mean as defined in 16 C.F.R. § 255.0.
5. “Food” shall mean as defined in Section 15 of the Federal Trade Commission Act, 15 U.S.C. § 55.

**I.**

IT IS ORDERED that respondent, directly or through any corporation, subsidiary, division, or other device, in connection with the labeling, advertising, promotion, offering for sale, sale, or distribution of fried chicken, in or affecting commerce, shall not make any representation, in any manner, expressly or by

Decision and Order

implication, including through the use of endorsements or the product name that:

- A. Eating KFC fried chicken is better for a consumer's health than eating a Burger King Whopper; or
- B. Eating KFC fried chicken is compatible with "low carbohydrate" weight loss programs;

unless the representation is true and, at the time it is made, respondent possesses and relies upon competent and reliable evidence, which for purposes of Part I.A. of this Order must be competent and reliable scientific evidence, that substantiates the representation.

**II.**

IT IS FURTHER ORDERED that respondent, directly or through any corporation, subsidiary, division, or other device, in connection with the labeling, advertising, promotion, offering for sale, sale, or distribution of chicken or any food or combination of foods in which chicken is a component, in or affecting commerce, shall not make any representation, in any manner, expressly or by implication, including through the use of endorsements or the product name, about:

- A. The absolute or comparative amount of fat (including, but not limited to, total fat, saturated fat, and trans fat), cholesterol, sodium, calories or any other nutrient in such food;
- B. The compatibility of such food with any weight loss program; or
- C. The health benefits of such food, including but not limited to characterizing such food as better for consumers' health than another food;

## Decision and Order

unless the representation is true and, at the time it is made, respondent possesses and relies upon competent and reliable evidence, which for purposes of Parts II.A. and II.C. of this Order must be competent and reliable scientific evidence, that substantiates the representation. If any representation covered by this Part either expressly or by implication conveys any nutrient content or health claim defined (for purposes of labeling) by any regulation promulgated by the Food and Drug Administration, compliance with this Part shall be governed by the qualifying amount for such defined claim as set forth in that regulation. *Provided, however,* that a numerical statement of the absolute amount of a particular nutrient in such food shall not, by itself, be considered to make a claim covered by Part II.B. or II.C. hereof.

**III.**

Nothing in this order shall prohibit respondent from making any representation for any product that is specifically permitted in labeling for such product by regulations promulgated by the Food and Drug Administration pursuant to the Nutrition Labeling and Education Act of 1990.

**IV.**

IT IS FURTHER ORDERED that respondent shall, for five (5) years after the last date of dissemination of any representation covered by this order, maintain and upon request make available to the Federal Trade Commission for inspection and copying:

- A. All advertisements and promotional materials containing the representation including recordings of all such broadcast advertisements;
- B. All materials that were relied upon in disseminating the representation; and
- C. All tests, reports, studies, surveys, demonstrations or other evidence in their possession or control that contradict,

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qualify, or call into question the representation, or the basis relied upon for the representation, including complaints and other communications with governmental or consumer protection organizations.

**V.**

IT IS FURTHER ORDERED that respondent, for a period of three (3) years after the date of issuance of this order, shall deliver a copy of this order to all current and future principals, officers, and directors, and to all current and future employees, agents, and representatives having managerial responsibilities with respect to the subject matter of this order, and shall secure from each such person a signed and dated statement acknowledging receipt of the order. Respondent shall deliver this order to current personnel within thirty (30) days after the date of service of this order, and to future personnel within thirty (30) days after the person assumes such position or responsibilities.

**VI.**

IT IS FURTHER ORDERED that respondent shall notify the Commission at least thirty (30) days prior to any proposed change in its corporate structure that may affect compliance obligations arising under this order, including but not limited to a dissolution, assignment, sale, merger, or other action that would result in the emergence of a successor corporation; the creation or dissolution of a subsidiary, parent, or affiliate that engages in any acts or practices subject to this order; the proposed filing of a bankruptcy petition; or a change in the corporate name or address. Provided, however, that, with respect to any proposed change in the corporation about which respondent learn less than thirty (30) days prior to the date such action is to take place, respondent shall notify the Commission as soon as is practicable after obtaining such knowledge. All notices required by this Part shall be sent by certified mail to the Associate Director, Division of Enforcement, Bureau of Consumer Protection, Federal Trade Commission, 600 Pennsylvania Avenue, NW, Washington, D.C. 20580.

Decision and Order

**VII.**

IT IS FURTHER ORDERED that respondent shall, within sixty (60) days from the date of service of this order, and at such other times as the Federal Trade Commission may require, file with the Commission a report, in writing, setting forth in detail the manner and form in which it has complied with this order.

**VIII.**

This order will terminate on September 9, 2024, or twenty (20) years from the most recent date that the United States or the Federal Trade Commission files a complaint (with or without an accompanying consent decree) in federal court alleging any violation of the order, whichever comes later; provided, however, that the filing of such a complaint will not affect the duration of:

- A. Any Part in this order that terminates in less than twenty (20) years;
- B. This order's application to any respondent that is not named as a defendant in such complaint; and
- C. This order if such complaint is filed after the order has terminated pursuant to this Part.

Provided further, that if such complaint is dismissed or a federal court rules that the respondent did not violate any provision of the order, and the dismissal or ruling is either not appealed or upheld on appeal, then the order will terminate according to this Part as though the complaint had never been filed, except that the order will not terminate between the date such complaint is filed and the later of the deadline for appealing such dismissal or ruling and the date such dismissal or ruling is upheld on appeal.

Analysis

**Analysis of Proposed Consent Order to Aid Public Comment**

The Federal Trade Commission has accepted, subject to final approval, an agreement containing a consent order from KFC Corporation (“KFCC”).

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

This matter involves the advertising and promotion of KFC Original Recipe fried chicken. According to the FTC complaint, KFC represented that eating KFC fried chicken, specifically 2 Original Recipe fried chicken breasts, is better for a consumer's health than eating a Burger King Whopper. The complaint alleges that this claim is false. Although 2 KFC Original Recipe fried chicken breasts have slightly less total fat (38 g. v. 43 g.) and saturated fat (12 g. v. 13 g.) than Burger King's Whopper, they have more trans fat (3.5 g. vs. 1 g.), more cholesterol (290 mg. v. 85 mg.), more sodium (2300 mg. vs. 980 mg.), and more calories (760 v. 710).

The FTC's complaint also alleges that KFCC represented that eating KFC fried chicken is compatible with “low carbohydrate” weight loss programs. The FTC alleges that this claim is false because “low carbohydrate” weight loss programs such as the Atkins Diet and the South Beach Diet, for example, advise against eating breaded, fried foods.

The proposed consent order contains provisions designed to prevent KFCC from engaging in similar acts and practices in the future.



## Analysis

Part I of the order prohibits KFCC from representing that eating KFC fried chicken is better for a consumer's health than eating a Burger King Whopper, or that eating KFC fried chicken is compatible with "low carbohydrate" weight loss programs, unless the representation is true and, at the time it is made, KFCC possesses and relies upon competent and reliable evidence – which in certain specified cases must be competent and reliable scientific evidence – that substantiates the representation.

Part II prohibits KFCC from making certain representations about the absolute or comparative amount of fat, cholesterol, sodium, calories or any other nutrient in any food it sells that contains chicken, about the compatibility of such food with any weight loss program, or about the health benefits of such food, unless the representation is true and, at the time it is made, KFCC possesses and relies upon competent and reliable evidence – which in certain specified cases must be competent and reliable scientific evidence – that substantiates the representation.

Part II also provides that representations conveying nutrient content or health claims that have been defined (for labeling purposes) by regulations promulgated by the Food and Drug Administration ("FDA") will be evaluated using the same nutrient thresholds that FDA has established for those claims.

Furthermore, Part II provides that a mere numerical statement of the amount of a particular nutrient in such food will not, by itself, be considered to be a weight loss compatibility or health benefit claim covered by Part II.

Part III permits any representation for any product that is permitted in labeling for such product pursuant to regulations promulgated by FDA pursuant to the Nutrition Labeling and Education Act of 1990.

Parts IV through VII of the order require KFCC to keep copies of relevant advertisements and materials substantiating claims made in the advertisements; to provide copies of the order to certain of its current and future personnel for three years; to notify the

Analysis

Commission of changes in corporate structure; and to file compliance reports with the Commission. Part VIII provides that the order will terminate after twenty (20) years under certain circumstances.

The purpose of this analysis is to facilitate public comment on the proposed order, and it is not intended to constitute an official interpretation of the agreement and proposed order or to modify in any way their terms.

Statement

**STATEMENT OF COMMISSIONER PAMELA JONES  
HARBOUR**

The Commission has accorded final approval to a consent agreement with KFC Corp. (“KFCC”) to settle allegations that the company deceptively advertised its fried chicken as being compatible with low-carbohydrate weight loss programs, among other claims. I concur with the Commission’s admirable results in obtaining strong injunctive relief, and I applaud staff for bringing a national advertising case. I believe, however, that an even stronger remedy is warranted. KFCC is fully aware of our nation’s struggle with obesity, yet has cynically attempted to exploit a massive health problem through deceptive advertising. Companies should not be allowed to benefit monetarily from this kind of deception, especially where the health and safety of consumers are compromised. Therefore, I encourage the Commission to find ways to seek monetary relief in future cases like this one.

Our nation’s obesity rate has “reached epidemic proportions, afflicting 6 out of every 10 Americans.”<sup>1</sup> Being overweight or obese is “the second leading cause of preventable death, after smoking, resulting in an estimated 300,000 deaths per year. The costs, direct and indirect, associated with [being] overweight and obes[e] are estimated to exceed \$100 billion a year.”<sup>2</sup> Obesity has been described as both an “epidemic” and a “crisis.”<sup>3</sup> Many

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<sup>1</sup> *Weight-Loss Advertising: An Analysis of Current Trends, A Report of the Staff of the Federal Trade Commission* (Sept. 2002), at vii (“Executive Summary”), available at <http://www.ftc.gov/bcp/reports/weightloss.pdf>.

<sup>2</sup> *Id.*

<sup>3</sup> See *The Time/ABC News Summit on Obesity* (Preliminary Agenda for June 2-4, 2004), available at <http://www.time.com/time/2004/obesity>; *America’s Obesity Crisis*, TIME (June 7, 2004).

Statement

consumers are interested in controlling their weight, and they rely heavily on the nutritional information in food advertisements to help them make choices about which foods to eat.

In the fall of 2003, KFCC apparently was suffering from decreased fried chicken sales, perhaps as a result of consumers' interest in a healthier diet.<sup>4</sup> In October 2003, KFCC embarked on an ad campaign in which it deceptively advertised that eating KFC fried chicken is compatible with a "low carbohydrate" weight loss program, even though "low carbohydrate weight loss programs such as the Atkins Diet and the South Beach Diet advise against eating breaded, fried foods."<sup>5</sup> In another ad, KFCC advertised that eating two of its "Original Recipe" fried chicken breasts was better for a consumer's health than eating a Burger King Whopper – even though the chicken is nearly equivalent to the Whopper in fat grams and is actually higher in trans fat, cholesterol, sodium and calories.<sup>6</sup> Both ads also promote an entire bucket of chicken, even though the voiceovers in the ads

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<sup>4</sup> See *20/20: Fast Not Fat: Fast Food Chains Will Go to Any Lengths to Keep People Eating Their Food* (ABC News television broadcast, Oct. 31, 2003); *Editorial, KFC blunders in "health" ads*, ADVERTISING AGE (Nov. 3, 2003), at 22; Bob Garfield, *Garfield's AdReview: KFC serves big, fat bucket of nonsense in "healthy" spots*, ADVERTISING AGE (Nov. 3, 2003), at 61.

<sup>5</sup> *In the Matter of KFC Corporation*, File No. 042-3033, Complaint at ¶¶ 5, 8-9 (June 2, 2004).

<sup>6</sup> *Id.* at ¶ 7 ("While compared to Burger King's Whopper, two KFC Original Recipe fried chicken breasts have slightly less total fat (38 g. v. 43 g.) and saturated fat (12 g. v. 13 g.), they have more trans fat (3.5 g. vs. 1 g.), more cholesterol (290 mg. v. 85 mg.), more sodium (2300 mg. vs. 980 mg.), and more calories (760 v. 710).").

## Statement

referenced one or two-piece servings.<sup>7</sup>

KFCC knew (or certainly should have known) that its ads were false and deceptive, and that the ads would encourage consumers to believe that KFC fried chicken was much healthier for them than it actually is. Only a few days after the ads aired, an *Advertising Age* editorial strongly criticized KFCC for running them, describing the ads as “desperate and sleazy tactics.”<sup>8</sup> In an interview on National Public Radio, the executive editor of *Advertising Age* stated that it was “very unusual” for the publication to run such a staff editorial, but justified it by saying that “[i]nstead of being truth well told, which is what advertising should be, it seems like not only an exaggerated claim, but basically an effort to deceive.”<sup>9</sup> Consumer advocacy groups complained about the ads as well, and the ads were the subject of much discussion until they stopped airing in late November 2003.<sup>10</sup>

I voted to accept the proposed settlement because it contains very strong injunctive relief that will go a long way toward

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<sup>7</sup> See, e.g., *World News Tonight with Peter Jennings: Good for You? KFC Adverts* (ABC television broadcast, Nov. 19, 2003); *NBC Nightly News with Tom Brokaw: Federal Trade Commission Wanting Proof That KFC’s Chicken Can Be Called a Health Food in TV Commercials* (NBC television broadcast, Nov. 18, 2003); *KFC Corporation, Complaint* at ¶ 5 (setting forth voiceovers).

<sup>8</sup> Garfield, *supra* note 4.

<sup>9</sup> *Day To Day: Jonah Bloom Discusses Advertising Age Magazine’s Editorial Criticism of KFC’s New Ad Campaign* (National Public Radio broadcast, Nov. 6, 2003).

<sup>10</sup> See, e.g., Bruce Schreiner, *KFC Ends Healthy Fried Chicken Ad Blitz*, ASSOC. PRESS ONLINE (Nov. 19, 2003); 20/20, *supra* note 4.

Statement

preventing KFCC from engaging in similar deceptive advertising in the future. In addition to addressing the specific claims made in the KFCC ads, the consent agreement also contains more general language prohibiting KFCC from making representations about the absolute or comparative amount of fat, cholesterol, sodium, calories, or any other nutrient in any food it sells that contains chicken; about the compatibility of such food with any weight loss program; or about the health benefits of such food, unless the representation is true and, at the time it is made, KFCC possesses and relies upon competent and reliable evidence – which in certain specified cases must be competent and reliable scientific evidence – that substantiates the representation.<sup>11</sup>

Accepting injunctive relief alone is reasonably consistent with the Commission's prior settlements in similar cases. However, where a company appears to have exploited a national health crisis, an even stronger response from the Commission is warranted. While I recognize that it may be difficult to calculate monetary relief in these kinds of cases, I would like to see the Commission develop methodological approaches that would support seeking such remedies in future cases of similar types of deceptive advertising, as the Commission has done in the past. For example, in 1995, the FTC settled charges with The Dannon Company that it had made false or misleading claims for its Pure Indulgence line of frozen yogurt. As part of the consent agreement, Dannon agreed to pay \$150,000 in disgorgement.<sup>12</sup> Similarly, in 1983, the FTC settled charges with Estee Corporation that it had misled consumers by falsely claiming that

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<sup>11</sup> *In the Matter of KFC Corporation*, File No. 042-3033, Analysis of Proposed Consent Order to Aid Public Comment (June 2, 2004).

<sup>12</sup> FTC Press Release, *Dannon Agrees To Settle FTC Charges That Low-Fat Ad Claims for Frozen Yogurt were False and Misleading* (Nov. 25, 1995); *In the Matter of The Dannon Company, Inc.*, Dkt. No. C-3643, 121 F.T.C. 136, 139 (March 18, 1996) (consent order).

## Statement

the sweeteners in its foods had been accepted by the American Diabetes Association and the Food and Drug Administration. Estee Corporation agreed to pay \$25,000 in *cy pres* relief to the American Diabetes Association or the Juvenile Diabetes Foundation.<sup>13</sup>

While injunctive relief is important in deceptive advertising cases such as this one, monetary relief may further serve to correct unlawful conduct, reverse its ill effects, and deter future violations of the law. Well-formulated *cy pres* relief, in particular, may provide real benefits to consumers. It is not only reasonably related to the violation, but also reasonably likely to reach the individuals most injured by a particular deceptive advertisement. Should the appropriate case present itself in the future, I strongly encourage the Commission to consider the applicability and effectiveness of *cy pres* and other potential monetary remedies.

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<sup>13</sup> *In the Matter of Estee Corporation*, Dkt. No. C-3126, 102 F.T.C. 1804, 1812 (Nov. 16, 1983) (consent order). *Cy pres* relief, also known as indirect restitution or fluid recovery, is used in situations where injured persons cannot be directly compensated. Instead, under *cy pres*, restitutionary funds are awarded in some alternate way that indirectly benefits the injured persons.

Complaint

IN THE MATTER OF

**GATEWAY LEARNING CORP.**

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

*Docket C-4120; File No. 0423047*

*Complaint, September 10, 2004--Decision, September 10, 2004*

This consent order, among other things, prohibits Respondent Gateway Learning Corporation -- a marketer and seller of products designed for children who are learning math and reading under the "Hooked on Phonics" brand name and trademark -- from misrepresenting, in connection with the collection of personal information from or about an individual, (1) that it will not sell, rent, or loan to third parties such personal information; (2) that it will not provide to any third party personal information about children under the age of thirteen; (3) the manner by which it will notify consumers of changes to its privacy policy; or (4) the manner in which it will collect, use, or disclose personal information. The order also prohibits the respondent from disclosing to any third party any personal information collected on its Web site prior to the date it posted its revised privacy policy permitting third-party sharing (June 20, 2003) without the express affirmative ("opt-in") consent of the consumers to whom such personal information relates. In addition, the order prohibits the respondent -- in connection with the posting in the future of any privacy policy that materially changes the previous version of the policy -- from applying such changes to information collected from or about consumers before the date of the posting without the express affirmative ("opt-in") consent of those consumers. The order also requires the respondent to disgorge to the United States Treasury its profits from renting customer data.

*Participants*

For the Commission: *Laura Mazzarella, Loretta H. Garrison, Jessica Rich, Joel Winston and [Bureau of Economics]*.

For the Respondent: *D. Reed Freeman, Jr., Collier Shannon Scott, PLLC.*

**COMPLAINT**

The Federal Trade Commission, having reason to believe that Gateway Learning Corporation, a corporation ("Respondent") has



## Complaint

violated the provisions of the Federal Trade Commission Act, and it appearing to the Commission that this proceeding is in the public interest, alleges:

1. Respondent Gateway Learning Corporation is a Delaware corporation with its principal office or place of business at 2900 South Harbor Boulevard, Suite 202, Santa Ana, CA 92704.
2. The acts and practices of Respondent as alleged in this complaint have been in or affecting commerce, as “commerce” is defined in Section 4 of the Federal Trade Commission Act.
3. Respondent markets and sells products designed for children who are learning math and reading under the “Hooked on Phonics” brand name and trademark. Since at least 2000, Respondent has marketed its products to parents and teachers through the Internet at its Web site, [www.hop.com](http://www.hop.com) (the “Gateway Learning Web site”).
4. Respondent collects personal information from parents who visit the Gateway Learning Web site and purchase Respondent’s products online. This personal information includes the parent’s first and last name, billing address, shipping address, phone number, email address, purchase history, and his or her child’s age and gender.
5. Since at least 2000, Respondent has disseminated or has caused to be disseminated various privacy policies on the Gateway Learning Web site, including but not necessarily limited to the attached Exhibit A, containing the following statements regarding the privacy and confidentiality of personal information collected through Respondent’s Web site:

**Our Promise of Privacy**

We at Gateway Learning Corporation are committed to protecting the privacy of our visitors, and we treat

Complaint

any information you share with discretion, care and respect. This notice describes our privacy policy for the Hooked on Phonics Web site (“Site”).

**Do we share your personally identifiable information with third parties?**

We do not sell, rent or loan any personally identifiable information regarding our consumers with any third party unless we receive a customer’s explicit consent. We do share information with third parties that help us run our operations or provide services to customers (e.g., credit card processing and shipping companies), but only to the extent necessary to provide these services.

\* \* \*

**What about children’s privacy?**

The Site does not sell products for purchase by children; we sell children’s products for purchase by adults. Children under 13 years of age may not submit personal information without the consent of their parents. We do not provide any personally identifiable information about children under 13 years of age to any third party for any purpose whatsoever.

\* \* \*

**Will this policy change?**

If at some future time there is a material change to our information usage practices that affect your personally identifiable information, we will notify you of the relevant changes on this Site or by e-mail. You will then be able to opt-out of this information usage by sending an e-mail to: [webmaster@hop.com](mailto:webmaster@hop.com). You should also check this privacy policy for changes.

## Complaint

Exhibit A, Gateway Learning Web Site Privacy Policy, December 6, 2001 (emphasis in original).

6. In April 2003, Respondent began renting personal information provided by consumers on the Gateway Learning Web site, including first and last name, address, phone number, and purchase history, without seeking or receiving any form of consent from such consumers. As part of the rental, Respondent also provided the age range (0-5 years old, 2-5 years old, and 6-10 years old) and gender of consumers' children for use by marketers in targeting parents. This personal information was used by third parties to send direct mail and make telemarketing calls to Gateway's online customers.
7. On June 20, 2003, Respondent posted on its Web site a revised privacy policy, attached hereto as Exhibit B. The June 20, 2003, privacy policy contained the same statements regarding children's privacy and policy changes as the previous policy, and the following revised statement regarding the sharing of personal information collected through Respondent's Web site:

**Our Promise of Privacy**

\* \* \*

**Do we share your personally identifiable information with third parties?**

From time to time, we may provide your name, address and phone number (not your e-mail address) to reputable companies whose products or services you may find of interest. If you do not want us to share this information with these companies, please write to us at: Gateway Learning Corporation, 2900 South Harbor Blvd., Suite 202, Santa Ana, CA 92704,

Complaint

call 1-800-544-7323 or e-mail us at [webmaster@hop.com](mailto:webmaster@hop.com) with the word do-not-share in the subject line.

Exhibit B, Gateway Learning Web Site Privacy Policy, June 20, 2003 (emphasis in original).

8. When Respondent posted the revised privacy policy, it did not take any additional steps to alert consumers that it had changed its privacy policy to permit third-party sharing of consumers' personal information. Respondent continued to rent to third parties personal information collected on the Gateway Learning Web site before June 20, 2003, including information about consumers' children.
9. On or about July 1, 2003, Respondent temporarily suspended rental of any customer data collected on its Web site. Prior to that date, Respondent had rented personal information provided by its online customers, all of whom had provided personal information under a privacy policy that stated that Respondent "do[es] not sell, rent or loan" personal information (see Exhibit A). Respondent earned approximately \$4,608 from the rental orders.
10. On July 17, 2003, Respondent posted on its Web site a further revised privacy policy, attached hereto as Exhibit C. Respondent also added the phrase "(updated July 17, 2003)" to the hyperlink for the revised policy. The revised policy contained the same statement about policy changes as the previous policies, and the following revised statements regarding children's privacy and the sharing of personal information collected through Respondent's Web site:

**Our Promise of Privacy**

We at Gateway Learning Corporation are committed to protecting the privacy of our customers, and we treat any information you share with discretion, care and respect. This notice describes Gateway Learning

## Complaint

Corporation's privacy policy for information we collect from individuals both online (on our website) and offline (such as by mail or telephone).

\* \* \*

**Do we disclose your personally identifiable information to third parties?**

From time to time, we may provide your name, address and telephone number (not your e-mail address) to reputable companies whose products or services you may find of interest. If you do not want us to disclose this information to these companies, please write to us at: Gateway Learning Corporation, 2900 South Harbor Blvd., Suite 202, Santa Ana, CA 92704, call 1-800-544-7323 or e-mail us at do-not-rent@hop.com with your full name in the subject line. Please be sure to include your first name, last name, address, city, state, zip code, and phone number to ensure we can process your request. We will process your request promptly. Please be aware that you may receive another contact before your name removal takes effect. We regret any inconvenience this may cause.

\* \* \*

**What about children's privacy?**

The Site is not targeted to children, and we do not knowingly collect personally-identifiable information from children under the age of 13 on this site. We do not sell products for purchase by children; we sell children's products for purchase by adults. This site is entirely aimed at adults.

Exhibit C, Gateway Learning Web Site Privacy Policy, July 17, 2003 (emphasis in original).

Complaint

11. Through the means described in Paragraph 5, Respondent has represented, expressly or by implication, that:
  - A. Respondent would not sell, rent, or loan to third parties any personal information collected from consumers on the Gateway Learning Web site unless it received consumers' explicit consent.
  - B. Respondent would not provide to any third party for any purpose any personal information about children under the age of thirteen.
12. In truth and in fact:
  - A. Respondent did rent to third parties personal information collected from consumers without receiving consumers' explicit consent.
  - B. Respondent did provide to third parties personal information about children under the age of thirteen, specifically, age range (0-5 years old, 2-5 years old, and 6-10 years old), gender, and parent's name and address.

Therefore, the representations set forth in Paragraph 11 were false or misleading.

13. As described in Paragraphs 7 - 9, Respondent posted a revised privacy policy containing material changes to its practices that were inconsistent with Respondent's original promise to consumers. Respondent retroactively applied such changes to personal information it had previously collected from consumers. Respondent's retroactive application of its revised privacy policy caused or is likely to cause substantial injury to consumers that is not outweighed by countervailing benefits to consumers or competition and is not reasonably avoidable by consumers. The practice was, and is, an unfair act or practice.

## Complaint

14. Through the means described in Paragraph 5, Respondent has represented, expressly or by implication, that Respondent would notify consumers of material changes to its information practices.
15. In truth and in fact, Respondent did not notify consumers of material changes to its information practices. Instead, Respondent posted a revised privacy policy on its Web site without any indication that the policy had materially changed or what aspects of the policy had changed. Therefore, the representation set forth in Paragraph 14 was, and is, false or misleading.
16. The acts and practices of Respondent as alleged in this complaint constitute unfair and deceptive acts or practices in or affecting commerce in violation of Section 5(a) of the Federal Trade Commission Act.

THEREFORE, the Federal Trade Commission this tenth day of September, 2004, has issued this complaint against Respondent.

**EXHIBIT A**





About Us



Click Here to Chat



Call our toll-free number: 1-800-532-3607

- Reading
- Better Grades
- Math
- For Teachers

# Promise of Privacy

**Any information you provide us is held in trust with care and security.**

## Our Promise of Privacy

We at Gateway Learning Corporation are committed to protecting the privacy of our visitors, and we treat any information you share with discretion, care and respect. This notice describes our privacy policy for the Hooked on Phonics Web site ("Site").

### Do we share your personally identifiable information with third parties?

We do not sell, rent or loan any personally identifiable information regarding our consumers with any third party unless we receive a customer's explicit consent. We do share information with third parties that help us run our operations or provide services to customers (e.g., credit card processing and shipping companies), but only to the extent necessary to provide these services.

### How secure is the personally identifiable information that you provide?

We protect the security of your credit card information during transmission by using Secure Sockets Layer (SSL) software, which encrypts information you input. We reveal only the last four digits of your credit card number when confirming an order. We do transmit the entire credit card number to the appropriate credit card company during order processing. We have also implemented security measures to protect against the loss, misuse, and alteration of other personally identifiable user information submitted to our Site.

We gather personally identifiable information during checkout, during membership or sweepstakes registration and when visitors request our information packet or other materials.

We also receive and store certain types of information automatically through the use of "cookies" and 1-pixel gifs. Cookies are files that your Web browser places on your computer's hard drive. 1-pixel gifs are tags that reside on certain of our Web pages. We use cookies and gifs to track your experience with this Site, to keep track of items you put into your shopping cart, to tell us whether you have visited this Site previously, and to help us determine if you came from a particular link or banner advertisement. You may set your browser to reject cookies, but this may limit some functionality of the Site.

We do not use cookies or gifs to retrieve personal information about you from your computer.

### What type of personal information is gathered?

We gather the following information: name, address, phone number, e-mail address, billing information (i.e., credit card number and expiration date) and responses to specific questions (e.g., reasons for visiting our Site). We may also record the types of product information you have requested on the Site. In addition, members may have the option of adding children's names and ages to their membership record.

Like most Web sites, we may also add to the above personally identifiable information a variety of technical data, including (but not limited to) your IP address (a unique number that identifies your access account on the Internet), domain, and Web browser information. We may track the page you visited before coming to our Site, the page you link to when you leave, which of our pages you access, and how long you spend on each page.

**Why is this information gathered?**

We use personally identifiable information for shipping and billing purposes, to send brochures to visitors who request information, to enter members in sweepstakes (and to inform sweepstakes winners of their selection), to provide visitors with special offers, and to notify visitors of new product launches.

We also use the personally identifiable information to personalize your experience on the Site, to customize our reading assessment and to recommend products that are best suited to a particular child's educational needs.

We occasionally use information about what banners or links have brought you to our Site to measure advertising effectiveness and to determine payment to advertising partners.

If you would prefer not to be contacted by us, you may opt out of future communications (see "opting-out" section below).

**How is non-personally identifiable data used?**

We use non-personally identifiable data for internal business and marketing purposes, and share such data with third parties, including current or potential business partners.

**What about children's privacy?**

The Site does not sell products for purchase by children; we sell children's products for purchase by adults. Children under 13 years of age may not submit personal information without the consent of their parents. We do not provide any personally identifiable information about children under 13 years of age to any third party for any purpose whatsoever.

We may in the future offer products to be used by children online, some of which may require you to enter additional information such as a child's age, gender or reading ability in order to deliver a quality experience. A child's participation in such a program will be entirely at your discretion. Again, no personally identifiable information about children under 13 years of age will be shared with any third party for any purpose whatsoever.

**Additional information gathering and disclosure**

Please note that our business partners may also place cookies or 1-pixel gifs on our site in order to track orders and revenue generated through referral programs. The information transmitted to our business partners is not personally identifiable.

Notwithstanding anything else in this policy, we may: (a) disclose personal and aggregate information when required by a valid legal mechanism such as a search warrant, subpoena, or court order, or when we deem it necessary to protect the safety of Site users, our employees or property; and (b) disclose personal information in the context of the sale of some or all of our assets.

**How are e-mail links treated?**

We use e-mail links located on the "Contact Us" page to allow you to contact us directly with any questions or comments you may have. We read every message sent in and try to reply promptly to each one. This information is used to respond directly to your questions or comments. We may also file

your comments to improve the Site and program, or review and discard the information.

**Can I opt out of receiving communications from Gateway Learning Corporation?**

Yes. This Site gives you the following options for removing your information from our database so that you will not receive future communications:

You can send an e-mail to [webmaster@hop.com](mailto:webmaster@hop.com) with the word UNSUBSCRIBE in the subject line.

You can send mail to the following postal address:  
Gateway Learning Corporation  
665 Third St., Suite 225  
San Francisco, CA 94107  
Attn: Webmaster

**Links**

This Site may contain links to other Web sites. Gateway Learning Corporation is not responsible for the privacy practices or the content of such Web sites.

**How can I modify my personal information?**

This Site gives users the following options for changing and modifying information previously provided:

You can send e-mail to [webmaster@hop.com](mailto:webmaster@hop.com).

You can send mail to the following postal address:  
Gateway Learning Corporation  
665 Third Street, Suite 225  
San Francisco, CA 94107  
Attn: Webmaster

**Will this policy change?**

If at some future time there is a material change to our information usage practices that affect your personally identifiable information, we will notify you of the relevant changes on this Site or by e-mail. You will then be able to opt-out of this information usage by sending an e-mail to: [webmaster@hop.com](mailto:webmaster@hop.com). You should also check this privacy policy for changes.

**How do I contact the Web site?**

If you have any questions about this privacy statement, the practices of this Site, or your dealings with this Site, you may contact:

Webmaster  
Gateway Learning Corporation  
665 Third Street, Suite 225  
San Francisco, CA 94107

or [webmaster@hop.com](mailto:webmaster@hop.com)

**EXHIBIT B**



Questions? We can help!

1-800-532-3607 (Dept 59)

Reading Better Grades Math For Teachers

# Promise of Privacy



Any information you provide us is held in trust with care and security.



## Our Promise of Privacy

We at Gateway Learning Corporation are committed to protecting the privacy of our visitors, and we treat any information you share with discretion, care and respect. This notice describes our privacy policy for the Hooked on Phonics Web site ("Site").

### Do we share your personally identifiable information with third parties?

From time to time, we may provide your name, address and phone number (not your e-mail address) to reputable companies whose products or services you may find of interest. If you do not want us to share this information with these companies, please write to us at: Gateway Learning Corporation, 2900 South Harbor Blvd., Suite 202, Santa Ana, CA 92704, call 1-800-544-7323 or e-mail us at [privacy@hookedonphonics.com](mailto:privacy@hookedonphonics.com) with the word do-not-share in the subject line.

### How secure is the personally identifiable information that you provide?

We protect the security of your credit card information during transmission by using Secure Sockets Layer (SSL) software, which encrypts information you input. We reveal only the last four digits of your credit card number when confirming an order. We do transmit the entire credit card number to the appropriate credit card company during order processing. We have also implemented security measures to protect against the loss, misuse, and alteration of other personally identifiable user information submitted to our Site.

We gather personally identifiable information during checkout, during membership or sweepstakes registration and when visitors request our information packet or other materials.

6/20/03 PM

We also receive and store certain types of information automatically through the use of "cookies" and 1-pixel gifs. Cookies are files that your Web browser places on your computer's hard drive. 1-pixel gifs are tags that reside on certain of our Web pages. We use cookies and gifs to track your experience with this Site, to keep track of items you put into your shopping cart, to tell us whether you have visited this Site previously, and to help us determine if you came from a particular link or banner advertisement. You may set your browser to reject cookies, but this may limit some functionality of the Site.

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Like most Web sites, we may also add to the above personally identifiable information a variety of technical data, including (but not limited to) your IP address (a unique number that identifies your access account on the Internet), domain, and Web browser information. We may track the page you visited before coming to our Site, the page you link to when you leave, which of our pages you access, and how long you spend on each page.

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**How are e-mail links treated?**

We use e-mail links located on the "Contact Us" page to allow you to contact us directly with any questions or comments you may have. We read every message sent in and try to reply promptly to each one. This information is used to respond directly to your questions or comments. We may also file your comments to improve the Site and program, or review and discard the information.

**Can I opt out of receiving communications from Gateway Learning**

**Corporation?**

Yes. This Site gives you the following options for removing your information from our database so that you will not receive future e-mail communications:

You can send an e-mail to [webmaster@hookedonphonics.com](mailto:webmaster@hookedonphonics.com) with the word UNSUBSCRIBE in the subject line.

You can send mail to the following postal address:

Gateway Learning Corporation  
2900 South Harbor Blvd., Suite 202  
Santa Ana, CA 92704  
Attn: Webmaster

**Links**

This Site may contain links to other Web sites. Gateway Learning Corporation is not responsible for the privacy practices or the content of such Web sites.

**How can I modify my personal information?**

This Site gives users the following options for changing and modifying information previously provided:

You can send e-mail to [webmaster@hookedonphonics.com](mailto:webmaster@hookedonphonics.com).

You can send mail to the following postal address:

Gateway Learning Corporation  
2900 South Harbor Blvd., Suite 202  
Santa Ana, CA 92704  
Attn: Webmaster

**Will this policy change?**

If at some future time there is a material change to our information usage practices that affect your personally identifiable information, we will notify you of the relevant changes on this Site or by e-mail. You will then be able to opt-out of this information usage by sending an e-mail to: [webmaster@hookedonphonics.com](mailto:webmaster@hookedonphonics.com). You should also check this privacy policy for changes.

**How do I contact the Web site?**

If you have any questions about this privacy statement, the practices of this Site, or your dealings with this Site, you may contact:

Webmaster  
Gateway Learning Corporation  
2900 South Harbor Blvd., Suite 202



Santa Ana, CA 92704

or www.hopewell.com

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**EXHIBIT C**

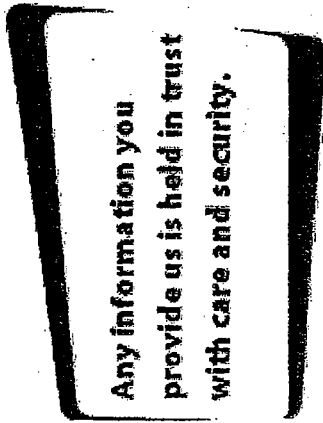


HOOKED ON PHONICS™

Questions? We can help!

1-866-746-6533 (Dept. 1030)

# Promise of Privacy



## Our Promise of Privacy

We at Gateway Learning Corporation are committed to protecting the privacy of our customers, and we treat any information you share with discretion, care and respect. This notice describes Gateway Learning Corporation's privacy policy for information we collect from individuals both online (on our website) and offline (such as by mail or telephone).

### What types of personal and non-personal information do we gather online and offline?

We gather personally identifiable information when you contact Hooked on Phonics by mail, phone, e-mail, visit our Site, or by filling out requests for information through our advertisements and promotions, and by subscribing to newsletters. We collect only personal information that you provide to us such as: name, address, phone number, e-mail address, responses to specific questions (e.g., reasons for visiting our Site, the age of a child that requires a reading program, and for orders, shipping and billing information (i.e., credit card number and expiration date). We may also record the types of product information you have requested on the Site.

### How do we use the personal and non-personal information that we gather?

We use personally identifiable information for shipping and billing purposes, to respond to consumers' requests, to provide consumers with special offers, and to notify consumers of new product launches. We also use the personally identifiable information to personalize your experience on our Site, to customize our reading assessment, to recommend products that are best suited to a particular child's educational needs, and to allow us to better understand how Hooked on Phonics may serve your needs.

Like most Web sites, we may also add to the above personally identifiable information a variety of technical data, including (but not limited to) your IP address (a unique number that identifies your access account on the

About Us View Cart

Click Here to Chat

For Teachers

Math

Better Grades

Reading

Internet), domain, and Web browser information. We may track the page you visited before coming to our Site, the page you link to when you leave, which of our pages you access, and how long you spend on each page.

**How is non-personally identifiable data used?**

We use non-personally identifiable data for internal business and marketing purposes, and share such data with third parties, including current or potential business partners. For example, we occasionally use information about what banners or links have brought you to our Site to measure online advertising effectiveness and to determine payment to our online advertising partners.

**What about cookies and gifs?**

We receive and store certain types of information automatically through the use of "cookies" and 1-pixel gifs. Cookies are files that your Web browser places on your computer's hard drive. 1-pixel gifs are tags that reside on certain pages of our Web site. We use cookies and gifs to track your experience with this website, to keep track of items you put into your shopping cart, to tell us whether you have visited this site previously, and to help us determine if you came from a particular link or banner advertisement. You may set your browser to reject cookies, but this may limit some functionality of the Site.

We do not use cookies or gifs to retrieve personal information about you from your computer.

Please note that our business partners may also place cookies or 1-pixel gifs on our site in order to track orders and revenue generated through referral programs. This information is not personally identifiable.

**Do we disclose your personally identifiable information to third parties?**

From time to time, we may provide your name, address and telephone number (not your e-mail address) to reputable companies whose products or services you may find of interest. If you do not want us to disclose this information to these companies, please write to us at: Gateway Learning Corporation, 2900 South Harbor Blvd., Suite 202, Santa Ana, CA 92704, call 1-800-544-7323 or e-mail us at do-not-rent@hop.com with your full name in the subject line. Please be sure to include your first name, last name, address, city, state, zip code, and phone number to ensure we can process your request. We will process your request promptly. Please be aware that you may receive another contact before your name removal takes effect. We regret any inconvenience this may cause.

We also provide personally-identifiable information with third parties that we

use for our own business purposes; such as to process your order or request for information, or to provide services for us.

Notwithstanding anything else in this policy, we may: (a) disclose personal and aggregate information when required by a valid legal mechanism such as a search warrant, subpoena, or court order, or when we deem it necessary to protect the safety of Site users, our employees or property; and (b) disclose personal information in the context of the sale of some or all of our assets.

#### **How secure is the credit card information I enter online?**

We protect the security of the credit card information you provide online by using Secure Sockets Layer (SSL) software, which encrypts information you input into our shopping cart during transmission to our servers and is stored in secure locations. We reveal only the last four digits of your credit card number when confirming an order placed online. Of course, we do transmit the entire credit card number to the appropriate credit card company during order processing.

#### **What about children's privacy?**

The Site is not targeted to children, and we do not knowingly collect personally-identifiable information from children under the age of 13 on this site. We do not sell products for purchase by children; we sell children's products for purchase by adults. This site is entirely aimed at adults. We may in the future offer computerized learning products to be used by children online, some of which may require you to enter additional information such as a child's age, gender or reading ability in order to deliver a quality experience.

#### **How are e-mail links treated?**

We use e-mail links located on the "Contact Us" page to allow you to contact us directly with any questions or comments you may have. We read every message sent in and try to reply promptly to each one. This information is used to respond directly to your questions or comments. We may also file your comments to improve the website and learning programs, or review and discard the information.

#### **How can I remove my information from your rental list?**

If you do not want us to disclose personal information that you provide to us to third parties for their own marketing purposes, please write to us at: Gateway Learning Corporation, 2900 South Harbor Blvd., Suite 202, Santa Ana, CA 92704, call 1-800-544-7323 or e-mail us at [Do-not-rent@HQ.com](mailto:Do-not-rent@HQ.com) with your full name in the subject line. Please be sure to include your first name, last name, address, city, state, zip code, and phone number to ensure we can process your request. We will process your request promptly. Please

be aware that you may receive another contact before your name removal takes effect. We regret any inconvenience this may cause.

### **Can I opt out of receiving communications from Gateway Learning Corporation?**

Yes. We will process your request promptly. Please be aware that you may receive another contact before your name removal takes effect. We regret any inconvenience this may cause. This website gives you the following options:

If you do not wish to receive direct mail communications, send an e-mail to [Do-not-mail@HOP.com](mailto:Do-not-mail@HOP.com) with your full name in the subject line. Please include your first name, last name, address, city, state, zip code, and phone number to ensure we can process your request.

If you do not wish to receive e-mail communications, send an e-mail to [Opt-out@HOP.com](mailto:Opt-out@HOP.com) with the word UNSUBSCRIBE in the subject line. Please include your first name, last name, address, city, state, zip code, and phone number to ensure we can process your request.

If you do not wish to receive telephone communications, send an e-mail to [Do-not-call@HOP.com](mailto:Do-not-call@HOP.com) with your full name in the subject line. Please include your first name, last name, address, city, state, zip code, and phone number to ensure we can process your request.

If you do not wish to receive any communications, send an e-mail to [Do-not-contact@HOP.com](mailto:Do-not-contact@HOP.com) with your full name in the subject line. Please include your first name, last name, address, city, state, zip code, and phone number to ensure we can process your request.

If you prefer, you can send us a letter at the following address. Please include your first name, last name, address, city, state, zip code, and phone number to ensure we can process your request:

Gateway Learning Corporation  
2900 South Harbor Blvd., Suite 202  
Santa Ana, CA 92704  
Attn: Customer Service

### **Links**

This Site may contain links to other Web sites. Gateway Learning Corporation is not responsible for the privacy practices or the content of such Web sites.

### **How can I modify my personal information?**

This Site gives users the following options for changing and modifying information previously provided:

You can send e-mail to [customerservice@HOP.com](mailto:customerservice@HOP.com) with CHANGE INFO REQUEST in the subject line. Please include your first name, last name, address, city, state, zip code, and phone number to ensure we can process your request.

If you prefer, you can send us a letter at the following address. Please include your first name, last name, address, city, state, zip code, and phone number to ensure we can process your request.

Gateway Learning Corporation  
2900 South Harbor Blvd., Suite 202  
Santa Ana, CA 92704  
Attn: Customer Service

**Will this policy change?**

If at some future time there is a material change to our information usage practices that affect your personally identifiable information, we will notify you of the relevant changes on this Site or by e-mail. You will then be able to opt-out of this information usage by sending an e-mail to: [customerservice@HOP.com](mailto:customerservice@HOP.com). You should also check this privacy policy for changes.

**How do I contact the Web site?**

If you have any questions about this privacy statement, the practices of this Site, or your dealings with this Site, you may contact:

Customer Service  
Gateway Learning Corporation  
2900 South Harbor Blvd., Suite 202  
Santa Ana, CA 92704

or [customerservice@HOP.com](mailto:customerservice@HOP.com)

Policy updated July 17, 2003

Customer Service | Promise of Privacy | Contact | Affiliates | KinderCare® | Disclosures  
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Decision and Order

## DECISION AND ORDER

The Federal Trade Commission having initiated an investigation of certain acts and practices of the Respondent named in the caption hereof, and the Respondent having been furnished thereafter with a copy of a draft Complaint that the Bureau of Consumer Protection proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge the Respondent with violation of the Federal Trade Commission Act, 15 U.S.C. § 45 et seq;

The Respondent, its attorney, and counsel for the Commission having thereafter executed an Agreement Containing Consent Order (“Consent Agreement”), an admission by the Respondent of all the jurisdictional facts set forth in the aforesaid draft Complaint, a statement that the signing of said Consent Agreement is for settlement purposes only and does not constitute an admission by Respondent that the law has been violated as alleged in such Complaint, or that the facts as alleged in such Complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it has reason to believe that the Respondent has violated the said Act, and that a Complaint should issue stating its charges in that respect, and having thereupon accepted the executed Consent Agreement and placed such Consent Agreement on the public record for a period of thirty (30) days, and having duly considered the comment filed thereafter by an interested party pursuant to Section 2.34 of its Rules, now in further conformity with the procedure described in Section 2.34 of its Rules, the Commission hereby issues its Complaint, makes the following jurisdictional findings and enters the following Order:

1. Respondent Gateway Learning Corporation is a Delaware corporation with its principal office or place of business at 2900 South Harbor Boulevard, Suite 202, Santa Ana, CA 92704.



## Decision and Order

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the Respondents, and the proceeding is in the public interest.

ORDER

## DEFINITIONS

For purposes of this Order, the following definitions shall apply:

1. “Personally identifiable information” or “personal information” shall mean individually identifiable information from or about an individual including, but not limited to: (a) a first and last name; (b) a home or other physical address, including street name and name of city or town; (c) an email address or other online contact information, such as an instant messaging user identifier or a screen name that reveals an individual’s email address; (d) a telephone number; (e) a Social Security number; (f) a persistent identifier, such as a customer number held in a “cookie” or processor serial number, that is combined with other available data that identifies an individual; or (g) any other information from or about an individual that is combined with any of (a) through (f) above.
2. Unless otherwise specified, “Respondent” shall mean Gateway Learning Corporation and its successors and assigns and its officers, and its agents, representatives, and employees.
3. “Commerce” shall mean as defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44.

## I.

IT IS ORDERED that Respondent, directly or through any corporation, subsidiary, division, or other device, in connection with the collection of personal information from or about an individual, shall not misrepresent in any manner, expressly or by

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implication:

- A. That Respondent will not sell, rent, or loan to third parties such personal information;
- B. That Respondent will not provide to any third party personal information about children under the age of thirteen;
- C. The manner by which Respondent will notify consumers of changes to its privacy policy; or
- D. The manner in which Respondent will collect, use, or disclose personal information.

II.

IT IS FURTHER ORDERED that Respondent, directly or through any corporation, subsidiary, division, or other device, shall not disclose to any third party any personal information collected on the [www.hop.com](http://www.hop.com) Web site prior to the date Gateway posted its revised privacy policy permitting third-party sharing (June 20, 2003), unless Respondent obtains the express affirmative (“opt-in”) consent of the consumers to whom such personal information relates.

III.

IT IS FURTHER ORDERED that Respondent, in connection with the posting of any privacy policy that contains a material change from the previous version of the policy, shall not apply such changes to information collected from or about consumers before the date of the posting, unless Respondent obtains the express affirmative (“opt-in”) consent of the consumers to whom such personal information relates.

## Decision and Order

## IV.

IT IS FURTHER ORDERED that within five (5) days of the date of service of this Order, Respondent, its successors and assigns, shall pay \$4,608 to the United States Treasury as disgorgement. Such payment shall be by cashier's check or certified check made payable to the Treasurer of the United States. In the event of any default in payment, which default continues for more than ten (10) days beyond the due date of payment, Respondent shall also pay interest as computed under 28 U.S.C. § 1961, which shall accrue on the unpaid balance from the date of default until the date the balance is fully paid.

## V.

IT IS FURTHER ORDERED that respondent Gateway Learning Corporation and its successors and assigns shall, for a period of five (5) years after the date of issuance of this Order, maintain and upon request make available to the Federal Trade Commission for inspection and copying a print or electronic copy of all documents demonstrating their compliance with the terms and provisions of this Order, including, but not limited to:

- A. a sample copy of each different privacy statement or communication relating to the collection of personally identifiable information containing representations about how personally identifiable information will be used or disclosed. Each Web page copy shall be dated and contain the full URL of the Web page where the material was posted online. Electronic copies shall include all text and graphics files, audio scripts, and other computer files used in presenting the information on the Web; provided, however, that after creation of any Web page or screen in compliance with this Order, Respondent shall not be required to retain a print or electronic copy of any amended Web page or screen to the extent that the amendment does not affect Respondent's compliance obligations under this Order;

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- B. a sample copy of each different document relating to any attempt by Respondent to obtain the express affirmative (“opt-in”) consent of consumers and copies of any documents demonstrating such consent provided by consumers, as required by Parts II and III of this Order; and
- C. all invoices, communications, and records relating to the disclosure of personally identifiable information to third parties.

VI.

IT IS FURTHER ORDERED that respondent Gateway Learning Corporation and its successors and assigns shall deliver a copy of this Order to all current and future principals, officers, directors, and managers, and to all current and future employees, agents, and representatives having responsibilities with respect to the subject matter of this Order. Respondent shall deliver this Order to such current personnel within thirty (30) days after the date of service of this Order, and to such future personnel within thirty (30) days after the person assumes such position or responsibilities.

VII.

IT IS FURTHER ORDERED that respondent Gateway Learning Corporation and its successors and assigns shall notify the Commission at least thirty (30) days prior to any change in the corporation(s) that may affect compliance obligations arising under this Order, including, but not limited to, a dissolution, assignment, sale, merger, or other action that would result in the emergence of a successor corporation; the creation or dissolution of a subsidiary, parent, or affiliate that engages in any acts or practices subject to this Order; the proposed filing of a bankruptcy petition; or a change in the corporate name or address. Provided, however, that, with respect to any proposed change in the corporation about which a respondent learns less than thirty (30)

## Decision and Order

days prior to the date such action is to take place, the respondent shall notify the Commission as soon as is practicable after obtaining such knowledge. All notices required by this Part shall be sent by certified mail to the Associate Director, Division of Enforcement, Bureau of Consumer Protection, Federal Trade Commission, Washington, D.C. 20580.

## VIII.

IT IS FURTHER ORDERED that respondent Gateway Learning Corporation and its successors and assigns shall, within sixty (60) days after service of this Order, and at such other times as the Federal Trade Commission may require, file with the Commission a report, in writing, setting forth in detail the manner and form in which it has complied with this Order.

## IX.

This Order will terminate on September 10, 2024, or twenty (20) years from the most recent date that the United States or the Federal Trade Commission files a complaint (with or without an accompanying consent decree) in federal court alleging any violation of the Order, whichever comes later; provided, however, that the filing of such a complaint will not affect the duration of:

- A. Any Part in this Order that terminates in less than twenty (20) years;
- B. This Order's application to any respondent that is not named as a defendant in such complaint; and
- C. This Order if such complaint is filed after the Order has terminated pursuant to this Part.

Provided, further, that if such complaint is dismissed or a federal court rules that a respondent did not violate any provision of the Order, and the dismissal or ruling is either not appealed or upheld on appeal, then the Order will terminate according to this Part as

Decision and Order

though the complaint had never been filed, except that the Order will not terminate between the date such complaint is filed and the later of the deadline for appealing such dismissal or ruling and the date such dismissal or ruling is upheld on appeal.

## Analysis

**Analysis of Proposed Consent Order to Aid Public Comment**

The Federal Trade Commission has accepted an agreement, subject to final approval, to a proposed consent order from Gateway Learning Corporation ("GLC"). GLC markets and sells products designed for children who are learning math and reading under the "Hooked on Phonics" brand name and trademark.

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 period will become part of the public record. After thirty (30) days, the Commission will again review the agreement and the comments received and will decide whether it should withdraw from the agreement and take other appropriate action or make final the agreement's proposed order.

This matter concerns alleged misrepresentations about how personal information collected from consumers through the proposed respondent's Web site would be used and alleged unfair practices in connection with proposed respondent's changes to its online privacy policy. The proposed respondent collects personal information from consumers on its Web site, including information from parents who purchase Hooked on Phonics products for their children. Such information includes the parent's first and last name, address, phone number, email address, purchase history, and his or her child's age range and gender. The proposed respondent maintains a privacy policy on its Web site that describes how it handles personal information collected from consumers.

The Commission's complaint charges that the proposed respondent falsely represented that information collected from consumers through its Web site would not be sold, rented, or loaned to third parties and that personal information about children under the age of thirteen would not be provided to any third party for any purpose. In fact, the complaint alleges, proposed respondent rented to third parties information about

Analysis

consumers and the age range and gender of their children. This information was used to send direct mail and make telemarketing calls to consumers.

The complaint also alleges that by posting a revised privacy policy containing material changes to its practices that were inconsistent with its original promise to consumers and retroactively applying such changes to previously-collected information, the proposed respondent engaged in an unfair practice. As alleged in the complaint, the proposed respondent collected personal information under a privacy policy that specifically stated that it did not sell, rent, or loan such information to third parties. It then changed its posted privacy policy to state that it may provide such information to third parties and, without providing any additional notice to consumers, applied this change to information collected under the earlier policy. Thus, without sufficient notice to consumers, the proposed respondent adopted a new policy and practice of sharing information with third parties that directly contradicted the promise made to consumers when the information was collected. The complaint alleges that this retroactive application of proposed respondent's revised privacy policy caused or is likely to cause substantial injury to consumers by subjecting them to unwanted direct mail and telemarketing calls. Further, such injury is not outweighed by countervailing benefits to consumers or competition and is not reasonably avoidable by consumers.

Lastly, the complaint alleges that the proposed respondent misrepresented that it would notify consumers of material changes to its information practices, when in fact, it did not notify consumers of material changes to its information practices. Instead, the proposed respondent posted a revised privacy policy on its Web site without any indication that the policy had materially changed or what aspects of the policy had changed.

Part I of the consent order prohibits the proposed respondent, in connection with the collection of personal information from or about an individual, from misrepresenting (1) that it will not sell,



## Analysis

rent, or loan to third parties such personal information; (2) that it will not provide to any third party personal information about children under the age of thirteen; (3) the manner by which it will notify consumers of changes to its privacy policy; or (4) the manner in which it will collect, use, or disclose personal information.

Part II of the order prohibits the proposed respondent from disclosing to any third party any personal information collected on its Web site prior to the date it posted its revised privacy policy permitting third-party sharing (June 20, 2003), unless it obtains the express affirmative (“opt-in”) consent of the consumers to whom such personal information relates. Part III of the order prohibits the proposed respondent, in connection with the posting in the future of any privacy policy that contains a material change from the previous version of the policy, from applying such changes to information collected from or about consumers before the date of the posting, unless it obtains the express affirmative (“opt-in”) consent of the consumers to whom such personal information relates. Part IV of the order requires the proposed respondent to pay \$4,608 to the United States Treasury as disgorgement of its profits from renting customer data.

The remainder of the proposed order contains standard requirements that the proposed respondent: maintain copies of privacy statements and other documents relating to the collection, use or disclosure of personally identifiable information and to any efforts to obtain the consent of consumers and documents demonstrating such consent as required by Parts II and III of the order; distribute copies of the order to certain company officials and employees; notify the Commission of any change in the corporation that may affect compliance obligations under the order; and file one or more reports detailing its compliance with the order. Part IX of the proposed order is a provision whereby the order, absent certain circumstances, terminates twenty years from the date of issuance.

The purpose of this analysis is to facilitate public comment on

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the proposed order, and is not intended to constitute an official interpretation of the agreement and proposed order or to modify in any way its terms.

The proposed order, if issued in final form, will resolve the claims alleged in the complaint against the named respondent. It is not the Commission's intent that acceptance of this consent agreement and issuance of a final decision and order will release any claims against any unnamed persons or entities associated with the conduct described in the complaint.

Complaint

IN THE MATTER OF

**SANOFI-SYNTHÉLABO, ET AL.**CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 7 OF THE CLAYTON ACT AND SEC. 5 OF THE FEDERAL TRADE  
COMMISSION ACT*Docket C-4112; File No. 0410031  
Complaint, July 28, 2004--Decision, September 20, 2004*

This consent order, among other things, requires Respondents Sanofi-Synthélabo and Aventis to divest all manufacturing facilities and other assets used to produce Arixtra® -- a factor Xa inhibitor; that is, an anticoagulant product used in acute settings to treat and prevent venous thromboembolism and other conditions relating to excessive blood clot formation -- to Glaxo SmithKline. The order also requires the respondents to divest to Pfizer all United States intellectual property -- and key clinical trials, currently conducted by Aventis -- related to Camptosar®, a cytotoxic drug used to treat colorectal cancer. In addition, the order requires the respondents to divest their royalty and other contractual rights to Estorra® -- a prescription drug for the treatment of insomnia marketed by Sepracor -- to Sepracor or another Commission-approved acquirer. An accompanying Order to Maintain Assets is requires the respondents to preserve, among other things, the viability, marketability, and competitiveness of the assets to be divested pending their divestiture.

*Participants*

For the Commission: *Joanne C. Lewers, Paul R. Frontczak, David A. Von Nirschl, Anne R. Schenof, Michele Cerullo, Daniel P. Ducore, Michael R. Moiseyev, Morris E. Morkre, Aileen Thompson and Mark Frankena.*

For the Respondents: *Cathy Hoffman and Michael Sohn, Arnold & Porter, and Michael Miller, Sullivan & Cromwell.*

**COMPLAINT**

Pursuant to the Clayton Act and the Federal Trade Commission Act, and its authority thereunder, the Federal Trade Commission (“Commission”), having reason to believe that Respondent Sanofi-Synthélabo (“Sanofi”), a corporation subject to the jurisdiction of the Commission, has offered to acquire the

Complaint

common shares of Aventis (“Aventis”), a corporation subject to the jurisdiction of the Commission, in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act (“FTC Act”), as amended, 15 U.S.C. § 45, and it appearing to the Commission that a proceeding in respect thereof would be in the public interest, hereby issues its Complaint, stating its charges as follows:

**I. DEFINITIONS**

1. “Arixtra” means all products that contain the active pharmaceutical ingredient Fondaparinux and any dose form, presentation or line extension thereof. “Arixtra” includes, without limitation, any combination of Fondaparinux with any other product.
2. “Camptosar” means all product(s) that contain the active pharmaceutical ingredient Irinotecan and any dose form, presentation or line extension thereof. “Camptosar” includes, without limitation, any combination of Irinotecan with any other product.
3. “Colorectal Cancer” means cancer of the colon or rectum.
4. “Commission” means the Federal Trade Commission.
5. “Cytotoxic Drugs” means drugs that work by targeting and damaging cells that grow at a rapid rate.
6. “Eloxatin” means all products that contain the active pharmaceutical ingredient oxalplatin and/or that are marketed or sold under the Product Trademark Eloxatin or Eloxatine. “Eloxatin” includes all such products whether marketed within or outside the United States.
7. “Estorra” means any product that contains (+) zopiclone as an active pharmaceutical ingredient. “Estorra” includes any

## Complaint

product that contains (+) zopiclone and one or more other active ingredients.

8. “Factor Xa Inhibitors” are anticoagulants used to treat and prevent venous thromboembolism and related conditions, including deep vein thrombosis and pulmonary embolism.
9. “FDA” means the United States Food and Drug Administration.
10. “GlaxoSmithKline” means GlaxoSmithKline plc, a corporation organized, existing and doing business under and by virtue of the laws of the United Kingdom, with its offices and principal place of business located at 980 Great West Road, Brentford, Middlesex XO TW8 9GS, United Kingdom.
11. “Insomnia” means the perception or complaint of inadequate sleep.
12. “Pfizer” means Pfizer Inc., a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 235 East 42<sup>nd</sup> Street, New York, New York 10017.
13. “Respondents” means Sanofi and Aventis individually and collectively.
14. “Sepracor” means Sepracor Inc., a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 84 Waterford Drive, Marlborough, Massachusetts 01752.
15. “Yakult” means Yakult Honsha Co. Limited, a corporation organized, existing and doing business under and by virtue of the laws of Japan, having its principal place of business

Complaint

at No. 1-19, Higashi-Shinbashi 1-chome, Minato-ku,  
Tokyo, Japan.

## II. RESPONDENTS

16. Respondent Sanofi is a corporation organized, existing and doing business under and by virtue of the laws of the French Republic, with its office and principal place of business located at 174, avenue de France, 75013 Paris, France. Sanofi's principal subsidiary in the United States is located at 90 Park Avenue, New York, New York 10016. Sanofi, among other things, is engaged in the research, development, manufacture and sale of human pharmaceutical products.
17. Respondent Aventis is a corporation organized, existing and doing business under and by virtue of the laws of the French Republic, with its office and principal place of business located at 16, avenue de l'Europe, 67300 Schiltigheim, France. Aventis' principal subsidiary in the United States is Aventis Pharmaceuticals Inc., located at 300 Somerset Corporate Boulevard, Bridgewater, New Jersey 08807-2854. Aventis, among other things, is engaged in the research, development, manufacture and sale of human pharmaceutical products.
18. Respondents are, and at all times relevant herein have been, engaged in commerce, as "commerce" is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12, and are corporations whose business is in or affects commerce, as "commerce" is defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

## III. THE PROPOSED ACQUISITION

19. On January 26, 2004, Sanofi made an unsolicited tender offer of stock and cash for the voting securities of Aventis.

## Complaint

On April 25, 2004, Aventis accepted an improved offer from Sanofi (“Acquisition”). The Acquisition is valued at approximately \$64 billion.

**IV. THE RELEVANT MARKETS**

20. For the purposes of this Complaint, the relevant lines of commerce in which to analyze the effects of the Acquisition are:
- a. the research, development, manufacture and sale of factor Xa inhibitors;
  - b. the research, development, manufacture and sale of cytotoxic drugs for the treatment of colorectal cancer; and
  - c. the research, development, manufacture and sale of prescription drugs for the treatment of insomnia.
21. For the purposes of this Complaint, the United States is the relevant geographic area in which to analyze the effects of the Acquisition in the relevant lines of commerce.

**V. THE STRUCTURE OF THE MARKETS**

22. Aventis dominates the market for the research, development, manufacture and sale of factor Xa inhibitors with its Lovenox product that has a 92 percent share. Sanofi recently entered the market with its product Arixtra. Sanofi and Aventis are two of only three companies that are well-positioned to compete successfully in the market for factor Xa inhibitors for the next two years.
23. Sanofi and Pfizer dominate the market for the research, development, manufacture and sale of cytotoxic drugs for the treatment of colorectal cancer. Sanofi sells Eloxatin and Pfizer sells the main competitor to Eloxatin,

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Camptosar, under a licensing agreement from Yakult. Pfizer relies on Aventis for the results of key clinical trials conducted by Aventis, the data from which Pfizer relies on in applying for FDA approval. Pfizer also relies on intellectual property rights from Aventis and a data transfer agreement with Aventis. Through the existing relationship between Aventis and Pfizer, the Acquisition would give Respondent Sanofi access to competitively sensitive information concerning Camptosar pricing, forecasts and marketing strategy. Furthermore, post-acquisition, Sanofi would control its main competitor's key clinical trials and important intellectual property.

24. Sanofi dominates the market for the research, development, manufacture and sale of prescription drugs for the treatment of insomnia with its Ambien product that has an 87 percent share. Sepracor plans to enter this market within the next nine months with its product Estorra, which is licensed to Sepracor from Aventis. Under the licence agreement, Aventis is entitled to royalty payments based on Estorra sales. After the acquisition, Sanofi would control the leading product in this market and have a financial stake in what is likely to be its main competitor.

## VI. ENTRY CONDITIONS

25. Entry into any of the relevant lines of commerce described in Paragraphs 20(a) through 20(c) would not be timely, likely or sufficient in its magnitude, character and scope to deter or counteract the anticompetitive effects of the Acquisition. Developing and obtaining FDA approval takes at least two years for even the simplest product and significantly longer for more complex products.

Additionally, patents and other intellectual property create significant barriers to entry into these markets.



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**VII. EFFECTS OF THE ACQUISITION**

26. The effects of the Acquisition, if consummated, may be to substantially lessen competition and to tend to create a monopoly in the relevant markets in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the FTC Act, as amended, 15 U.S.C. § 45, in the following ways, among others:
- a. by eliminating actual, direct, and substantial competition between Sanofi and Aventis, and lessening competition, in the market for the research, development, manufacture and sale of factor Xa inhibitors, thereby increasing the ability of the merged entity to unilaterally raise prices of factor Xa inhibitors;
  - b. by affording Respondent Sanofi access to competitively sensitive information concerning Camptosar pricing, forecasts and marketing strategy, and control over its main competitor's key clinical trials and important intellectual property, thus diluting competition between Sanofi and Pfizer in the market for the research, development, manufacture and sale of cytotoxic drugs for the treatment of colorectal cancer, thereby (a) increasing the likelihood of unilateral anticompetitive effects and coordinated interaction, and (b) increasing the likelihood that customers would be forced to pay higher prices for cytotoxic drugs for the treatment of colorectal cancer; and
  - c. by giving Respondent Sanofi a financial stake in its imminent main competitor, Sepracor, thus diluting competition in the market for the research, development, manufacture and sale of prescription drugs for the treatment of insomnia and increasing the likelihood that purchasers would be forced to pay higher prices for prescription drugs for the treatment of insomnia.

Complaint

**VIII. VIOLATIONS CHARGED**

27. The tender offer and the Acquisition Agreement described in Paragraph 19 constitute violations of Section 5 of the FTC Act, as amended, 15 U.S.C. § 45.
28. The Acquisition described in Paragraph 19, if consummated, would constitute a violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the FTC Act, as amended, 15 U.S.C. § 45.

WHEREFORE, THE PREMISES CONSIDERED, the Federal Trade Commission on this twenty-eighth day of July, 2004, issues its Complaint against said Respondents.

Decision and Order

**DECISION AND ORDER**

The Federal Trade Commission (“Commission”) having initiated an investigation of the proposed acquisition by Respondent Sanofi-Synthélabo (“Sanofi”) of Respondent Aventis (“Aventis”), hereinafter referred to as “Respondents,” and Respondents having been furnished thereafter with a copy of a draft of a Complaint that the Bureau of Competition proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge Respondents with violations of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45; and

Respondents, their attorneys, and counsel for the Commission having thereafter executed an Agreement Containing Consent Orders (“Consent Agreement”), containing an admission by Respondents of all the jurisdictional facts set forth in the aforesaid draft of a Complaint, a statement that the signing of said Consent Agreement is for settlement purposes only and does not constitute an admission by Respondents that the law has been violated as alleged in such Complaint, or that the facts as alleged in such Complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission’s Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that Respondents have violated the said Acts, and that a Complaint should issue stating its charges in that respect, and having thereupon issued its Complaint and an Order to Maintain Assets, and having accepted the executed Consent Agreement and placed such Consent Agreement on the public record for a period of thirty (30) Days for the receipt and consideration of public comments, now in further conformity with the procedure described in Commission Rule 2.34, 16 C.F.R. § 2.34, the Commission hereby makes the following jurisdictional findings and issues the following Decision and Order (“Order”):

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1. Respondent Sanofi is a French *société anonyme* organized, existing and doing business under and by virtue of the laws of the French Republic, with its registered office located at 174, avenue de France, 75013 Paris, France.

2. Respondent Aventis is a French *société anonyme* organized, existing and doing business under and by virtue of the laws of the French Republic, with its registered office located at 16, avenue de l'Europe, 67300 Schiltigheim, France.

3. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the Respondents, and the proceeding is in the public interest.

**ORDER**

**I.**

**IT IS ORDERED** that, as used in this Order, the following definitions shall apply:

- A. "Sanofi" means Sanofi-Synthélabo, a French *société anonyme*, its directors, officers, employees, agents, representatives, predecessors, successors, and assigns; its joint ventures, subsidiaries, divisions, groups, and affiliates in each case controlled by Sanofi-Synthélabo and the respective directors, officers, employees, agents, representatives, successors, and assigns of each. After the Acquisition, Sanofi shall include Aventis.
- B. "Aventis" means Aventis, a French *société anonyme*, its directors, officers, employees, agents, representatives, predecessors, successors, and assigns; its joint ventures, subsidiaries, divisions, groups, and affiliates in each case controlled by Aventis, and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

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- C. “Respondents” means Sanofi and Aventis, individually and collectively.
- D. “Acquisition” means the point in the transaction at which the shareholders of Respondent Aventis shall have sold to Respondent Sanofi more than 50 percent of the shares and voting rights of Respondent Aventis in furtherance of the tender offer launched by Respondent Sanofi with respect to Respondent Aventis on the terms set forth in the “*Note d’Information*” that received approval of the French *Autorité des Marchés Financiers*, under the Visa 04-384 dated May 7, 2004, as the same may be amended.
- E. “Commission” means the Federal Trade Commission.
- F. “GlaxoSmithKline” means GlaxoSmithKline plc, a corporation organized, existing, and doing business under and by virtue of the laws of the United Kingdom, with its offices and principal place of business located at 980 Great West Road, Brentford, Middlesex XO TW8 9GS, United Kingdom.
- G. “Pfizer” means Pfizer Inc., a corporation organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its offices and principal place of business located at 235 East 42<sup>nd</sup> Street, New York, New York 10017.
- H. “Sepracor” means Sepracor Inc., a corporation organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its offices and principal place of business located at 111 Locke Drive, Marlborough, Massachusetts 01752.
- I. “Yakult” means Yakult Honsha Co. Limited, a corporation organized, existing, and doing business under and by virtue of the laws of Japan, having its principal place of business at No. 1-19, Higashi-Shinbashi 1-chome, Minato-ku,

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Tokyo, Japan.

- J. “Agency(ies)” means any governmental regulatory authority or authorities in the world responsible for granting approval(s), clearance(s), qualification(s), license(s), or permit(s) for any aspect of the research, Development, manufacture, marketing, distribution, or sale of a Product. The term “Agency” includes, but is not limited to, the United States Food and Drug Administration (“FDA”).
- K. “Application,” “New Drug Application” (“NDA”), “Abbreviated New Drug Application” (“ANDA”), “Supplemental New Drug Application” (“SNDA”), or “Marketing Authorization Application” (“MAA”) means the applications for a Product filed or to be filed with the FDA pursuant to 21 C.F.R. Part 314, or its foreign Agency equivalent, and all supplements, amendments, and revisions thereto, any preparatory work, drafts and data necessary for the preparation thereof, and all correspondence between Respondent(s) and the FDA or other Agency relative thereto.
- L. “Arixtra” means all Products that contain the active pharmaceutical ingredient Fondaparinux and any dose form, presentation, or line extension thereof. “Arixtra” includes, without limitation, any combination of Fondaparinux with any other Product.
- M. “Arixtra Assets” means all of Respondent Sanofi’s rights, title, and interest in and to all assets related to Respondent Sanofi’s worldwide business related to Arixtra, to the extent legally transferable, including the research,

Development, manufacture, distribution, marketing, or sale of Arixtra, including, without limitation, the following:

1. all Product Intellectual Property;

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2. perpetual, fully paid-up and royalty-free worldwide license(s) with rights to sublicense to all Product Licensed Intellectual Property to use, make, distribute, offer for sale, promote, advertise, sell, import, export, or have used, made, distributed, offered for sale, promoted, advertised, sold, imported, or exported Arixtra anywhere in the world; *provided, however*, that such license(s) shall be on an exclusive basis (even as to Respondents) in accordance with the Remedial Agreement(s);
3. all Product and all Product Registrations;
4. all Product Trade Dress;
5. a list of all targeted customers for the Product and the planned or proposed pricing of the Product for such customers;
6. at the Commission-approved Acquirer's option, each of the Product Assumed Contracts;
7. all Product Marketing Materials;
8. all Website(s) related to the Product;
9. a list of all of the NDC Numbers related to the Product;
10. all rights to the Drug Master Files including, but not limited to, the pharmacology and toxicology data contained in all NDAs, ANDAs, SNDAs, and MAAs;
11. all rights (if such rights exist) to information similar to the Drug Master Files submitted to any Agency other than the FDA;
12. Product Scientific and Regulatory Material;
13. all unfilled customer orders for finished goods as of the

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Closing Date (a list of such orders is to be provided to the Commission-approved Acquirer within two (2) Days after the Closing Date);

14. Product Manufacturing Technology, and Product manufacturing and manufacturing processes;
15. at the Commission-approved Acquirer's option, all inventories in existence as of the Closing Date, including, but not limited to, syringes, crude drug substance, finished drug substance (Fondaparinux), building blocks (including D<sub>11</sub> and EF<sub>9</sub>) and building block intermediates, and Product specific packaging and labels;
16. at the Commission-approved Acquirer's option, the Arixtra Manufacturing Facility (including, but not limited to, the real estate assets related to the Arixtra Manufacturing Facility);
17. at the Commission-approved Acquirer's option, all manufacturing and other equipment located at the Arixtra Manufacturing Facility that was used in, or suitable for use in, the research, Development, or manufacture of Arixtra; and
18. all Respondent Sanofi's books, records, and files related to the foregoing, including, but not limited to, the following specified documents: the Product Registrations; Drug Master Files, including, but not limited to, the pharmacology and toxicology data contained in all NDAs, ANDAs, SNDAs, and MAAs; all data submitted to and all correspondence with the FDA and other Agencies; all validation documents and data; all market studies; all sales histories, including, without limitation, clinical data, and sales force call activity, for Arixtra from January 1, 2001, through the Closing Date, and quality control histories pertaining to Arixtra owned by, or in the possession or control of, Respondent Sanofi,



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or to which Respondent Sanofi has a right of access, in each case such as is in existence as of the Closing Date;

*provided, however,* that, in cases in which documents or other materials included in the Arixtra Assets contain information: (1) that relates both to Arixtra and to other Products or businesses of Respondent Sanofi and cannot be segregated in a manner that preserves the usefulness of the information as it relates to Arixtra; or (2) for which Respondent Sanofi has a legal obligation to retain the original copies, Respondent Sanofi shall be required to provide only copies or relevant excerpts of the documents and materials containing this information. In instances where such copies are provided to the Commission-approved Acquirer, Respondent Sanofi shall provide the Commission-approved Acquirer access to original documents under circumstances where copies of documents are insufficient for evidentiary or regulatory purposes. The purpose of this proviso is to ensure that Respondent Sanofi provides the Commission-approved Acquirer with the above-described information without requiring Respondent Sanofi completely to divest itself of information that, in content, also relates to Products and businesses other than Arixtra;

*provided, however,* that the term “Arixtra Assets” does not include any rights, titles, or interests in or to owned or leased real property or buildings other than, at the Commission-approved Acquirer’s option, the Arixtra Manufacturing Facility.

- N. “Arixtra Asset Purchase Agreement” means the “Master Asset Purchase Agreement between Sanofi-Synthélabo, Glaxo Group Limited, Glaxo Wellcome Production S.A.S. and GlaxoSmithKline plc” dated April 13, 2004, and all amendments, exhibits, attachments, agreements, and schedules thereto, related to the Arixtra Assets to be divested, that have been approved by the Commission to

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accomplish the requirements of this Order. The Arixtra Asset Purchase Agreement is attached to this Order as non-public Appendix II.

- O. “Arixtra Core Employee(s)” means the following employees related to Arixtra: (1) Product Manufacturing Employees; (2) Product Marketing Employees; and (3) Product Research and Development Employees, collectively; *provided, however*, that if the Arixtra Asset Purchase Agreement is the Remedial Agreement for the Arixtra Assets, then, for purposes other than the Moratorium/Waiting Period, as defined at Paragraph II.H of this Order, and those involving the treatment and use of Confidential Business Information, the Arixtra Core Employees shall be limited to those Arixtra employees identified by job title as “other relevant employees” under the Arixtra Asset Purchase Agreement.
- P. “Arixtra Manufacturing Facility” means Respondent Sanofi’s manufacturing and packaging facility located at Notre Dame de Bondeville, Seine-Maritime, France used by Respondent Sanofi in the manufacture of Arixtra and other Products.
- Q. “Arixtra Ongoing Clinical Development Employees” means those employees of Respondent Sanofi who are engaged in any ongoing clinical trials related to Arixtra.
- R. “Arixtra Releasees” means the Commission-approved Acquirer for Arixtra or any entity controlled by or under common control with such Commission-approved Acquirer, or any licensees, sublicensees, manufacturers, suppliers, distributors, and customers of such Commission-approved Acquirer, or of such Commission-approved Acquirer-affiliated entities.
- S. “Camptosar” means all Product(s) that contain the active pharmaceutical ingredient Irinotecan and any dose form,

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presentation, or line extension thereof. “Camptosar” includes, without limitation, any combination of Irinotecan with any other Product.

- T. “Camptosar Asset Purchase Agreement” means the “Asset Purchase Agreement by and between Sanofi-Synthélabo and Pfizer Inc.” dated June 25, 2004, and the letter agreement between Aventis and Pfizer dated July 1, 2004, and all amendments, exhibits, attachments, agreements, and schedules thereto, related to the Camptosar Assets to be divested, that have been approved by the Commission to accomplish the requirements of this Order. The Camptosar Asset Purchase Agreement is attached to this Order as non-public Appendix III.
- U. “Camptosar Assets” means all rights, title, and interest in and to (*except as is otherwise provided below*) all United States Patents and all assets related to the Development of Camptosar for the United States market that are owned or controlled by, or licensed to Respondent Aventis on or before the Effective Date, to the extent legally transferable, including, without limitation, the following:
1. all United States Patents related to Camptosar; *provided, however,* that, with respect to those United States Patents that relate to Camptosar and to other Products, Respondent Aventis shall grant to Pfizer an irrevocable, fully-paid-up, royalty-free license under such United States Patents;
  2. all rights to all Camptosar Key Clinical Trials; *provided, however,* Respondents may retain a Right of Reference or Use to information similar to the Drug Master Files submitted to any Agency (other than the FDA, including, but not limited to, the European Agency for the Evaluation of Medicinal Products) solely for the purposes of satisfying certain requirements contained in decisions of the Commission of the European Communities in Case COMP/M.3354, including the divestiture of such Right of

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Reference or Use to any acquirer approved by the Commission of the European Communities pursuant to such decisions;

3. at Pfizer's option, all contracts or agreements related to the Camptosar Key Clinical Trials;
4. Right of Reference or Use in the United States (if such rights exist) to information similar to the Drug Master Files submitted to any Agency other than the FDA, including, but not limited to, such information submitted to the European Agency for the Evaluation of Medicinal Products;
5. all Product Scientific and Regulatory Material related to the Camptosar Key Clinical Trials or to the United States Patents related to Camptosar; and
6. all Respondent Aventis' books, records and files related to the foregoing, owned by, or in the possession or control of, Respondent Aventis, or to which Respondent Aventis has a right of access, in each case such as is in existence as of the Closing Date;

*provided, however,* that in cases in which documents or other materials included in the Camptosar Assets contain information: (1) that relates both to Camptosar and to other Products or businesses of Respondent Aventis and cannot be segregated in a manner that preserves the usefulness of the information as it relates to Camptosar; or (2) for which Respondent Aventis has a legal obligation to retain the original copies, Respondent Aventis shall be required to provide only copies or relevant excerpts of the documents and materials containing this information. In instances where such copies are provided to Pfizer, Respondent Aventis shall provide Pfizer access to original documents under circumstances where copies of documents are insufficient for evidentiary or regulatory purposes. The purpose of this proviso is to ensure that Respondent Aventis provides Pfizer with the above-

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described information without requiring Respondent Aventis completely to divest itself of information that, in content, also relates to Products and businesses other than Camptosar.

- V. “Camptosar Core Employees” means the individuals identified as “Key Irinotecan Employees” in Schedule 7.10(e) (iii) to the Camptosar Asset Purchase Agreement contained in Appendix III of this Order.
  
- W. “Camptosar Key Clinical Trials” means the following clinical trials related to the Development of Camptosar (or Campto, under which tradename Camptosar is marketed in Europe), individually and collectively: (1) Aventis V307 (adjuvant therapy of early colon cancer); (2) Aventis ACCORD2 (adjuvant therapy of high-risk early colon cancer); (3) Aventis/EORTC Study 40986 (metastatic colon rectal cancer); (4) Aventis Study V306 (Phase II and Phase III, metastatic gastric cancer); and (5) Aventis oral irinotecan clinical studies. These trials are identified in the Camptosar Asset Purchase Agreement.
  
- X. “Closing Date” means the date on which Respondent(s) (or a Divestiture Trustee) and a Commission-approved Acquirer consummate a transaction to assign, grant, license, divest, transfer, deliver or otherwise convey the relevant assets pursuant to this Order.
  
- Y. “Commission-approved Acquirer” means the following:
  - (1) an entity that is specifically identified in this Order to acquire particular assets that the Respondents are required to assign, grant, license, divest, transfer, deliver, or otherwise convey pursuant to this Order and that has been approved by the Commission to accomplish the requirements of this Order in connection with the Commission’s determination to make this Order final; or
  - (2) an entity approved by the Commission to acquire particular assets that the Respondents are required to assign, grant, license, divest, transfer, deliver, or otherwise

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convey pursuant to this Order.

- Z. “Confidential Business Information” means all information owned by, or in the possession or control of, Respondents that is not in the public domain related to the research, Development, manufacture, marketing, commercialization, distribution, importation, exportation, cost, pricing, supply, sales, sales support, or use of a Product.
- AA. “Contract Manufacture” means the manufacture of a Product to be supplied by a Respondent or a Designee specifically identified in this Order for sale to the Commission-approved Acquirer.
- BB. “Day(s)” means the period of time prescribed under this Order as computed pursuant to 16 C.F.R. § 4.3 (a).
- CC. “Designee” means any entity other than the Respondents that will manufacture a Product for a Commission-approved Acquirer.
- DD. “Development” means all preclinical and clinical drug development activities (including formulation), including test method development and stability testing, toxicology, formulation, process development, manufacturing scale-up, development-stage manufacturing, quality assurance/quality control development, statistical analysis and report writing, conducting clinical trials for the purpose of obtaining any and all approvals, licenses, registrations or authorizations from any Agency necessary for the manufacture, use, storage, import, export, transport, promotion, marketing, and sale of a Product (including any governmental price or reimbursement approvals), Product approval and registration, and regulatory affairs related to the foregoing. “Develop” means to engage in Development.
- EE. “Direct Cost” means the cost of direct labor and direct

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material used to provide the relevant assistance or service.

- FF. “Divestiture Trustee” means a trustee appointed by the Commission pursuant to the relevant provisions of this Order.
- GG. “Domain Name” means the domain name(s) (universal resource locators), and registration(s) thereof, issued by any entity or authority that issues and maintains the domain name registration. “Domain Name” shall not include any trademark or service mark rights to such domain names other than the rights to the Product Trademarks required to be divested.
- HH. “Drug Master Files” means the information submitted to the FDA as described in 21 C.F.R. § 314.420 related to a Product.
- II. “Effective Date” means the date on which the Acquisition occurs.
- JJ. “Eloxatin” means all Products that contain the active pharmaceutical ingredient oxalplatin and/or that are marketed or sold under the Product Trademark Eloxatin<sup>®</sup> or Eloxatine.<sup>®</sup> “Eloxatin” includes all such Products whether marketed within or outside the United States.
- KK. “Employee Notification” means the “Notice of Antitrust Remedy and Requirement for Confidentiality” attached to this Order as public Appendix I, and to the Order to Maintain Assets as public Appendix A.
- LL. “Estorra” means any Product that contains (+) zopiclone as an active pharmaceutical ingredient. “Estorra” includes any Product that contains (+) zopiclone and one or more other active ingredients.
- MM. “Estorra License Agreement” means the “License and

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Assignment Agreement” by and between Sepracor Inc. and Rhône-Poulenc Rorer SA, dated September 30, 1999, and all amendments, exhibits, attachments, agreements, and schedules thereto. The Estorra License Agreement includes the “Amendment and Patent Assignment Agreement” by and between Sepracor Inc. and Aventis Pharma SA (successor in interest to Rhône-Poulenc Rorer SA) to the original Estorra License and Assignment Agreement dated July 2, 2004. The Estorra License Agreement is attached to this Order as non-public Appendix IV.

- NN. “Estorra Releasees” means Sepracor or any entity controlled by or under common control with Sepracor, or any licensees, sublicensees, manufacturers, suppliers, distributors, and customers of Sepracor, or of Sepracor-affiliated entities.
- OO. “Estorra Royalties” means any financial payment or other consideration from Sepracor related to the Estorra License Agreement that is either of the following:
1. based on the actual amount of sales or profits of Estorra realized at any time after the Effective Date; or
  2. a payment that is due upon the realization of any aggregate amount of sales or profits on Estorra.
- PP. “Fondaparinux” means fondaparinux sodium including all pharmaceutically active derivatives thereof, including, without limitation, esters, salts (including, without limitation, decakis salts), hydrates, solvates, polymorphs, prodrugs, metabolites, and isomers thereof, and all hydrates, solvates, polymorphs, prodrugs, and isomers of such salts.
- QQ. “Governmental Entity” means any Federal, state, local or non-U.S. government, or any court, legislature,



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- governmental agency, or governmental commission, or any judicial or regulatory authority of any government.
- RR. “Interim Monitor” means any monitor appointed pursuant to Paragraph V of this Order or Paragraph III of the related Order to Maintain Assets.
- SS. “Investigational New Drug Application” (“IND”) means the application filed with the FDA pursuant to 21 C.F.R. § 312.1, et seq. (as defined in 21 C.F.R. § 312.3), or its foreign Agency equivalent, and all supplements, amendments, and revisions thereto, any preparatory work, drafts, and data necessary for the preparation thereof, and all correspondence between Respondent(s) and the FDA or other Agency relative thereto.
- TT. “Irinotecan” means irinotecan hydrochloride including all pharmaceutically active derivatives thereof, including, without limitation, esters, salts, hydrates, solvates, polymorphs, and isomers thereof and all hydrates, solvates, polymorphs, and isomers of such salts.
- UU. “Law” means all laws, statutes, rules, regulations, ordinances, and other pronouncements by any Governmental Entity having the effect of law.
- VV. “Lovenox” means all Product(s) that contain the active pharmaceutical ingredient enoxaparin and/or that are marketed or sold under the Product Trademark Lovenox.<sup>®</sup>
- WW. “NDC Numbers” means the National Drug Code numbers(s) assigned by the FDA to a Product.
- XX. “Patents” means all patents, patent applications, and statutory invention registrations, in each case existing as of the Effective Date (*except* where this Order specifies a different time), and includes all reissues, divisions,

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continuations, continuations-in-part, supplementary protection certificates, extensions and reexaminations thereof, all inventions disclosed therein, all rights therein provided by international treaties and conventions, and all rights to obtain and file for patents and registrations thereto in the world, related to any Product of or owned by Respondent(s) as of the Closing Date.

- YY. “Product” means any pharmaceutical, biological, or genetic composition containing any formulation or dosage of a compound referenced as its pharmaceutically, biologically, or genetically active ingredient.
- ZZ. “Product Assumed Contracts” means all of the following contracts or agreements:
1. pursuant to which any Third Party purchases the Product(s) from the Respondent(s);
  2. pursuant to which the Respondent(s) purchases any materials from any Third Party for use in connection with the manufacture of the Product(s);
  3. relating to any clinical trial involving the Product(s);
  4. constituting the material transfer agreements involving the transfer of the Product(s);
  5. relating to the marketing of the Product(s) or educational matters relating to the Product(s);
  6. relating to the manufacture of the Product(s);
  7. constituting confidentiality agreements involving the Product(s);
  8. involving any royalty, licensing, or similar arrangement

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involving the Product(s);

9. pursuant to which any services are provided with respect to the Product(s) or the Product(s) business, including consultation arrangements; and/or
10. pursuant to which any Third Party collaborates with the Respondent(s) in the performance of research or Development of the Product(s) or the Product(s) business;

*provided, however,* that where any such contract or agreement also relates to Product(s) of the Respondent(s) other than the Product(s) required to be divested pursuant to this Order, Respondent(s) shall assign the Commission-approved Acquirer all such rights under the contract or agreement as are related to the Product(s) required to be divested pursuant to this Order, but concurrently may retain similar rights for the purposes of the other Product(s).

AAA. “Product Copyrights” means rights to all original works of authorship of any kind related to the Product(s) and any registrations and applications for registrations thereof, including, but not limited to, the following: all promotional materials for healthcare providers; all promotional materials for patients; educational materials for the sales force; copyrights in all pre-clinical, clinical and process development data and reports relating to the research and Development of the Product(s) or of any materials used in the research, Development, manufacture, marketing or sale of the Product(s), including all raw data relating to clinical trials of the Product(s), all case report forms relating thereto and all statistical programs developed (or modified in a manner material to the use or function thereof (other than through user references)) to analyze clinical data, all market research data, market intelligence reports and statistical programs (if any) used for marketing and

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sales research; customer information, promotional and marketing materials, the Product(s) sales forecasting models, medical education materials, sales training materials, Website content and advertising and display materials; all records relating to employees who accept employment with the Commission-approved Acquirer (excluding any personnel records the transfer of which is prohibited by applicable Law); all records, including customer lists, sales force call activity reports, vendor lists, sales data, reimbursement data, speaker lists, manufacturing records, manufacturing processes, and supplier lists; all data contained in laboratory notebooks relating to the Product(s) or relating to its biology; all adverse experience reports and files related thereto (including source documentation) and all periodic adverse experience reports and all data contained in electronic data bases relating to adverse experience reports and periodic adverse experience reports; all analytical and quality control data; and all correspondence with the FDA.

- BBB. “Product Employee Information” means the following, as and to the extent permitted by the Law of the country in which the employee is employed:
1. a complete and accurate list containing the name of each relevant employee (including former employees who were employed by Respondent(s) within ninety (90) Days of the execution date of any Remedial Agreement). This list shall be organized by the relevant respective employee categories defined in this Order (*i.e.*, Product Manufacturing Employees, Product Marketing Employees, Product Research and Development Employees, or Product Sales Employees, as applicable);
  2. with respect to each such employee, the following information:

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- a. the date of hire and effective service date;
  - b. job title or position held;
  - c. a specific description of the employee's responsibilities related to the relevant Product; *provided, however*, in lieu of this description, Respondent(s) may provide the employee's most recent performance appraisal;
  - d. the base salary or current wages;
  - e. the most recent bonus paid, aggregate annual compensation for the Respondent's last fiscal year and current target or guaranteed bonus, if any;
  - f. employment status (*i.e.*, active or on leave or disability; full-time or part-time); and
  - g. any other material terms and conditions of employment in regard to such employee that are not otherwise generally available to similarly situated employees; and
3. at the Commission-approved Acquirer's option or the Proposed Acquirer's option (as applicable), copies of all employee benefit plans and summary plan descriptions (if any) applicable to the relevant employees.

CCC. "Product Intellectual Property" means all of the following related to the Product(s):

1. Patents;
2. Product Copyrights;
3. Product Software, other than Product Licensed Intellectual Property;
4. Product Trademarks;

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5. trade secrets, know-how, techniques, data, inventions, practices, methods and other confidential or proprietary technical, business, research, Development and other information, and all rights in any jurisdiction to limit the use or disclosure thereof, other than Product Licensed Intellectual Property;
6. rights to obtain and file for Patents and registrations thereof; and
7. rights to sue and recover damages or obtain injunctive relief for infringement, dilution, misappropriation, violation, or breach of any of the foregoing;

*provided, however*, that “Product Intellectual Property” does not include the names “Sanofi,” “Sanofi-Synthelabo,” “Synthelabo,” “Aventis,” or the names of any other corporations or companies owned by Respondent Sanofi or Respondent Aventis or related logos to the extent used on other of Respondents’ Products;

*provided further* that “Product Intellectual Property” does not include the name “Organon<sup>®</sup>” to the extent that Respondent Sanofi is licensed to use that name.

DDD. “Product Licensed Intellectual Property” means the following:

1. Patents that are related to a Product that is the subject of a divestiture under this Order and that Respondent(s) can demonstrate have been routinely used, prior to the Effective Date, by either Respondent Aventis or Respondent Sanofi (as applicable) for Product(s) other than the Product that is the subject of the relevant divestiture;
2. Product Software that is used in connection with the analysis of clinical trial data for a Product that is the subject of a divestiture under this Order that Respondent(s) can

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demonstrate has been routinely used, prior to the Effective Date, by either Respondent Sanofi or Respondent Aventis (as applicable) for Product(s) other than the Product that is the subject of the relevant divestiture; and

3. trade secrets, know-how, techniques, data, inventions, practices, methods, and other confidential or proprietary technical, business, research, Development, and other information, and all rights in any jurisdiction to limit the use or disclosure thereof, that are related to a Product that is the subject of a divestiture under this Order and that Respondent(s) can demonstrate have been routinely used, prior to the Effective Date, by either Respondent Aventis or Respondent Sanofi (as applicable) for Product(s) other than the Product that is the subject of the relevant divestiture.

EEE. “Product Manufacturing Employees” means all salaried employees of Respondent(s) who directly have participated (irrespective of the portion of working time involved) in the manufacture of the Product(s), including, but not limited to, those involved in the quality assurance and quality control of the Product(s), within the eighteen (18) month period immediately prior to the Closing Date.

FFF. “Product Manufacturing Technology” means all technology, trade secrets, know-how, and proprietary information related to the manufacture, validation, packaging, release testing, stability, and shelf life of the Product(s), including the Product(s)’ formulation, in existence and in the possession of Respondent(s) as of the Closing Date, including, but not limited to, manufacturing records, sampling records, standard operating procedures, and batch records related to the manufacturing process, and supplier lists.

GGG. “Product Marketing Employees” means all management level employees of Respondent(s) who

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directly have participated (irrespective of the portion of working time involved) in the marketing, contracting, or promotion of the Product(s) in the United States within the eighteen (18) month period immediately prior to the Closing Date. These employees include, without limitation, all management level employees having any responsibilities in the areas of sales management, brand management, sales training, market research, managed care contracting, hospital market and other specialty markets, but excluding administrative assistants.

- HHH. “Product Marketing Materials” means all marketing materials used anywhere in the world related to the Product(s) as of the Closing Date, including, without limitation, all advertising materials, training materials, product data, price lists, mailing lists, sales materials (e.g., detailing reports; vendor lists; sales data; reimbursement data), marketing information (e.g., competitor information; research data; market intelligence reports; statistical programs (if any) used for marketing and sales research; customer information, including customer sales information; sales forecasting models; medical educational materials; Website content and advertising and display materials; speaker lists), promotional and marketing materials, artwork for the production of packaging components, television masters and other similar materials related to the Product(s); *provided, however,*

that “Product Marketing Materials” does not include any such material with the Organon<sup>®</sup> trademark or label.

- III. “Product Registrations” means all registrations, permits, licenses, consents, authorizations, and other approvals, and pending applications and requests therefor, required



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by applicable Agencies related to the research, Development, manufacture, distribution, finishing, packaging, marketing, or sale of the Product worldwide, including all INDs, NDAs, ANDAs, SNDAs, MAAs, in existence for the Product as of the Closing Date.

JJJ. “Product Research and Development Employees” means all employees of Respondent(s) who directly have participated (irrespective of the portion of working time involved) in the research, Development, regulatory approval process, or clinical studies of the Product(s) within the eighteen (18) month period immediately prior to the Closing Date.

KKK. “Product Sales Employees” means all employees of Respondent(s) who directly have participated (irrespective of the portion of working time involved) in the detailing, marketing or promotion of the Product(s) in the United States directly to physicians, pharmacists, professional distributors, managed care, or other insurance providers, hospitals, employers, or governmental entities within the twelve (12) month period immediately prior to the Closing Date. This includes employees trained to perform such detailing for the Product within the twelve (12) month period immediately prior to the Closing Date.

LLL. “Product Scientific and Regulatory Material” means all technological, scientific, chemical, biological, pharmacological, toxicological, regulatory, and clinical trial materials and information related to the Product(s), and all rights thereto, in any and all jurisdictions.

MMM. “Product Software” means computer programs, including all software implementations of algorithms, models, and methodologies whether in source code or object code form, databases and compilations, including any and all data and collections of data, all

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documentation, including user manuals and training materials, related to any of the foregoing and the content and information contained on any Website; *provided, however*, that “Product Software” does not include software that is readily purchasable or licensable and which has not been modified in a manner material to the use or function thereof (other than through user preference settings).

- NNN. “Product Trade Dress” means the current trade dress of the Product(s), including, but not limited to, product packaging associated with the sale of the Product(s) worldwide and the lettering of the Product(s)’ trade name or brand name.
- OOO. “Product Trademark(s)” means all proprietary names or designations, trademarks, tradenames, and brand names, including registrations and applications for registration therefor (and all renewals, modifications, and extensions thereof) and all common law rights, and the goodwill symbolized thereby and associated therewith, for the Product(s).
- PPP. “Proposed Acquirer” means an entity proposed by the Respondent(s) (or a Divestiture Trustee) to the Commission and submitted for the approval of the Commission as the acquirer for particular assets required to be assigned, granted, licensed, divested, transferred, delivered or otherwise conveyed by Respondent(s) pursuant to this Order.
- QQQ. “Remedial Agreement” means the following: (1) any agreement between Respondent(s) and a Commission-approved Acquirer that is specifically referenced and attached to this Order, including all amendments, exhibits, attachments, agreements, and schedules thereto, related to the relevant assets to be assigned, granted, licensed, divested, transferred, delivered, or

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otherwise conveyed, and that has been approved by the Commission to accomplish the requirements of the Order in connection with the Commission's determination to make this Order final; and/or (2) any agreement between the Respondent(s) and a Commission-approved Acquirer (or between a Divestiture Trustee and a Commission-approved Acquirer) that has been approved by the Commission to accomplish the requirements of this Order, including all amendments, exhibits, attachments, agreements, and schedules thereto, related to the relevant assets to be assigned, granted, licensed, divested, transferred, delivered, or otherwise conveyed, and that has been approved by the Commission to accomplish the requirements of this Order.

- RRR. "Right of Reference or Use" means the authority to rely upon, and otherwise use, an investigation for the purpose of obtaining approval of an Application, including the ability to make available the underlying raw data from the investigation for FDA (or the European Agency for the Evaluation of Medicinal Products or other comparable Agency) audit.
- SSS. "Royalty Monetization Firm" means any Third Party that acquires the right from the Respondent(s) to receive the payment of royalties, *excluding* any entity that engages in scientific research, Development, manufacture, distribution, marketing, or selling of a Product.
- TTT. "Supply Cost" means the manufacturer's average direct per unit cost of manufacturing the Product plus costs of manufacturing the Product that are directly attributable to regulatory, quality control and compliance requirements imposed by the FDA (or the European Agency for the Evaluation of Medicinal Products or other comparable Agency). "Supply Cost" shall

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expressly exclude any intracompany business transfer profit.

- UUU. “Third Party(ies)” means any private entity other than the following: (1) the Respondents, or (2) the Commission-approved Acquirer for the relevant assets to be divested related to a particular Product(s).
- VVV. “Website” means the content of the Website(s) located at the Domain Names, the Domain Names, and all copyrights in such Website(s), to the extent owned by Respondents; *provided, however*, “Website” shall not include the following: (1) content owned by Third Parties and other Product Intellectual Property not owned by Respondent(s) that are incorporated in such Website(s), such as stock photographs used in the Website(s), *except* to the extent that Respondent(s) can convey its rights, if any, therein; or (2) content unrelated to the Product(s).

**II.**

**IT IS FURTHER ORDERED** that:

- A. Not later than twenty (20) Days after the Effective Date or September 1, 2004, whichever is later, Respondents shall divest the Arixtra Assets, absolutely and in good faith, to GlaxoSmithKline pursuant to and in accordance with the Arixtra Asset Purchase Agreement (which agreement shall not vary or contradict, or be construed to vary or contradict, the terms of this Order, it being understood that nothing in this Order shall be construed to reduce any rights or benefits of GlaxoSmithKline or to reduce any obligations of the Respondents under such agreement), and such agreement, if it becomes the Remedial Agreement related to the Arixtra Assets, is incorporated by reference into this Order and made a part hereof. If Respondents do not divest the Arixtra Assets to

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GlaxoSmithKline within twenty (20) Days after the Effective Date, or September 1, 2004, whichever is later, the Commission may appoint a Divestiture Trustee to divest the Arixtra Assets;

*provided, however,* that if Respondents have divested the Arixtra Assets to GlaxoSmithKline prior to the date this Order becomes final, and if, at the time the Commission determines to make this Order final, the Commission notifies Respondents that GlaxoSmithKline is not an acceptable purchaser of the Arixtra Assets, then Respondents shall immediately rescind the transaction with GlaxoSmithKline and shall divest the Arixtra Assets within six (6) months from the date the Order becomes final, absolutely and in good faith, at no minimum price, to a Commission-approved Acquirer and only in a manner that receives the prior approval of the Commission;

*provided further* that if the Respondents have divested the Arixtra Assets to GlaxoSmithKline prior to the date this Order becomes final, and if, at the time the Commission determines to make this Order final, the Commission notifies the Respondents that the manner in which the divestiture was accomplished is not acceptable, the Commission may direct the Respondents, or appoint a Divestiture Trustee, to effect such modifications to the manner of divestiture of the Arixtra Assets to GlaxoSmithKline (including, but not limited to, entering into additional agreements or arrangements) as the Commission may determine are necessary to satisfy the requirements of this Order.

- B. Any Remedial Agreement related to the Arixtra Assets shall be deemed incorporated into this Order, and any failure by Respondents to comply with any term of such Remedial Agreement related to the Arixtra Assets shall constitute a failure to comply with this Order.
- C. Respondents shall include in any Remedial Agreement related to the Arixtra Assets the following provisions:

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1. Respondents shall Contract Manufacture and deliver to the Commission-approved Acquirer, in a timely manner and under reasonable terms and conditions, a supply of any of the ingredients (including, but not limited to, crude drug substance (Fondaparinux), building blocks (including D<sub>11</sub> and EF<sub>9</sub>) and building block intermediates) necessary to manufacture Arixtra finished drug product, at Respondent Sanofi's Supply Cost, for a period of time sufficient to allow the Commission-approved Acquirer (or the Designee of the Commission-approved Acquirer) to obtain all the relevant Agency approvals necessary to manufacture Arixtra finished drug product independently of Respondents and secure sources of supply of such ingredients from entities other than the Respondents;
  
2. Respondents shall make representations and warranties to the Commission-approved Acquirer that the ingredients supplied through Contract Manufacture pursuant to the Remedial Agreement meet the relevant Agency-approved specifications. For those Product(s) to be marketed or sold in the United States, Respondents shall agree to indemnify, defend and hold the Commission-approved Acquirer harmless from any and all suits, claims, actions, demands, liabilities, expenses or losses alleged to result from the failure of the ingredients supplied to the Commission-approved Acquirer pursuant to the Remedial Agreement by the Respondents to meet current good manufacturing practices of the FDA, as set forth in 21 C.F.R. Parts 210 and 211. This obligation shall be contingent upon the Commission-approved Acquirer's giving Respondents prompt, adequate notice of such claim and cooperating fully in the defense of such claim. The Remedial Agreement shall be consistent with the obligations assumed by Respondents under this Order; *provided, however*, that Respondents may reserve the right to control the defense of any such litigation, including the right to settle the litigation, so long as such settlement is consistent with the Respondents' responsibilities to supply the ingredients in

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the manner required by this Order; *provided further* that this obligation shall not require Respondents to be liable for any negligent act or omission of the Commission-approved Acquirer or for any representations and warranties, express or implied, made by the Commission-approved Acquirer that exceed the representations and warranties made by the Respondents to the Commission-approved Acquirer; *provided further* that if the Arixtra Asset Purchase Agreement is the Remedial Agreement for the Arixtra Assets, then such agreement may contain limits on Respondents' aggregate liability resulting from the failure of the ingredients supplied to the Commission-approved Acquirer pursuant to the Remedial Agreement by the Respondents to meet current good manufacturing practices of the FDA, as set forth in 21 C.F.R. Parts 210 and 211;

3. Respondents shall make representations and warranties to the Commission-approved Acquirer that Respondents shall hold harmless and indemnify the Commission-approved Acquirer for any liabilities or loss of profits resulting from the failure by Respondents to deliver the ingredients in a timely manner as required by the Remedial Agreement unless the Respondents can demonstrate that their failure was entirely beyond the control of the Respondents and in no part the result of negligence or willful misconduct by Respondents; *provided, however*, if the Arixtra Asset Purchase Agreement is the Remedial Agreement for the Arixtra Assets, then such agreement may contain limits on Respondents' aggregate liability for such a breach;
4. during the term of the Contract Manufacture between Respondent(s) and the Commission-approved Acquirer, upon request of the Commission-approved Acquirer or Interim Monitor (if applicable), Respondents shall make available to the Commission-approved Acquirer and the Interim Monitor (if applicable) all records that relate to the manufacture of the ingredients for Arixtra that are generated or created after the Closing Date;

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5. upon reasonable notice and request from the Commission-approved Acquirer to the Respondents, Respondents shall provide in a timely manner at no greater than Direct Cost the following:
  - a. assistance and advice to enable the Commission-approved Acquirer (or the Designee of the Commission-approved Acquirer) to obtain all necessary permits and approvals from any Agency or Governmental Entity to manufacture and sell Arixtra;
  - b. assistance to the Commission-approved Acquirer (or the Designee of the Commission-approved Acquirer) to manufacture Arixtra in substantially the same manner and quality employed or achieved by Respondent Sanofi; and
  - c. consultation with knowledgeable employees of Respondents and training, at the request of the Commission-approved Acquirer and at a facility chosen by the Commission-approved Acquirer, until the Commission-approved Acquirer (or the Designee of the Commission-approved Acquirer) obtains all FDA approvals necessary to manufacture Arixtra independently of the Respondents and sufficient to satisfy management of the Commission-approved Acquirer that its personnel (or the Designee's personnel) are adequately trained in the manufacture of Arixtra;
6. upon reasonable notice and request from the Commission-approved Acquirer to Respondents, Respondents shall provide, in a timely manner, at no greater than Direct Cost, assistance of knowledgeable employees of the Respondents

to assist the Commission-approved Acquirer to defend against, respond to, or otherwise participate in any litigation related to the Product Intellectual Property;



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7. Respondents shall covenant to the Commission-approved Acquirer that Respondents shall not join, file, prosecute or maintain any suit, in law or equity, against the Commission-approved Acquirer under Patents that: (1) are owned or licensed by Respondents as of the Effective Date; or (2) may be assigned, granted, licensed, or otherwise conveyed to Respondents after the Effective Date, if such suit would have the potential to interfere with the Commission-approved Acquirer's freedom to practice in the research, Development, manufacture, use, import, export, distribution or sale of Arixtra; and
8. Respondents shall covenant to the Commission-approved Acquirer that: (1) any Third Party assignee, transferee or licensee of the above-described Patents shall agree to provide a covenant not to sue the Arixtra Releasees, at least as protective as those extended pursuant to the preceding Paragraph II.C.7, as a condition of such assignment, transfer or license; and (2) with respect to any Third Party rights licensed to Respondents as of or after the Effective Date, and as to which Respondents do not control the right of prosecution of any legal action, Respondents shall not actively induce, assist or participate in any legal action or proceeding relating to Arixtra against the Arixtra Releasees, unless required by Law or contract (such contract not to be solicited or entered into for the purpose of circumventing any of the requirements of this Order);

*provided, however,* that if the Arixtra Asset Purchase Agreement is the Remedial Agreement for the Arixtra Assets, then Respondents shall be deemed to have complied with any of the Supply Cost and Direct Cost requirements described in

Paragraphs II.C.1, II.C.5, and II.C.6 by complying with the cost provisions as provided in the Arixtra Asset Purchase Agreement.

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Respondents shall:

9. submit to the Commission-approved Acquirer, at Respondents' expense, all Confidential Business Information related to Arixtra;
10. deliver such Confidential Business Information as follows:  
(1) in good faith; (2) as soon as practicable, avoiding any delays in transmission of the respective information; and  
(3) in a manner that ensures its completeness and accuracy and that fully preserves its usefulness;
11. pending complete delivery of all such Confidential Business Information to the Commission-approved Acquirer, provide the Commission-approved Acquirer and the Interim Monitor (if any has been appointed) with access to all such Confidential Business Information and employees who possess or are able to locate such information for the purposes of identifying the books, records, and files related to Arixtra that contain such Confidential Business Information and facilitating the delivery in a manner consistent with this Order;
12. not use, directly or indirectly, any such Confidential Business Information related to the research, Development, manufacturing, marketing, or sale of Arixtra (other than as necessary to comply with the following: (1) the requirements of this Order; (2) the Respondents' obligations to the Commission-approved Acquirer under the terms of any Remedial Agreement related to the Arixtra Assets; or (3) applicable Law); and
13. not disclose or convey any such Confidential Business Information, directly or indirectly, to any person except the Commission-approved Acquirer;

*provided, however*, this Paragraph II.D shall not apply to any Confidential Business Information related to Arixtra that

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Respondent Aventis can demonstrate it obtained without the assistance of Respondent Sanofi prior to the Effective Date.

D. Respondents shall:

1. for a period of at least six (6) months from the earlier of the following dates: (1) ten (10) Days after notice by staff of the Commission to the Respondents to provide the opportunity to enter into employment contracts; or (2) the Closing Date, provide the Commission-approved Acquirer with the opportunity to enter into employment contracts with the Product Marketing Employees and Product Sales Employees; and for a period of at least twelve (12) months from the earlier of the following dates: (1) ten (10) Days after notice by staff of the Commission to provide the opportunity to enter into employment contracts; or (2) the Closing Date, provide the Commission-approved Acquirer with the opportunity to enter into employment contracts with the Product Manufacturing Employees and Product Research and Development Employees. These periods are hereinafter referred to as the “Arixtra Access Period”;

*provided, however,* that any such employment contracts entered into prior to the Closing Date shall be contingent upon approval by the Commission of the agreements relating to the Arixtra Assets (*i.e.*, those agreements proposed by Respondents (or the Divestiture Trustee) to the Commission) as the Remedial Agreements for the Arixtra Assets; and

2. not later than the earlier of the following dates: (1) ten (10) Days after notice by staff of the Commission to the Respondents to provide the Product Employee Information; or (2) ten (10) Days after the Closing Date, provide the Commission-approved Acquirer or the Proposed Acquirer with the Product Employee Information related to the Arixtra Core Employees. Failure by Respondents to provide the Product Employee Information for any relevant employee within the time provided herein shall extend the

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Arixtra Access Period with respect to that employee in an amount equal to the delay.

E. Respondents shall:

1. during the Arixtra Access Period, not interfere with the hiring or employing by the Commission-approved Acquirer of Arixtra Core Employees, and remove any impediments within the control of Respondents that may deter these employees from accepting employment with the Commission-approved Acquirer, including, but not limited to, any noncompete provisions of employment or other contracts with Respondents that would affect the ability or incentive of those individuals to be employed by the Commission-approved Acquirer. In addition, Respondents shall not make any counteroffer to an Arixtra Core Employee who receives a written offer of employment from the Commission-approved Acquirer;

*provided, however,* that this Paragraph II.F.1 shall not prohibit the Respondents from making offers of employment to or employing any Arixtra Core Employee during the Arixtra Access Period where the Commission-approved Acquirer has notified the Respondents in writing that the Commission-approved Acquirer does not intend to make an offer of employment to that employee;

*provided further* that if the Respondents notify the Commission-approved Acquirer in writing of their desire to make an offer of employment to a particular Arixtra Core Employee and the Commission-approved Acquirer does not make an offer of employment to that employee within twenty

(20) Days of the date the Commission-approved Acquirer receives such notice, the Respondents may make an offer of employment to that employee;

2. until the Closing Date, provide all Arixtra Core Employees

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with reasonable financial incentives to continue in their positions. Such incentives shall include a continuation of all employee benefits offered by Respondents until the Closing Date for the divestiture of the Arixtra Assets has occurred, including regularly scheduled raises, bonuses, and vesting of pension benefits (as permitted by Law). In addition to the foregoing, Respondents shall provide to each Arixtra Core Employee (other than those employees who transfer to the Commission-approved Acquirer by operation of Law) who accepts employment with the Commission-approved Acquirer, an incentive equal to three (3) months of such employee's base annual salary to be paid upon the employee's completion of one (1) year of employment with the Commission-approved Acquirer;

*provided, however*, that nothing in this Order requires or shall be construed to require the Respondents to terminate the employment of any employee; and

3. for a period of one (1) year from the Closing Date, not:
  - a. directly or indirectly, solicit or otherwise attempt to induce any employee of the Commission-approved Acquirer with any amount of responsibility related to Arixtra ("Arixtra Employee") to terminate his or her employment relationship with the Commission-approved Acquirer; or
  - b. hire any Arixtra Employee; *provided, however*, Respondents may hire any former Arixtra Employee whose employment has been terminated by the Commission-approved Acquirer or who independently applies for employment with the

Respondents, as long as such employee was not solicited in violation of the nonsolicitation requirements contained herein;

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*provided, however*, Respondents may do the following: (1) advertise for employees in newspapers, trade publications or other media not targeted specifically at the Arixtra Employees; or (2) hire an Arixtra Employee who contacts Respondents on his or her own initiative without any direct or indirect solicitation or encouragement from the Respondents.

F. Prior to the Closing Date, Respondents shall secure all consents and waivers from all Third Parties that are necessary for the divestiture of the Arixtra Assets to the Commission-approved Acquirer, or for the continued research, Development, manufacture, sale, marketing or distribution of Arixtra by the Commission-approved Acquirer;

*provided, however*, Respondents may satisfy this requirement by certifying that the Commission-approved Acquirer has executed all such agreements directly with each of the relevant Third Parties.

G. For the periods as set forth in this Paragraph II.H. (collectively, the “Moratorium/Waiting Period”), Respondents shall not market or promote Lovenox in the United States using the services of any employee who has directly participated in the marketing, contracting, promotion or sale of Arixtra, regardless of the portion of work time expended on Arixtra, within the eighteen (18) month period immediately prior to the Closing Date. The Moratorium/Waiting Period shall be as follows: (1) at least six (6) months from the Closing Date with respect to the Product Sales Employees related to Arixtra; and (2) at least twelve (12) months from the Closing Date for all Product Marketing Employees related to Arixtra.

H. For a period of at least six (6) months after the completion of any clinical trials related to Arixtra that were ongoing as of the Effective Date, Respondents shall not use any Arixtra Ongoing Clinical Development Employee for any

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purpose related to the Development of Lovenox.

- I. Respondents shall require, as a condition of continued employment post-divestiture, that each Arixtra Core Employee sign a confidentiality agreement pursuant to which such employee shall be required to maintain all Confidential Business Information related to Arixtra strictly confidential, including the nondisclosure of such information to all other employees, executives or other personnel of Respondents (other than as necessary to comply with the requirements of this Order).
- J. Respondents shall provide written notification of the restrictions on the use of the Confidential Business Information related to Arixtra by Respondents' personnel to all of Respondents' employees who:
  1. are or were involved in the research, Development, manufacturing, distribution, sale or marketing of Arixtra;
  2. are involved in the research, Development, manufacturing, distribution, sale or marketing of Lovenox; and/or
  3. may have Confidential Business Information related to Arixtra.

Such notification shall be in substantially the form set forth in the Employee Notification. Respondents shall give such notification by e-mail with return receipt requested or similar transmission, and keep a file of such receipts for one (1) year after the Closing Date. Respondents shall provide a copy of such notification to the Commission-approved Acquirer. Respondents shall maintain complete records of all such agreements at Respondents' corporate headquarters and shall provide an officer's certification to the Commission stating that such acknowledgment program has been implemented and is being complied with. Respondents shall provide the Commission-approved Acquirer with copies of all

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certifications, notifications and reminders sent to Respondents' personnel.

- K. Upon reasonable notice and request by the Commission-approved Acquirer, Respondents shall make available to the Commission-approved Acquirer, at no greater than Direct Cost (or, if the Arixtra Asset Purchase Agreement is the Remedial Agreement for the Arixtra Assets, then at such cost as provided therein), such personnel, assistance and training as the Commission-approved Acquirer might reasonably need to transfer the Arixtra Assets, and shall continue providing such personnel, assistance and training, at the request of the Commission-approved Acquirer, until the Commission-approved Acquirer (or the Designee of the Commission-approved Acquirer) is fully validated, qualified, and approved by the FDA, and able to manufacture Arixtra independently of the Respondents;

*provided, however*, the Commission may eliminate, or limit the duration of, the Respondents' obligation under this provision if the Commission determines that the Commission-approved Acquirer is not using commercially reasonable best efforts to secure the FDA approvals necessary to manufacture Arixtra finished drug product in a facility that is independent of Respondents.

- L. Pending divestiture of the Arixtra Assets, Respondents shall take such actions as are necessary to maintain the full economic viability and marketability of the business associated with the Arixtra Assets, to minimize any risk of loss of competitive potential for such business, and to prevent the destruction, removal, wasting, deterioration, or impairment of any of the Arixtra Assets except for ordinary wear and tear.
- M. Counsel for Respondents (including in-house counsel under appropriate confidentiality arrangements) may retain unredacted copies of all documents or other



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materials provided to the Commission-approved Acquirer and may have access to original documents (under circumstances where copies of documents are insufficient or otherwise unavailable) provided to the Commission-approved Acquirer only in order to do the following:

1. comply with any Remedial Agreement, this Order, any Law (including, without limitation, any requirement to obtain regulatory licenses or approvals), any data retention requirement of any applicable Governmental Entity, or any taxation requirements; or
2. defend against, respond to, or otherwise participate in any litigation, investigation, audit, process, subpoena or other proceeding relating to the divestiture or any other aspect of the Arixtra Assets or Arixtra business; *provided, however*, that Respondents may disclose such information as necessary for the purposes set forth in this Paragraph pursuant to an appropriate confidentiality order, agreement or arrangement;

*provided, however*, that pursuant to this Paragraph II.N., Respondents shall: (1) require those who view such unredacted documents or other materials to enter into confidentiality agreements with the Commission-approved Acquirer (but shall not be deemed to have violated this requirement if the Commission-approved Acquirer withholds such agreement unreasonably); and (2) use their best efforts to obtain a protective order to protect the confidentiality of such information during any adjudication.

- N. Respondents shall maintain manufacturing facilities for the Arixtra finished drug product that are validated, qualified and approved by the FDA, and fully capable of producing Arixtra finished drug product until the Commission-approved Acquirer (or the Designee of the Commission-approved Acquirer) has acquired the Arixtra Manufacturing Facility or is otherwise fully validated,

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qualified and approved by the FDA and able to manufacture Arixtra finished drug product in a facility that is independent of Respondents;

*provided, however,* the Commission may eliminate, or limit the duration of, the Respondents' obligation under this provision if the Commission determines that the Commission-approved Acquirer is not using commercially reasonable best efforts to secure the FDA approvals necessary to manufacture Arixtra finished drug product in a facility that is independent of Respondents.

- O. Respondents shall maintain manufacturing facilities for any of the ingredients that are necessary to manufacture Arixtra finished drug product and that, at any time prior to the Effective Date, were manufactured by the Respondents, until the Commission-approved Acquirer (or the Designee of the Commission-approved Acquirer) has secured sources of supply of these ingredients that are independent of Respondents. Such ingredients include, but are not limited to, crude drug substance (Fondaparinux), building blocks (including D<sub>11</sub> and EF<sub>9</sub>) and building block intermediates;

*provided, however,* that if GlaxoSmithKline receives all its requirements for any of the ingredients that are necessary to manufacture Arixtra finished drug product from a Third Party, as provided for in the Arixtra Asset Purchase Agreement, then Respondents shall cause that Third Party to maintain the manufacturing facilities for any of those ingredients;

*provided further* that the Commission may eliminate, or limit the duration of, the Respondents' obligation under this provision if the Commission determines that the Commission-approved Acquirer is not using commercially reasonable best efforts to secure sources of supply of the ingredients necessary to manufacture Arixtra finished drug product that are independent of Respondents.

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- P. Respondents shall not join, file, prosecute or maintain any suit, in law or equity, against the Commission-approved Acquirer or the Arixtra Releasee(s) for the research, Development, manufacture, use, import, export, distribution, or sale of Arixtra under the following:
1. any Patents owned or licensed by Respondents as of the Effective Date or acquired after the Effective Date that claim the use of Arixtra;
  2. any Patents owned or licensed at any time after the Effective Date by Respondents that claim any aspect of the research, Development, manufacture, use, import, export, distribution, or sale of Arixtra, other than such Patents that claim inventions conceived by and reduced to practice by Respondents' employees after the Effective Date.
- Q. Respondents shall not, in any jurisdiction throughout the world: (1) use the Product Trademarks related to Arixtra or any mark confusingly similar to the Product Trademarks, as a trademark, tradename, or service mark; (2) attempt to register the Product Trademarks; (3) attempt to register any mark confusingly similar to the Product Trademarks; (4) challenge or interfere with the Commission-approved Acquirer's use and registration of the Product Trademarks; or (5) challenge or interfere with the Commission-approved Acquirer's efforts to enforce its trademark registrations for and trademark rights in the Product Trademarks against Third Parties.
- R. The purpose of the divestiture of the Arixtra Assets is to ensure the continued use of the Arixtra Assets in the same business, independent of Respondents, in which the Arixtra Assets were engaged at the time of the announcement of the Acquisition, and to remedy the lessening of competition resulting from the Acquisition as alleged in the Commission's Complaint.

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**III.**

**IT IS FURTHER ORDERED** that:

- A. Not later than twenty (20) Days after the Effective Date or September 1, 2004, whichever is later, Respondents shall divest the Camptosar Assets (to the extent that such assets are not already owned, controlled or in the possession of Pfizer), absolutely and in good faith, to Pfizer pursuant to and in accordance with the Camptosar Asset Purchase Agreement (which agreement shall not vary or contradict, or be construed to vary or contradict, the terms of this Order, it being understood that nothing in this Order shall be construed to reduce any rights or benefits of Pfizer or to reduce any obligations of the Respondents under such agreement), and such agreement, if it becomes the Remedial Agreement for the Camptosar Assets, is incorporated by reference into this Order and made a part hereof. If Respondents do not divest the Camptosar Assets to Pfizer within twenty (20) Days after the Effective Date or September 1, 2004, whichever is later, the Commission may appoint a Divestiture Trustee to divest the Camptosar Assets;

*provided, however,* that if the Respondents have divested the Camptosar Assets to Pfizer prior to the date this Order becomes final, and if, at the time the Commission determines to make this Order final, the Commission notifies the Respondents that the manner in which the divestiture was accomplished is not acceptable, the Commission may direct the Respondents, or appoint a Divestiture Trustee, to effect such modifications to the manner of divestiture of the Camptosar Assets to Pfizer (including, but not limited to, entering into additional agreements or arrangements) as the Commission may determine are necessary to satisfy the requirements of this Order.

- B. Any Remedial Agreement related to the Camptosar Assets

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shall be deemed incorporated into this Order, and any failure by Respondents to comply with the terms of such Remedial Agreement to the extent that such terms relate to the Camptosar Assets shall constitute a failure to comply with this Order.

- C. Respondents shall include in any Remedial Agreement related to the Camptosar Assets a provision that provides that upon reasonable notice and request from Pfizer to the Respondents, Respondents shall provide, in a timely manner at no greater than Direct Cost, assistance and advice of knowledgeable employees of the Respondent(s) for the following purposes: (1) to facilitate Pfizer in obtaining approvals from the FDA for indications on Camptosar that were the subject of the Camptosar Key Clinical Trials; and (2) to defend against, respond to, or otherwise participate in any litigation related to the United States Patents related to Camptosar.
- D. Prior to the Closing Date, Respondents shall secure all consents and waivers from all Third Parties (including, but not limited to, Yakult) that are necessary for the divestiture of the Camptosar Assets to Pfizer, or for the continued research, Development, manufacture, sale, marketing, or distribution of Camptosar in the United States by Pfizer;

*provided, however*, Respondents may satisfy this requirement by certifying that Pfizer has executed all such agreements directly with each of the relevant Third Parties.

E. Respondents shall:

1. submit to Pfizer, at Respondents' expense, all Confidential Business Information related to the Camptosar Assets;
2. deliver such Confidential Business Information as follows:
  - (1) in good faith;
  - (2) as soon as practicable, avoiding any

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delays in transmission of the respective information; and (3) in a manner that ensures its completeness and accuracy and that fully preserves its usefulness;

3. pending the complete delivery of all such Confidential Business Information to Pfizer, provide Pfizer and the Interim Monitor (if any has been appointed) with access to all such Confidential Business Information and employees who possess or are able to locate such information for the purposes of identifying the books, records, and files related to the Camptosar Assets that contain such Confidential Business Information and facilitating the delivery in a manner consistent with this Order;
4. not use, directly or indirectly, any such Confidential Business Information related to the Camptosar Assets (other than as necessary to comply with the following: (1) the requirements of this Order; (2) the Respondents' obligations to Pfizer under the terms of any Remedial Agreement related to the Camptosar Assets; (3) the Respondents' obligations to Yakult related to the Camptosar Assets; or (4) applicable Law); and
5. not disclose or convey any such Confidential Business Information, directly or indirectly, to any person except Pfizer;

*provided, however*, this Paragraph III.E shall not apply to any Confidential Business Information related to the Camptosar Assets that Respondent Sanofi can demonstrate it obtained without the assistance of Respondent Aventis prior to the Effective Date.

F. Respondents shall:

1. for a period of at least twelve (12) months from the earlier of the following dates: (1) ten (10) Days after notice by staff of the Commission to the Respondents to provide the

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opportunity to enter into employment contracts; or (2) the Closing Date, provide Pfizer with the opportunity to enter into employment contracts with the Camptosar Core Employees. This period is hereinafter referred to as the “Camptosar Access Period”;

*provided, however,* that any such employment contracts entered into prior to the Closing Date shall be contingent upon approval by the Commission of the agreements relating to the Camptosar Assets (*i.e.*, those agreements proposed by Respondents (or the Divestiture Trustee) to the Commission) as the Remedial Agreements for the Camptosar Assets; and

2. not later than the earlier of the following dates: (1) ten (10) Days after notice by staff of the Commission to the Respondents to provide the Product Employee Information; or (2) ten (10) Days after the Closing Date, provide Pfizer with the Product Employee Information related to the Camptosar Core Employees. Failure by Respondents to provide the Product Employee Information for any relevant employee within the time provided herein shall extend the Camptosar Access Period with respect to that employee in an amount equal to the delay.

G. Respondents shall:

1. during the Camptosar Access Period, not interfere with the hiring or employing by Pfizer of Camptosar Core Employees, and remove any impediments within the control of Respondents that may deter these employees from accepting employment with Pfizer, including, but not limited to, any noncompete provisions of employment or other contracts with Respondents that would affect the ability or incentive of those individuals to be employed by Pfizer. In addition, Respondents shall not make any counteroffer to a Camptosar Core Employee who receives a written offer of employment from Pfizer;

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*provided, however,* that this Paragraph III.G.1 shall not prohibit the Respondents from making offers of employment to or employing any Camptosar Core Employee during the Camptosar Access Period where Pfizer has notified the Respondents in writing that Pfizer does not intend to make an offer of employment to that employee;

*provided further* that if the Respondents notify Pfizer in writing of their desire to make an offer of employment to a particular Camptosar Core Employee and Pfizer does not make an offer of employment to that employee within twenty (20) Days of the date Pfizer receives such notice, the Respondents may make an offer of employment to that employee;

2. until the Closing Date for the divestiture of the Camptosar Assets has occurred, provide all Camptosar Core Employees with reasonable financial incentives to continue in their positions until the Closing Date. Such incentives shall include a continuation of all employee benefits offered by Respondents, including regularly scheduled raises, bonuses, and vesting of pension benefits (as permitted by Law). In addition to the foregoing, Respondents shall provide to each Camptosar Core Employee (other than those employees who transfer to Pfizer by operation of Law) who accepts employment with Pfizer, an incentive equal to three (3) months of such employee's base annual salary to be paid upon the employee's completion of one (1) year of employment with Pfizer;

*provided, however,* that nothing in this Order requires or shall be construed to require the Respondents to terminate the employment of any employee; and

3. for a period of one (1) year from the Closing Date, not:

a. directly or indirectly, solicit or otherwise attempt to induce any employee of Pfizer with any amount of responsibility related to the Camptosar Assets ("Camptosar Employee") to



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terminate his or her employment relationship with Pfizer; or

- b. hire any Camptosar Employee; *provided, however*, Respondents may hire any former Camptosar Employee whose employment has been terminated by Pfizer or who independently applies for employment with the Respondents, as long as such employee was not solicited in violation of the nonsolicitation requirements contained herein;

*provided, however*, Respondents may do the following: (1) advertise for employees in newspapers, trade publications or other media not targeted specifically at the Camptosar Employees; or (2) hire a Camptosar Employee who contacts Respondents on his or her own initiative without any direct or indirect solicitation or encouragement from the Respondents.

- H. For a period of at least twelve (12) months after the Closing Date, Respondents shall not use any Product Research and Development Employee related to the Camptosar Assets for any purpose related to the Development of Eloxatin.
- I. Respondents shall require, as a condition of continued employment post-divestiture, that each Product Research and Development Employee related to the Camptosar Assets sign a confidentiality agreement pursuant to which such employee shall be required to maintain all Confidential Business Information related to the Camptosar Assets strictly confidential, including the nondisclosure of such information to all other employees, executives or other personnel of Respondents (other than as necessary to comply with the requirements of this Order or the requirements contained in the decisions of the Commission of the European Communities in Case COMP/M.3354).
- J. Respondents shall provide written notification of the restrictions on the use of the Confidential Business

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Information related to the Camptosar Assets by Respondents' personnel to all of Respondents' employees who:

1. are or were involved in the research, Development, manufacturing, distribution, sale or marketing of Camptosar;
2. are involved in the research, Development, manufacturing, distribution, sale or marketing of Eloxatin; and/or
3. may have Confidential Business Information related to the Camptosar Assets. Such notification shall be in substantially the form set forth in the Employee Notification.

Respondents shall give such notification by e-mail with return receipt requested or similar transmission, and keep a file of such receipts for one (1) year after the Closing Date. Respondents shall provide a copy of such notification to Pfizer. Respondents shall maintain complete records of all such agreements at Respondents' corporate headquarters and shall provide an officer's certification to the Commission stating that such acknowledgment program has been implemented and is being complied with. Respondents shall provide Pfizer with copies of all certifications, notifications and reminders sent to Respondents' personnel.

- K. Upon reasonable notice and request by Pfizer, Respondents shall make available to Pfizer (at costs as described in the Camptosar Asset Purchase Agreement) such personnel, assistance and training as Pfizer might reasonably need to transfer the Camptosar Assets, and shall continue providing such personnel, assistance and training, at the request of Pfizer, until such assets are fully transferred to Pfizer.
- L. Counsel for Respondents (including in-house counsel under appropriate confidentiality arrangements) may retain

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unredacted copies of all documents or other materials provided to Pfizer and may have access to original documents (under circumstances where copies of documents are insufficient or otherwise unavailable) provided to Pfizer only in order to:

1. comply with any Remedial Agreement, this Order, any Law (including, without limitation, any requirement to obtain regulatory licenses or approvals), any data retention requirement of any applicable Governmental Entity, or any taxation requirements; or
2. defend against, respond to, or otherwise participate in any litigation, investigation, audit, process, subpoena or other proceeding relating to the divestiture or any other aspect of the Camptosar Assets; *provided, however*, that Respondents may disclose such information as necessary for the purposes set forth in this Paragraph pursuant to an appropriate confidentiality order, agreement or arrangement;

*provided, however*, that pursuant to this Paragraph III.L. Respondents shall: (1) require those who view such unredacted documents or other materials to enter into confidentiality agreements with Pfizer (but shall not be deemed to have violated this requirement if Pfizer withholds such agreement unreasonably); and (2) use their best efforts to obtain a protective order to protect the confidentiality of such information during any adjudication.

- M. Pending divestiture of the Camptosar Assets, Respondents shall take such actions as are necessary to maintain the full economic viability and marketability of the Camptosar Assets, to minimize any risk of loss of competitive potential for such assets, and to prevent the destruction, removal, wasting, deterioration, or impairment of any of the Camptosar Assets except for ordinary wear and tear.
- N. The purpose of the divestiture of the Campostar Assets is

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to ensure the continued use of the Campostar Assets in the same business in which the Campostar Assets were engaged at the time of the announcement of the Acquisition, and to remedy the lessening of competition resulting from the Acquisition as alleged in the Commission's Complaint.

**IV.**

**IT IS FURTHER ORDERED** that:

- A. Not later than ninety (90) Days after the date this Order becomes final, Respondents shall divest the Estorra Royalties, absolutely and in good faith, at no minimum price, to either of the following:
  1. Sepracor in a manner that receives the prior approval of the Commission; or
  2. a Royalty Monetization Firm that receives the prior approval of the Commission and only in a manner that receives the prior approval of the Commission.
- B. After the Effective Date, Respondents shall cease and desist from receiving, accepting, or being entitled to receive or accept any Estorra Royalties *except* for the purposes of transferring such Estorra Royalties to a Royalty Monetization Firm.
- C. Respondents shall abide in good faith by all rights, representations, warranties and covenants as granted in favor of Sepracor under the Estorra License Agreement (which agreement shall not vary or contradict, or be construed to vary or contradict, the terms of this Order, it being understood that nothing in this Order shall be construed to reduce any rights or benefits of Sepracor or to reduce any obligations of the Respondents under such agreement). Respondents shall provide that all such

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benefits to Sepracor remain in full force and effect as if the Estorra Royalties had been paid by Sepracor to the Respondents in accordance with the Estorra License Agreement and shall perform as such under the Estorra License Agreement. Such rights to Sepracor include, but are not limited to, the following:

1. the exclusive right (even as to Respondents) under the terms of the Estorra License Agreement to import Products containing (+) zopiclone into the United States, or to make, have made, use, market, sell, offer for sale, have sold, import, and distribute Products containing (+) zopiclone within the United States;
2. the right to the assistance of knowledgeable employees of the Respondents to assist Sepracor to defend against, respond to, or otherwise participate in any litigation related to the Product Intellectual Property within the United States that is the subject of the Estorra License Agreement and to the extent provided in the Estorra License Agreement; and
3. the right to restrict the use or disclosure by the Respondents of the Confidential Business Information related to Estorra to the extent provided in the Estorra License Agreement.

D. Respondents shall:

1. at Sepracor's request, submit to Sepracor, at Respondents' expense, all Confidential Business Information related to the business of researching, Developing, manufacturing, marketing or sale of Estorra to the extent that Respondent Aventis has not already provided such Confidential Business Information to Sepracor and to the extent provided for in the Estorra License Agreement;
2. deliver such Confidential Business Information as follows:
  - (1) in good faith;
  - (2) as soon as practicable, avoiding any delays in transmission of the respective information; and
  - (3)

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in a manner that ensures its completeness and accuracy and that fully preserves its usefulness; and

3. pending complete delivery of all such Confidential Business Information to Sepracor, provide Sepracor and the Interim Monitor (if any has been appointed) with access to all such Confidential Business Information and employees who possess or are able to locate such information for the purposes of identifying the books, records, and files related to Estorra that contain such Confidential Business Information and facilitating the delivery in a manner consistent with this Order.
- E. Respondents shall not join, file, prosecute or maintain any suit, in law or equity, against Sepracor or the Estorra Releasee(s) for the research, Development, manufacture, use, import, export, distribution, or sale of Estorra in the United States under the following:
1. any United States Patents owned or licensed by Respondents as of the Effective Date or acquired after the Effective Date that claim the use of Estorra;
  2. any United States Patents owned or licensed at any time after the Effective Date by Respondents that claim any aspect of the research, Development, manufacture, use, import, export, distribution, or sale of Estorra other than such Patents that claim inventions conceived by and reduced to practice by Respondents' employees after the Effective Date.
- F. The purpose of the remedy is to ensure an independent, viable and effective competitor in the relevant market in which Estorra competed at the time of the announcement of the Acquisition, and to remedy the lessening of competition resulting from the Acquisition as alleged in the Commission's Complaint.

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**V.****IT IS FURTHER ORDERED** that:

- A. At any time after Respondents sign the Consent Agreement in this matter, the Commission may appoint an Interim Monitor to assure that Respondents expeditiously comply with all of their obligations and perform all of their responsibilities as required by this Order and the Order to Maintain Assets (collectively “the Orders”) and the Remedial Agreements. The Commission may appoint one or more Interim Monitors to assure Respondents’ compliance with the requirements of the Orders and the related Remedial Agreements.
- B. The Commission shall select the Interim Monitor, subject to the consent of Respondents, which consent shall not be unreasonably withheld. If neither Respondent has opposed, in writing, including the reasons for opposing, the selection of a proposed Interim Monitor within ten (10) Days after notice by the staff of the Commission to Respondents of the identity of any proposed Interim Monitor, Respondents shall be deemed to have consented to the selection of the proposed Interim Monitor.
- C. Not later than ten (10) Days after the appointment of the Interim Monitor, Respondents shall execute an agreement that, subject to the prior approval of the Commission, confers on the Interim Monitor all the rights and powers necessary to permit the Interim Monitor to monitor Respondents’ compliance with the relevant requirements of the Orders in a manner consistent with the purposes of the Orders.
- D. If one or more Interim Monitors are appointed pursuant to this Paragraph or pursuant to the relevant provisions of the Order to Maintain Assets in this matter, Respondents shall consent to the following terms and conditions regarding

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the powers, duties, authorities, and responsibilities of each Interim Monitor:

1. The Interim Monitor shall have the power and authority to monitor Respondents' compliance with the divestiture and asset maintenance obligations and related requirements of the Orders, and shall exercise such power and authority and carry out the duties and responsibilities of the Interim Monitor in a manner consistent with the purposes of the Orders and in consultation with the Commission;
2. The Interim Monitor shall act in a fiduciary capacity for the benefit of the Commission;
3. The Interim Monitor shall serve until the latest of:
  - a. with respect to the Arixtra Assets, the completion by Respondents of the divestiture of the Arixtra Assets required to be divested pursuant to the Decision and Order in a manner that fully satisfies the requirements of the Orders and notification by the Commission-approved Acquirer to the Interim Monitor that it is fully capable of producing the relevant Product(s) acquired pursuant to a Remedial Agreement independently of Respondents (including, but not limited to, the manufacture of all registered steps necessary to produce Arixtra finished drug product);
  - b. with respect to the Camptosar Assets, the completion by Respondents of the divestiture of the Camptosar Assets required to be divested pursuant to the Decision and Order in a manner that fully satisfies the requirements of the Orders and notification by Pfizer to the Interim Monitor that it is fully capable of completing the Camptosar Key Clinical Trials; and
  - c. the completion by Respondents of the last obligation under the Orders pertaining to the Interim Monitor's service;



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*provided, however,* that the Commission may extend or modify this period as may be necessary or appropriate to accomplish the purposes of the Orders;

4. Subject to any demonstrated legally recognized privilege, the Interim Monitor shall have full and complete access to Respondents' personnel, books, documents, records kept in the normal course of business, facilities and technical information, and such other relevant information as the Interim Monitor may reasonably request, related to Respondents' compliance with their obligations under the Orders, including, but not limited to, their obligations related to the relevant assets. Respondents shall cooperate with any reasonable request of the Interim Monitor and shall take no action to interfere with or impede the Interim Monitor's ability to monitor Respondents' compliance with the Orders;
5. The Interim Monitor shall serve, without bond or other security, at the expense of Respondents on such reasonable and customary terms and conditions as the Commission may set. The Interim Monitor shall have authority to employ, at the expense of the Respondents, such consultants, accountants, attorneys and other representatives and assistants as are reasonably necessary to carry out the Interim Monitor's duties and responsibilities;
6. Respondents shall indemnify the Interim Monitor and hold the Interim Monitor harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Interim Monitor's duties, including all reasonable fees of counsel and other reasonable expenses incurred in connection with the preparations for, or defense of, any claim, whether or not resulting in any liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from misfeasance, gross negligence, willful or wanton acts, or bad faith by the Interim Monitor;

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7. Respondents shall report to the Interim Monitor in accordance with the requirements of this Order and/or as otherwise provided in any agreement approved by the Commission. The Interim Monitor shall evaluate the reports submitted to the Interim Monitor by Respondents, and any reports submitted by the Commission-approved Acquirer with respect to the performance of Respondents' obligations under the Orders or the Remedial Agreement. Within one (1) month from the date the Interim Monitor receives these reports, the Interim Monitor shall report in writing to the Commission concerning performance by Respondents of their obligations under the Orders; and
8. Respondents may require the Interim Monitor and each of the Interim Monitor's consultants, accountants, attorneys and other representatives and assistants to sign a customary confidentiality agreement; *provided, however*, that such agreement shall not restrict the Interim Monitor from providing any information to the Commission.
- E. The Commission may, among other things, require the Interim Monitor and each of the Interim Monitor's consultants, accountants, attorneys and other representatives and assistants to sign an appropriate confidentiality agreement related to Commission materials and information received in connection with the performance of the Interim Monitor's duties.
- F. If the Commission determines that the Interim Monitor has ceased to act or failed to act diligently, the Commission may appoint a substitute Interim Monitor in the same manner as provided in this Paragraph or the relevant provisions of the Order to Maintain Assets in this matter.
- G. The Commission may on its own initiative, or at the request of the Interim Monitor, issue such additional orders or directions as may be necessary or appropriate to assure compliance with the requirements of the Orders.

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- H. The Interim Monitor appointed pursuant to this Order or the relevant provisions of the Order to Maintain Assets in this matter may be the same person appointed as a Divestiture Trustee pursuant to the relevant provisions of this Order.

**VI.****IT IS FURTHER ORDERED** that:

- A. If Respondents have not fully complied with the obligations to assign, grant, license, divest, transfer, deliver or otherwise convey relevant assets as required by this Order, the Commission may appoint a Divestiture Trustee(s) to assign, grant, license, divest, transfer, deliver or otherwise convey the assets required to be assigned, granted, licensed, divested, transferred, delivered or otherwise conveyed pursuant to each of the relevant Paragraphs in a manner that satisfies the requirements of each such Paragraph. The Commission may appoint a different Divestiture Trustee to accomplish each of the divestitures described in Paragraphs II, and III, and IV, respectively. In the event that the Commission or the Attorney General brings an action pursuant to § 5(*l*) of the Federal Trade Commission Act, 15 U.S.C. § 45(*l*), or any other statute enforced by the Commission, Respondents shall consent to the appointment of a Divestiture Trustee in such action to assign, grant, license, divest, transfer, deliver or otherwise convey the relevant assets. Neither the appointment of a Divestiture Trustee nor a decision not to appoint a Divestiture Trustee under this Paragraph shall preclude the Commission or the Attorney General from seeking civil penalties or any other relief available to it, including a court-appointed Divestiture Trustee, pursuant to § 5(*l*) of the Federal Trade Commission Act or any other statute enforced by the Commission, for any failure by Respondents to comply with this Order.

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- B. The Commission shall select the Divestiture Trustee, subject to the consent of Respondents, which consent shall not be unreasonably withheld. The Divestiture Trustee shall be a person with experience and expertise in acquisitions and divestitures. If Respondents have not opposed, in writing, including the reasons for opposing, the selection of any proposed Divestiture Trustee within ten (10) Days after notice by the staff of the Commission to Respondents of the identity of any proposed Divestiture Trustee, Respondents shall be deemed to have consented to the selection of the proposed Divestiture Trustee.
- C. Not later than ten (10) Days after the appointment of a Divestiture Trustee, Respondents shall execute a trust agreement that, subject to the prior approval of the Commission, transfers to the Divestiture Trustee all rights and powers necessary to permit the Divestiture Trustee to effect the divestiture required by the Order.
- D. If a Divestiture Trustee is appointed by the Commission or a court pursuant to this Paragraph, Respondents shall consent to the following terms and conditions regarding the Divestiture Trustee's powers, duties, authority, and responsibilities:
1. Subject to the prior approval of the Commission, the Divestiture Trustee shall have the exclusive power and authority to assign, grant, license, divest, transfer, deliver or otherwise convey the assets that are required by this Order to be assigned, granted, licensed, divested, transferred, delivered or otherwise conveyed.
  2. The Divestiture Trustee shall have one (1) year after the date the Commission approves the trust agreement described herein to accomplish the divestiture, which shall be subject to the prior approval of the Commission. If, however, at the end of the twelve-month period, the Divestiture Trustee has submitted a plan of divestiture or believes that the

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divestiture can be achieved within a reasonable time, the divestiture period may be extended by the Commission, or, in the case of a court-appointed Divestiture Trustee, by the court; *provided, however*, the Commission may extend the divestiture period only two (2) times.

3. Subject to any demonstrated legally recognized privilege, the Divestiture Trustee shall have full and complete access to the personnel, books, records and facilities related to the relevant assets that are required to be assigned, granted, licensed, divested, delivered or otherwise conveyed by this Order and to any other relevant information, as the Divestiture Trustee may request. Respondents shall develop such financial or other information as the Divestiture Trustee may request and shall cooperate with the Divestiture Trustee. Respondents shall take no action to interfere with or impede the Divestiture Trustee's accomplishment of the divestiture. Any delays in divestiture caused by Respondents shall extend the time for divestiture under this Paragraph in an amount equal to the delay, as determined by the Commission or, for a court-appointed Divestiture Trustee, by the court.
4. The Divestiture Trustee shall use commercially reasonable best efforts to negotiate the most favorable price and terms available in each contract that is submitted to the Commission, subject to Respondents' absolute and unconditional obligation to divest expeditiously and at no minimum price. Each divestiture shall be made in the manner and to an acquirer as required by this Order; *provided, however*, if the Divestiture Trustee receives bona fide offers from more than one acquiring entity, and if the Commission determines to approve more than one such acquiring entity, the Divestiture Trustee shall divest to the acquiring entity selected by Respondents from among those approved by the Commission; *provided further* that Respondents shall select such entity within five (5) Days after receiving notification of the Commission's approval.

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5. The Divestiture Trustee shall serve, without bond or other security, at the cost and expense of Respondents, on such reasonable and customary terms and conditions as the Commission or a court may set. The Divestiture Trustee shall have the authority to employ, at the cost and expense of Respondents, such consultants, accountants, attorneys, investment bankers, business brokers, appraisers, and other representatives and assistants as are necessary to carry out the Divestiture Trustee's duties and responsibilities. The Divestiture Trustee shall account for all monies derived from the divestiture and all expenses incurred. After approval by the Commission and, in the case of a court-appointed Divestiture Trustee, by the court, of the account of the Divestiture Trustee, including fees for the Divestiture Trustee's services, all remaining monies shall be paid at the direction of the Respondents, and the Divestiture Trustee's power shall be terminated. The compensation of the Divestiture Trustee shall be based at least in significant part on a commission arrangement contingent on the divestiture of all of the relevant assets that are required to be divested by this Order.
6. Respondents shall indemnify the Divestiture Trustee and hold the Divestiture Trustee harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Divestiture Trustee's duties, including all reasonable fees of counsel and other expenses incurred in connection with the preparation for, or defense of, any claim, whether or not resulting in any liability, *except* to the extent that such losses, claims, damages, liabilities, or expenses result from misfeasance, gross negligence, willful or wanton acts, or bad faith by the Divestiture Trustee.
7. In the event that the Divestiture Trustee determines that he or she is unable to assign, grant, license, divest, transfer, deliver or otherwise convey the relevant assets required to be assigned, granted, licensed, divested, transferred,

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delivered or otherwise conveyed in a manner that preserves their marketability, viability and competitiveness and ensures their continued use in the research, Development, manufacture, distribution, marketing, promotion, sale, or after-sales support of the relevant Product, the Divestiture Trustee may assign, grant, license, divest, transfer, deliver or otherwise convey such additional assets of Respondents and effect such arrangements as are necessary to satisfy the requirements of this Order.

8. The Divestiture Trustee shall have no obligation or authority to operate or maintain the relevant assets required to be assigned, granted, licensed, divested, transferred, delivered or otherwise conveyed by this Order.
  9. The Divestiture Trustee shall report in writing to Respondents and to the Commission every sixty (60) Days concerning the Divestiture Trustee's efforts to accomplish the divestiture.
  10. Respondents may require the Divestiture Trustee and each of the Divestiture Trustee's consultants, accountants, attorneys and other representatives and assistants to sign a customary confidentiality agreement; *provided, however*, such agreement shall not restrict the Divestiture Trustee from providing any information to the Commission.
- E. If the Commission determines that a Divestiture Trustee has ceased to act or failed to act diligently, the Commission may appoint a substitute Divestiture Trustee in the same manner as provided in this Paragraph.
- F. The Commission or, in the case of a court-appointed Divestiture Trustee, the court, may on its own initiative or at the request of the Divestiture Trustee issue such additional orders or directions as may be necessary or appropriate to accomplish the divestiture required by this Order.

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- G. The Divestiture Trustee appointed pursuant to this Paragraph may be the same person appointed as Interim Monitor pursuant to the relevant provisions of this Order or the relevant provisions of the Order to Maintain Assets in this matter.

**VII.**

**IT IS FURTHER ORDERED** that:

- A. Within five (5) Days of the Acquisition, Respondents shall submit to the Commission a letter certifying the date on which the Acquisition occurred.
- B. Within thirty (30) Days after the date this Order becomes final, and every sixty (60) Days thereafter until Respondents have fully complied with Paragraphs II.A., III.A., and IV.A., Respondents shall submit to the Commission a verified written report setting forth in detail the manner and form in which they intend to comply, are complying, and have complied with this Order. Respondents shall submit at the same time a copy of their report concerning compliance with this Order to the Interim Monitor, if any Interim Monitor has been appointed. Respondents shall include in their reports, among other things that are required from time to time, a full description of the efforts being made to comply with the relevant Paragraphs of the Order, including a description of all substantive contacts or negotiations related to the divestiture of the relevant assets and the identity of all parties contacted. Respondents shall include in their reports copies of all written communications to and from such parties, all internal memoranda, and all reports and recommendations concerning completing the obligations.
- C. One (1) year after the date this Order becomes final, annually for the next nine (9) years on the anniversary of the date this Order becomes final, and at other times as the



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Commission may require, Respondents shall file a verified written report with the Commission setting forth in detail the manner and form in which they have complied and are complying with this Order.

**VIII.**

**IT IS FURTHER ORDERED** that Respondents shall notify the Commission at least thirty (30) Days prior to any proposed (1) dissolution of the Respondents, (2) acquisition, merger, or consolidation of Respondents, or (3) other change in the Respondents that may affect compliance obligations arising out of the order, including, but not limited to, assignment, the creation or dissolution of subsidiaries, or any other change in Respondents.

**IX.**

**IT IS FURTHER ORDERED** that, for the purpose of determining or securing compliance with this Order, and subject to any legally recognized privilege, and upon written request with reasonable notice to Respondents made to their principal United States offices, Respondents shall permit any duly authorized representative of the Commission:

- A. Access, during office hours of Respondents and in the presence of counsel, to all facilities and access to inspect and copy all books, ledgers, accounts, correspondence, memoranda and all other records and documents in the possession or under the control of Respondents related to compliance with this Order; and
- B. Upon five (5) Days' notice to Respondents and without restraint or interference from Respondents, to interview officers, directors, or employees of Respondents, who may have counsel present, regarding such matters.

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**X.**

**IT IS FURTHER ORDERED** that this Order shall terminate on September 20, 2014.

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**PUBLIC APPENDIX I TO THE DECISION AND ORDER****NOTICE OF ANTITRUST REMEDY AND  
REQUIREMENT FOR CONFIDENTIALITY**

On [INSERT], Sanofi-Synthélabo, S.A. (“Sanofi”) and Aventis (“Aventis”) hereinafter referred to as “Respondents,” entered into an Agreement Containing Consent Orders (“Consent Agreement”) with the Federal Trade Commission (“FTC”) relating to the divestiture of certain assets. That Consent Agreement includes two orders: the Decision and Order and the Order to Maintain Assets.

The Decision and Order requires the divestiture of assets relating to Arixtra<sup>®</sup>. These assets are hereinafter referred to as the “Sanofi Divested Assets.” The Decision and Order also requires the divestiture of certain assets relating to certain Aventis products including Camptosar<sup>®</sup> (marketed under the tradename Campto<sup>®</sup> in Europe), and the enantiomer of Imovane<sup>®</sup> known as Estorra<sup>®</sup> (a product owned by Sepracor in the United States but subject to a licensing agreement with Aventis). These assets are hereinafter referred to as the “Aventis Divested Assets.” Both the Decision and Order and the Order to Maintain Assets require Respondents to commit that no Confidential Business Information relating to the Sanofi Divested Assets or the Aventis Divested Assets will be disclosed to or used by any employee of the combined entity formed by the acquisition of a controlling interest in Aventis by Sanofi (“Combined Entity”). In particular, this is to protect such information from being used in any way for the research, development, sale or manufacture of any product that competes or may compete with any product that is marketed by the Respondents after the proposed acquisition. The Decision and Order also requires the complete divestiture of ALL documents (including electronically stored material) that contain Confidential Business Information related to the Sanofi Divested Assets and Aventis Divested Assets. Accordingly, no employee of the Combined Entity may maintain copies of documents containing such information, except as otherwise required by law or to the

Decision and Order

extent necessary (1) in the case of Arixtra, to supply drug substance and to continue the Arixtra Ongoing Clinical Development, on behalf of GlaxoSmithKine as provided for in the Arixtra Asset Purchase Agreement, and (2) in the case of Camptosar/Campto, to comply with the requirements contained in decisions of the Commission of the European Communities in Case COMP/M.3354, or to comply with Sanofi's obligations in the Camptosar Asset Purchase Agreement.

Under the Decision and Order, the Respondents are required to divest the Sanofi Divested Assets and Aventis Divested Assets to acquirers that must be approved by the FTC. Companies have been proposed to the FTC as the acquirers for these assets. Until a complete divestiture of all of the Sanofi Divested Assets and Aventis Divested Assets occurs, the requirements of the second order – the Order to Maintain Assets – are in place to ensure the continued marketability, viability and competitive vigor of the Sanofi Divested Assets and Aventis Divested Assets. This includes preserving the work force that performs functions related to the Sanofi Divested Assets and Aventis Divested Assets. You are receiving this notice because you are one or more of the following: (i) an employee with work responsibilities related to the Sanofi Divested Assets; (ii) an employee with work responsibilities related to the Aventis Divested Assets; (iii) an employee for Sanofi, Aventis or the Combined Entity who has work responsibilities in some way related to products that compete or may compete with the Sanofi Divested Assets or Aventis Divested Assets; or (iv) an employee or former employee of Aventis or Sanofi who might have Confidential Business Information in your possession related to the Sanofi Divested Assets or Aventis Divested Assets.

All Confidential Business Information related to Sanofi Divested Assets and Aventis Divested Assets must be retained and maintained by the persons involved in the operation of that business on a confidential basis, and such persons must not provide, discuss, exchange, circulate, or otherwise disclose any such information to or with any other person whose employment

## Decision and Order

involves responsibilities unrelated to the Sanofi Divested Assets or Aventis Divested Assets (such as persons with job responsibilities related to Sanofi or Aventis products that compete or may compete with the Sanofi Divested Assets or Aventis Divested Assets). In addition, any person who possesses such Confidential Business Information related to the Aventis Divested Assets or Sanofi Divested Assets and who becomes involved in the Combined Entity's business related to any product that competes or may compete with the Sanofi Divested Assets or Aventis Divested Assets must not provide, discuss, exchange, circulate, or otherwise disclose any such information to or with any other person whose employment relates to such businesses. Finally, any Sanofi, Aventis or former Sanofi or Aventis employee with documents that contain information that he or she believes might be considered Confidential Business Information related to the Aventis Divested Assets or Sanofi Divested Assets and who has not received specific instructions as to how the documents in his or her possession should be disposed of should contact the contact person identified at the end of this notice.

Furthermore, the Decision and Order places restrictions upon the functions that management level employees of Sanofi or Aventis can perform for the Combined Entity for one (1) year from the closing of the Sanofi/Aventis transaction, as follows: any employee of Sanofi who was involved in the marketing of Arixtra may not perform a similar function for the Combined Entity relating to Lovenox. In addition, any employee involved in sales efforts for Arixtra may not perform a similar function for the Combined Entity regarding Lovenox for six (6) months from the closing of the Sanofi/Aventis transaction.

The Decision and Order also places restrictions upon the functions that research and development employees related to Campto can perform for the Combined Entity for one (1) year from the closing of the Sanofi/Aventis transaction, as follows: any employee of Aventis who was involved in the research and development of Campto may not perform any functions for the Combined Entity relating to Eloxatin.

Decision and Order

Any violation of the Decision and Order or the Order to Maintain Assets may subject Sanofi, Aventis, or the Combined Entity to civil penalties and other relief as provided by law. If you have any questions regarding the contents of this notice, the confidentiality of information, the Decision and Order or the Order to Maintain Assets, you should contact Jean-Claude Armbruster, Senior Vice President, Human Resources.

**ACKNOWLEDGMENT**

I, \_\_\_\_\_ (print name),  
hereby acknowledge that I have read the above notification and  
agree to abide by its provisions.

Decision and Order

**NON-PUBLIC  
APPENDIX II  
TO THE DECISION AND ORDER  
ARIXTRA ASSET PURCHASE AGREEMENT  
[Redacted From the Public Record Version But Incorporated  
By Reference]**

**NON-PUBLIC  
APPENDIX III  
TO THE DECISION AND ORDER**

**CAMPTOSAR ASSET PURCHASE AGREEMENT  
[Redacted From the Public Record Version But Incorporated  
By Reference]**

**NON-PUBLIC  
APPENDIX IV  
TO THE DECISION AND ORDER**

**ESTORRA LICENSE AGREEMENT  
[Redacted From the Public Record Version But Incorporated  
By Reference]**

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### **ORDER TO MAINTAIN ASSETS**

The Federal Trade Commission (“Commission”) having initiated an investigation of the proposed acquisition by Respondent Sanofi-Synthélabo (“Sanofi”) of Respondent Aventis (“Aventis”), hereinafter referred to as “Respondents,” and Respondents having been furnished thereafter with a copy of a draft of a Complaint that the Bureau of Competition proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge Respondents with violations of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45; and

Respondents, their attorneys, and counsel for the Commission having thereafter executed an Agreement Containing Consent Orders (“Consent Agreement”), containing an admission by Respondents of all the jurisdictional facts set forth in the aforesaid draft of a Complaint, a statement that the signing of said Consent Agreement is for settlement purposes only and does not constitute an admission by Respondents that the law has been violated as alleged in such Complaint, or that the facts as alleged in such Complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission’s Rules; and

The Commission having thereafter considered the matter and having determined to accept the executed Consent Agreement and to place such Consent Agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, now in further conformity with the procedure described in Commission Rule 2.34, 16 C.F.R. § 2.34, the Commission hereby issues its Complaint, makes the following jurisdictional findings and issues this Order to Maintain Assets:

1. Respondent Sanofi is a French *société anonyme* organized, existing and doing business under and by virtue of the laws of the French Republic, with its registered office located at 174, avenue de France, Paris, 75013, France.



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2. Respondent Aventis is a French *société anonyme* organized, existing and doing business under and by virtue of the laws of the French Republic, with its registered office located at 16, avenue de l'Europe, 67300 Schiltigheim, France.

3. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of Respondents, and the proceeding is in the public interest.

**ORDER****I.**

**IT IS ORDERED** that, as used in this Order to Maintain Assets, the following definitions and the definitions used in the Consent Agreement and the proposed Decision and Order (and when made final, the Decision and Order), which are attached hereto as Appendix B and incorporated herein by reference and made a part of hereof, shall apply:

- A. "Sanofi" means Sanofi-Synthélabo, a French *société anonyme*, its directors, officers, employees, agents, representatives, predecessors, successors, and assigns; its joint ventures, subsidiaries, divisions, groups, and affiliates in each case controlled by Sanofi-Synthélabo and the respective directors, officers, employees, agents, representatives, successors, and assigns of each. After the Acquisition, Sanofi shall include Aventis.
- B. "Aventis" means Aventis, a French *société anonyme*, its directors, officers, employees, agents, representatives, predecessors, successors, and assigns; its joint ventures, subsidiaries, divisions, groups, and affiliates in each case controlled by Aventis, and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

Order

- C. “Respondents” means Sanofi and Aventis, individually and collectively.
- D. “Pfizer” means Pfizer Inc., a corporation organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its offices and principal place of business located at 235 East 42<sup>nd</sup> Street, New York, New York 10017.
- E. “Acquisition” means the point in the transaction at which the shareholders of Respondent Aventis shall have sold to Respondent Sanofi more than 50 percent of the shares and voting rights of Respondent Aventis in furtherance of the tender offer launched by Respondent Sanofi with respect to Respondent Aventis on the terms set forth in the “*Note d’Information*” that received approval of the French *Autorité des Marchés Financiers*, under the Visa 04-384 dated May 7, 2004, as the same may be amended.
- F. “Commission” means the Federal Trade Commission.
- G. “Closing Date” means the date on which Respondent(s) (or a Divestiture Trustee) and a Commission-approved Acquirer consummate a transaction to assign, grant, license, divest, transfer, deliver or otherwise convey the relevant assets pursuant to the Decision and Order.
- H. “Commission-approved Acquirer” means the following:  
(1) an entity that is specifically identified in the Decision and Order to acquire particular assets that the Respondents are required to assign, grant, license, divest, transfer, deliver, or otherwise convey pursuant to the Decision and Order and that has been approved by the Commission to accomplish the requirements of the Decision and Order in connection with the Commission’s determination to make the Decision and Order final; or (2) an entity approved by the Commission to acquire particular assets that the Respondents are required to assign, grant, license, divest,

## Order

transfer, deliver, or otherwise convey pursuant to the Decision and Order.

- I. “Confidential Business Information” means all information owned by, or in the possession or control of, Respondents that is not in the public domain related to the research, Development, manufacture, marketing, commercialization, distribution, importation, exportation, cost, pricing, supply, sales, sales support, or use of a Product.
- J. “Divestiture Assets” means the Arixtra Assets and the Camptosar Assets, individually and collectively, as defined in the Decision and Order.
- K. “Effective Date” means the date on which the Acquisition occurs.
- L. “Interim Monitor” means any monitor appointed pursuant to Paragraph III of this Order to Maintain Assets or Paragraph V of the Decision and Order .
- M. “Orders” means the Decision and Order and this Order to Maintain Assets.
- N. “Remedial Agreement” means the following: (1) any agreement between Respondent(s) and a Commission-approved Acquirer that is specifically referenced and attached to the Decision and Order, including all amendments, exhibits, attachments, agreements, and schedules thereto, related to the relevant assets to be assigned, granted, licensed, divested, transferred, delivered, or otherwise conveyed, and that has been approved by the Commission to accomplish the requirements of the Decision and Order in connection with the Commission’s determination to make the Decision and Order final; and/or (2) any agreement between the Respondent(s) and a Commission-approved Acquirer (or between a Divestiture Trustee and a Commission-

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approved Acquirer) that has been approved by the Commission to accomplish the requirements of the Decision and Order, including all amendments, exhibits, attachments, agreements, and schedules thereto, related to the relevant assets to be assigned, granted, licensed, divested, transferred, delivered, or otherwise conveyed, and that has been approved by the Commission to accomplish the requirements of the Decision and Order.

**II.**

**IT IS FURTHER ORDERED** that from the date this Order to Maintain Assets becomes final:

- A. Respondents shall take such actions as are necessary to maintain the full economic viability, marketability and competitiveness of the businesses associated with the Divestiture Assets, to minimize any risk of loss of competitive potential for the businesses associated with the Divestiture Assets, and to prevent the destruction, removal, wasting, deterioration, or impairment of any of the Divestiture Assets except for ordinary wear and tear. Respondents shall not sell, transfer, encumber or otherwise impair the full economic viability, marketability or competitiveness of the Divestiture Assets.
- B. Respondents shall maintain the operations of the Divestiture Assets in the regular and ordinary course of business and in accordance with past practice (including regular repair and maintenance of the Divestiture Assets) and shall use their best efforts to preserve the existing relationships with suppliers, vendors, customers, Agencies, employees, and others having business relations with the Divestiture Assets. Respondents' responsibilities shall include, but are not limited to, the following:
  1. providing the Divestiture Assets with sufficient working capital to operate the Divestiture Assets at least at current

## Order

rates of operation, to meet all capital calls with respect to the Divestiture Assets and to carry on, at least at their scheduled pace, all capital projects, business plans and promotional activities for the Divestiture Assets;

2. continuing, at least at their scheduled pace, any additional expenditures for the Divestiture Assets authorized prior to the date the Consent Agreement was signed by Respondents (including all research and Development expenditures);
  3. making available for use by the Divestiture Assets funds sufficient to perform all routine maintenance and all other maintenance as may be necessary for, and all replacements of, the Divestiture Assets;
  4. providing the Divestiture Assets with such funds as are necessary to maintain the full economic viability, marketability and competitiveness of the Divestiture Assets; and
  5. providing such support services to the Divestiture Assets as were being provided to these businesses by Respondents as of the date the Consent Agreement was signed by Respondents.
- C. Respondents shall maintain a work force equivalent in size, training, and expertise to what has been associated with the Divestiture Assets, including providing the employees associated with the Divestiture Assets with reasonable and appropriate financial incentives to continue their employment positions until the Closing Date.
- D. Respondents shall:
1. during the Arixtra Access Period, (a) not interfere with the hiring or employing by the Commission-approved Acquirer of Arixtra Core Employees, and (b) remove any impediments within the control of Respondents that may

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deter these employees from accepting employment with the Commission-approved Acquirer, including, but not limited to, any noncompete provisions of employment or other contracts with Respondents that would affect the ability or incentive of those individuals to be employed by the Commission-approved Acquirer. In addition, Respondents shall not make any counteroffer to an Arixtra Core Employee who receives a written offer of employment from the Commission-approved Acquirer;

*provided, however,* that this Paragraph II.D.1 shall not prohibit the Respondents from making offers of employment to or employing any Arixtra Core Employee during the Arixtra Access Period where the Commission-approved Acquirer has notified the Respondents in writing that the Commission-approved Acquirer does not intend to make an offer of employment to that employee;

*provided further* that, if the Respondents notify the Commission-approved Acquirer in writing of their desire to make an offer of employment to a particular Arixtra Core Employee and the Commission-approved Acquirer does not make an offer of employment to that employee within twenty (20) Days of the date the Commission-approved Acquirer receives such notice, the Respondents may make an offer of employment to that employee; and

2. until the Closing Date, provide all Arixtra Core Employees with reasonable financial incentives to continue in their positions. Such incentives shall include a continuation of all employee benefits offered by Respondents until the Closing Date for the divestiture of the Arixtra Assets has occurred, including regularly scheduled raises, bonuses, and vesting of pension benefits (as permitted by Law). In addition to the foregoing, Respondents shall provide to each Arixtra Core Employee (other than those employees who transfer to the Commission-approved Acquirer by operation of Law) who accepts employment with the Commission-

## Order

approved Acquirer, an incentive equal to three (3) months of such employee's base annual salary to be paid upon the employee's completion of one (1) year of employment with the Commission-approved Acquirer;

*provided, however,* that nothing in this Paragraph II.D.2 or in this Order to Maintain Assets requires or shall be construed to require the Respondents to terminate the employment of any employee.

## E. Respondents shall:

1. during the Camptosar Access Period, (a) not interfere with the hiring or employing by Pfizer of Camptosar Core Employees, and (b) remove any impediments within the control of Respondents that may deter these employees from accepting employment with Pfizer, including, but not limited to, any noncompete provisions of employment or other contracts with Respondents that would affect the ability or incentive of those individuals to be employed by Pfizer. In addition, Respondents shall not make any counteroffer to a Camptosar Core Employee who receives a written offer of employment from Pfizer;

*provided, however,* that this Paragraph II.E.1 shall not prohibit the Respondents from making offers of employment to or employing any Camptosar Core Employee during the Camptosar Access Period where Pfizer has notified the Respondents in writing that Pfizer does not intend to make an offer of employment to that employee;

*provided further* that, if the Respondents notify Pfizer in writing of their desire to make an offer of employment to a particular Camptosar Core Employee and Pfizer does not make an offer of employment to that employee within twenty (20) Days of the date Pfizer receives such notice, the Respondents may make an offer of employment to that employee; and

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2. until the Closing Date, provide all Camptosar Core Employees with reasonable financial incentives to continue in their positions. Such incentives shall include a continuation of all employee benefits offered by Respondents until the Closing Date for the divestiture of the Camptosar Assets has occurred, including regularly scheduled raises, bonuses, and vesting of pension benefits (as permitted by Law). In addition to the foregoing, Respondents shall provide to each Camptosar Core Employee (other than those employees who transfer to Pfizer by operation of Law) who accepts employment with Pfizer, an incentive equal to three (3) months of such employee's base annual salary to be paid upon the employee's completion of one (1) year of employment with Pfizer;

*provided, however,* that nothing in this Paragraph II.E.2 or in this Order to Maintain Assets requires or shall be construed to require the Respondents to terminate the employment of any employee.

- F. Not later than sixty (60) Days following the Effective Date, Respondents shall provide to all of Respondents' employees and other personnel who may have access to Confidential Business Information related to Arixtra, or to the Camptosar Assets, as the case may be, written or electronic notification of the restrictions on the use of such information by Respondents' personnel. At the same time, if not provided earlier, Respondents shall provide a copy of such notification by e-mail with return receipt requested or similar transmission, and keep an electronic file of such receipts for one (1) year after the Closing Date. Respondents shall provide a copy of the form of such notification to the Commission-approved Acquirer (or, with respect to the Camptosar Assets, to Pfizer), the Interim Monitor(s), and the Commission. Respondents shall also obtain from each employee covered by this Paragraph II.F. an agreement to abide by the applicable restrictions. Such



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agreement and notification shall be in substantially the form set forth in the “Notice of Antitrust Remedy and Requirement for Confidentiality” attached as Appendix A to this Order to Maintain Assets. Respondents shall maintain complete records of all such agreements at Respondents’ corporate headquarters and shall provide an officer’s certification to the Commission stating that such acknowledgment program has been implemented and is being complied with. Respondents shall monitor the implementation by their employees and other personnel of all applicable restrictions, and take corrective actions for the failure of such employees and personnel to comply with such restrictions or to furnish the written agreements and acknowledgments required by this Order to Maintain Assets. Respondents shall provide the Commission-approved Acquirer (or, with respect to the Camptosar Assets, Pfizer) with copies of all certifications, notifications and reminders sent to Respondents’ employees and other personnel.

- G. Respondents shall adhere to and abide by the Remedial Agreements (which agreements shall not vary or contradict, or be construed to vary or contradict, the terms of the Orders, it being understood that nothing in the Orders shall be construed to reduce any obligations of Respondents under such agreement(s)), which are incorporated by reference into this Order to Maintain Assets and made a part hereof.
- H. The purpose of this Order to Maintain Assets is to maintain the full economic viability, marketability and competitiveness of the businesses associated with the Divestiture Assets, to minimize any risk of loss of competitive potential for the businesses associated with the Divestiture Assets, and to prevent the destruction, removal, wasting, deterioration, or impairment of any of the Divestiture Assets except for ordinary wear and tear.

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**III.**

**IT IS FURTHER ORDERED** that:

- A. At any time after Respondents sign the Consent Agreement in this matter, the Commission may appoint an Interim Monitor to assure that Respondents expeditiously comply with all of their obligations and perform all of their responsibilities as required by the Orders and the Remedial Agreements. The Commission may appoint one or more Interim Monitors to assure Respondents' compliance with the requirements of the Orders and the related Remedial Agreements.
- B. The Commission shall select the Interim Monitor, subject to the consent of Respondents, which consent shall not be unreasonably withheld. If neither Respondent has opposed, in writing, including the reasons for opposing, the selection of a proposed Interim Monitor within ten (10) Days after notice by the staff of the Commission to Respondents of the identity of any proposed Interim Monitor, Respondents shall be deemed to have consented to the selection of the proposed Interim Monitor.
- C. Not later than ten (10) Days after the appointment of the Interim Monitor, Respondents shall execute an agreement that, subject to the prior approval of the Commission, confers on the Interim Monitor all the rights and powers necessary to permit the Interim Monitor to monitor Respondents' compliance with the relevant requirements of the Orders in a manner consistent with the purposes of the Orders.
- D. If one or more Interim Monitors are appointed pursuant to this Paragraph or pursuant to the relevant provisions of the Decision and Order in this matter, Respondents shall consent to the following terms and conditions regarding

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the powers, duties, authorities, and responsibilities of each Interim Monitor:

1. The Interim Monitor shall have the power and authority to monitor Respondents' compliance with the divestiture and asset maintenance obligations and related requirements of the Orders, and shall exercise such power and authority and carry out the duties and responsibilities of the Interim Monitor in a manner consistent with the purposes of the Orders and in consultation with the Commission;
2. The Interim Monitor shall act in a fiduciary capacity for the benefit of the Commission;
3. The Interim Monitor shall serve until the latest of:
  - a. with respect to the Arixtra Assets, the completion by Respondents of the divestiture of the Arixtra Assets required to be divested pursuant to the attached Decision and Order in a manner that fully satisfies the requirements of the Orders and notification by the Commission-approved Acquirer to the Interim Monitor that it is fully capable of producing the relevant Product(s) acquired pursuant to a Remedial Agreement independently of Respondents (including, but not limited to, the manufacture of all registered steps necessary to produce Arixtra finished drug product);
  - b. with respect to the Camptosar Assets, the completion by Respondents of the divestiture of the Camptosar Assets required to be divested pursuant to the Decision and Order in a manner that fully satisfies the requirements of the Orders and notification by Pfizer to the Interim Monitor that it is fully capable of completing the Camptosar Key Clinical Trials; and
  - c. the completion by Respondents of the last obligation under the Orders pertaining to the Interim Monitor's service;

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*provided, however,* that the Commission may extend or modify this period as may be necessary or appropriate to accomplish the purposes of the Orders.

- E. Subject to any demonstrated legally recognized privilege, the Interim Monitor shall have full and complete access to Respondents' personnel, books, documents, records kept in the normal course of business, facilities and technical information, and such other relevant information as the Interim Monitor may reasonably request, related to Respondents' compliance with their obligations under the Orders, including, but not limited to, their obligations related to the relevant assets. Respondents shall cooperate with any reasonable request of the Interim Monitor and shall take no action to interfere with or impede the Interim Monitor's ability to monitor Respondents' compliance with the Orders.
- F. The Interim Monitor shall serve, without bond or other security, at the expense of Respondents on such reasonable and customary terms and conditions as the Commission may set. The Interim Monitor shall have authority to employ, at the expense of the Respondents, such consultants, accountants, attorneys and other representatives and assistants as are reasonably necessary to carry out the Interim Monitor's duties and responsibilities.
- G. Respondents shall indemnify the Interim Monitor and hold the Interim Monitor harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Interim Monitor's duties, including all reasonable fees of counsel and other reasonable expenses incurred in connection with the preparations for, or defense of, any claim, whether or not resulting in any liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from misfeasance, gross negligence, willful or wanton acts, or bad faith by the Interim Monitor.

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- H. Respondents shall report to the Interim Monitor in accordance with the requirements of this Order to Maintain Assets and/or as otherwise provided in any agreement approved by the Commission. The Interim Monitor shall evaluate the reports submitted to the Interim Monitor by Respondents, and any reports submitted by the Commission-approved Acquirer with respect to the performance of Respondents' obligations under the Orders or the Remedial Agreement. Within one (1) month from the date the Interim Monitor receives these reports, the Interim Monitor shall report in writing to the Commission concerning performance by Respondents of their obligations under the Orders.
- I. Respondents may require the Interim Monitor and each of the Interim Monitor's consultants, accountants, attorneys and other representatives and assistants to sign a customary confidentiality agreement;
- provided, however, that such agreement shall not restrict the Interim Monitor from providing any information to the Commission.
- J. The Commission may, among other things, require the Interim Monitor and each of the Interim Monitor's consultants, accountants, attorneys and other representatives and assistants to sign an appropriate confidentiality agreement related to Commission materials and information received in connection with the performance of the Interim Monitor's duties.
- K. If the Commission determines that the Interim Monitor has ceased to act or failed to act diligently, the Commission may appoint a substitute Interim Monitor in the same manner as provided in this Paragraph or the relevant provisions of the Decision and Order in this matter.
- L. The Commission may on its own initiative, or at the request

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of the Interim Monitor, issue such additional orders or directions as may be necessary or appropriate to assure compliance with the requirements of the Orders.

- M. The Interim Monitor appointed pursuant to this Order to Maintain Assets or the relevant provisions of the Decision and Order in this matter may be the same person appointed as a Divestiture Trustee pursuant to the relevant provisions of the Decision and Order.

#### IV.

**IT IS FURTHER ORDERED** that within thirty (30) Days after the date this Order to Maintain Assets becomes final, and every thirty (30) Days thereafter until Respondents have fully complied with their obligations to assign, grant, license, divest, transfer, deliver or otherwise convey relevant assets as required by Paragraph II.A., III.A, and IV.A. of the related Decision and Order in this matter, Respondents shall submit to the Commission a verified written report setting forth in detail the manner and form in which they intend to comply, are complying, and have complied with this Order to Maintain Assets and the related Decision and Order; *provided, however*, that, after the Decision and Order in this matter becomes final, the reports due under this Order to Maintain Assets may be consolidated with, and submitted to the Commission at the same time as, the reports required to be submitted by Respondents pursuant to Paragraph VII of the Decision and Order.

**IT IS FURTHER ORDERED** that Respondents shall notify the Commission at least thirty (30) Days prior to any proposed (1) dissolution of the Respondents, (2) acquisition, merger, or consolidation of Respondents, or (3) other change in the Respondents that may affect compliance obligations arising out of the order, including, but not limited to, assignment, the creation or dissolution of subsidiaries, or any other change in Respondents.

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**V.**

**IT IS FURTHER ORDERED** that, for the purposes of determining or securing compliance with this Order to Maintain Assets, and subject to any legally recognized privilege, and upon written request with reasonable notice to Respondents made to their principal United States offices, Respondents shall permit any duly authorized representatives of the Commission:

- A. Access, during office hours of Respondents and in the presence of counsel, to all facilities and access to inspect and copy all books, ledgers, accounts, correspondence, memoranda and all other records and documents in the possession or under the control of Respondents relating to compliance with this Order to Maintain Assets; and
- B. Upon five (5) Days' notice to Respondents and without restraint or interference from Respondents, to interview officers, directors, or employees of Respondents, who may have counsel present, regarding such matters.

**VI.**

**IT IS FURTHER ORDERED** that this Order to Maintain Assets shall terminate on the earlier of:

- A. Three (3) Days after the Commission withdraws its acceptance of the Consent Agreement pursuant to the provisions of Commission Rule 2.34, 16 C.F.R. § 2.34; or
- B. The day after the divestiture of all of the Divestiture Assets, as required by and described in the Decision and Order, has been completed and each Interim Monitor, in consultation with Commission staff and the Commission-approved Acquirer(s), notifies the Commission that all related assignments, conveyances, deliveries, grants, licenses, transactions, transfers and other transitions are complete, or

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the Commission otherwise directs that this Order to  
Maintain Assets be terminated.



Order

**PUBLIC**  
**APPENDIX A**  
**TO THE ORDER TO MAINTAIN ASSETS**

**NOTICE OF ANTITRUST REMEDY AND  
REQUIREMENT FOR CONFIDENTIALITY**

On [INSERT], Sanofi-Synthélabo (“Sanofi”) and Aventis (“Aventis”) hereinafter referred to as “Respondents,” entered into an Agreement Containing Consent Orders (“Consent Agreement”) with the Federal Trade Commission (“FTC”) relating to the divestiture of certain assets. That Consent Agreement includes two orders: the Decision and Order and the Order to Maintain Assets.

The Decision and Order requires the divestiture of assets relating to Arixtra<sup>®</sup>. These assets are hereinafter referred to as the “Sanofi Divested Assets.” The Decision and Order also requires the divestiture of certain assets relating to certain Aventis products including Camptosar<sup>®</sup> (marketed under the tradename Campto<sup>®</sup> in Europe), and the enantiomer of Imovane<sup>®</sup> known as Estorra<sup>®</sup> (a product owned by Sepracor in the United States but subject to a licensing agreement with Aventis). These assets are hereinafter referred to as the “Aventis Divested Assets.” Both the Decision and Order and the Order to Maintain Assets require Respondents to commit that no Confidential Business Information relating to the Sanofi Divested Assets or the Aventis Divested Assets will be disclosed to or used by any employee of the combined entity formed by the acquisition of a controlling interest in Aventis by Sanofi (“Combined Entity”). In particular, this is to protect such information from being used in any way for the research, development, sale or manufacture of any product that competes or may compete with any product that is marketed by the Respondents after the proposed acquisition. The Decision and Order also requires the complete divestiture of ALL documents (including electronically stored material) that contain Confidential Business Information related to the Sanofi Divested Assets and Aventis Divested Assets. Accordingly, no employee of the

Order

Combined Entity may maintain copies of documents containing such information, except as otherwise required by law or to the extent necessary (1) in the case of Arixtra, to supply drug substance and to continue the Arixtra Ongoing Clinical Development, on behalf of GlaxoSmithKine as provided for in the Arixtra Asset Purchase Agreement, and (2) in the case of Camptosar/Campto, to comply with the requirements contained in decisions of the Commission of the European Communities in Case COMP/M.3354, or to comply with Sanofi's obligations in the Camptosar Asset Purchase Agreement.

Under the Decision and Order, the Respondents are required to divest the Sanofi Divested Assets and Aventis Divested Assets to acquirers that must be approved by the FTC. Companies have been proposed to the FTC as the acquirers for these assets. Until a complete divestiture of all of the Sanofi Divested Assets and Aventis Divested Assets occurs, the requirements of the second order – the Order to Maintain Assets – are in place to ensure the continued marketability, viability and competitive vigor of the Sanofi Divested Assets and Aventis Divested Assets. This includes preserving the work force that performs functions related to the Sanofi Divested Assets and Aventis Divested Assets. You are receiving this notice because you are one or more of the following: (i) an employee with work responsibilities related to the Sanofi Divested Assets; (ii) an employee with work responsibilities related to the Aventis Divested Assets; (iii) an employee for Sanofi, Aventis or the Combined Entity who has work responsibilities in some way related to products that compete or may compete with the Sanofi Divested Assets or Aventis Divested Assets; or (iv) an employee or former employee of Aventis or Sanofi who might have Confidential Business Information in your possession related to the Sanofi Divested Assets or Aventis Divested Assets.

All Confidential Business Information related to Sanofi Divested Assets and Aventis Divested Assets must be retained and maintained by the persons involved in the operation of that business on a confidential basis, and such persons must not

## Order

provide, discuss, exchange, circulate, or otherwise disclose any such information to or with any other person whose employment involves responsibilities unrelated to the Sanofi Divested Assets or Aventis Divested Assets (such as persons with job responsibilities related to Sanofi or Aventis products that compete or may compete with the Sanofi Divested Assets or Aventis Divested Assets). In addition, any person who possesses such Confidential Business Information related to the Aventis Divested Assets or Sanofi Divested Assets and who becomes involved in the Combined Entity's business related to any product that competes or may compete with the Sanofi Divested Assets or Aventis Divested Assets must not provide, discuss, exchange, circulate, or otherwise disclose any such information to or with any other person whose employment relates to such businesses. Finally, any Sanofi, Aventis or former Sanofi or Aventis employee with documents that contain information that he or she believes might be considered Confidential Business Information related to the Aventis Divested Assets or Sanofi Divested Assets and who has not received specific instructions as to how the documents in his or her possession should be disposed of should contact the contact person identified at the end of this notice.

Furthermore, the Decision and Order places restrictions upon the functions that management level employees of Sanofi or Aventis can perform for the Combined Entity for one (1) year from the closing of the Sanofi/Aventis transaction, as follows: any employee of Sanofi who was involved in the marketing of Arixtra may not perform a similar function for the Combined Entity relating to Lovenox. In addition, any employee involved in sales efforts for Arixtra may not perform a similar function for the Combined Entity regarding Lovenox for six (6) months from the closing of the Sanofi/Aventis transaction.

The Decision and Order also places restrictions upon the functions that research and development employees related to Campto can perform for the Combined Entity for one (1) year from the closing of the Sanofi/Aventis transaction, as follows: any employee of Aventis who was involved in the research and

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development of Campto may not perform any functions for the Combined Entity relating to Eloxatin.

Any violation of the Decision and Order or the Order to Maintain Assets may subject Sanofi, Aventis, or the Combined Entity to civil penalties and other relief as provided by law. If you have any questions regarding the contents of this notice, the confidentiality of information, the Decision and Order or the Order to Maintain Assets, you should contact Jean-Claude Armbruster, Senior Vice President, Human Resources.

**ACKNOWLEDGMENT**

I, \_\_\_\_\_ (print name),

hereby acknowledge that I have read the above notification and

agree to abide by its provisions.

Order

**PUBLIC**  
**APPENDIX B**  
**TO THE ORDER TO MAINTAIN ASSETS**  
**AGREEMENT CONTAINING CONSENT ORDER**  
**AND**  
**PROPOSED DECISION AND ORDER**

Analysis

**Analysis of Proposed Consent Order To Aid Public Comment**

The Federal Trade Commission has accepted, subject to final approval, an Agreement Containing Consent Orders (“Consent Agreement”) from Sanofi-Synthelabo (“Sanofi”) and Aventis. The Consent Agreement contains an Order to Maintain Assets to preserve, among other things, the viability, marketability, and competitiveness of the assets to be divested pending their divestiture. The Consent Agreement also contains a Decision and Order that is designed to remedy the anticompetitive effects of Sanofi’s proposed acquisition of Aventis. Under the terms of the Consent Agreement, the companies will be required to: (1) divest all Arixtra® assets; (2) divest to Pfizer all United States intellectual property and key clinical trials, currently conducted by Aventis, related to Camptosar®; and (3) divest Aventis’ royalty rights to Sepracor’s Estorra®.

The proposed Consent Agreement has been placed on the public record for thirty days for receipt of comments by interested persons. Comments received during this period will become part of the public record. After thirty days, the Commission will again review the agreement and any comments received and will decide whether it should withdraw from the agreement or make final the agreement’s proposed Consent Order.

Pursuant to a tender offer launched January 26, 2004, Sanofi proposes to acquire Aventis. The offer accepted by Aventis’ Board values Aventis at approximately \$64 billion. The Commission’s Complaint alleges that the proposed acquisition, if consummated, would constitute a violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, in the markets for: (1) factor Xa inhibitors; (2) cytotoxic drugs that treat colorectal cancer; and (3) prescription drugs that treat insomnia. The proposed Consent Agreement would remedy the alleged violations by replacing the lost competition that would result from the acquisition in each of these markets.

## Analysis

**Factor Xa Inhibitors**

Factor Xa inhibitors are anticoagulant products that are used in acute settings to treat and prevent venous thromboembolism (“VTE”) and other conditions relating to excessive blood clot formation. Although unfractionated heparin was once the standard of care for the acute prevention and treatment of VTE and related complications, factor Xa inhibitors have become the treatment of choice due in large part to a better side effect profile and ease of use. Annual U.S. sales of factor Xa inhibitors totaled \$1.35 billion in 2003.

The U.S. market for factor Xa inhibitors is highly concentrated. Aventis’ market leading Lovenox® currently accounts for over 90 percent of factor Xa inhibitor sales in the United States. Sanofi markets Arixtra®, a more recent market entrant whose competitive significance is likely to expand as it receives Food and Drug Administration (“FDA”) approval for new indications. Although other factor Xa inhibitors are available in the United States – including Pfizer’s Fragmin® and Pharmion’s Innohep® – they have not been successful competitors in the market.

As with most pharmaceutical products, entry into the manufacture and sale of factor Xa inhibitors is difficult, expensive and time consuming. In order to enter the market, a firm must incur substantial sunk costs to research, develop, manufacture and sell factor Xa inhibitors. In addition, the approval for multiple indications is critical to the success of a new factor Xa inhibitor. Gaining FDA approval for each indication takes a significant amount of time because of the need to conduct clinical trials in support of each indication. New or expanded entry sufficient to deter or counteract the anticompetitive effects of the acquisition likely would not occur in a timely manner. New entry is unlikely to occur in the face of a 5 to 10 percent increase in the price of these drugs, and current factor Xa inhibitors also would be unlikely to counteract such a price increase. The only firm that is likely to launch a product in the United States in the foreseeable future is AstraZeneca, which recently filed a New Drug

Analysis

Application with the FDA for its own factor Xa inhibitor, Exanta®. However, Exanta® is a direct thrombin inhibitor rather than a factor Xa inhibitor. Further, AstraZeneca is seeking approval for only one of the indications that factor Xa inhibitors are approved for. Therefore, it is unlikely that entry by Exanta® would have a sufficient, timely effect on competition to resolve the competitive effects of the proposed acquisition.

The proposed acquisition would cause significant anticompetitive harm in the U.S. market for factor Xa inhibitors by eliminating the actual, direct, and substantial competition between Sanofi and Aventis. This loss of competition likely would result in higher prices.

The proposed Consent Order maintains competition in the factor Xa inhibitor market by requiring that: (1) Sanofi divest Arixtra® to GlaxoSmithKline; (2) Sanofi transfer to GlaxoSmithKline the manufacturing facilities used by Sanofi to produce Arixtra® in final finished form; (3) Sanofi contract manufacture the active pharmaceutical ingredient (“API”) and certain intermediate step ingredients until such time as GlaxoSmithKline obtains the necessary regulatory approvals and supply sources that will allow it to manufacture the API independently; (4) Sanofi assist GlaxoSmithKline in completing three key clinical trials; (5) Sanofi provide incentives to certain employees to continue in their positions until the divestiture is accomplished; (6) for a period of time after the assets are divested, Sanofi provide GlaxoSmithKline an opportunity to enter into employment contracts with individuals who have experience relating to Arixtra®; and (7) Sanofi take steps to maintain the confidentiality of confidential information related to Arixtra®.

### **Cytotoxic Drugs for the Treatment of Colorectal Cancer**

Colorectal cancer is the second leading cause of cancer-related deaths in the United States for both men and women. Approximately 146,940 new cases of colorectal cancer will be diagnosed in 2004 and 56,730 people will die from the disease.



## Analysis

Cytotoxic colorectal cancer drugs have been shown to be more effective than older, generic drug treatments. The U.S. market for cytotoxic colorectal cancer therapies currently generates approximately \$1 billion in annual sales.

The U.S. market for cytotoxic colorectal cancer drugs is highly concentrated. Two major cytotoxic products approved by the FDA for the treatment of colorectal cancer are Sanofi's product, Eloxatin®, and Camptosar®, a product developed by Yakult Honsha ("Yakult") and marketed in the U.S. by Pfizer. Combined, the two products have over 80 percent of the U.S. cytotoxic colorectal cancer drug market. Roche is the only other provider in the market with more than a 1 percent market share.

Entry into the market for cytotoxic colorectal cancer drugs is difficult, time consuming, and costly because of the lengthy development periods, the need for FDA approval, and the substantial sunk costs required to research, develop, manufacture and sell these drugs.

Although Aventis does not directly market a cytotoxic colorectal cancer drug in the United States, there are significant contractual entanglements between Aventis and Pfizer that affect the U.S. market. Pfizer licenses irinotecan (under the brand name Camptosar®) from Yakult for sales in the United States. Aventis licenses irinotecan (under the brand name Campto®) from Yakult for sales in other territories. Under a data transfer agreement, Pfizer and Aventis share the results of key clinical trials. Aventis also possesses a number of U.S. patents relating to Camptosar®. These entanglements allow Aventis to impact the Camptosar® business. The proposed acquisition thus creates an overlap in the U.S. market between Sanofi's Eloxatin® and Aventis' contractual ties to Camptosar®. This overlap affords the combined firm (1) access to competitively sensitive information from its main competitor, Pfizer, and (2) control over key clinical trials that Pfizer relies on for FDA applications that would expand Camptosar® indications in the United States. Therefore, the proposed acquisition would cause significant anticompetitive

Analysis

harm in the U.S. market for cytotoxic colorectal cancer drugs by reducing the actual, substantial competition between Sanofi and Pfizer.

The proposed Consent Agreement eliminates the potential anticompetitive effects of the acquisition in the U.S. cytotoxic colorectal cancer drug market by requiring the parties to: (1) divest to Pfizer key clinical studies for Campto® that are currently conducted by Aventis, together with certain U.S. patents and other assets pertaining to territories where Pfizer currently markets Camptosar®; (2) provide Pfizer with the opportunity to enter into employment contracts with certain employees involved in the key clinical trials; (3) deliver to Pfizer all confidential business information regarding Camptosar® that Aventis has in its possession; and (4) commit to maintain the assets to be divested in a manner that preserves the integrity, viability, and value of the assets, until the divestitures are accomplished.

### **Prescription Drugs for the Treatment of Insomnia**

More than 50 million people in the United States suffer from insomnia, the perception or complaint of inadequate sleep. The U.S. insomnia treatment market is estimated to have generated approximately \$1.65 billion in 2003 sales and is projected to increase to \$3.36 billion by 2010.

Sanofi dominates the market for prescription drugs that treat insomnia with its well known product, Ambien®. Sanofi's market share in the United States exceeded 85 percent in 2003. Sepracor is developing a product called Estorra®, which is expected to be launched in the beginning of 2005 and is likely to become a significant competitor to Ambien®. Although Aventis does not market a prescription sleep drug in the United States, there are financial and informational entanglements between Aventis and Sepracor relating to the Estorra® product. Therefore, the acquisition creates an overlap between Ambien® and Aventis' royalty rights to Estorra®.

## Analysis

The proposed acquisition would create anticompetitive effects in the market for prescription drugs that treat insomnia by diluting competition between Sanofi and Sepracor. Although several new products are expected to enter the market in the next five years, it is unlikely that the entry of these products, alone or in combination, could counteract the anticompetitive effects of the acquisition. Accordingly, allowing Sanofi to acquire Aventis' rights to Estorra would reduce Sanofi's incentives to compete against Sepracor in the prescription sleep drug market and would be likely to lead to higher prices.

The proposed Consent Agreement remedies the acquisition's anticompetitive effects by requiring the parties to divest their contractual rights to Estorra®. No later than 90 days after the Order becomes final, the parties are required to divest their rights to Estorra® royalties in a manner that receives Commission approval, either to Sepracor or to a third party approved by the Commission.

**Interim Monitor**

The Commission has appointed Francis J. Civile as Interim Monitor to oversee the asset transfers and to ensure Sanofi's and Aventis' compliance with all of the provisions of the proposed Consent Order. Mr. Civile has over 35 years of experience in the pharmaceutical industry and is well-respected in the industry. In order to ensure that the Commission remains informed about the status of the proposed divestitures and the transfers of assets, the proposed Consent Order requires Sanofi and Aventis to file reports with the Commission periodically until the divestitures and transfers are accomplished.

The purpose of this analysis is to facilitate public comment on the Consent Agreement, and it is not intended to constitute an official interpretation of the Consent Agreement or to modify its terms in any way.

Complaint

**IN THE MATTER OF**

**CEPHALON, INC.**

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 7 OF THE CLAYTON ACT AND SEC. 5 OF THE FEDERAL TRADE  
COMMISSION ACT

*Docket C-4121; File No. 0410025*

*Complaint, September 20, 2004--Decision, September 20, 2004*

This consent order, among other things, requires Respondent Cephalon, Inc., the only United States marketer of a self-administered and portable dosage form breakthrough cancer pain (“BTCP”) drug -- called Actiq, and used to help reduce or eliminate the spikes of intense pain experienced by patients receiving opioid therapy for their chronic pain -- to grant Barr Laboratories, Inc., or another Commission-approved buyer, a fully paid-up, irrevocable license to make and sell a generic equivalent of Actiq. The order also requires Respondent Cephalon to effect certain other license and technology transfers to enable Barr to compete aggressively in the BTCP market against Actiq. In addition, the order prohibits Respondent Cephalon from making certain regulatory filings that would delay Food and Drug Administration approval of Barr’s generic version of Actiq.

*Participants*

For the Commission: *Elizabeth A. Jex, Jeffrey H. Perry, Kari A. Wallace, Tammy L. Imhoff, Sylvia M. Brooks, Lauren T. Kearney, Patrick English, Michael R. Moiseyev, David A. Von Nirschl, Daniel P. Ducore, Laura Hosken, Aileen Thompson, and Mark Frankena.*

For the Respondents: *Willard K. Tom, Morgan Lewis & Bockius and Karen Silverman, Latham & Watkins.*

**COMPLAINT**

Pursuant to the Federal Trade Commission Act and the Clayton Act, and by virtue of the authority vested in it by said Acts, the Federal Trade Commission (“Commission”), having reason to believe that Respondent Cephalon, Inc. (“Cephalon”), a corporation subject to the jurisdiction of the Commission, has

## Complaint

agreed to merge with Respondent CIMA LABS INC. (“Cima”), a corporation subject to the jurisdiction of the Commission, in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, and it appearing to the Commission that a proceeding in respect thereof would be in the public interest, hereby issues its Complaint, stating its charges as follows:

**I. DEFINITIONS**

1. “Asset Purchase Agreement” means the Agreement and Plan of Merger by and between Cephalon, Cima, and C MergerCo, Inc., dated November 3, 2003.
2. “Respondents” means Cephalon and Cima individually and collectively.

**II. RESPONDENTS**

3. Respondent Cephalon is a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 145 Brandywine Parkway, West Chester, PA 19308. Cephalon, among other things, is engaged in the research, development, manufacture and sale of human pharmaceutical products.
4. Respondent Cima is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 10000 Valley View Road, Eden Prairie, MN 55344. Cima, among other things, is engaged in the research, development, manufacture, and sale of human pharmaceutical products.
5. Respondents are, and at all times relevant herein have been, engaged in commerce, as “commerce” is defined in Section 1 of the Clayton Act as amended, 15 U.S.C. § 12, and are corporations whose business is in or affects commerce, as “commerce” is

Complaint

defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

### **III. THE PROPOSED ACQUISITION**

6. On November 3, 2003, Cephalon and Cima entered into an Asset Purchase Agreement whereby Cephalon agreed to acquire, through its wholly-owned subsidiary C MergerCo, Inc., 100 percent of the issued and outstanding shares of Cima (“Acquisition”). Cephalon intends to pay consideration such that each issued and outstanding share of Cima common stock will be converted into the right to receive \$34.00 in cash. The parties estimate the aggregate value of the transaction to be approximately \$500 million. After the completion of the transaction, Cephalon will be the surviving corporate entity.

### **IV. THE RELEVANT MARKET**

7. For the purposes of this Complaint, the relevant line of commerce in which to analyze the effects of the Acquisition is the manufacture and sale of prescription drug products for the treatment of breakthrough cancer pain (“BTCP”).

8. For the purposes of this Complaint, the United States is the relevant geographic area in which to analyze the effects of the Acquisition in the relevant line of commerce.

### **V. THE STRUCTURE OF THE MARKETS**

9. Cephalon dominates the market for the research, development, manufacture, and sale of prescription drug products for the treatment of BTCP with its product Actiq. Actiq is currently the only drug approved by the Food and Drug Administration (“FDA”) for the treatment of breakthrough cancer pain. Cima is in Phase III of clinical development with its OraVescent fentanyl product, and it is the firm best positioned to next enter the market. Other firms that have undertaken efforts to

## Complaint

develop BTCP products have either failed in their efforts or lag well behind Cima.

**VI. ENTRY CONDITIONS**

10. Entry into the relevant line of commerce described in Paragraph 7 would not be timely, likely, or sufficient in its magnitude, character, and scope to deter or counteract the anticompetitive effects of the Acquisition. Developing and obtaining FDA approval for either generic or branded products takes at least two years due to substantial regulatory, technological, patent, and other intellectual property barriers.

**VII. EFFECTS OF THE ACQUISITION**

11. The effects of the Acquisition, if consummated, may be to lessen competition and tend to create a monopoly in the relevant market in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the FTC Act, as amended, 15 U.S.C. § 45, in the following ways, among others: (a) by eliminating potential competition between Cephalon and Cima in the market for the manufacture and sale of prescription drugs for the treatment of BTCP, thereby increasing the ability of the combined entity to unilaterally raise prices of BTCP products; (b) by increasing the likelihood that the combined entity would delay or forego the launch of Cima's OraVescent fentanyl, thereby delaying or eliminating the price competition that would have resulted from Cima's entry into the market for BTCP products; and (c) by reducing the likelihood of effective generic entry.

**VIII. VIOLATIONS CHARGED**

12. The Asset Purchase Agreement described in Paragraph 6 constitutes a violation of Section 5 of the FTC Act, as amended, 15 U.S.C. § 45.

13. The Acquisition described in Paragraph 6, if consummated, would constitute a violation of Section 7 of the

Complaint

Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the  
FTC Act, as amended, 15 U.S.C. § 45.

WHEREFORE, THE PREMISES CONSIDERED, the Federal  
Trade Commission on this twentieth day of September, 2004,  
issues its Complaint against said Respondents.



Decision and Order

**DECISION AND ORDER**

The Federal Trade Commission (“Commission”) having initiated an investigation of the proposed merger of Respondent Cephalon, Inc. (“Cephalon”) and Respondent CIMA LABS INC. (“CIMA”), hereinafter referred to as “Respondents,” and Respondents having been furnished thereafter with a copy of a draft of Complaint that the Bureau of Competition proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge Respondents with violations of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45; and

Respondents, their attorneys, and counsel for the Commission having thereafter executed an Agreement Containing Consent Order (“Consent Agreement”), containing an admission by Respondents of all the jurisdictional facts set forth in the aforesaid draft of Complaint, a statement that the signing of said Consent Agreement is for settlement purposes only and does not constitute an admission by Respondents that the law has been violated as alleged in such Complaint, or that the facts as alleged in such Complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission’s Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that Respondents have violated the said Acts, and that a Complaint should issue stating its charges in that respect, and having accepted the executed Consent Agreement and placed such Consent Agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, now in further conformity with the procedure described in Commission Rule 2.34, 16 C.F.R. § 2.34, the Commission hereby makes the following jurisdictional findings and issues the following Decision and Order (“Order”):

Decision and Order

1. Respondent Cephalon is a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its offices and principal place of business located at 145 Brandywine Parkway, West Chester, Pennsylvania 19380.

2. Respondent CIMA is a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its offices and principal place of business located at 10000 Valley View Road, Eden Prairie, Minnesota 55344.

3. The Federal Trade Commission has jurisdiction over the subject matter of this proceeding and of Respondents, and the proceeding is in the public interest.

**ORDER**

**I.**

**IT IS ORDERED** that, as used in this Order, the following definitions shall apply:

- A. “Cephalon” means Cephalon, Inc., its directors, officers, employees, agents, representatives, predecessors, successors, and assigns; its joint ventures, subsidiaries, divisions, groups and affiliates controlled by Cephalon, Inc. (including, but not limited to, MergerCo), and the respective directors, officers, employees, agents, representatives, successors, and assigns of each. After the Effective Date, the term “Cephalon” shall include CIMA.
- B. “CIMA” means CIMA LABS INC., its directors, officers, employees, agents, representatives, predecessors, successors, and assigns; its joint ventures, subsidiaries, divisions, groups and affiliates controlled by CIMA LABS, INC., and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

## Decision and Order

- C. “Respondents” means Cephalon and CIMA, individually and collectively.
- D. “Commission” means the Federal Trade Commission.
- E. “Barr” means Barr Laboratories, Inc., a corporation organized, existing, and doing business under and by virtue of the laws of the State of Delaware, having its principal place of business located at Two Quaker Road, P.O. Box 2900, Pomona, New York 10970.
- F. “Acquisition” means the acquisition contemplated by the “Agreement and Plan of Merger” dated as of November 3, 2003, by and among Cephalon, CIMA and MergerCo (“Acquisition Agreement”), whereby Cephalon agreed to acquire CIMA.
- G. “Agency(ies)” means any governmental regulatory authority or authorities in the world responsible for granting approval(s), clearance(s), qualification(s), license(s) or permit(s) for any aspect of the research, Development, manufacture, marketing, distribution or sale of Oral Opioid Fentanyl. The term “Agency” includes, but is not limited to, the United States Food and Drug Administration (“FDA”) and the United States Drug Enforcement Administration (“DEA”).
- H. “Application”, “New Drug Application” (“NDA”), “Abbreviated New Drug Application” (“ANDA”), “Supplemental New Drug Application” (“SNDA”), or “Marketing Authorization Application” (“MAA”) mean the applications for a Product filed or to be filed with the FDA pursuant to 21 C.F.R. Part 314, or its foreign Agency equivalent, and all supplements, amendments, and revisions thereto, any preparatory work, drafts and data necessary for the preparation thereof, and all correspondence between Respondents and the FDA or other Agency relative thereto.

Decision and Order

- I. “Approvable Letter” means a letter from the FDA that an Application is basically approvable as described in 21 C.F.R. Part 314.110.
- J. “Approval Letter” means a letter from the FDA approving an Application as described in 21 C.F.R. Part 314.105.
- K. “Closing Date” means the date on which Respondents (or a Divestiture Trustee) and a Commission-approved Acquirer consummate a transaction to grant, license, deliver or otherwise convey relevant assets pursuant to this Order. (Pursuant to Paragraph II.A. of this Order, the Closing Date is required to occur not later than ten (10) Days after the Effective Date.)
- L. “Commission-approved Acquirer” means the following:
  - 1. Barr, if Barr has not been rejected by the Commission pursuant to Paragraph II.A. of this Order; or
  - 2. an entity approved by the Commission to acquire particular assets that the Respondents are required to grant, license, deliver or otherwise convey pursuant to this Order.
- M. “Confidential Business Information” means all information owned by, or in the possession or control of, Respondents that is not in the public domain and that is related to the research, Development, manufacture, marketing, importation, exportation, supply, sales, sales support, or use of Oral Opioid Fentanyl.
- N. “Contract Manufacture” means the manufacture of Oral Opioid Fentanyl to be supplied by Respondents or a Designee specifically identified in this Order for sale to the Commission-approved Acquirer.

## Decision and Order

- O. “Day(s)” means the period of time prescribed under this Order as computed pursuant to 16 C.F.R. § 4.3 (a).
- P. “Designee” means any entity other than the Respondent(s) that will manufacture Oral Opioid Fentanyl for a Commission-approved Acquirer.
- Q. “DD5” means the Product in preclinical development by Respondent Cephalon as of the Effective Date that is a buccal patch formulation comprising Fentanyl and is designated “DD5.”
- R. “Development” means all preclinical and clinical drug development activities (including formulation), including test method development and stability testing, toxicology, bioequivalency, formulation, process development, manufacturing scale-up, development-stage manufacturing, quality assurance/quality control development, statistical analysis and report writing, conducting clinical trials for the purpose of obtaining any and all approvals, licenses, registrations or authorizations from any Agency necessary for the manufacture, use, storage, import, export, transport, promotion, marketing and sale of a Product (including any governmental price or reimbursement approvals), Product approval and registration, and regulatory affairs related to the foregoing. “Develop” means to engage in Development.
- S. “Direct Cost” means the cost of direct labor and direct material used to provide the relevant assistance or service.
- T. “Divestiture Trustee” means a trustee appointed by the Commission pursuant to the relevant provisions of this Order.
- U. “Drug Master Files” means the information submitted to the FDA as described in 21 C.F.R. Part 314.420 related to a Product.

Decision and Order

- V. “Effective Date” means the earlier of the following dates:
1. the date the Respondents close on the Acquisition Agreement; or
  2. the date the merger contemplated by the Acquisition Agreement becomes effective by filing the certificate of merger with the Secretary of State of the State of Delaware.
- W. “Fentanyl” means the chemical substance known by the international non-proprietary name fentanyl citrate and/or all pharmaceutically active derivatives thereof including, without limitation, esters, salts, hydrates, solvates, polymorphs, prodrugs, metabolites and isomers thereof and all hydrates, solvates, polymorphs, prodrugs and isomers of such salts.
- X. “Field” means the prevention, treatment, diagnosis, or control of a particular medical condition.
- Y. “Final FDA Approval” means approval of a Product by the FDA pursuant the Federal Food, Drug, and Cosmetic Act § 505(b), 21 U.S.C. 355(b).
- Z. “Final Finished Form” means a Product packaged in final form and ready for sale by the Commission-approved Acquirer to the Commission-approved Acquirer’s ultimate customer (other than for the addition of the Commission-approved Acquirer’s specific packaging and/or labeling).
- AA. “Generic Entrant Forbearance Date” means the earlier of the following dates:
1. August 3, 2007; or
  2. one hundred eighty (180) Days after the Marketing Licensing Date.

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- BB. “Governmental Entity” means any Federal, state, local or non-U.S. government or any court, legislature, governmental agency or governmental commission or any judicial or regulatory authority of any government.
- CC. “Interim Monitor” means a monitor appointed by the Commission pursuant to Paragraph III of this Order.
- DD. “Law” means all laws, statutes, rules, regulations, ordinances and other pronouncements having the effect of law by any Governmental Entity.
- EE. “Marketing Licensing Date” means the following dates:
1. with respect to Substantially Sugar-Free Formulations of Oral Opioid Fentanyl, the earliest of the following dates:
    - a. the date of Final FDA Approval of OVF;
    - b. the date of notice of a withdrawal of approval by the FDA of NDA No. 20-747; or
    - c. the date of Final FDA Approval of a Substantially Sugar-Free Formulation of Oral Opioid Fentanyl (*unless*, at least sixty (60) Days prior to the occurrence of the Marketing Licensing Date with respect to all other formulations of Oral Opioid Fentanyl (as determined below), the FDA determines such formulation is therapeutically equivalent to other formulations of Oral Opioid Fentanyl already approved by the FDA, *i.e.*, the FDA determines that any actual or potential bioequivalence problems have been resolved with adequate evidence supporting bioequivalence);

*provided, however*, that should Marketing Licensing Date with respect to Substantially Sugar-Free Formulations of Oral Opioid Fentanyl (as determined above) occur prior to

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the occurrence of the Marketing Licensing Date with respect to all other formulations of Oral Opioid Fentanyl (as determined below), then the Marketing Licensing Date for the Sugar-Free Formulations of Oral Opioid Fentanyl shall instead be defined to be the same date as Marketing Licensing Date with respect to all other formulations of Oral Opioid Fentanyl (as determined below); and

2. with respect to all other formulations of Oral Opioid Fentanyl the earliest of the following dates:
  - a. the date of Final FDA Approval of OVF;
  - b. September 5, 2006, if Respondents are not granted Pediatric Exclusivity with respect to Oral Opioid Fentanyl; or
  - c. February 3, 2007, if Respondents are granted Pediatric Exclusivity with respect to Oral Opioid Fentanyl,

*provided, however*, if Respondents have not obtained Final FDA Approval of a Substantially Sugar-Free Formulation of Oral Opioid Fentanyl on or before the later of the following dates: (1) July 1, 2005; or (2) one hundred eighty (180) Days from the date of an Approvable Letter for a Substantially Sugar-Free Formulation of Oral Opioid Fentanyl issued to the Respondents (but only if such Approvable Letter is issued on or before July 1, 2005), then the Marketing Licensing Date with respect to Substantially Sugar Free Formulations and all other formulations of Oral Opioid Fentanyl shall be no later than September 5, 2006.

FF. “Not Approvable Letter” means a letter from the FDA that an Application may not be approved, as described in 21 C.F.R. Part 314.120.



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- GG. “Oral Opioid Fentanyl” means all Products that contain the active pharmaceutical ingredient Fentanyl and any dose form, presentation or line extension thereof existing as of the Effective Date. The term “Oral Opioid Fentanyl” also includes all Products marketed or in Development by Respondent Cephalon on or before the Effective Date that contain active pharmaceutical ingredient Fentanyl and are planned to be marketed for use in the Field of pain management. This includes all sugar-free versions of such Products (*except* where this Order specifically differentiates between Substantially Sugar-Free Formulation(s) and other formulations of the Products); *provided, however*, the term “Oral Opioid Fentanyl” does not include the following: (1) Products that were owned or controlled by Respondent CIMA prior to the Effective Date and that were not owned or controlled by Respondent Cephalon prior to such date; and (2) Respondent Cephalon’s Product DD5.
- HH. “Oral Opioid Fentanyl Assets” means all of Respondent Cephalon’s rights in and to all Product Intellectual Property and Product Manufacturing Technology related to Respondent Cephalon’s business in the United States related to the Oral Opioid Fentanyl to the extent legally transferable, including the research, Development, manufacture, distribution, marketing or sale of Oral Opioid Fentanyl, including, without limitation, the following:
1. license(s) to all Product Intellectual Property;
  2. Right of Reference or Use to the Drug Master Files including, but not limited to, the pharmacology and toxicology data contained in all Applications, NDAs, ANDAs, SNDAs and MAAs;

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3. Rights of Reference or Use (if such rights exist) to information similar to the Drug Master Files submitted to any Agency other than the FDA;
4. copies of all Product Scientific and Regulatory Material;
5. licenses to all Product Manufacturing Technology;
6. copies of all Respondents' books, records and files related to the foregoing, including, but not limited to, the following specified documents:
  - a. the Product Registrations;
  - b. Drug Master Files, including, but not limited to, the pharmacology and toxicology data contained in all Applications, NDAs, ANDAs, SNDAs and MAAs; all data submitted to and all correspondence with the FDA and other Agencies; all validation documents and data; including, without limitation, clinical data, and quality control histories pertaining to Oral Opioid Fentanyl owned by, or in the possession or control of, Respondents, or to which Respondents have a right of access, in each case such as is in existence as of the Closing Date;

*provided, however*, the Oral Opioid Fentanyl Assets do not include the following: (1) businesses and assets that were owned or controlled by Respondent CIMA prior to the Effective Date and that were not owned or controlled by Respondent Cephalon prior to such date; and (2) and assets solely related to Respondent Cephalon's Product DD5.

II. "Oral Opioid Fentanyl Core Employees" means Product Manufacturing Employees, and Product Research and Development Employees.

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- JJ. “Oral Opioid Fentanyl License and Supply Agreement” means the “License and Supply Agreement” by and between Cephalon Inc. and Barr Laboratories, Inc. dated July 7, 2004, and all amendments, exhibits, attachments, agreements, and schedules thereto, related to the Oral Opioid Fentanyl Assets to be granted, licensed, delivered, or otherwise conveyed, that have been approved by the Commission to accomplish the requirements of this Order. The Oral Opioid Fentanyl License and Supply Agreement is attached to this Order as non-public Appendix I.
- KK. “Oral Opioid Fentanyl Releasee(s)” means the Commission-approved Acquirer or any entity controlled by or under common control with the Commission-approved Acquirer, or any licensees, sublicensees, manufacturers, suppliers, distributors, and customers of the Commission-approved Acquirer, or of such Commission-approved Acquirer-affiliated entities.
- LL. “Oral Opioid Risk Management Program” means a strategic safety program designed to decrease product risk by using one or more interventions or tools beyond the package insert, which program may be modified or amended from time to time and may be a condition of Final FDA Approval.
- MM. “OVF” means the Product, OraVescent<sup>®</sup> Fentanyl, under development by Respondent CIMA that contains Fentanyl and is formulated with an effervescent agent and is the subject of an IND No. 65,447 or any other IND subsequently filed by Respondents.
- NN. “Patents” means all patents, patent applications and statutory invention registrations, in each case existing as of the Effective Date (*except* where this Order specifies a different time), and includes all reissues, divisions, continuations, continuations-in-part, substitutions, reexaminations, restorations, and /or patent term

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extensions thereof, all inventions disclosed therein, all rights therein provided by international treaties and conventions, and all rights to obtain and file for patents and registrations thereto in the United States, related to a Product of or owned by Respondent Cephalon as of the Effective Date.

- OO. “Pediatric Exclusivity” means exclusivity obtained in accordance with the requirements of Federal Food, Drug, and Cosmetic Act § 505a, 21 U.S.C. 355a.
- PP. “Product” means any pharmaceutical, biological, or genetic composition containing any formulation or dosage of a compound referenced as its pharmaceutically, biologically or genetically active ingredient.
- QQ. “Product Employee Information” means the following:
1. a complete and accurate list containing the name of each relevant employee as of the execution date of the related Remedial Agreement. This list shall be organized by the relevant respective employee categories defined in this Order, (*i.e.*, “Product Manufacturing Employees,” or “Product Research and Development Employees,” as applicable);
  2. with respect to each such employee the following information:
    - a. job title or position held;
    - b. a specific description of the employee’s responsibilities related to Oral Opioid Fentanyl; *provided, however*, in lieu of this description, Respondents may provide the employee’s most recent performance appraisal.

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RR. “Product Intellectual Property” means all of the following related to the Product(s):

1. Patents;
2. Product Trademarks;
3. trade secrets, know-how, techniques, data, inventions, practices, methods and other confidential or proprietary technical, business, research, Development and other information; and
4. rights to obtain and file for Patents and registrations thereof;

*provided, however*, “Product Intellectual Property” does not include the names “CIMA”, “Cephalon,” or the names of any other corporations or companies owned by Respondents or related logos to the extent used on other of Respondent CIMA’s or Respondent Cephalon’s Products;

*provided further, however*, “Product Intellectual Property” does not include the trade name Actiq<sup>®</sup>.

SS. “Product Manufacturing Employees” means all salaried employees of Respondent(s) who directly have participated (irrespective of the portion of working time involved) in the manufacture of the Oral Opioid Fentanyl, including, but not limited to, the Senior Director of Commercial Manufacturing, the Associate Director of Production Planning, and the Manager of Commercial Manufacturing, and all those involved in the quality assurance and quality control of the Oral Opioid Fentanyl, within the eighteen (18) month period immediately prior to the Closing Date.

TT. “Product Manufacturing Technology” means all technology, trade secrets, know-how, and proprietary

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information (whether patented, patentable or otherwise) related to the manufacture (including all equipment used to manufacture a Product in Final Finished Form), validation, packaging, release testing, stability and shelf life of Oral Opioid Fentanyl, including all product formulations, in existence and in the possession of Respondents as of the Closing Date, product specifications, processes, product designs, plans, trade secrets, ideas, concepts, manufacturing, engineering and other manuals and drawings, standard operating procedures, flow diagrams, chemical, pharmacological, toxicological, pharmaceutical, physical and analytical, safety, efficacy, bioequivalency, quality assurance, quality control and clinical data, research records, compositions, annual product reviews, process validation reports, analytical method validation reports, specifications for stability trending and process controls, testing and reference standards for impurities in and degradation of products, technical data packages, chemical and physical characterizations, dissolution test methods and results, formulations for administration, clinical trial reports, regulatory communications and labeling and all other information related to the manufacturing process, and supplier lists.

- UU. “Product Research and Development Employees” means all employees of Respondent(s) who directly have participated (irrespective of the portion of working time involved) in the research, Development, regulatory approval process, or clinical studies of Oral Opioid Fentanyl within the eighteen (18) month period immediately prior to the Closing Date.
- VV. “Product Scientific and Regulatory Material” means all technological, scientific, chemical, biological, pharmacological, toxicological, regulatory and clinical trial materials and information related to Oral Opioid

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Fentanyl, and full rights to use such materials, in any and all jurisdictions.

WW. “Product Trademark(s)” means the following as related to Oral Opioid Fentanyl:

1. the U.S. Trademark Registration No. 2,622,734 as needed for a single dose entity of any generic version of Oral Opioid Fentanyl;
2. at the Commission-approved Acquirer’s option, any trademark or trade dress covering the size, shape and color of a single dose entity of any generic version of Oral Opioid Fentanyl;
3. the Oral Opioid Risk Management Program; and
4. the appearance, structure, textual or graphical content and/or color scheme of any labeling, dosing information, product inserts, storage containers and/or other materials, to the extent that the FDA or and other Agency requires the Commission-approved Acquirer to duplicate such appearance, structure, textual or graphical content and/or color scheme of any labeling, dosing information, product inserts, storage containers and/or other materials.

XX. “Proposed Acquirer” means an entity proposed by the Respondents (or a Divestiture Trustee) to the Commission and submitted for the approval of the Commission as the acquirer for particular assets required to be granted, licensed, delivered or otherwise conveyed by Respondents pursuant to this Order.

YY. “Remedial Agreement” means the following:

1. the Oral Opioid Fentanyl License and Supply Agreement, if such agreement has not been rejected by

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the Commission pursuant to Paragraph II.A. of this Order; or

2. any agreement between a Respondent(s) and a Commission-approved Acquirer (or between a Divestiture Trustee and a Commission-approved Acquirer) that has been approved by the Commission to accomplish the requirements of this Order, and all amendments, exhibits, attachments, agreements, and schedules thereto, related to the relevant assets to be granted, licensed, delivered or otherwise conveyed that have been approved by the Commission to accomplish the requirements of this Order.

ZZ. “Right of Reference or Use” means the authority to rely upon, and otherwise use, an investigation for the purpose of obtaining approval of an Application, including the ability to make available the underlying raw data from the investigation for FDA audit.

AAA. “Substantially Sugar-Free Formulation(s)” means either of the following:

1. a Product containing less than one-half (0.5) grams of Sugar(s) per dosage; or
2. a Product approved by the FDA for labeling as “Sugar-Free.”

BBB. “Sugar(s)” means the sum of all free mono- and disaccharides (such as glucose, fructose, lactose, and sucrose) as defined in 21 C.F.R. §101.9(c)(6)(ii).

CCC. “Supply Cost” means the manufacturer’s average direct per unit cost of manufacturing the Product plus costs of manufacturing the Product that are directly attributable to FDA regulatory, quality control and



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compliance. "Supply Cost" shall expressly exclude any intracompany business transfer profit.

DDD. "Third Party(ies)" means any private entity other than the following: (1) the Respondents, or (2) the Commission-approved Acquirer.

**II.****IT IS FURTHER ORDERED** that:

- A. Not later than ten (10) Days after the Effective Date, Respondents shall grant irrevocable, perpetual, fully paid-up and royalty-free license(s) in the United States to the Oral Opioid Fentanyl Assets and shall grant, license, deliver or otherwise convey the Oral Opioid Fentanyl Assets, absolutely and in good faith, on a non-exclusive basis to Barr pursuant to and in accordance with the Oral Opioid Fentanyl License and Supply Agreement (which agreement shall not vary or contradict, or be construed to vary or contradict, the terms of this Order, it being understood that nothing in this Order shall be construed to reduce any rights or benefits of Barr or to reduce any obligations of Respondents under such agreement). Such licenses shall be effective as follows:
1. as of the Closing Date, as to Barr's rights to manufacture and Develop Oral Opioid Fentanyl using the Oral Opioid Fentanyl Assets; and
  2. not later than the Marketing Licensing Date, as to Barr's rights to distribute, market or sell Oral Opioid Fentanyl using the Oral Opioid Fentanyl Assets.

If Respondents do not grant, license, deliver or otherwise convey the Oral Opioid Fentanyl Assets to Barr within ten (10) Days after the Effective Date as provided above, the Commission may, pursuant to Paragraph IV of this Order, appoint a Divestiture Trustee to license, grant, deliver and

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otherwise convey the Oral Opioid Fentanyl Assets;

*provided, however,* that, if Respondents have granted, licensed, delivered or otherwise conveyed the Oral Opioid Fentanyl Assets to Barr prior to the date this Order becomes final, and if, at the time the Commission determines to make this Order final, the Commission notifies Respondents that Barr is not an acceptable purchaser of the Oral Opioid Fentanyl Assets, then Respondent shall immediately rescind the transaction with Barr and shall grant, license, deliver or otherwise convey the Oral Opioid Fentanyl Assets within six (6) months from the date the Order becomes final, absolutely and in good faith, at no minimum price, to a Commission-approved Acquirer and only in a manner that receives the prior approval of the Commission;

*provided further, however,* that if the Respondents have granted, licensed, delivered or otherwise conveyed the Oral Opioid Fentanyl Assets to Barr prior to the date this Order becomes final, and if, at the time the Commission determines to make this Order final, the Commission notifies the Respondents that the manner in which the grant, license, delivery or conveyance was accomplished is not acceptable, the Commission may direct the Respondents, or appoint a Divestiture Trustee, pursuant to Paragraph IV of this Order, to effect such modifications to the manner of granting, licensing, delivery or conveyance of the Oral Opioid Fentanyl Assets to Barr (including, but not limited to, entering into additional agreements or arrangements) as the Commission may be necessary to satisfy the requirements of this Order.

B. Not later than ten (10) Days after the Closing Date, Respondents shall begin to deliver to the Commission-approved Acquirer, at Respondent's expense, copies of all Confidential Business Information related to the Product Manufacturing Technology, Product Scientific and Regulatory Material, and Product Trademarks related to Oral Opioid Fentanyl Assets. Not later than one hundred

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eighty (180) Days after the Closing Date, Respondents shall complete delivery of all such Confidential Business Information to the Commission-approved Acquirer and certify to the Commission that such delivery has occurred in accordance with this Order. Respondents shall deliver such Confidential Business Information as follows: (1) in good faith; (2) as soon as practicable, avoiding any delays in transmission of the respective information; and (3) in a manner that insures its completeness and accuracy and that fully preserves its usefulness. Pending complete delivery of all such Confidential Business Information to the Commission-approved Acquirer, Respondents shall provide the Commission-approved Acquirer and the Interim Monitor (if any has been appointed) with access to all such Confidential Business Information and employees who possess or are able to locate such information for the purposes of identifying the books, records, and files related to the Oral Opioid Fentanyl Assets that contain such Confidential Business Information and facilitating the delivery in a manner consistent with this Order.

- C. Respondents shall not enforce any agreement against a Third Party or the Commission-approved Acquirer to the extent that such agreement may limit or otherwise impair the ability of the Commission-approved Acquirer to acquire the Product Manufacturing Technology or related equipment from the Third Party. Such agreements include, but are not limited to, agreements with respect to the disclosure of Confidential Business Information related to the Product Manufacturing Technology.
- D. Not later than ten (10) Days after the Effective Date, Respondents shall grant a release to each Third Party that is subject to an agreement as described in Paragraph II.C. that allows the Third Party to provide the relevant Product Manufacturing Technology or related equipment to the Commission-approved Acquirer. Within five (5) Days of the execution of each such release, Respondents shall

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provide a copy of the release to the Commission-approved Acquirer.

- E. Any Remedial Agreement that has been approved by the Commission between Respondents (or a Divestiture Trustee) and a Commission-approved Acquirer of the Oral Opioid Fentanyl Assets shall be deemed incorporated into this Order, and any failure by Respondents to comply with any term of such Remedial Agreement related to the Oral Opioid Fentanyl Assets shall constitute a failure to comply with this Order.
- F. Respondents shall include in any Remedial Agreement related to the Oral Opioid Fentanyl Assets the following provisions:
  - 1. At the Commission-approved Acquirer's Option, Respondents shall Contract Manufacture and deliver to the Commission-approved Acquirer, in a timely manner and under reasonable terms and conditions, a supply of Oral Opioid Fentanyl, including such Product in Final Finished Form, at Respondents' Supply Cost, for a period of time sufficient to allow the Commission-approved Acquirer (or the Designee of the Commission-approved Acquirer) to obtain all FDA approvals necessary to manufacture Oral Opioid Fentanyl independently of Respondents; *provided, however*, Respondents' obligation to Contract Manufacture shall not exceed six (6) years from the Closing Date.
  - 2. After the Closing Date and continuing for the term of the Contract Manufacture related to Oral Opioid Fentanyl, Respondents will make inventory of Oral Opioid Fentanyl available for sale or resale only to the Commission-approved Acquirer (other than for use in Respondents' own business related to Oral Opioid Fentanyl).

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3. The Respondents' obligation to supply Oral Opioid Fentanyl to the Commission-approved Acquirer shall take priority over the manufacture and supply of Oral Opioid Fentanyl for Respondents' own use or sale.
4. Respondents shall make representations and warranties to the Commission-approved Acquirer that the Oral Opioid Fentanyl supplied through Contract Manufacture pursuant to the Remedial Agreement meets current good manufacturing practices of the FDA, as set forth in 21 C.F.R. Parts 210 and 211. Respondents shall agree to indemnify, defend and hold the Commission-approved Acquirer harmless from any and all suits, claims, actions, demands, liabilities, expenses or losses alleged to result from the failure of the Oral Opioid Fentanyl supplied to the Commission-approved Acquirer pursuant to the Remedial Agreement by the Respondents to meet such specifications. This obligation shall be contingent upon the Commission-approved Acquirer giving Respondents prompt, adequate notice of such claim and cooperating fully in the defense of such claim. The Remedial Agreement shall be consistent with the obligations assumed by Respondents under this Order; *provided, however*, Respondents may reserve the right to control the defense of any such litigation, including the right to settle the litigation, so long as such settlement is consistent with the Respondents' responsibilities to supply Oral Opioid Fentanyl in the manner required by this Order; *provided further, however*, this obligation shall not require Respondents to be liable for any negligent act or omission of the Commission-approved Acquirer or for any representations and warranties, express or implied, made by the Commission-approved Acquirer that exceed the representations and warranties made by the Respondents to the Commission-approved Acquirer.

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5. Respondents shall make representations and warranties to the Commission-approved Acquirer that Respondents will hold harmless and indemnify the Commission-approved Acquirer for any liabilities including, but not limited to, indirect damages, special damages, consequential damages, lost profits, legal fees and costs resulting from the failure by Respondents to deliver Oral Opioid Fentanyl in a timely manner as required by the Remedial Agreement unless Respondents can demonstrate that their failure was entirely beyond the control of the Respondents and in no part the result of negligence or willful misconduct by Respondents.
6. During the term of the Contract Manufacture between Respondents and the Commission-approved Acquirer, upon request of the Commission-approved Acquirer or Interim Monitor (if applicable), Respondents shall make available to the Commission-approved Acquirer or the Interim Monitor all records that relate to the manufacture of Oral Opioid Fentanyl that are generated or created after the Closing Date.
7. Upon reasonable notice and request from the Commission-approved Acquirer to the Respondents, Respondents shall provide in a timely manner at no greater than Direct Cost the following:
  - a. assistance and advice to enable the Commission-approved Acquirer (or the Designee of the Commission-approved Acquirer) to obtain all necessary permits and approvals from any Agency or Governmental Entity to manufacture and sell Oral Opioid Fentanyl;
  - b. assistance to the Commission-approved Acquirer (or the Designee of the Commission-approved Acquirer) to manufacture Oral Opioid Fentanyl in substantially

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the same manner and quality employed or achieved by Respondent Cephalon; and

- c. consultation with knowledgeable employees of Respondents and training, at the request of the Commission-approved Acquirer and at a facility chosen by the Commission-approved Acquirer, until the Commission-approved Acquirer (or the Designee of the Commission-approved Acquirer) obtains all FDA approvals necessary to manufacture Oral Opioid Fentanyl independently of the Respondents and sufficient to satisfy management of the Commission-approved Acquirer that its personnel (or the Designee's personnel) are adequately trained in the manufacture of Oral Opioid Fentanyl.
8. Upon reasonable notice and request from the Commission-approved Acquirer to the Respondents, after the Marketing Licensing Date, Respondent shall provide in a timely manner, at no greater than Direct Cost, assistance with knowledgeable employees of the relevant Respondent to assist the Commission-approved Acquirer to defend against, respond to, or otherwise participate in any litigation related to the Product Intellectual Property related to Oral Opioid Fentanyl.
  9. Respondents shall covenant to the Commission-approved Acquirer that, after the Marketing Licensing Date (*except* for the manufacture and Development of Oral Opioid Fentanyl, in which case, the covenant shall begin as of the Closing Date), Respondents shall not join, or file, prosecute or maintain any suit, in Law or equity, against the Commission-approved Acquirer or the Oral Opioid Fentanyl Releasee(s) for the research, Development, manufacture, use, import, distribution, or sale of Oral Opioid Fentanyl (but only as to those Products that are commercialized or in Development as of the Closing Date) under Patents that:

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- a. are owned or licensed by Respondent Cephalon as of immediately prior to the closing on the acquisition of CIMA; or
  - b. may be assigned, granted, licensed, or otherwise conveyed to Respondents after the Effective Date, if such suit would have the potential to interfere with the Commission-approved Acquirer's freedom to practice in the research, Development, manufacture, use, import, sale, marketing or distribution of Oral Opioid Fentanyl (but only as to those Products that are commercialized or in Development as of the Closing Date) in the Field of pain management.
10. Respondents shall covenant to the Commission-approved Acquirer that, after the Marketing Licensing Date (*except* for the manufacture and Development of Oral Opioid Fentanyl, in which case, the covenant shall begin as of the Closing Date):
- a. any Third Party assignee or licensee of the above-described Patents shall agree to provide a covenant not to sue the Oral Opioid Fentanyl Releasees, at least as protective as those extended pursuant to the preceding Paragraph II.F.9, as a condition of such assignment or license; and
  - b. with respect to any Third Party rights licensed to Respondents as of or after the Effective Date, and as to which Respondents do not control the right of prosecution of any suit, legal or other action, Respondents shall not actively induce, assist or participate in any suit, legal or other action or proceeding relating to the Oral Opioid Fentanyl Products (but only as to those Products that are commercialized or in Development as of the Closing Date) against the Oral Opioid Releasees, unless required by Law or contract (such contract not to be



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solicited or entered into for the purpose of circumventing any of the requirements of this Order).

*provided, however,* that if the Oral Opioid Fentanyl License and Supply Agreement is the Remedial Agreement for the Oral Opioid Fentanyl Assets, then Respondents shall be deemed to have complied with any of the Supply Cost and Direct Cost requirements described in this Paragraph II.F. by complying with the such cost provisions as provided in the Oral Opioid Fentanyl License and Supply Agreement.

- G. For a period from the Closing Date until August 3, 2007, (“the Oral Opioid Fentanyl Access Period”), Respondents shall provide the Commission-approved Acquirer with the opportunity to enter into employment contracts with the Oral Opioid Fentanyl Core Employees. Respondents shall remove any impediments within the control of Respondents that may deter these employees from accepting employment with the Commission-approved Acquirer, including, but not limited to, any non-compete provisions of employment or other contracts with Respondents that would affect the ability of those individuals to be employed by the Commission-approved Acquirer.
- H. Not later than the earlier of the following dates: (1) ten (10) Days after notice by staff of the Commission to the Respondents to provide the Product Employee Information; or (2) ten (10) Days after the Closing Date, Respondents shall provide the Commission-approved Acquirer or the Proposed Acquirer the Product Employee Information related to the Oral Opioid Fentanyl Core Employees. Failure by Respondents to provide the Product Employee Information for any relevant employee within the time provided herein shall extend the Oral Opioid Fentanyl Access Period with respect to that employee in an amount equal to the delay.

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- I. Prior to the Closing Date, Respondents shall secure all consents and waivers from all Third Parties that are necessary for the licensing of the Oral Opioid Fentanyl Assets to the Commission-approved Acquirer, or for the continued research, Development, manufacture, use, import, sale, marketing or distribution of Oral Opioid Fentanyl by the Commission-approved Acquirer.
- J. Upon reasonable notice and request from the Commission-approved Acquirer to the Respondents, Respondents shall provide (in a timely manner and at no greater than Direct Cost) to the Commission-approved Acquirer consultation with, assistance, training, and advice from, knowledgeable employees of Respondents with respect to the Development and manufacture of Oral Opioid Fentanyl, that the Commission-approved Acquirer might reasonably need in order to receive and use the Oral Opioid Fentanyl Assets in a manner consistent with this Order, and shall continue providing such consultation, assistance, training and advice, at the request of the Commission-approved Acquirer, until the Commission-approved Acquirer (or the Designee of the Commission-approved Acquirer) is fully validated, qualified, and approved by the FDA, and able to manufacture Oral Opioid Fentanyl independently of the Respondents.
- K. Pending the granting, licensing, delivery or conveyance of the Oral Opioid Fentanyl Assets, Respondents shall take such actions as are necessary to maintain the full economic viability, marketability and competitiveness of the business associated with the Oral Opioid Fentanyl Assets, to minimize any risk of loss of competitive potential for the business associated with the Oral Opioid Fentanyl Assets, and to prevent the destruction, removal, wasting, deterioration, or impairment of any of the Oral Opioid Fentanyl Assets except for ordinary wear and tear.

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- L. After the Marketing Licensing Date (*except* for the manufacture and Development of Oral Opioid Fentanyl, in which case, this Paragraph shall apply as of the Closing Date), Respondents shall not join, or file, prosecute or maintain any suit, in Law or equity, against the Commission-approved Acquirer or the Oral Opioid Fentanyl Releasee(s) for the research, Development, manufacture, use, import, sale, marketing or distribution of Oral Opioid Fentanyl (but only as to those Products that are commercialized or in Development as of the Closing Date) under the following:
1. any Patents owned or licensed by Respondents as of the Effective Date or acquired after the Effective Date that claim the use of Oral Opioid Fentanyl in the Field of pain management; or
  2. that claim any aspect of the research, Development, manufacture, use, import, sale, marketing, or distribution of Oral Opioid Fentanyl other than such Patents that claim inventions conceived by and reduced to practice by Respondents' employees after the Effective Date.
- M. Respondents shall maintain manufacturing facilities for the Oral Opioid Fentanyl finished drug product, that are validated, qualified and approved by the FDA, and fully capable of producing Oral Opioid Fentanyl finished drug product and shall Contract Manufacture and supply such finished drug product to the Commission-approved Acquirer until the Commission-approved Acquirer (or the Designee of the Commission-approved Acquirer) is fully validated, qualified and approved by the FDA and able to manufacture Oral Opioid Fentanyl finished drug product in a facility that is independent of Respondents;
- provided, however*, this obligation shall not exceed six (6) years from the Closing Date;

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*provided further, however*, the Commission may eliminate, or further limit the duration of, the Respondent's obligation under this provision should the Commission determine that the Commission-approved Acquirer is not using commercially reasonable best efforts to secure the FDA approvals necessary to manufacture Oral Opioid Fentanyl finished drug product in a facility that is independent of Respondents.

N. At any time after the Generic Entrant Forbearance Date, Respondents shall not seek to enforce any Patent(s) related to Oral Opioid Fentanyl that is filed pursuant to 21 U.S.C. § 355(b)(1) as a part of the following:

1. the NDA No. 20-747, as supplemented, or amended; or
2. any Application filed by the Respondents for the purposes of obtaining an approval to label a formulation of Oral Opioid Fentanyl as "Sugar-Free" or an equivalent labeling designation,

against any Third Party to the extent that such enforcement might prohibit, limit, or otherwise impair the Third Party's ability to commercialize a Product under an ANDA filed by the Third Party that references such Patent(s) and the Product listed under the above-referenced NDA; *provided, however*, that this Paragraph shall not apply to Patents solely related to Substantially Sugar-Free Formulations of Oral Opioid Fentanyl until Final FDA Approval of OVF.

O. Not later than the Generic Entrant Forbearance Date, Respondents shall make available to the public those patent applications filed by Respondents, not already published, that are related to Oral Opioid Fentanyl.

P. The purpose of the grant, license, delivery and conveyance of the Oral Opioid Fentanyl Assets to a Commission-approved Acquirer is to create an independent, viable and effective competitor in the relevant market in which the

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Oral Opioid Fentanyl Assets were engaged at the time of the announcement of the Acquisition, and to remedy the lessening of competition resulting from the Acquisition as alleged in the Commission's Complaint.

**III.****IT IS FURTHER ORDERED** that:

- A. At any time after Respondents sign the Consent Agreement in this matter, the Commission may appoint a monitor ("Interim Monitor") to assure that Respondents expeditiously comply with all of their obligations and perform all of their responsibilities as required by this Order, and the Remedial Agreements.
- B. The Commission shall select the Interim Monitor, subject to the consent of Respondents, which consent shall not be unreasonably withheld. If neither Respondent has opposed, in writing, including the reasons for opposing, the selection of a proposed Interim Monitor within ten (10) Days after notice by the staff of the Commission to Respondents of the identity of any proposed Interim Monitor, Respondents shall be deemed to have consented to the selection of the proposed Interim Monitor.
- C. Not later than ten (10) Days after the appointment of the Interim Monitor, Respondents shall execute an agreement that, subject to the prior approval of the Commission, confers on the Interim Monitor all the rights and powers necessary to permit the Interim Monitor to monitor Respondents' compliance with the relevant requirements of the Order in a manner consistent with the purposes of the Order.
- D. If an Interim Monitor is appointed, Respondents shall consent to the following terms and conditions regarding

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the powers, duties, authorities, and responsibilities of the Interim Monitor:

1. The Interim Monitor shall have the power and authority to monitor Respondents' compliance with the divestiture and asset maintenance obligations and related requirements of the Order, and shall exercise such power and authority and carry out the duties and responsibilities of the Interim Monitor in a manner consistent with the purposes of the Order and in consultation with the Commission.
2. The Interim Monitor shall act in a fiduciary capacity for the benefit of the Commission.
3. The Interim Monitor shall serve until the later of:
  - a. the completion by Respondents of the divestiture of all relevant assets required to be granted, licensed, delivered, or otherwise conveyed pursuant to this Order in a manner that fully satisfies the requirements of the Order and notification by the Commission-approved Acquirer to the Interim Monitor that it is fully capable of producing the relevant Product(s) acquired pursuant to a Remedial Agreement independently of Respondents; or
  - b. the completion by Respondents of the last obligation under the Order pertaining to the Interim Monitor's service;

*provided, however,* that the Commission may extend or modify this period as may be necessary or appropriate to accomplish the purposes of the Order.

4. Subject to any demonstrated legally recognized privilege, the Interim Monitor shall have full and complete access to Respondents' personnel, books,

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documents, records kept in the normal course of business, facilities and technical information, and such other relevant information as the Interim Monitor may reasonably request, related to Respondents' compliance with their obligations under the Order, including, but not limited to, their obligations related to the relevant assets. Respondents shall cooperate with any reasonable request of the Interim Monitor and shall take no action to interfere with or impede the Interim Monitor's ability to monitor Respondents' compliance with the Order.

5. The Interim Monitor shall serve, without bond or other security, at the expense of Respondents on such reasonable and customary terms and conditions as the Commission may set. The Interim Monitor shall have authority to employ, at the expense of the Respondents, such consultants, accountants, attorneys and other representatives and assistants as are reasonably necessary to carry out the Interim Monitor's duties and responsibilities.
6. Respondents shall indemnify the Interim Monitor and hold the Interim Monitor harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Interim Monitor's duties, including all reasonable fees of counsel and other reasonable expenses incurred in connection with the preparations for, or defense of, any claim, whether or not resulting in any liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from misfeasance, gross negligence, willful or wanton acts, or bad faith by the Interim Monitor.
7. Respondents shall report to the Interim Monitor in accordance with the requirements of this Order and/or as otherwise provided in any agreement approved by the Commission. The Interim Monitor shall evaluate the

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reports submitted to the Interim Monitor by Respondents, and any reports submitted by the Commission-approved Acquirer with respect to the performance of Respondents' obligations under the Order or the Remedial Agreement. Within thirty (30) Days from the date the Interim Monitor receives these reports, the Interim Monitor shall report in writing to the Commission concerning performance by Respondents of their obligations under the Order.

8. Respondents may require the Interim Monitor and each of the Interim Monitor's consultants, accountants, attorneys and other representatives and assistants to sign a customary confidentiality agreement; *provided, however,* that such agreement shall not restrict the Interim Monitor from providing any information to the Commission.
- E. The Commission may, among other things, require the Interim Monitor and each of the Interim Monitor's consultants, accountants, attorneys and other representatives and assistants to sign an appropriate confidentiality agreement related to Commission materials and information received in connection with the performance of the Interim Monitor's duties.
  - F. If the Commission determines that the Interim Monitor has ceased to act or failed to act diligently, the Commission may appoint a substitute Interim Monitor in the same manner as provided in this Paragraph.
  - G. The Commission may on its own initiative, or at the request of the Interim Monitor, issue such additional orders or directions as may be necessary or appropriate to assure compliance with the requirements of the Order.



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- H. The Interim Monitor appointed pursuant to this Order may be the same person appointed as a Divestiture Trustee pursuant to the relevant provisions of this Order.

**IV.****IT IS FURTHER ORDERED** that:

- A. If Respondents have not fully complied with the obligations to grant, license, deliver or otherwise convey relevant assets as required by this Order, the Commission may appoint a trustee (“Divestiture Trustee”) to grant, license, deliver or otherwise convey the assets required to be granted, licensed, delivered or otherwise conveyed pursuant to each of the relevant Paragraphs in a manner that satisfies the requirements of each such Paragraph. In the event that the Commission or the Attorney General brings an action pursuant to § 5(*l*) of the Federal Trade Commission Act, 15 U.S.C. § 45(*l*), or any other statute enforced by the Commission, Respondents shall consent to the appointment of a Divestiture Trustee in such action to grant, license, deliver or otherwise convey the relevant assets. Neither the appointment of a Divestiture Trustee nor a decision not to appoint a Divestiture Trustee under this Paragraph shall preclude the Commission or the Attorney General from seeking civil penalties or any other relief available to it, including a court-appointed Divestiture Trustee, pursuant to § 5(*l*) of the Federal Trade Commission Act, or any other statute enforced by the Commission, for any failure by Respondents to comply with this Order.
- B. The Commission shall select the Divestiture Trustee, subject to the consent of Respondents, which consent shall not be unreasonably withheld. The Divestiture Trustee shall be a person with experience and expertise in acquisitions and divestitures. If Respondents have not opposed, in writing, including the reasons for opposing, the selection of

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any proposed Divestiture Trustee within ten (10) Days after notice by the staff of the Commission to Respondents of the identity of any proposed Divestiture Trustee, Respondents shall be deemed to have consented to the selection of the proposed Divestiture Trustee.

- C. Not later than ten (10) Days after the appointment of a Divestiture Trustee, Respondents shall execute a trust agreement that, subject to the prior approval of the Commission, transfers to the Divestiture Trustee all rights and powers necessary to permit the Divestiture Trustee to effect the divestiture required by the Order.
- D. If a Divestiture Trustee is appointed by the Commission or a court pursuant to this Paragraph, Respondents shall consent to the following terms and conditions regarding the Divestiture Trustee's powers, duties, authority, and responsibilities:
  1. Subject to the prior approval of the Commission, the Divestiture Trustee shall have the exclusive power and authority to grant, license, deliver or otherwise convey the assets that are required by this Order to be granted, licensed, delivered or otherwise conveyed.
  2. The Divestiture Trustee shall have one (1) year after the date the Commission approves the trust agreement described herein to accomplish the divestiture, which shall be subject to the prior approval of the Commission. If, however, at the end of the one (1) year period, the Divestiture Trustee has submitted a plan of divestiture or believes that the divestiture can be achieved within a reasonable time, the divestiture period may be extended by the Commission, or, in the case of a court-appointed Divestiture Trustee, by the court; *provided, however*, the Commission may extend the divestiture period only two (2) times.

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3. Subject to any demonstrated legally recognized privilege, the Divestiture Trustee shall have full and complete access to the personnel, books, records and facilities related to the relevant assets that are required to be assigned, granted, licensed, divested, delivered or otherwise conveyed by this Order and to any other relevant information, as the Divestiture Trustee may request. Respondents shall develop such financial or other information as the Divestiture Trustee may request and shall cooperate with the Divestiture Trustee. Respondents shall take no action to interfere with or impede the Divestiture Trustee's accomplishment of the divestiture. Any delays in divestiture caused by Respondents shall extend the time for divestiture under this Paragraph in an amount equal to the delay, as determined by the Commission or, for a court-appointed Divestiture Trustee, by the court.
4. The Divestiture Trustee shall use commercially reasonable efforts to negotiate the most favorable price and terms available in each contract that is submitted to the Commission, subject to Respondents' absolute and unconditional obligation to divest expeditiously and at no minimum price. Each divestiture shall be made in the manner and to an acquirer as required by this Order; *provided, however*, if the Divestiture Trustee receives bona fide offers from more than one acquiring entity, and if the Commission determines to approve more than one such acquiring entity, the Divestiture Trustee shall divest to the acquiring entity selected by Respondents from among those approved by the Commission; *provided further, however*, that Respondents shall select such entity within five (5) Days after receiving notification of the Commission's approval.
5. The Divestiture Trustee shall serve, without bond or other security, at the cost and expense of Respondents,

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on such reasonable and customary terms and conditions as the Commission or a court may set. The Divestiture Trustee shall have the authority to employ, at the cost and expense of Respondents, such consultants, accountants, attorneys, investment bankers, business brokers, appraisers, and other representatives and assistants as are necessary to carry out the Divestiture Trustee's duties and responsibilities. The Divestiture Trustee shall account for all monies derived from the divestiture and all expenses incurred. After approval by the Commission of the account of the Divestiture Trustee, including fees for the Divestiture Trustee's services, all remaining monies shall be paid at the direction of the Respondents, and the Divestiture Trustee's power shall be terminated. The compensation of the Divestiture Trustee shall be based at least in significant part on a commission arrangement contingent on the divestiture of all of the relevant assets that are required to be divested by this Order.

6. Respondents shall indemnify the Divestiture Trustee and hold the Divestiture Trustee harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Divestiture Trustee's duties, including all reasonable fees of counsel and other expenses incurred in connection with the preparation for, or defense of, any claim, whether or not resulting in any liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from misfeasance, gross negligence, willful or wanton acts, or bad faith by the Divestiture Trustee.
7. In the event that the Divestiture Trustee determines that he or she is unable to grant, license, deliver or otherwise convey the relevant assets required to be granted, licensed, delivered or otherwise conveyed in a manner that preserves their marketability, viability and competitiveness and ensures their continued use in the

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research, Development, manufacture, import, distribution, marketing, promotion, sale, or after-sales support of the relevant Product, the Divestiture Trustee may assign, grant, license, transfer, divest, deliver or otherwise convey such additional assets of Respondents and effect such arrangements as are necessary to satisfy the purposes and requirements of this Order.

8. The Divestiture Trustee shall have no obligation or authority to operate or maintain the relevant assets required to be granted, licensed, transferred, delivered or otherwise conveyed by this Order.
  9. The Divestiture Trustee shall report in writing to Respondents and to the Commission every sixty (60) Days concerning the Divestiture Trustee's efforts to accomplish the divestiture.
  10. Respondents may require the Divestiture Trustee and each of the Divestiture Trustee's consultants, accountants, attorneys and other representatives and assistants to sign a customary confidentiality agreement; *provided, however*, such agreement shall not restrict the Divestiture Trustee from providing any information to the Commission.
- E. If the Commission determines that a Divestiture Trustee has ceased to act or failed to act diligently, the Commission may appoint a substitute Divestiture Trustee in the same manner as provided in this Paragraph.
- F. The Commission or, in the case of a court-appointed Divestiture Trustee, the court, may on its own initiative or at the request of the Divestiture Trustee issue such additional orders or directions as may be necessary or appropriate to accomplish the divestiture required by this Order.

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- G. The Divestiture Trustee appointed pursuant to this Paragraph may be the same person appointed as Interim Monitor pursuant to the relevant provisions of this Order.

**V.**

**IT IS FURTHER ORDERED** that:

- A. Within five (5) Days of the Acquisition, Respondents shall submit to the Commission a letter certifying the date on which the Acquisition occurred.
- B. Within five (5) Days of the occurrence of each of the following events, Respondent shall notify the Commission, the Commission-approved Acquirer, and the Interim Monitor (if any has been appointed) in writing of the occurrence of such event:
1. the following events related to an Application related to OVF:
    - a. filing of an Application;
    - b. issuance of an Approvable Letter; and
    - c. issuance of an Approval Letter; and
  2. the following events related to an Application seeking pediatric exclusivity related to Oral Opioid Fentanyl:
    - a. receipt by Respondents of a request from the FDA to submit a pediatric study to the FDA;
    - b. submission by the Respondents to the FDA of the protocol related to the pediatric study;
    - c. submission by the Respondents of the pediatric study to the FDA; and

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- d. receipt by Respondents of grant or denial of Pediatric Exclusivity from the FDA.
3. the following events related to an Application seeking approval of a Substantially Sugar-Free Formulation(s) of Oral Opioid Fentanyl:
    - a. filing of an Application;
    - b. issuance of an Approvable Letter;
    - c. issuance of a Not Approvable Letter; and
    - d. issuance of an Approval Letter.
- C. Within thirty (30) Days after the date this Order becomes final, and every sixty (60) Days thereafter until Respondents have fully complied with Paragraphs II.A. (*i.e.* has granted, licensed, delivered or otherwise conveyed all relevant assets to the Commission-approved Acquirer in a manner that fully satisfies the requirements of the Order), II.B., II.D., and all its responsibilities to render transitional services to the Commission-approved Acquirer as provided in the Remedial Agreement(s), Respondents shall submit to the Commission a verified written report setting forth in detail the manner and form in which they intends to comply, are complying, and have complied with this Order. Respondents shall submit at the same time a copy of its report concerning compliance with this Order to the Interim Monitor, if any Interim Monitor has been appointed. Respondents shall include in their reports, among other things that are required from time to time:
1. a full description of the efforts being made to comply with the relevant Paragraphs of the Order;
  2. if Barr is rejected by the Commission pursuant to Paragraph II.A., a description of all substantive contacts

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or negotiations related to the licensing of the Oral Opioid Fentanyl Assets and the identity of all parties contacted and copies of all written communications to and from such parties, all internal memoranda, and all reports and recommendations concerning completing its obligations to license the Oral Opioid Fentanyl Assets;

3. a detailed plan to deliver all Confidential Business Information required to be delivered to the Commission-approved Acquirer pursuant to Paragraph II.B, and agreed upon by the Commission-approved Acquirer and the Interim Monitor (if applicable) and any updates or changes to such plan;
  4. a description of all Confidential Business Information delivered to the Commission-approved Acquirer, including the type of information delivered, method of delivery, and date(s) of delivery;
  5. a description of the Confidential Business Information currently remaining to be delivered and a projected date(s) of delivery; and
  6. a description of all technical assistance provided to the Commission-approved Acquirer during the reporting period.
- D. One (1) year after the date this Order becomes final, annually for the next nine (9) years on the anniversary of the date this Order becomes final, and at other times as the Commission may require, Respondents shall file a verified written report with the Commission setting forth in detail the manner and form in which they have complied and are complying with this Order.



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**VI.**

**IT IS FURTHER ORDERED** that Respondents shall notify the Commission at least thirty (30) Days prior to any proposed (1) dissolution of the Respondents, (2) acquisition, merger or consolidation of Respondents, or (3) any other change in the Respondents that may affect compliance obligations arising out of the order, including, but not limited to, assignment, the creation or dissolution of subsidiaries, or any other change in Respondents.

**VII.**

**IT IS FURTHER ORDERED** that, for the purpose of determining or securing compliance with this Order, and subject to any legally recognized privilege, and upon written request with reasonable notice to Respondents made to their principal United States offices, Respondents shall permit any duly authorized representative of the Commission:

- A. Access, during office hours of Respondents and in the presence of counsel, to all facilities and access to inspect and copy all books, ledgers, accounts, correspondence, memoranda and all other records and documents in the possession or under the control of Respondents related to compliance with this Order; and
- B. Upon five (5) Days' notice to Respondents and without restraint or interference from Respondents, to interview officers, directors, or employees of Respondents, who may have counsel present, regarding such matters.

**VIII.**

**IT IS FURTHER ORDERED** that this Order shall terminate on September 20, 2024.

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**APPENDIX I**  
**NON-PUBLIC**  
**ORAL OPIOID FENTANYL LICENSE AND SUPPLY**  
**AGREEMENT**

**[Redacted From Public Record Version But Incorporated By  
Reference]**

Statement

**STATEMENT OF THE COMMISSION**

Today, the Commission released a proposed complaint and accepted for public comment a proposed consent order that obtains significant relief regarding Cephalon, Inc.'s proposed acquisition of Cima Labs Inc. The complaint alleges that the acquisition may substantially lessen competition in the market for the manufacture and sale of prescription drug products to treat breakthrough cancer pain (BTCP). These medications bring many cancer patients significant improvement in the quality of their lives. Cephalon's product Actiq is the only treatment on the market indicated for BTCP. Cima Labs is developing oravescent fentanyl (OVF), which is in Phase III clinical trials and is the product best positioned to enter the market.

To address potential anticompetitive effects that may arise from the transaction as originally contemplated, the Commission has required the merging parties to grant a license and transfer all of the technological know-how for Actiq to Barr Laboratories, Inc., a leading generic drug manufacturer. This transfer will significantly expedite the entry of a generic BTCP product. Our experience and the empirical literature<sup>1</sup> demonstrate that the entry of a generic BTCP product will provide a substantially lower-priced alternative to consumers and thereby significantly lower the average price of BTCP medication. The availability of a substantially lower-priced BTCP medication will be particularly important for patients on limited budgets or without insurance.

Normally, creation of a generic competitor would be insufficient to solve the anticompetitive problems raised by a merger of two branded pharmaceutical competitors. In the usual case, such a remedy would not replace the lost promotion and innovation competition between the branded companies regarding the particular illness the companies competed to treat. In this

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<sup>1</sup> This literature is reviewed at *Generic Drug Entry Prior to Patent Expiration: An FTC Study* 9 (July 2002).

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case, however, the facts showed that an important anticompetitive effect of the merger was to defeat generic competition. The facts further showed that there is not likely to be *any* further innovation competition between Cephalon and Cima for BTCP products because, among other things, Actiq is near the end of its patent life and neither Cephalon nor Cima has any other BTCP products in the pipeline. Moreover, Actiq and OVF are both formulations of fentanyl, a readily-available, non-patented active ingredient.

The earlier entry of lower-priced generic Actiq, made possible by the remedy, will more than restore any loss in brand-to-brand price competition that would have occurred between Cephalon and Cima. The average price that consumers will pay for BTCP medication will be lower after the merger and the proposed remedy than it would have been without the merger and remedy. In addition, the consent order ensures that the competition between Actiq and its generic equivalent will be robust. Because the generic product should be on the market no later than the launch of OVF,<sup>2</sup> Cephalon will be unable to shift patients preemptively to OVF to undermine generic competition. Thus, the proposed remedy would bring significant benefits to patients and would reverse the anticompetitive effects of the proposed acquisition.

Commissioner Thompson has dissented, arguing that the Commission should have sought a preliminary injunction to block this transaction on the grounds that there is a group of consumers who would purchase a branded BTCP product and would thus face higher prices. However, the evidence is not clear that this

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<sup>2</sup> The license to Barr provided by the order enables Barr to begin marketing the generic versions of Actiq at the earliest of final FDA approval of OVF or various specified dates. If Cephalon delays the introduction of OVF, the license allows Barr to market the generic products at specific dates that approximate the time that the parties' premerger documents predict OVF would have been launched.

## Statement

will happen. Even if it were to happen, this outcome would be a well-recognized result of the introduction of generic competition.<sup>3</sup> In the past, the Commission has recognized and resolved the particular tradeoff that concerns Commissioner Thompson today. The Commission, including Commissioner Thompson, has recognized the net benefits that arise from the entry of generic pharmaceutical products and consequently has devoted substantial resources to identify and prohibit anticompetitive practices that have made the entry of generic drugs more difficult.<sup>4</sup> As in our earlier cases, the benefits that earlier generic entry will bring to consumers of BTCP treatment in terms of lower average prices

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<sup>3</sup> In the face of generic entry, branded companies frequently raise the price for branded products that did not previously face such competition. *See supra* note 1. In this case, however, given the particular characteristics regarding the branded formulations, it is unclear whether the branded price actually will increase.

<sup>4</sup> *See, e.g., Schering-Plough Corp.*, Dkt. No. 9297, available at <http://www.ftc.gov/os/adjpro/d9297/031218commissionopinion.pdf> (agreement between branded and generic manufacturers to delay entry of generic); *Biovail Corp.*, Dkt. No. C-4060 (consent order); available at <http://www.ftc.gov/os/2002/04/biovailcomplaint.htm> (wrongful Orange Book listing for Tiazac); *Biovail Corp. and Elan Corp.*, Dkt. No. C-4057 (consent order), available at <http://www.ftc.gov/os/2002/06/biovailelancomp.pdf> (agreement among generic drug companies to divide market for generic Adalat CC); *Abbott Labs.*, Dkt. No. C-3945 (consent order), complaint available at <http://www.ftc.gov/os/2000/05/c3945complaint.htm>; *Geneva Pharm., Inc.*, Dkt. No. C-3946 (consent order), complaint available at <http://www.ftc.gov/os/2000/05/c3946complaint.htm>; *Hoechst Marion Roussel, Inc.*, Dkt. No. 9293 (consent order), complaint available at <http://www.ftc.gov/os/2000/03/hoechstandrxcplaint.htm>.

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greatly exceed any price increases to the less price-sensitive patients who may continue to choose branded products.<sup>5</sup> Contrary to Commission Thompson's claim, the underlying rationale for the relief mandated in this case is supported by unanimous Commission precedent.

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<sup>5</sup> In his dissent, Commissioner Thompson relies on a statement in the old case of *United States v. Philadelphia National Bank*, 374 U.S. 321, 371 (1963), that anticompetitive mergers cannot be justified by some "ultimate reckoning of social or economic debits and credits." We support this general principle. The issue here, however, is whether the transaction, as modified by the Order, can be considered anticompetitive in the first place when price increases, if any, are weighed against much larger price decreases to the same group of customers. In any merger case, predictions of procompetitive and anticompetitive effects are inherently uncertain, and – whether we choose to challenge or to pass – there often is a risk that one set of consumers will benefit and another set will lose. We are choosing between *probabilities* rather than sets of consumers.

## Analysis

**Analysis of Proposed Consent Order to aid Public Comment**

The Federal Trade Commission has accepted, subject to final approval, an Agreement Containing Consent Orders (“Consent Agreement”) from Cephalon, Inc. and Cima Labs, Inc., which is designed to remedy the anticompetitive effects of the acquisition of Cima by Cephalon. Under the terms of the proposed Consent Agreement, Cephalon would be required to grant to a third party company, a fully paid-up, irrevocable license to make and sell a generic equivalent of its breakthrough cancer pain (“BTCP”) drug Actiq in the United States.

The proposed Consent Agreement has been placed on the public record for thirty days for receipt of comments by interested persons. Comments received during this period will become part of the public record. After thirty days, the Commission will again review the proposed Consent Agreement and the comments received, and will decide whether it should withdraw from the proposed Consent Agreement or make final the Decision and Order (“Order”).

Pursuant to an Agreement and Plan of Merger dated November 3, 2003, between Cephalon and Cima, Cephalon proposes to acquire 100 percent of the issued and outstanding shares of Cima in a stock-for-stock transaction valued at approximately \$515 million. Cephalon also intends to pay consideration such that each issued and outstanding share of Cima common stock will be converted into the right to receive \$34.00 in cash. The Commission’s Complaint alleges that the proposed acquisition, if consummated, would constitute a violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, in the market for prescription drug products indicated for the treatment of BTCP. The proposed Consent Agreement will remedy the alleged violations by replacing the lost potential competition that would result from the merger in this market.

Drugs for the treatment of BTCP help to reduce or eliminate

Analysis

the spikes of intense pain experienced by patients receiving opioid therapy for their chronic pain. By providing a faster onset of pain relief than short-acting oral opioids, BTCP products allow patients to be more active. Because many patients with BTCP are not in hospitals, BTCP products are self-administered and produced in a convenient and portable dosage form. These characteristics of BTCP medications provide terminally ill cancer patients a significant improvement to the quality of their lives. Annual sales of BTCP drugs total more than \$200 million in the United States, and the market is growing rapidly.

The U.S. market for drugs to treat BTCP is a monopoly. Cephalon markets Actiq, the only product currently indicated for the treatment of BTCP on the market. Actiq is a fentanyl-containing, berry-flavored lollipop. Cephalon is also developing a sugar free formulation of Actiq which it expects to launch in 2005. Cima is in Phase III of clinical development of its OraVescent fentanyl (“OVF”) product, which is a fast-dissolving, effervescent, sugar-free fentanyl tablet. Cima intends to seek approval from the Food and Drug Administration (“FDA”) by the end of 2004 or in the first quarter of 2005. OVF is expected to enter the U.S. market in 2006 or 2007 and is the product best-positioned to enter the U.S. market and compete with Cephalon’s Actiq.

Both branded and generic entry into the market for BTCP products is difficult, time consuming, and costly. Cima is the firm best positioned to enter the market. Other firms that have undertaken efforts to develop BTCP products are well behind Cima. In fact, entry in the BTCP market by any other branded or generic firm is not expected to occur until at least 2008. Both generic and branded entry is delayed by numerous barriers, including intellectual property, regulatory, technological, manufacturing, and marketing. Entry, therefore, would not be likely, timely, or sufficient to counteract the anticompetitive effects of the acquisition.

The proposed acquisition would cause significant



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anticompetitive harm in the U.S. market for BTCP products by eliminating potential competition between Cephalon and Cima. With only one firm currently marketing a BTCP drug to customers in this market (Cephalon), the entry of Cima likely would increase competition and reduce prices for drugs indicated for the treatment of BTCP. Accordingly, allowing Cephalon to control both Cima's product and its own potentially competing product would reduce the number of rivals in the future from two to one and likely force customers to pay higher prices for their BTCP drugs. Moreover, Cephalon's ownership of both products will allow it to undermine generic entry by shifting patients to the patent-protected OVF product prior to generic launch, depriving consumers of the full benefits of generic competition.

The proposed Consent Agreement therefore requires Cephalon to grant a license and transfer all of its technological know-how and intellectual property related to Actiq ("Actiq license assets") to an upfront buyer no later than ten days after the acquisition is consummated. Cephalon has selected Barr Laboratories, Inc. ("Barr") as the upfront buyer. Barr is a reputable generic manufacturer and is well-positioned to manufacture a generic version of Actiq. If the Commission determines that Barr is not an acceptable purchaser, or if the manner of the grant, license, delivery or conveyance is not acceptable, Cephalon and Cima must rescind the transaction with Barr and grant, license, deliver or otherwise convey the Actiq license assets to a Commission-approved buyer not later than six months from the date the Order becomes final. Should they fail to do so, the Commission may appoint a trustee to divest the Actiq license assets.

The proposed remedy contains several provisions designed to ensure the successful and timely development of OVF, sugar-free Actiq, and generic Actiq. Cephalon must transfer all of its technological know how and intellectual property related to both the sugar and sugar free formulations of Actiq to Barr immediately in accordance with the terms of the Cephalon/Barr License and Supply Agreement. In the event that Barr is not able to manufacture an FDA-approved generic version of Actiq by the

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date the licenses take effect, the Order requires Cephalon to supply Barr with Actiq to be marketed as a generic. The Order also contains date certain provisions that provide incentives for Cephalon not to delay the development and launch of OVF or sugar-free Actiq. The licenses for the marketing rights for sugar and sugar-free Actiq are triggered by dates certain. These dates certain triggers provide Cephalon with a strong incentive to launch OVF as soon as possible or risk Barr's launch of generic Actiq even before Cephalon's OVF. Further, the Order contains provisions that require Cephalon to timely develop the sugar free formulation by a date certain, or if it fails to do so, to license Barr five months earlier. With the licenses and technology transfer provided by Cephalon, Barr will be able to compete aggressively in the BTCP market against Actiq. The proposed remedy also prohibits Cephalon from making certain regulatory filings that would delay FDA approval of Barr's generic Actiq. These provisions ensure that Barr will be in a position to launch a generic version of Actiq no later than OVF launch, eliminating the anticompetitive effects of the proposed acquisition and providing patients with earlier access to a lower priced generic product.

Normally a generic remedy would not be sufficient to solve the anticompetitive problems raised by a merger of two branded pharmaceutical competitors because it does not replace the lost promotion and innovation competition between branded companies. In this case, the evidence showed that there is not likely to be any further innovation competition between Cephalon and Cima because, among other things, Actiq is near the end of its patent life. Moreover, Actiq and OVF are both formulations of fentanyl, a readily-available, non-patented active ingredient. The facts showed that an important anticompetitive effect of the merger was to defeat generic competition. The evidence in this case also suggests that, regardless of the merger, Cephalon will no longer promote the sugar-based Actiq formulation after OVF's launch. Finally, any lost brand-to-brand price competition which would have occurred between Cephalon and Cima is more than restored by the early entry of lower priced generic versions of

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sugar and sugar-free Actiq. As a result, the generic remedy replaces the lost price competition that likely would have occurred. The proposed remedy would bring significant benefits to patients and would reverse the anticompetitive effects of the proposed acquisition.

The purpose of this analysis is to facilitate public comment on the proposed Consent Agreement, and it is not intended to constitute an official interpretation of the proposed Consent Agreement or to modify its terms in any way.

Statement

**DISSENTING STATEMENT OF COMMISSIONER  
MOZELLE W. THOMPSON**

The Commission has accepted, subject to public comment and final approval, a proposed settlement from Cephalon, Inc., and Cima Labs Inc. This settlement is intended to remedy the likely anticompetitive effects of Cephalon's \$515 million acquisition of Cima in the \$200 million market for drugs that treat terminally ill patients for sporadic breakthrough cancer pain ("BTCP"). I must dissent from the Commission's acceptance of the unprecedented proposed remedy because neither the merging parties nor the investigation have demonstrated that the remedy would substantially restore the lost competition between Cephalon and Cima.

I strongly concur with the allegations in the Commission's complaint, which correctly alleges that Cephalon is a monopolist in the BTCP drug market. It also alleges that Cephalon unlawfully proposes to acquire Cima, the best-positioned potential competitor who would otherwise have likely entered the market within the next several years – well ahead of other potential entrants.

"Every order in a merger case has the same goal: to preserve fully the existing competition in the relevant market or markets."<sup>1</sup> The proposed settlement in this case – which seeks to restore the lost branded competition from Cima by facilitating the entry of a generic product – fails because it cannot meet this goal. Accordingly, the Commission should have rejected the proposed settlement. Further, because the Cephalon/Cima merger in substance appears to be for the primary purpose of allowing

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<sup>1</sup> Staff of the Bureau of Competition, "Frequently Asked Questions About Merger Consent Order Provisions," (Answer to Question 1.), available at <http://www.ftc.gov/bc/mergerfaq.htm>.

## Statement

Cephalon to gain control of Cima's new BTCP product,<sup>2</sup> I believe that the Commission should have sought to block this merger in court.

The Commission may challenge a proposed transaction that it believes will lessen competition, or it may take a settlement that restores the competition lost. Historically, the Commission has been extraordinarily successful in identifying and blocking proposed mergers that are likely anticompetitive. In a case such as this one, which involves a monopolist's acquiring the best-positioned potential entrant, I am confident that the Commission would be able to successfully block the proposed merger and preserve competition. Indeed, I found the evidence supporting the Commission's complaint against Cephalon and Cima particularly compelling and sufficient to demonstrate that the proposed combination would eliminate the expected future competition between the two companies. This elimination of future competition would allow Cephalon to keep BTCP drug prices at monopoly levels, which would harm cancer patients – a particularly vulnerable group of consumers. Litigation and a district court's entry of a "full-stop" injunction would have been warranted because of the unusual strength of this antitrust case.

I recognize that in many Commission merger investigations, merging parties offer a settlement to avoid a Commission challenge to their proposed transaction. In such cases, "the burden of coming forward with adequate restructure proposals should be on the sponsors of the merger."<sup>3</sup> Furthermore, divestiture is typically employed where selling the assets used to manufacture and sell one company's competing product to a qualified new competitor can effectively replace the lost

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<sup>2</sup> Cephalon outbid several alternative suitors, whose deals with Cima would not likely have raised antitrust concerns.

<sup>3</sup> Robert Pitofsky, "The Nature and Limits of Restructuring in Merger Review," February 17, 2000, *available at* <http://www.ftc.gov/speeches/pitofsky/restruct.htm>.

## Statement

competition.<sup>4</sup> Perhaps because divesting one of the merging companies' branded products is the most effective and efficient means of restoring lost competition, the Commission has never taken a settlement for a pharmaceutical merger that requires a respondent to take measures to facilitate generic entry where companies are marketing (or here, where one is marketing and the other likely soon will also be selling) branded products. I understand the argument that by requiring Cephalon to license generic entry, such entry is more certain and more quickly achieved, thus assuring that some customers would gain significant savings. However, while generic products and branded products are interchangeable to some extent, they are not necessarily considered reasonable substitutes by a significant segment of consumers in the typical pharmaceutical market. As a result, the Commission historically has been unwilling to trade away a branded product for a generic one in a Commission merger settlement.

I acknowledge the argument in this case that some end-stage cancer patients who buy BTCP drug products may be more price sensitive than customers in typical pharmaceutical markets because they do not have sufficient insurance coverage. But the investigation failed to develop any empirical or other compelling evidence substantiating that this particular market has such exceptional characteristics that a generic product could serve as a substitute for a branded product. Without such compelling evidence, the Commission should not accept a proposed settlement because "(t)he risk of inadequate relief . . . should not be borne by consumers."<sup>5</sup> The parties likewise failed to present

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<sup>4</sup> Staff of the Bureau of Competition, "Statement of the Federal Trade Commission's Bureau of Competition on Negotiating Merger Remedies," (In discussion under "The Assets to Be Divested"), *available at* <http://www.ftc.gov/bc/bestpractices/bestpractices030401.htm>.

<sup>5</sup> Richard G. Parker and David A. Balto, "The Evolving Approach to Merger Remedies," at 2, *available at*

## Statement

evidence that shows that facilitating generic entry in the BTCP drug market will substantially replace the competition lost between Cephalon and Cima. By contrast, I found it particularly troubling that based on a range of economically reasonable assumptions about this pharmaceutical market, the Commission could have concluded just as easily that less price-sensitive patients could well suffer price increases that may possibly amount to tens of millions of dollars, notwithstanding the licensing of generic entry following the merger.

The majority statement cites other Commission challenges to restraints as support for picking which consumers will win and which will lose in pharmaceutical markets. However, these challenged restraints were intended to, and did, hinder generic entry, and the thrust in our remedies in these cases is to allow free competition to work. A subtle but important policy perspective is that the free market picked the winners and losers; we only allowed the market to work. The Commission did not manipulate the outcome of these markets.

In reading the majority's statement, I observe though that the majority unfortunately compares market outcomes in its statement instead of evaluating the Commission's appropriate role in providing antitrust protection in American markets. Our Clayton Act, Section 7 mandate is simple: protect markets so that the competitive process provides the market outcomes, such as quantity produced, prices charged, and who wins and loses financially. I disagree with a merger remedy policy that instead embraces manipulating the structure of market competition and trades off recognized (or probable) benefits for one segment of consumers for recognized (or probable) harm to another. As the Supreme Court over 40 years ago established, antitrust policy does not countenance mergers that are anticompetitive but are, "on some ultimate reckoning of social or economic debits and

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<http://www.ftc.gov/speeches/other/remedies.htm>.

Statement

credits, . . . deemed beneficial.”<sup>6</sup> This policy principle equally – if not even more so – applies to government-imposed restructurings in merger remedies. Accordingly, I believe that the Commission should refrain from accepting settlements that expressly contemplate benefitting one group of customers at the expense of other customers, especially where challenging a merger would likely be successful and the Commission is able to fulfill its mandate to protect all consumers from antitrust harm. For all of these reasons, I believe that the Commission should have rejected the proposed settlement and challenged this transaction.

As a final note, I recognize that the pharmaceutical industry over the recent past has transformed itself to an industry where larger, established companies refrain from developing the bulk of their products internally and instead often acquire smaller R&D companies as a means of stocking their portfolio of products. This transaction provides the Commission with the opportunity to demonstrate its commitment to aggressively protect pharmaceutical consumers under these changed market dynamics. Instead, I fear that the Commission today may be signaling the industry that dominant firms in pharmaceutical markets now have the antitrust “green light” to acquire competitors or potential entrants in exchange for a remedy that restructures markets in ways that trump the free market decision as to who will benefit

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<sup>6</sup> Setting out the bounds of Section 7 enforcement, the Court further cautions decision makers: “A value choice of such magnitude is beyond the ordinary limits of judicial competence, and in any event has been made for us already, by Congress when it enacted the amended § 7.” *United States v. Philadelphia National Bank*, 83 S.Ct. 1715, 1745 (1963). The majority statement strains in a failed attempt to distinguish away this Supreme Court case. Regardless of whether customers are within different geographic markets or within different segments of a relevant product market, a reasonable reading of the case is that the Supreme Court does not condone the type of consumer welfare tradeoffs that the majority statement endorses.



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from the market and who will be harmed, as well as the extent of these effects on different groups of consumers. Accordingly, I believe that the Commission should have rejected the proposed settlement and challenged the transaction in order to protect fully consumers in the BTCP drug market and to signal the Commission's antitrust resolve in both challenging anticompetitive mergers and only accepting remedies that minimize consumer exposure to anticompetitive risk.

Complaint

IN THE MATTER OF

**VIRGINIA BOARD OF FUNERAL DIRECTORS AND  
EMBALMERS**

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

*Docket C-4124; File No. 0410014  
Complaint, October 1, 2004--Decision, October 1, 2004*

This consent order, among other things, prohibits Respondent Virginia Board of Funeral Directors and Embalmers -- an industry regulatory board of the Commonwealth of Virginia, and the sole licensing authority for providers of funeral goods and services in Virginia -- from in any way acting to restrict, impede or discourage its licensees from any truthful and non-misleading price-related advertising, and from enforcing any regulation the effect of which would be to prevent licensees from notifying potential customers of prices or discounts through the use of truthful and non-misleading advertising. The order also requires the respondent to eliminate any regulation -- the effect of which would be to prevent licensees from notifying potential customers of prices or discounts through the use of truthful and non-misleading advertising -- and to publish the order in a number of ways intended to make clear to licensees that they are not restricted from engaging in truthful and non-misleading price-related advertising, including the advertising of discounts.

*Participants*

For the Commission: *Robert Davis, Stephanie Langley, Patrick J. Roach, Geoffrey D. Oliver, Joseph Eckhaus, Elizabeth A. Piotrowski, Alan Fisher, Michael G. Vita, and Mark Frankena.*

For the Respondent: *Jack Kotvas, Assistant Attorney General for the Commonwealth of Virginia, and Sarah Allen.*

**COMPLAINT**

Pursuant to the provisions of the Federal Trade Commission Act, as amended, 15 U.S.C. § 41, *et seq.*, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that the Virginia Board of Funeral Directors and Embalmers violated Section 5 of the Federal Trade

## Complaint

Commission Act, 15 U.S.C. § 45, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues this Complaint stating its charges in that respect as follows:

**NATURE OF THE CASE**

This matter concerns horizontal agreements among competing funeral directors, as members of the Virginia Board of Funeral Directors and Embalmers (the "Board"), that restricted price competition in the provision of funeral products and services in the Commonwealth of Virginia. The funeral directors, through the regulations of the Board, restricted price competition in the provision of funeral products and services in Virginia by restricting the advertising of prices, and discounts off of ordinary prices, for funeral products and services.

**RESPONDENT AND ITS MEMBERS**

1. The Board is organized, exists, and transacts business under and by virtue of the laws of the Commonwealth of Virginia, with its principal office and place of business located at 6603 West Broad St., 5th Fl. Richmond, VA 23230-1712.
2. The Board was created by the legislature of the Commonwealth of Virginia to supervise the provision of funeral products and services and the preneed provision of funeral products and services.
3. By statute, the Board is composed of nine members, seven of whom must be funeral service licensees of the Board with at least five consecutive years of funeral service practice in the Commonwealth immediately prior to appointment. The Board is further composed of two "citizen members." Members of the Board are appointed by the Governor.

Complaint

4. While serving their membership terms, funeral director members of the Board may, and do, continue to engage in the business of providing funeral products and services and preneed funeral products and services for a fee. Compensation for being on the Board is limited to expenses plus \$50 per day of work done for the Board.
5. Except to the extent that competition has been restrained as alleged below, and depending on their geographic location, licensed funeral directors in Virginia compete with each other and with funeral director members of the Board.
6. The Board promulgates regulations, including the regulation at issue in this Complaint by majority vote of the members of the Board.
7. The Board is the sole licensing authority for the provision of funeral directing services in Virginia. It is unlawful for an individual to practice or to offer to practice funeral directing in Virginia unless he or she holds a current license to practice from the Board.
8. The Board is authorized by Virginia law to take disciplinary action against any licensee who violates any rule or regulation promulgated by the Board. Disciplinary action by the Board may include the suspension or revocation of a license, or other limitations or restrictions on a licensee.

**JURISDICTION**

9. The Board is a state regulatory body and is a “person” within the meaning of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45.
10. The acts and practices of the Board, including the acts and practices alleged herein, have been or are in or affecting “commerce” within the meaning of Section 4 of the

## Complaint

Federal Trade Commission Act, as amended, 15 U.S.C. § 44. In particular, funeral directors perform funerals for residents of other states, receive substantial sums of money that cross state lines in payment for those services and as payment for otherwise in-state funeral products and services from preneed funeral arrangements, and purchase and use supplies and equipment that are shipped across state lines. Furthermore, the regulation at issue prevents the flow of price information across state lines, and affects interstate commerce in funeral supplies and services in neighboring states.

**STATE REGULATION OF ADVERTISING FOR  
FUNERAL SERVICES**

11. With the exception of the requirement that no direct initial solicitation of any consumer be in person, the requirement that no direct initial solicitation for at-need funeral products and services be done by any means, and the requirement that all advertising be truthful and not misleading, Virginia statutes do not restrict advertising or solicitation relating to the ordinary prices of funeral products and services or discounts off of ordinary prices of funeral products and services.

**BOARD CONDUCT**

12. For many years and continuing up to and including the date of the filing of this Complaint, the Board has restrained competition in the provision of funeral and preneed funeral products and services in Virginia by combining and agreeing with its members or others, or by acting as a combination of its members or others, to restrict access to price information relating to funeral products and services and preneed funeral products and services by prohibiting truthful and non-misleading advertising of members' prices, and discounts from their usual prices.

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13. For many years and continuing up to July 28, 2004, the Board had engaged in various acts or practices in furtherance of this combination, including, among other things, the following:
  - A. The Board promulgated and implemented a regulation that prohibits funeral licensees from advertising the prices of the products and services they sell for preneed funeral services;
  - B. The Board actively disseminated its rules, including the prohibition on advertising prices or discounts, by, among other means: mailing the rules to licensees, making speeches to local associations of funeral licensees, and publishing newsletters regarding its rules.

**EFFECTS**

14. The effects of the combination and acts or practices described above have been to restrain competition unreasonably and injure consumers in the following ways, among others:
  - A. Consumers were deprived of truthful information about prices for funeral products and services;
  - B. Funeral licensees were prevented from disseminating truthful information about their prices for funeral products and services;
  - C. Consumers were deprived of the benefits of vigorous price competition among Board licensees; and
  - D. Some consumers paid higher prices for funeral products and services than they would have paid in the absence of the combination, acts, and practices alleged in this Complaint.

Complaint

**VIOLATION**

15. The combination, acts, and practices described above constitute unfair methods of competition in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. Such combination, acts, and practices, or the effects thereof, may continue or recur in the absence of the relief herein requested.

**WHEREFORE, THE PREMISES CONSIDERED,** the Federal Trade Commission on this first day of October, 2004, issues its Complaint against Respondent Virginia Board of Funeral Directors and Embalmers.

Decision and Order

## **DECISION AND ORDER**

The Federal Trade Commission (“Commission”) having initiated an investigation of certain acts and practices of the Virginia Board of Funeral Directors and Embalmers (the “Board”), hereinafter sometimes referred to as “Respondent,” and Respondent having been furnished thereafter with a copy of the draft of the Complaint that the Bureau of Competition presented to the Commission for its consideration and which, if issued by the Commission, would charge Respondent with violations of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45; and

Respondent, its attorneys, and counsel for the Commission having thereafter executed an Agreement Containing Consent Order (“Consent Agreement”), containing an admission by Respondent of all the jurisdictional facts set forth in the aforesaid draft of Complaint, a statement that the signing of the Consent Agreement is for settlement purposes only and does not constitute an admission by Respondent that the law has been violated as alleged in such Complaint, or that the facts as alleged in such Complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission’s Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that Respondent has violated the said Act, and that a Complaint should issue stating its charges in that respect, and having accepted the executed Consent Agreement and placed such Consent Agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, and having duly considered the comments received from an interested person pursuant to section 2.34 of the Rules, now in further conformity with the procedure described in Commission Rule 2.34, 16 C.F.R. § 2.34 (2004), the Commission hereby makes the following jurisdictional findings and issues the following Decision and Order (“Order”):



## Decision and Order

1. Proposed Respondent, the Virginia Board of Funeral Directors and Embalmers, is an industry regulatory board established by the Commonwealth of Virginia with its principal office and place of business located at 6603 West Broad St., 5th Fl. Richmond, VA 23230-1712.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of Respondent, and the proceeding is in the public interest.

**ORDER****I.**

**IT IS ORDERED**, that for the purposes of this Order, the following definitions shall apply:

- A. "Respondent" or "Board" means the Virginia Board of Funeral Directors and Embalmers, its officers, members, committees, subcommittees, representatives, agents, employees, successors and assigns.
- B. "At-need or preneed funeral products, goods, or services" means any product, good, or service that the Board is authorized to regulate under Title 54.1 of the Virginia Code, Va. Code Ann. §§ 54.1-100 to 116, 54.1-200 to 204, 54.1-2800 to 2825 (Michie 2003). For the purposes of this Order, at-need or preneed funeral products, goods, or services includes any products, goods or services that are advertised, offered for sale, or sold to be used in a funeral service at the time of death, while death is imminent, or at any other time.
- C. "Board licensee" or "licensee" means any person or corporation that is entitled under the rules of the Board to provide at-need or preneed funeral products, goods, or services to consumers.

Decision and Order

- D. “Discounts from ordinary prices” means any reduction of the price ordinarily charged by a Board licensee in exchange for at-need or preneed funeral products, goods, or services.
- E. “Enforcing” a restriction or a regulation means any manner in which Respondent requires compliance with any of its regulations, including, but not limited to, investigations or hearings of purported violations of the regulation, dissemination of the terms or Board interpretations of the regulation in any manner to Board licensees, and assignments of penalties for any violation of the regulation.
- F. "Person" means both natural persons and artificial persons, including, but not limited to, corporations, unincorporated entities, and governments.
- G. “Prices” means any consideration proposed in exchange for at-need or preneed funeral products, goods, or services.
- H. “Truthful and non-misleading advertisements” means any advertisements that would not subject a Board licensee to disciplinary action under 18 Va. Admin. Code § 65-20-500(3) (West 2003) or Va. Code Ann. § 54.1-2806 (Michie 2003). For the purposes of this Order, truthful and non-misleading advertisements of prices or discounts from ordinary prices, includes advertisements that do not contain any promise, assertion, representation, or statement of fact which is untrue, deceptive, or misleading; contain inaccurate statements; or create an impression of things not likely to be true.
- I. 18 Va. Admin. Code § 65-30-50(C) (West 2003) means the Virginia regulation corresponding to that citation in place on June 28, 2004.

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**II.**

**IT IS FURTHER ORDERED** that Respondent, in or in connection with its activities in or affecting commerce, as “commerce” is defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44, shall forthwith cease and desist from, directly or indirectly, or through any rule, regulation, policy, or other conduct:

A. Prohibiting, restricting, impeding, or discouraging any person from engaging in truthful and non-misleading price advertising, including advertising prices, and discounts from ordinary prices, of at-need or preneed funeral products, goods, or services;

B. Enforcing any regulation or restriction on Board licensees, including the Board regulation at 18 Va. Admin. Code § 65-30-50(C) (West 2003), that might prevent licensees from using truthful and non-misleading advertisements to notify consumers of prices, and discounts from ordinary prices, for at-need or preneed funeral products, goods, or services.

*Provided, however,* that nothing contained herein shall prohibit the Respondent from adopting and enforcing reasonable rules, regulations or policies, or taking any other action, to prevent or prohibit advertising that the Board reasonably believes to be both materially fraudulent, false, deceptive or misleading and in violation of 18 Va. Admin. Code § 65-20-500(3) (West 2003) or Va. Code Ann. § 54.1-2806 (Michie 2003), or any future recodifications thereof.

**III.**

**IT IS FURTHER ORDERED** that Respondent shall, within one hundred and eighty (180) days after the date this Order becomes final, amend its rules to eliminate any regulation or restriction, including the Board regulation at 18 Va. Admin. Code § 65-30-50(C) (West 2003), that might prevent Board licensees from using

Decision and Order

truthful and non-misleading advertisements to notify consumers of prices, and discounts from ordinary prices, for at-need or preneed funeral products, goods, or services.

**IV.**

**IT IS FURTHER ORDERED** that, within ninety (90) days after the date this Order becomes final, Respondent shall prominently publish this Order, and the letter attached hereto as "Appendix," in the Newsletter for the Board of Funeral Directors and Embalmers.

**V.**

**IT IS FURTHER ORDERED** that, within thirty (30) days after the date this Order becomes final, Respondent shall mail or deliver a copy of this Order, under cover of the letter attached hereto as "Appendix," to each current licensee of Respondent, and for a period of three (3) years from the date of service of this Order, and Respondent shall mail or deliver a copy of this Order to each new licensee of Respondent within thirty (30) days of each such licensee's acceptance by Respondent as a Board licensee.

**VI.**

**IT IS FURTHER ORDERED** that, within sixty (60) days after the date this Order becomes final, and for a period of sixty (60) days thereafter, Respondent shall publish this Order on its World Wide Web site. Notice of such publication shall be made in a manner calculated to be viewed by all of Respondent's licensees and customers of Respondent's licensees. For purposes of this provision, notice will be deemed satisfactory if it is made by providing a direct link to the Order from a notice in the following language: "The FTC and the Board Settle Antitrust Charges Regarding Price Advertising Rules" posted as the first link under the "Important Announcements" section of the main Board web page (<http://www.dhp.state.va.us/fun/default.htm>). In the event

## Decision and Order

that the Board changes its site structure, a notice, equivalent in terms of ease of access and conspicuousness, must be provided. After such sixty (60) day period, Respondent shall maintain a link from the "Laws and Regulations Governing Funeral Directors and Embalmers" page ([http://www.dhp.state.va.us/fun/fun\\_laws\\_regs.htm](http://www.dhp.state.va.us/fun/fun_laws_regs.htm)), or its equivalent, to the Order in a manner that provides reasonable notice to interested parties. Respondent shall maintain its World Wide Web site in compliance with this Paragraph for five (5) years from the date this Order becomes final.

**VII.**

**IT IS FURTHER ORDERED** that Respondent shall notify the Commission at least thirty (30) days prior to any proposed change in Respondent or its regulations that may affect compliance obligations arising out of the Order.

**VIII.**

**IT IS FURTHER ORDERED** that Respondent shall file a written report within six (6) months of the date this Order becomes final, and annually on the anniversary date of the original report for each of the five (5) years thereafter, and at such other times as the Commission may require by written notice to Respondent, setting forth in detail the manner and form in which it has complied with this Order.

**IX.**

**IT IS FURTHER ORDERED** that this Order shall terminate on October 1, 2024.

Decision and Order

APPENDIX

(Letterhead of the Virginia Board of Funeral Directors and  
Embalmers)

Dear Licensee:

The Federal Trade Commission has ordered the Virginia Board of Funeral Directors and Embalmers (the "Board") to cease and desist the enforcement of any rule or regulation restricting the use of truthful and non-misleading advertising of prices and discounts by licensees. A copy of the Commission's Decision and Order is enclosed.

In order that you may readily understand the terms of the Order, we have set forth its essential provisions, although you must realize that the Order itself is controlling, rather than the following explanation of its provisions:

(1) The Board must cease and desist from enforcement of any regulation or restriction on Board licensees, including the Board regulation at 18 Va. Admin. Code § 65-30-50(C) (West 2003), that might prevent licensees from using truthful and non-misleading advertisements to notify consumers of prices, and discounts from ordinary prices, for at-need or preneed funeral products, goods, or services

(2) The Board must amend its rules to eliminate any regulation or restriction, including the Board regulation at 18 Va. Admin. Code § 65-30-50(C) (West 2003), that might prevent Board Licensees from using truthful and non-misleading advertisements to notify consumers of prices, and discounts from ordinary prices, for at-need or preneed funeral products, goods, or services.

Sincerely yours,

[appropriate Board member or officer]

Enclosure

## Analysis

**Analysis of Proposed Consent Order to Aid Public Comment**

The Federal Trade Commission has accepted for public comment an Agreement Containing Consent Order with the Virginia Board of Funeral Directors and Embalmers (the "Board" or "Respondent"). 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 the Board 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.

**I. The Commission's Complaint**

The proposed Complaint alleges that Respondent, an industry regulatory board of the Commonwealth of Virginia, has violated Section 5 of the Federal Trade Commission Act. Specifically, the proposed Complaint alleges that the Board has unlawfully restrained or eliminated price competition among the providers of funeral goods and services in Virginia.

The Board is the sole licensing authority for providers of funeral goods and services in Virginia and is authorized by Virginia statute to take disciplinary action against licensees who violate any rule promulgated by the Board. The Board is composed of nine members, seven of whom are required to be funeral service licensees themselves.

The proposed Complaint alleges that the Board has restrained trade by agreeing to, promulgating, and implementing a regulation (18 Va. Admin. Code § 65-30-50(C) (West 2003) ("18 VAC 65-30-50(C)")) that prohibited funeral licensees from advertising the prices of certain products and services they sell.<sup>1</sup> Board

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<sup>1</sup> As a result of the investigation, the Board has removed 18 VAC 65-30-50(C) from its regulations. *See Va. Regs. Reg.*, vol. 20, issue 21 at 1 (2004).

Analysis

regulation 18 VAC 65-30-50(C) read: “No licensee engaged in the business of preneed funeral planning or any of his agents shall advertise discounts; accept or offer enticements, bonuses, or rebates; or otherwise interfere with the freedom of choice of the general public in making preneed funeral plans.”

The proposed Complaint further alleges that the Board's conduct was anticompetitive because it had the following effects: the conduct deprived consumers of truthful information about prices for funeral products and services; the conduct prevented licensees from disseminating truthful information about their prices for funeral products and services; the conduct deprived consumers of the benefits of vigorous price competition among Board licensees; and the conduct caused consumers to pay higher prices for funeral products and services than they would have in the absence of that conduct.

## **II. Terms of the Proposed Consent Order**

The proposed Order would provide relief for the alleged anticompetitive effects of the conduct principally by means of a cease and desist order barring the Board, either by the enactment or enforcement of a new regulation or by the enforcement of any current regulation, from prohibiting, restricting, impeding, or discouraging any person from engaging in truthful and non-misleading price advertising of at-need or preneed funeral products, goods, or services.

Paragraph II of the proposed Order bars the Board from in any way acting to restrict, impede or discourage its licensees from any truthful and non-misleading price-related advertising. Paragraph II of the proposed Order further bars the Board from enforcing any regulation, including 18 VAC § 65-30-50(C), the effect of which regulation would be to prevent licensees from notifying potential customers of prices or discounts through the use of truthful and non-misleading advertising. As discussed below, the proposed Order does not prohibit the Board from adopting and enforcing reasonable rules to prohibit advertising that the Board



## Analysis

reasonably believes to be materially fraudulent, false, deceptive, or misleading.

Paragraph III of the proposed Order requires the Board to eliminate any regulation, the effect of which regulation would be to prevent licensees from notifying potential customers of prices or discounts through the use of truthful and nonmisleading advertising.

Paragraph IV of the proposed Order requires the Board to prominently publish the proposed Order along with a letter explaining the terms of the proposed Order in the Board's newsletter. Paragraph V of the proposed Order requires the Board to send to its licensees the proposed Order, along with a letter explaining the terms of the proposed Order. Paragraph VI of the proposed Order requires that the Board prominently publish the proposed Order on its World Wide Web site. Each of the methods of publishing the proposed Order is intended to make clear to licensees that they are not restricted from engaging in truthful and non-misleading price-related advertising, including the advertising of discounts.

Paragraphs VII and VIII of the proposed Order require the Board to inform the Commission of any change that could affect compliance with the proposed Order and to file compliance reports with the Commission for a number of years. Paragraph IX of the proposed Order states that it will terminate in twenty years.

### **III. The Conduct Prohibited under the Order**

The proposed Order prohibits the Board from discouraging its licensees from using truthful and non-misleading advertisements of prices and discounts. The proposed Order does not prohibit the Board from adopting and enforcing reasonable rules to prohibit advertising that the Board reasonably believes to be materially fraudulent, false, deceptive, or misleading. Because such a rule would not violate the proposed Order, and because the issues raised by this case arise frequently, it is appropriate to address the

Analysis

analysis required in some detail, focusing on the current restraint of the Board.

**A. Antitrust Analysis of the Legality of Competitive Restraints**

The Board's regulation was an agreement among competitors not to advertise price discounts. The fundamental question regarding the legality of restraints agreed upon between competitors is "whether or not the challenged restraint enhances competition."<sup>2</sup> A framework for analysis of the competitive impact of such agreements was described recently by the Commission in *PolyGram Holdings*.<sup>3</sup> Under that framework, the plaintiff has the initial burden of showing that the restriction is "inherently suspect" in that it has a likely tendency to suppress competition.<sup>4</sup> A restraint is shown to be inherently suspect when

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<sup>2</sup> *California Dental Assoc. v. Federal Trade Comm.*, 526 U.S. 756, 779 (1999) ("CDA"); see also *Chicago Board of Trade v. United States*, 246 U.S. 231, 238 (1918) ("The true test of legality is whether the restraint imposed is such as merely regulates and perhaps promotes competition or whether it is such as may suppress or even destroy competition.").

<sup>3</sup> 2003 WL 21770765 (FTC), slip op. at 29-35 ("*PolyGram Holdings*"). The *PolyGram Holdings* framework is not, of course, the only means of establishing a violation of the antitrust laws, which may also be accomplished by a showing of market power and a restraint likely to harm competition, or by actual competitive effects. See *PolyGram Holdings*, slip op. at 29 n.37; *Schering-Plough Corp.*, Dkt No. 9297, slip op. at 14-15 (FTC Dec. 8, 2003).

<sup>4</sup> *Id.* at 29; see also *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 19-20 (1979) (In characterizing conduct under the Sherman Act, the question is whether "the practice facially appears to be one that would always or almost always tend to restrict competition and decrease

## Analysis

“past judicial experience and current economic learning have shown [that conduct] to warrant summary condemnation.”<sup>5</sup> If the plaintiff can sustain that burden, the practice will be condemned unless the defendant can articulate a valid justification for the restriction.<sup>6</sup> A legitimate justification must be “cognizable” in the sense that the benefits that the defendant proposes from the restraint must be consistent with the goals of the antitrust laws.<sup>7</sup> A justification, to be legitimate, must also be plausible in the sense that the defendant can “articulate the specific link between the challenged restraint and the purported justification to merit a more searching inquiry into whether the restraint may advance procompetitive goals, even though it facially appears of the type likely to suppress competition.”<sup>8</sup> Once the defendant has overcome the presumption of the anticompetitive effect of the inherently suspect restraint by asserting legitimate procompetitive justifications for the restriction, then a more in-depth analysis of the specific effects of the restraint is necessary.<sup>9</sup>

**B. A Restriction on Price Advertising in the Funeral Industry is Inherently Suspect.**

In *CDA*, the Commission challenged a set of restrictions imposed by the California Dental Association. One of the

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output,... or instead one designed to ‘increase economic efficiency and render markets more, rather than less, competitive.’” (quoting *United States v. United States Gypsum Co.*, 438 U.S. 422, 441 n. 16 (1978))).

<sup>5</sup> *PolyGram Holdings*, slip op. at 29.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* at 30-31.

<sup>8</sup> *Id.* at 31-32.

<sup>9</sup> *Id.* at 33, fn. 44.

## Analysis

restrictions allowed the advertising of price discounts only where specified additional information was presented in the advertisement, purportedly needed to ensure that the price advertisement was strictly accurate, and another restriction was a flat restriction on the advertisement of quality claims by dentists.<sup>10</sup> The price advertising restriction was challenged as being so burdensome as to be, in effect, a ban on the advertisement of price discounts. The Association defended the restrictions as necessary to avoid false or misleading advertising, but the Commission and the Ninth Circuit held that the likely anticompetitive effects of the restrictions were clear, and that the Association therefore had, and did not sustain, the burden of establishing procompetitive benefits. The Supreme Court reversed, holding that the competitive effect of the restriction needed to be evaluated in light of the professional context in which it occurred, including the articulated justifications for the restriction.<sup>11</sup> The Court, in holding that the Court of Appeals had prematurely shifted the burden to the defendant, focused in particular on two facts: (1) the restriction at issue was "very far from a total ban on price discount advertising," and (2) since "the particular restrictions" at issue on their face were aimed at deceptive advertising, they might have the effect of promoting competition by "reducing the occurrence of unverifiable and misleading across-the-board

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<sup>10</sup> The restriction on price-related advertisement in *CDA* required that any such advertisement "fully and specifically" disclose "all variables and other relevant factors." The restriction also prohibited the use of qualitative phrases relating to the cost of dental services like "lowest prices." Finally, the restriction required that any comparative phrases like "low prices" must be based on verifiable data, and the burden of showing the accuracy of those statements is on the dentist. *CDA*, 526 U.S. at 760, fn. 1.

<sup>11</sup> See *CDA*, 526 U.S. at 771-773 ("The restrictions on both discount and nondiscount advertising are, at least on their face, designed to avoid false or deceptive advertising in a market characterized by striking disparities between the information available to the professional and the patient.").

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discount advertising."<sup>12</sup>

The current restriction of the Board is inherently suspect.<sup>13</sup> The regulation is the type of restriction that has been found inherently suspect by the Commission in the context of the optometry profession,<sup>14</sup> and is well understood in the economic literature as having anticompetitive effects in the context of professional services.<sup>15</sup> Studies show that advertising restrictions harm competition in the market for funeral services.<sup>16</sup> The importance of price information to funeral service consumers, especially when they receive that information early in the process, is a well-accepted fact of the industry.<sup>17</sup>

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<sup>12</sup> *Id.* at 773-774.

<sup>13</sup> In *CDA*, the advertising restraint could not be condemned because the FTC had not provided sufficient evidence to show “why the presumption of likely anticompetitive effects that applies in non-professional markets also applied in the professional setting” at issue there. *PolyGram Holdings*, slip op. at 33, n. 44.

<sup>14</sup> See *Massachusetts Board of Registration in Optometry*, 110 FTC 549, 606-607 (1988) (“*Mass. Board*”) (“By preventing optometrists from informing consumers that discounts are available, respondent eliminates a form of price competition.”); see also *PolyGram Holdings*, slip op. at 38-39, fn. 52 (citing economic literature).

<sup>15</sup> See *PolyGram Holdings*, slip op. at 38-39, fn. 52.

<sup>16</sup> See, e.g., *Funeral Industry Practices Mandatory Review 16 CFR Part 453: Final Staff Report to the FTC with Proposed Amended Trade Regulation Rule 64-65* (1990) (“1990 FTC Staff Report”).

<sup>17</sup> See, e.g., Wirthlin Worldwide, *Executive Summary of the Funeral and Memorial Information Counsel Study of American*

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Thus, restrictions on price advertising in the funeral industry are likely to suppress competition and will be condemned in the absence of a legitimate efficiency justification.

**C. The Order Permits Reasonable Regulation of Advertising.**

In *CDA*, the Supreme Court concluded that, before the type of restrictions at issue there could be condemned as anticompetitive, a more searching analysis was required. See 526 U.S. at 779-81. Several distinctions between the rule of the Board and the rules at issue in *CDA* are instructive, and further support the conclusion that there is reason to believe a violation of the FTC Act has occurred:

- Unlike in *CDA*, the restriction at issue here was a total ban on price discount advertising in the relevant market (that for preneed funeral services).
- Whereas in *CDA* the restrictions on their face purported to be aimed at limiting false or misleading advertising, here the fact that the restriction was imposed only on the sale of preneed services (where price competition is most likely to be effective), and was not imposed on at-need services (where, by all accounts, the consumer is most vulnerable), suggests that the regulation restricts price competition rather than eliminates deception.
- In *CDA*, there was a concern that price advertising that provided less than complete information regarding prices

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*Attitudes Toward Ritualization and Memorialization 3* (January 2000), available at <http://www.cremationassociation.org/docs/attitude.pdf> ("Wirthlin Survey") (Cost is one of the top factors influencing funeral home selection); *Id.* at 4 (Most often mentioned change recommended by consumers in funeral industry is to "see costs kept down.").

## Analysis

would allow dentists to create advertisements that would give the appearance that prices were lower when in fact they were not. This problem arose from the difficulty consumers might have in obtaining price information in the market for dental services.<sup>18</sup> Here, however, each funeral director is required by the FTC's funeral rule to disclose all price information to any consumer who might enquire about those services, including the prices of all products and services not subject to the discount.<sup>19</sup>

- Finally, in *CDA*, the respondent advanced the prevention of false and misleading claims as a justification for general restrictions on advertising. Here, there is a separate regulation that relates to the prevention of false and misleading claims.<sup>20</sup>

#### IV. Opportunity for Modification of the Order

The Board may seek to modify the proposed Order to permit it to promulgate and enforce rules that the proposed Order prohibits if it can demonstrate that the “state action” defense would shield its conduct from liability. The state action defense stems from *Parker v. Brown*.<sup>21</sup> In *Parker*, the Supreme Court held that Congress had not expressed any intent to apply the Sherman Act

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<sup>18</sup> *Id.* at 771-776.

<sup>19</sup> 16 C.F.R. § 453.2 (1994).

<sup>20</sup> The regulation at issue was the “Solicitation” provision in the Part of the preneed regulations entitled “Sale of Preneed Plans.” The Board has a separate set of regulations relating to false advertising generally that does not prohibit price and discount advertising, as long as the representations in the advertisement are not untrue, deceptive, or misleading. *See* 18 Va. Admin. Code § 65-20-500(3) (West 2003).

<sup>21</sup> 317 U.S. 341 (1943) (“*Parker*”).

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to anticompetitive acts of the states. Since *Parker*, the focus of courts evaluating assertions of the state action defense has been on whether the alleged actions were, in fact, acts of the state.<sup>22</sup> When the courts have determined that the alleged anticompetitive acts were acts of the state as sovereign, the state action defense protects those acts.<sup>23</sup> When the courts have determined that the allegedly anticompetitive acts were committed by subordinate agents of state governments, rather than the state itself, the state action defense could still apply if the acts were “pursuant to a state policy to displace competition with regulation or monopoly public service.”<sup>24</sup> Finally, when the allegedly anticompetitive act was committed by a private party, the state action defense can only apply if that action was pursuant to a clearly articulated state policy and the actions of the private party were “actively supervised by the state.”<sup>25</sup>

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<sup>22</sup> *FTC v. Ticor Title Insurance Co.*, 504 U.S. 621, 636 (1992) (“*Ticor*”) (The test under state action is “directed at ensuring that particular anticompetitive mechanisms operate because of a deliberate and intended state policy.”).

<sup>23</sup> *Hoover v. Ronwin*, 466 U.S. 558 (1984) (“*Hoover*”) (action of state supreme court regulating entry into the legal profession is state action exempt from liability under the Sherman Act).

<sup>24</sup> *Town of Hallie v. City of Eau Claire*, 471 U.S. 34, 39 (1984) (“*Hallie*”) (Municipality is not the state, but is exempt from liability for anticompetitive actions that were pursuant to a state policy to displace competition, when the conduct was a foreseeable result of the policy), quoting *City of Lafayette v. Louisiana Power & Light Co.*, 435 U.S. 389, 413 (1978) (plurality opinion); *Southern Motor Carriers Rate Conference Inc. v. U.S.*, 471 U.S. 48, 57 (1984) (“*Southern Motor Carriers*”).

<sup>25</sup> *California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980) (“*Midcal*”). The “active supervision” test requires that “the State has established sufficient independent judgment and control so that the details of the



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The clear articulation requirement ensures that, if a State is to displace national competition norms, it must replace them with specific state regulatory standards – a State may not simply authorize private parties to disregard federal laws,<sup>26</sup> but must genuinely substitute an alternative state policy.<sup>27</sup>

Because of federalism concerns at the heart of the state action doctrine, the policy to displace competition must be articulated by an entity that can be identified as the state rather than a

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[restraint] have been established as a product of deliberate state intervention, not simply by agreement among private parties.” *Ticor Title Ins. Co.*, 504 U.S. at 634-35. The Supreme Court has held that municipalities, unlike private parties, are not subject to the active supervision requirement and are protected by the state action doctrine if they are acting pursuant to a clearly articulated state policy. *Town of Hallie*, 471 U.S. at 46-7. The Court indicated in dicta that “it is likely that active state supervision would also not be required” when the relevant actor is a “state agency,” but declined to resolve the issue. *Id.* at 46 n. 10. Thus, the role of active supervision for the myriad varieties of governmental and quasi-governmental entities, including state regulatory boards, remains unclear. See FTC, Office of Policy Planning, Report of the State Action Task Force 15-19, 37-40, 55-56 (Sept. 2003) (“2003 FTC Staff Report”). Because the Board’s policy lacks clear articulation, it is unnecessary to resolve this issue here. The lack of clear articulation also renders unnecessary any analysis of possible preemption of the state law by federal antitrust law. See *Freedom Holdings, Inc. v. Spitzer*, 357 F.3d 205, 222-24 (2d Cir. 2004).

<sup>26</sup> *Parker*, 317 U.S. at 351; see generally *State Action Task Force Report* at 8, 25-26.

<sup>27</sup> See *New York v. United States*, 505 U.S. 144, 168-69 (1992); see also *Ticor*, 504 U.S. at 636 (State Action ensures that “particular anticompetitive mechanisms operate because of a deliberate and intended state policy.”).

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subordinate agency of the state.<sup>28</sup> Here, it is clear that the Board is not the state.<sup>29</sup> Therefore, the Board, to modify the proposed Order, must show that its conduct would be pursuant to a clearly articulated policy by the state. An agency or subdivision of the state, like the Board here, will be protected by the doctrine only where the conduct is both legally authorized by the state and that

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<sup>28</sup> *Southern Motor Carriers*, 471 U.S. at 62-63 (Public service commissions could not establish the clearly articulated policy of the state to displace competition needed to invoke the doctrine.).

<sup>29</sup> *See South Carolina State Board of Dentistry*, Dkt No. 9311, slip op. at 16-19 (FTC July 30, 2004) (South Carolina board regulating dentists and dental hygienists and composed largely of dentists is not the state for the purposes of the state action defense and can only claim the protection of the defense if it was acting pursuant to a clearly articulated and affirmatively stated state policy to displace competition found in state statutes); *Mass. Board*, 110 FTC at 612-613 (Massachusetts board regulating optometrists and composed largely of optometrists is not the state for the purposes of the state action defense and can only claim the protection of the defense if it was acting pursuant to a clearly articulated and affirmatively stated state policy to displace competition found in state statutes); *FTC v. Monahan*, 832 F.2d 688, 689 (1<sup>st</sup> Cir. 1987) (Massachusetts Board of Registration in Pharmacy, which was composed of pharmacists and regulated pharmacists was a “subordinate governmental unit” which could only claim the state action defense if its actions were pursuant to clearly articulated and affirmatively expressed state policy to displace competition); *see also Hoover*, 466 U.S. at 568 (“Closer analysis is required when the activity at issue is not directly that of the legislature or supreme court, but is carried out by others pursuant to state authorizations.”); *Southern Motor Carriers*, 471 U.S. at 62-63 (Public service commissions could not establish the clearly articulated policy of the state needed to invoke the doctrine.).

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conduct is pursuant to an “authority to suppress competition.”<sup>30</sup> With respect to the question of legal authority to act, an agency or municipality satisfies that requirement for the purposes of the state action defense if it can show that it has the authority to engage in that conduct when it does so in the substantively and procedurally correct manner, whether or not the agency actually did engage in the conduct in the substantively and procedurally correct manner in pursuing its allegedly anticompetitive conduct.<sup>31</sup>

Whether an articulated policy by the state is pursuant to an “authority to suppress competition” depends on the form of the statement of the state policy.<sup>32</sup> When the state has replaced some dimension of competition with a regulatory structure and gives an agency the discretion to determine how to implement that structure, as in *Southern Motor Carriers*, no more detail than a clear intent to displace competition is required.<sup>33</sup> When the state

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<sup>30</sup> *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 372-373 (1991) (“*Omni*”).

<sup>31</sup> *Id.* (“[N]o more is needed to establish for *Parker* purposes, the city’s authority to regulate than its unquestioned zoning power over the size, location, and spacing of billboards.”). Here, the Board’s authority to “establish standards of service and practice for the funeral service profession” in Virginia, Va. Code Ann. § 54.1-2803(1) (Michie 2003) (“VC 54.1-2803(1)”), presumably constitutes adequate legal authority to promulgate the regulation at issue sufficient to satisfy the first leg of the test in *Omni*. See 499 U.S. at 370-373.

<sup>32</sup> *Omni*, 499 U.S. at 372.

<sup>33</sup> See *Southern Motor Carriers*, 471 U.S. at 63-64 (Mississippi state statute requiring public service commission to prescribe just and reasonable rates is a sufficiently clear expression of intent to displace competition for the determination of prices to allow the commission to encourage private firms to

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does not displace competition with a regulatory structure, but simply gives some entity the authority to displace competition, as in *Omni* or *Hallie*, the question is whether the “suppression of competition is the ‘foreseeable result’ of what the statute authorizes.”<sup>34</sup> At present, the Board cannot demonstrate clear articulation under Virginia statutes by either means.

First, it does not appear, from the current statute granting the Board the authority to act, that the state intended that there be a broad displacement of price competition with regulation in the market for preneed funeral services.<sup>35</sup> Unlike the case of Mississippi in *Southern Motor Carriers*, the Virginia General Assembly did not single out price determination and assign responsibility for that determination to the agency rather than the market. Instead, the legislature was silent on how prices and price-related advertising were to be determined in the funeral services market, aside from emphasizing that “general advertising and preneed solicitation, other than in-person communication, shall be allowed.”<sup>36</sup>

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engage in collective rate-making and to allow adequately supervised private firms to do so.).

<sup>34</sup> *Omni*, 499 U.S. at 373, quoting *Hallie*, 471 U.S. at 42.

<sup>35</sup> The Board’s legal authority to promulgate restrictions on advertising stems from VC 54.1-2803(1), which gives the Board the authority to “establish standards of service and practice for the funeral service profession in Virginia.”

<sup>36</sup> See Va. Code Ann. § 54.1-2806(5) (Michie 2003). By way of contrast to its treatment of advertising and price competition in the market for preneed services, the General Assembly did displace competition with regulation by the Board regarding certain other aspects of the preneed funeral transaction. See Va. Code Ann. § 54.1-2803(9) (Michie 2003) (“VC 54.1-2803(9)”). A close look at the regime established by the statute indicates that

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Therefore, as in *Omni*, the question will be whether the type of anticompetitive regulation at issue is foreseeable from the Commonwealth's grant of authority to the Board. Unlike either *Hallie* or *Omni*, the regulation is not a foreseeable consequence of the Board's existing grant of authority. Instead, the relationship of the Board's regulation to its grant of authority – to “establish standards of service and practice for the funeral service profession” – “is one of precise neutrality.”<sup>37</sup> Further, a review of Virginia's overall statutory scheme demonstrates that this type of restriction is not foreseeable. First, the General Assembly, in passing the statutory scheme, showed no indication of a state policy to restrict price competition or advertising. Second, the Virginia statute itself prohibited in-person solicitation relating to preneed services, but made it clear that “general advertising and preneed solicitation, other than in-person communication, shall be allowed.” Finally, the 1989 Act did not change the Virginia statutory requirement that an itemized statement and general price list of funeral expenses be furnished to consumers, which is a similar requirement to that prescribed by the FTC Funeral Rule.<sup>38</sup>

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Virginia intended that certain types of competition be displaced by regulations: (1) the state intended that the forms for preneed contracts be specified by the Board, *Id.*; *see also* Va. Code Ann. § 54.1-2820 (Michie 2003); (2) the state intended that the disclosures made to consumers purchasing preneed services be established by regulations, VC 54.1-2803(9); and (3) the state intended that “reasonable bonds” be required to ensure performance of the preneed contract at-need. *Id.*

<sup>37</sup> *See Community Communications Co., Inc. v. City of Boulder*, 455 U.S. 40, 54-56 (1982) (holding that the “the general grant of power to enact ordinances” does not satisfy the clear articulation requirement.).

<sup>38</sup> Virginia adopted the Rule's requirements of disclosure, including price disclosure by statute, referencing the FTC Funeral Rule explicitly. *See* Va. Code Ann. § 54.1-2812 (Michie 2003). Under Virginia statute the Board may suspend or revoke the

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That section of the Virginia statute requires that “[a]ll regulations promulgated herewith shall promote the purposes of this section.” Because the purpose of the Funeral Rule is to increase the availability of information to consumers to improve price competition,<sup>39</sup> and because this section of the statute expressly incorporates that rule, it appears unlikely that the General Assembly intended to authorize a regulation inhibiting price competition as a foreseeable result of the Board’s general authority to regulate the funeral industry.<sup>40</sup>

**V. Opportunity for Public Comment**

The proposed Order has been placed on the public record for 30 days to receive comments from interested persons. Comments received during this period will become part of the public record. After 30 days, the Commission will again review the Agreement and comments received, and will decide whether it should withdraw from the Agreement or make final the Order contained in the Agreement.

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license of, or otherwise punish, a licensee for “[v]iolating or failing to comply with Federal Trade Commission rules regulating funeral industry practices.” *See* Va. Code Ann. § 54.1-2806(19) (Michie 2003). Virginia is one of 18 states that has adopted at least part of the requirements of the Funeral Rule. AARP, *The Deathcare Industry* 7 (Public Policy Institute May, 2000).

<sup>39</sup> *See e.g.*, 1990 FTC Staff Report at 12; Comments of AARP on the Commission's Review of the Funeral Rule, 16 C.F.R. Part 453 (September, 14, 1999), *available at* [http://www.ftc.gov/bcp/rulemaking/funeral/comments/ Comment A-55 - AARP Funeral Rule Comments.htm](http://www.ftc.gov/bcp/rulemaking/funeral/comments/Comment A-55 - AARP Funeral Rule Comments.htm) (“Certainly, one of the intended effects of implementing the Rule was to spur on competition, by making it easier for consumers to make an educated decision.”).

<sup>40</sup> *Indiana Movers Analysis* at 5.

## Analysis

By accepting the proposed Order subject to final approval, the Commission anticipates that the competitive issues described in the proposed Complaint will be resolved. The purpose of this analysis is to invite and facilitate public comment concerning the proposed Order. It is not intended to constitute an official interpretation of the Agreement and proposed Order or to modify their terms in any way.

Complaint

IN THE MATTER OF

**PIEDMONT HEALTH ALLIANCE, INC., ET AL.**

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

*Docket 9314; File No. 0210119*

*Complaint, December 27, 2003--Decision, October 1, 2004*

This consent order, among other things, prohibits Respondent Piedmont Health Alliance, Inc. ("PHA") -- a physician-hospital organization that includes physicians, hospitals, and other licensed health care providers in Alexander, Burke, Caldwell, and Catawba counties in western North Carolina (known as the "Unifour" area) -- and ten individual physician Respondents from entering into, participating in, or facilitating any agreement between or among any physicians: (1) to negotiate with payors on any physician's behalf; (2) to deal, not to deal, or threaten not to deal with payors; (3) on what terms to deal with any payor; or (4) not to deal individually with any payor, or to deal with any payor only through an arrangement involving PHA. The order also prohibits the respondents from exchanging or facilitating exchanges of information between or among physicians concerning whether, or on what terms, including price terms, they are willing to contract with a payor; from attempting to engage in any action prohibited by the order; and from inducing anyone else to engage in any action prohibited by the order. The order permits the individual physician Respondents to participate in activities that solely involve physicians who are part of their own medical group practices, or who are reasonably necessary to form, participate in, or further certain qualified risk-sharing joint arrangements, or certain qualified clinically-integrated joint arrangements. The order also permits Respondent PHA, beginning 30 months after the order becomes final, to participate in activities that are reasonably necessary to form, participate in, or further certain qualified risk-sharing joint arrangements, or certain qualified clinically-integrated joint arrangements, provided that PHA complies with certain requirements regarding prior notification to the Commission. The order also prohibits Respondent PHA, with certain exceptions, from preparing, maintaining, or participating in the preparation of any fee schedule regarding physician services; from collecting or maintaining information, or any summary or compilation of information, about price or other terms under which physicians deal, or are willing to deal, with payors; and from encouraging, facilitating, suggesting, advising, pressuring, inducing, or attempting to induce anyone to engage in such conduct. In addition, the order prohibits Respondent PHA, for 54 months after the order becomes final, from participating in a "Messenger Arrangement," as defined in the order, except that it may participate in a "Limited Messenger Arrangement" as defined in the order, beginning 30 months after the order becomes final. The order also



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requires Respondent PHA to provide payors with a copy of the order; to terminate without penalty any preexisting contract between the payor and Respondent PHA that the payor requests in writing be terminated; and, with certain limited exceptions and time extensions, to terminate within six months after the order becomes final all contracts between payors and Respondent PHA.

*Participants*

For the Commission: *David M. Narrow, Christi J. Braun, Karen R. Singh, Andrew Ginsburg, John P. DeGeeter, Steven J. Osnowitz, Robert Canterman, Mary Connelly-Draper, Emily Jones, Brian Beall, Jeanna Composti, Markus H. Meier, Jeffrey W. Brennan, Anne R. Schenof, Roberta S. Baruch, Thomas R. Iosso, Louis Silvia, Jr. and Timothy A. Deyak.*

For the Respondents: *Paul L. Yde, Freshfields Bruckhaus Derringer LLP*

**COMPLAINT**

Pursuant to the provisions of the Federal Trade Commission Act, as amended, 15 U.S.C. § 41 *et seq.*, and by virtue of the authority vested in it by said Act, the Federal Trade Commission (“Commission”), having reason to believe that Piedmont Health Alliance, Inc. (“PHA”), Peter H. Bradshaw, M.D., S. Andrews Deekens, M.D., Daniel C. Dillon, M.D., Sanford D. Guttler, M.D., David L. Harvey, M.D., John W. Kessel, M.D., A. Gregory Rosenfeld, M.D., James R. Thompson, M.D., Robert A. Yapundich, M.D., and William Lee Young III, M.D., herein collectively referred to as “Respondents,” have violated Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues this Complaint stating its charges in that respect as follows:

**NATURE OF THE CASE**

1. This action concerns a horizontal agreement among approximately 450 physician shareholders and non-shareholder

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subcontracted physicians (collectively, “physician members”) of PHA to agree collectively on the prices they demand for physician services from payors, including health insurance plans, health maintenance organizations, preferred provider organizations, employers directly providing self-funded health care benefits to their employees and their employees’ dependents, and other third-party purchasers of health care benefits. The physicians, with and through PHA, have eliminated price competition to the detriment of payors and consumers in the “Unifour area” of North Carolina, which comprises Alexander, Burke, Caldwell, and Catawba Counties.

**RESPONDENTS**

2. PHA, a physician-hospital organization (“PHO”), is a for-profit corporation organized, existing, and doing business under and by virtue of the laws of the State of North Carolina, with its principal address at 1899 Tate Boulevard, SE, Suite 2106, Hickory, North Carolina 28602.

3. The following persons (“Physician Respondents”) are physicians licensed to practice medicine in the State of North Carolina, and are shareholders in PHA. Their respective names, principal addresses, and roles in PHA are as follows:

- A. Peter H. Bradshaw, M.D., Hickory Surgical Clinic, 415 North Center Street, Suite 102, Hickory, North Carolina 28601, has been a voting member of the PHA Board of Directors (“PHA Board”);
- B. S. Andrews Deekens, M.D., Morganton Family Medicine, PLLC, 115 Foothills Drive, Morganton, North Carolina 28628, has served on the PHA Board as Chairman, a voting member, and a non-voting advisory member;
- C. Daniel C. Dillon, M.D., P.A., 11 13<sup>th</sup> Avenue, NE, Suite 102, Hickory, North Carolina 28601, has served on the

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PHA Board as Chairman, a voting member, and a non-voting advisory member;

- D. Sanford D. Guttler, M.D., Crown Health Care, PA, d/b/a Granite Falls Primary Care Physicians, One Trade Street, Granite Falls, North Carolina 28630, has been a voting member of the PHA Board, and has served both as the Chairman and as a member of the PHA Contracts Committee;
- E. David L. Harvey, M.D., Piedmont Nephrology & Hypertension Associates, 1899 Tate Boulevard, SE, Suite 2101, Hickory, North Carolina 28602, has been a voting member of the PHA Board, and was a member of the PHA Contracts Committee;
- F. John W. Kessel, M.D., Fairbrook Medical Clinic, 1985 Startown Road, Hickory, North Carolina 28602, has served both as a voting member and as a non-voting advisory member of the PHA Board;
- G. A. Gregory Rosenfeld, M.D., Piedmont Neurosurgery, P.A., 1899 Tate Boulevard, SE, Suite 2108, Hickory, North Carolina 28602, has been a voting member of the PHA Board, and was a member of the PHA Contracts Committee;
- H. James R. Thompson, M.D., Caldwell Family Care Center, 212 Mulberry Street, SW, Lenoir, North Carolina 28645, has served both as the Chairman and as a voting member of the PHA Board;
- I. Robert A. Yapundich, M.D., Neurology Associates, P.A., 1985 Tate Boulevard, SE, Suite 600, Hickory, North Carolina 28602, has been a voting member of the PHA Board, and was a member of the PHA Contracts Committee; and

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J. William Lee Young III, M.D., Hickory Family Practice Associates, P.A., 52 12<sup>th</sup> Avenue, NE, Hickory, North Carolina 28601, has served both as a voting member and as a non-voting advisory member of the PHA Board.

**JURISDICTION AND INTERSTATE COMMERCE**

4. At all times relevant to this Complaint, PHA has been engaged in the business of contracting with payors, on behalf of its physician and hospital members, for the provision of health care services to persons for a fee.

5. The general business practices of PHA, including the acts and practices herein alleged, are in or affecting “commerce,” as defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

6. Except to the extent that competition has been restrained as alleged herein, PHA’s physician members, including the Physician Respondents, have been, and are now, in competition with each other for the provision of physician services in the Unifour area to persons for a fee.

7. The general business practices of the Physician Respondents, including the acts and practices herein alleged, are in or affecting “commerce,” as defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

**BACKGROUND**

8. Payors often contract with physicians, hospitals, and other providers of health care services in a geographic area to create a network of health care providers (“provider network”) that have agreed to provide health care services to enrollees covered under the payors’ programs. Those providers may enter into contracts individually and directly with the payor, or through a provider organization, such as a PHO.

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9. To become members of payors' provider networks, physicians often enter into contracts with payors that establish the terms and conditions, including fees and other competitively significant terms, for providing health care services to enrollees under the payors' programs. Physicians entering into such contracts often agree to reductions in their usual compensation in order to obtain access to additional patients made available to them by the payors' contractual relationships with their enrollees. Such reductions in physician fees may permit payors to constrain increases in, or reduce, the premiums they charge to their customers, or to offer broader benefits coverage without increasing premium levels or out-of-pocket expenditures by enrollees.

10. Medicare's Resource Based Relative Value Scale ("RBRVS") is a system used by the United States Centers for Medicare and Medicaid Services to determine the amount to pay physicians for the services they render to Medicare patients. The RBRVS approach provides a method to determine fees for specific services. In general, payors in the Unifour area make contract offers to individual physicians or groups at a price level specified as some percentage of the RBRVS fees for a particular year (*e.g.*, "110% of 2003 RBRVS").

11. Absent agreements among competing physicians on the prices and other contract terms on which they will provide services to the payor's enrollees, competing physicians or medical group practices decide unilaterally whether to enter a contract to participate in the payor's provider network on the terms and conditions, including price, offered by the payor.

12. Some self-insured employers contract with other payors to gain access to established provider networks. Payors who are not self-insured employers typically sell their programs to various customers, including employers or other entities that purchase or arrange for (and sometimes pay all or part of the cost of) programs providing health care benefits to their employees and their employees' dependents.

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13. To be marketable and competitive in the Unifour area, a payor's health plan generally must include in its physician network a large number of primary care and specialist physicians, offering services in a sufficient number of practice fields, who are available to customers at convenient or accessible locations, and at affordable prices. Because the substantial majority of the primary care and specialist physicians who practice in the Unifour area are members of PHA, many payors doing business in the Unifour area cannot offer marketable and competitive health plans without having at least a substantial portion of PHA's physician members in their provider networks.

**PHA'S FORMATION AND EXPANSION**

14. In 1993, the Chief Executive Officer ("CEO") of Frye Regional Medical Center, Inc. ("Frye"), formulated a plan to create a PHO that would include Frye and physicians who practiced at Frye. Frye paid a health care consultant to conduct surveys of physicians practicing at Frye to determine their level of interest in forming a PHO, and the services they would expect the PHO to offer. The consultant told Frye that the surveyed physicians "stated a need to form the group to negotiate with group clout and power" and "maintain[] their income" in anticipation of the arrival of managed care organizations to the Unifour area.

15. Eight physicians practicing at Frye, including Physician Respondents Dillon and Guttler, were recruited to serve on a PHO "steering committee" with Frye's CEO and Chief Operating Officer ("COO"). This committee met periodically, for more than a year, to make decisions about the purpose, form, and organization of the PHO.

16. In 1994, PHA was incorporated and its shareholders elected a Board of Directors, made up of physician and hospital representatives from among the PHA membership. Frye's COO initially directed PHA's operations. In 1995, PHA hired a full-

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time CEO, who was charged with overseeing the day-to-day operations of PHA, subject to approval by the PHA Board.

17. In early 1995, representatives of PHA participated in discussions with Caldwell Memorial Hospital (“Caldwell Memorial”), Grace Hospital (“Grace”), and their medical staffs about the possibility of joining PHA to form a “super PHO.” In 1996, PHA amended its Articles of Incorporation, Bylaws, and Policies and Procedures to permit Grace, Caldwell Memorial, and their respective medical staffs to join PHA and share equally in its governance.

**RESPONDENTS HAVE ENGAGED IN PRICE-FIXING  
AND OTHER ANTICOMPETITIVE ACTS**

18. According to its records, PHA was “created to be a contracting entity for its members and serves to negotiate managed health care contracts with [payors].” In 1994, PHA informed potential physician members that “[e]ach [payor] contract will be carefully reviewed to determine advantages and disadvantages (including but not limited to reimbursement issues) to Piedmont Health Alliance participants and only those [contracts] which the directors determine to be favorable on balance to our participants as a whole will be signed.”

19. PHA’s physician members signed agreements that bound them to participate in all contracts that PHA entered, to accept PHA-negotiated prices, and to agree that if PHA entered into a contract with a payor with which the physician had an individual contract, then that physician would terminate the individual contract. PHA agreed to attempt to negotiate contracts with payors that included all PHA physician members.

20. In early 1994, the PHA steering committee established a Contracts Committee to negotiate contracts with payors on behalf of PHA and its physician and hospital members. The PHA Bylaws authorized the Contracts Committee to evaluate and negotiate proposed contracts with payors on behalf of PHA and its

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members. Until 2001, the Contracts Committee met regularly and was actively involved in PHA's contracting activities. Physician Respondents Guttler, Harvey, Rosenfeld, and Yapundich participated in the activities of the Contracts Committee during this period. Over that period, PHA negotiated and entered into more than 50 payor contracts.

21. From 1994 through early 1996, Frye's Chief Financial Officer ("CFO") and COO served as PHA's principal contract negotiators with payors. Beginning in 1996, PHA's CEO and her staff assumed the responsibility for negotiating PHA's payor contracts, and PHA's Board and Contracts Committee advised PHA's CEO regarding the price and other contract terms to demand from payors.

22. PHA's Board must approve PHA contracts with payors before they can take effect. PHA's Board is composed of 14 physician directors and six hospital directors, two representing each hospital (but with only one vote per hospital). Contract approval requires that both a majority of the PHA physician directors and two of the three hospital shareholders approve the contract. The Physician Respondents and the PHA hospitals' representatives on the PHA Board voted on the approval of contracts containing physician fee schedules that PHA collectively negotiated with payors.

23. PHA hired actuaries and other consultants to develop physician fee schedules containing price terms that PHA subsequently demanded from payors as a condition of contracting for the services of PHA's physician members.

24. PHA's most common contracting method has been to enter into a single-signature contract between PHA and a payor that covers the services of all PHA physician members. Payors that failed to reach agreement with PHA on contract terms, including price and price-related terms, were denied access to PHA's physician members for inclusion in their provider networks.



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25. PHA's physician members agreed with each other and with PHA that they would not deal individually, or through any other organization, with any payor with which PHA was attempting to negotiate, or had signed, a contract jointly on behalf of PHA's members. Until 2001, the physicians' participation agreements with PHA expressly included this provision. After 2001, this provision was no longer written into the PHA participation agreements, but PHA physicians nonetheless continued to adhere to it. PHA's physician members also refused to deal directly and individually with payors after PHA terminated its contracts with those payors.

26. By and through PHA, the member physicians and hospitals jointly agreed to require payors, as a condition of dealing with the PHA physicians, to refrain from contracting with non-PHA physicians or physician organizations in the Unifour area.

**PHA'S SO-CALLED "MESSENGER" APPROACH TO  
CONTRACTING CONSTITUTES PRICE-FIXING**

27. Competing physicians sometimes use a "messenger" to facilitate their contracting with payors in ways that do not constitute an unlawful agreement on prices and other competitively significant terms. Legitimate messenger arrangements can reduce contracting costs between payors and physicians. A messenger can be an efficient conduit to which a payor submits a contract offer, with the understanding that the messenger will transmit that offer to a group of physicians and inform the payor how many physicians across specialties accept the offer or have a counteroffer. At less cost, payors can thus discern physician willingness to contract at particular prices, and assemble networks, while physicians can market themselves to payors and assess contracting opportunities. A messenger may not negotiate prices or other competitively significant terms, however, and may not facilitate coordination among physicians on their responses to contract offers.

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28. In February 2001, the PHA Board voted to change prospectively PHA's method of contracting with payors for physician services. PHA called its new contracting method the "modified messenger model." PHA told physician members that this contracting method would not apply to existing PHA payor contracts or to contracts then in the final stages of negotiation – all of which contained price and other terms that the PHA physician members had fixed and jointly demanded through PHA. Since the PHA Board's decision to institute its so-called "messenger" method for contracting, many existing PHA payor contracts renewed, and a number of new contracts were finalized, without being processed through PHA's messenger model.

29. In setting up this new contracting method, PHA told its physician members to report to PHA the minimum price levels they would accept under payor contracts. To aid physicians in making these price decisions, PHA informed them of the prices they had been paid for their most common medical procedures under several pre-existing, PHA-negotiated payor contracts. All such contracts contained prices that the physicians had collusively fixed and demanded through PHA. Many PHA physician members used these fixed prices to determine the prices that they would demand under the new "messenger" method.

30. PHA has processed two payor contracts for its physician members pursuant to its "messenger" method for contracting – one with CIGNA HealthCare of North Carolina, Inc. ("CIGNA"), and the other with United HealthCare of North Carolina, Inc. ("United"). PHA and its members engaged in price-fixing in connection with both contracts. PHA negotiated with CIGNA and United, respectively, on the overall average price levels that each would pay to all PHA physicians in the aggregate. PHA engaged in this conduct without transmitting contract offers to its physician members for their unilateral acceptance or rejection. As a result of these negotiations, United and CIGNA each agreed to aggregate payment rates substantially higher than their respective aggregate payment rates for North Carolina physicians.

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31. After fixing the overall average price level that would be paid to all its physician members under each of these two contracts, PHA, through its actuarial consultant, created fee schedules that established different price levels for each medical procedure and for different medical specialties. The actuary calculated these fee schedules such that, in their aggregate, they would total the overall average price level that PHA had negotiated for all PHA physicians to receive under the contract. In effect, the overall average price level was the “pie” that the PHA physicians collectively would share, and the fee schedules were the “pieces of the pie” that individual physicians could earn – depending on their specialty and the procedures they performed. PHA negotiated for United’s and CIGNA’s acceptance of these fee schedules. It did so without transmitting contract offers to its physician members for their unilateral acceptance or rejection.

32. PHA negotiated with United and CIGNA regarding, or collectively agreed on, various other contract terms as well – including pricing terms such as a demand for periodic, across-the-board percentage increases in physician fee levels to occur at certain times under the contract, and cost containment programs – without transmitting contract offers to PHA physician members for their unilateral acceptance or rejection.

33. After PHA had collectively negotiated with United and CIGNA on behalf of its physician members, more than 90% of PHA’s physician members agreed to participate in those contracts.

**THE PHYSICIAN RESPONDENTS PARTICIPATED IN  
PRICE-FIXING AND OTHER ANTICOMPETITIVE ACTS**

34. All the Physician Respondents were voting members of the PHA Board. In that capacity, they participated in decisions of the PHA Board to: (a) approve or reject proposed contracts with payors that included fixed prices for PHA’s physician members; (b) authorize negotiations with payors by the PHA Contracts Committee and other PHA representatives aimed at gaining acceptance by the payors of physician fee schedules and prices

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collectively determined by PHA; (c) authorize development of, and approve, physician fee schedules for use by PHA in negotiating and contracting with payors; (d) terminate contracts between PHA and payors; (e) approve recommendations of the PHA Contracts Committee concerning payor contracts and contract terms, including physician prices; and (f) permit or not permit payors to obtain an exception from PHA's requirement that payors agree, as a condition of dealing with PHA, to refuse to deal with non-PHA physicians and physician organizations. The Physician Respondents directly profited from PHA's price-fixed contracts.

35. Physician Respondents Guttler, Harvey, Rosenfeld, and Yapundich were all members of the PHA Contracts Committee. In that capacity, they participated in activities and decisions of that Committee, including: (a) reviewing and deciding on, subject to final approval of the PHA Board, the acceptability of contracts and contract terms, including physician prices, proposed or offered by payors; (b) authorizing negotiations by PHA representatives with payors, and presentation to payors of specific requested contract terms, including price terms, or counteroffers to payors' offers; (c) recommending to the PHA Board that it approve contracts with payors that included collectively negotiated prices for the services of PHA physician members; (d) recommending to the PHA Board that it terminate contracts between PHA and certain payors; (e) approving or rejecting fee schedules, reimbursement terms, price levels, or other proposals or analyses relating to fees to be paid to PHA's physician members for use by PHA in negotiating and contracting with payors; and (f) recommending that the PHA Board approve or adopt fee schedules for reimbursement of PHA physician members in contracts between PHA and payors.

**RESPONDENTS' PRICE-FIXING IS NOT JUSTIFIED**

36. PHA's collective negotiation of fees and other competitively significant contract terms has not been, and is not,

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reasonably necessary to achieving any efficiency-enhancing integration.

**ANTICOMPETITIVE EFFECTS**

37. Respondents' actions described in Paragraphs 14 through 35 of this Complaint have had, or have tended to have, the effect of restraining trade unreasonably and hindering competition in the provision of physician services in the Unifour area of North Carolina in the following ways, among others:

- A. price and other forms of competition among PHA's physician members were unreasonably restrained;
- B. prices for physician services in the Unifour area have increased or been maintained at artificially high levels; and
- C. health plans, employers, and individual consumers were deprived of the benefits of competition among physicians.

**VIOLATION OF THE FEDERAL TRADE COMMISSION  
ACT**

38. The combination, conspiracy, acts, and practices described above constitute unfair methods of competition in violation of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45. Such combination, conspiracy, acts and practices, or the effects thereof, are continuing and will continue or recur in the absence of the relief herein requested.

**NOTICE**

Notice is hereby given to the Respondents that the twenty-second day of March, 2004, at 10:00 a.m., or such later date as determined by an Administrative Law Judge of the Federal Trade Commission, is hereby fixed as the time and Federal Trade Commission offices, 600 Pennsylvania Avenue, N.W., Room 532, Washington, D.C. 20580, as the place when and where a hearing

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will be had before an Administrative Law Judge of the Federal Trade Commission, on the charges set forth in this Complaint, at which time and place you will have the right under the Federal Trade Commission Act to appear and show cause why an order should not be entered requiring you to cease and desist from the violations of law charged in the Complaint.

You are notified that the opportunity is afforded to you to file with the Commission an answer to this Complaint on or before the twentieth (20th) day after service of it upon you. An answer in which the allegations of the Complaint are contested shall contain a concise statement of the facts constituting each ground of defense; and specific admission, denial, or explanation of each fact alleged in the Complaint or, if you are without knowledge thereof, a statement to that effect. Allegations of the Complaint not thus answered shall be deemed to have been admitted.

If you elect not to contest the allegations of fact set forth in the Complaint, the answer shall consist of a statement that you admit all of the material facts to be true. Such an answer shall constitute a waiver of hearings as to the facts alleged in the Complaint and, together with the Complaint, will provide a record basis on which the Administrative Law Judge shall file an initial decision containing appropriate findings and conclusions and an appropriate order disposing of the proceeding. In such answer, you may, however, reserve the right to submit proposed findings and conclusions under § 3.46 of the Commission's Rules of Practice for Adjudicative Proceedings and the right to appeal the initial decision to the Commission under § 3.52 of said Rules.

Failure to answer within the time above provided shall be deemed to constitute a waiver of your right to appear and contest the allegations of the Complaint and shall authorize the Administrative Law Judge, without further notice to you, to find the facts to be as alleged in the Complaint and to enter an initial decision containing such findings, appropriate conclusions, and order.

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The Administrative Law Judge will schedule an initial prehearing scheduling conference to be held not later than 14 days after the last answer is filed by any party named as a Respondent in the Complaint. Unless otherwise directed by the Administrative Law Judge, the scheduling conference and further proceedings will take place at the Federal Trade Commission, 600 Pennsylvania Avenue, N.W., Room 532, Washington, D.C. 20580. Rule 3.21(a) requires a meeting of the parties' counsel as early as practicable before the prehearing scheduling conference, and Rule 3.31(b) obligates counsel for each party, within five (5) days of receiving a Respondent's answer, to make certain initial disclosures without awaiting a formal discovery request.

**NOTICE OF CONTEMPLATED RELIEF**

Should the Commission conclude from the record developed in any adjudicative proceeding in this matter that Respondents Piedmont Health Alliance, Inc. ("PHA"), Peter H. Bradshaw, M.D., S. Andrews Deekens, M.D., Daniel C. Dillon, M.D., Sanford D. Guttler, M.D., David L. Harvey, M.D., John W. Kessel, M.D., A. Gregory Rosenfeld, M.D., James R. Thompson, M.D., Robert A. Yapundich, M.D., and William Lee Young III, M.D. ("Physician Respondents") are in violation of Section 5 of the Federal Trade Commission Act as alleged in the Complaint, the Commission may order such relief as is supported by the record and is necessary and appropriate, including, but not limited to:

1. An order to cease and desist from entering into, adhering to, participating in, maintaining, organizing, implementing, enforcing, or otherwise facilitating any combination, conspiracy, agreement, or understanding between or among any physicians: (a) to negotiate on behalf of any physician with any payor; (b) to deal, refuse to deal, or threaten to refuse to deal with any payor; (c) regarding any term, condition, or requirement upon which any physician deals, or is willing to deal, with any payor, including, but not limited to, price terms; or (d) not to deal individually with

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any payor, or not to deal with any payor through any arrangement other than PHA.

2. An order to cease and desist from exchanging, or facilitating in any manner the exchange or transfer of, information among physicians concerning any physician's willingness to deal with a payor, or the terms or conditions, including price terms, on which the physician is willing to deal.

3. An order to cease and desist from attempting to engage in any action prohibited by Paragraphs 1 or 2, above.

4. An order to cease and desist from encouraging, suggesting, advising, pressuring, inducing, or attempting to induce any person to engage in any action that would be prohibited by Paragraphs 1 through 3, above.

Provided, however, Paragraphs 1 through 3, above, would not prohibit any Physician Respondent from forming, participating in, or taking any action in furtherance of a qualified risk-sharing joint arrangement or a qualified clinically-integrated joint arrangement, or that solely involves physicians in the same medical group practice. Provided further, Paragraphs 1 through 3, above, would not prohibit PHA, following the seven (7) year period specified in Paragraph 6, from forming, participating in, or taking any action in furtherance of a qualified risk-sharing joint arrangement or a qualified clinically-integrated joint arrangement, so long as the arrangement does not restrict the ability, or facilitate the refusal, of physicians who participate in it to deal with payors on an individual basis or through any other arrangement.

5. An order that PHA cease and desist from evaluating or considering, on behalf of any physician, any information, term, condition, or requirement of dealing with any payor, and from advising any PHA physician member to accept or reject any term, condition, or requirement of dealing with any payor.



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6. An order that PHA cease and desist, for a period of seven (7) years, from: (a) acting as a messenger, or as an intermediary or agent, for or on behalf of any physicians, with payors regarding contracts or terms of dealing involving the physicians and payors; (b) participating in, organizing, or facilitating any discussion or understanding with or among any physicians or hospitals, pursuant to a qualified risk-sharing joint arrangement or a qualified clinically-integrated joint arrangement, relating to price or other terms or conditions of dealing with any payor; and (c) contacting a payor, pursuant to a qualified risk-sharing joint arrangement or a qualified clinically-integrated joint arrangement, to negotiate or enter into any agreement relating to price or other terms or conditions of dealing with any payor, on behalf of any physician or hospital in such arrangement.

7. A requirement that, for any pre-existing contract with any payor for the provision of physician services having a termination or renewal date of one (1) year or less after the date the order becomes final, PHA terminate such contract, without penalty or charge and in compliance with any applicable laws, at the earlier of:

(a) receipt by PHA of a written request from a payor to terminate such contract, or

(b) the earliest termination or renewal date (including any automatic renewal date) of such contract.

Provided, however, a preexisting contract may extend beyond any such termination or renewal date no later than one (1) year after the date on which the order becomes final if, prior to such termination or renewal date: (i) the payor submits to PHA a written request to extend such contract to a specific date no later than one (1) year after the order becomes final; and (ii) PHA has determined not to exercise any right to terminate. Provided further, that any payor making such request to extend a contract retains the right, pursuant to part (a) of this paragraph, to terminate the contract at any time.

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8. A requirement that, for any pre-existing contract with any payor for the provision of physician services having a termination or renewal date of more than one (1) year after the date this order becomes final, PHA terminate such contract, without penalty or charge and in compliance with any applicable laws, no later than one (1) year after the date on which the order becomes final. Provided, however, that any such payor retains the right, pursuant to part (a) of Paragraph 7, to terminate the contract at any time.
  
9. A requirement that, for five (5) years following the end of the seven (7) year period specified in Paragraph 6, PHA give notice to the Commission at least sixty (60) days prior to:
  - (a) participating in, organizing, or facilitating any discussion or understanding with or among any physicians or hospitals relating to price or other terms or conditions of dealing with any payor concerning a clinically-integrated or financial risk-sharing joint arrangement in which PHA participates; (b) contacting a payor, pursuant to any such joint arrangement, to negotiate or enter into any agreement concerning price or other terms or conditions of dealing with any payor on behalf of any physician or hospital participating in such joint arrangement; or (c) acting as a messenger, or as an agent on behalf of any physicians, with payors regarding contracts for physician services.
  
10. A requirement that PHA distribute a copy of the order and Complaint, within thirty (30) days after the order becomes final, to: (a) each physician who is participating, or has participated, in PHA; (b) each officer, director, manager, and employee of PHA; and (c) all payors with which PHA has been in contact since January 1, 1994, regarding contracting for the provision of physician or hospital services (including a notice to these payors of their right to terminate any of their existing contracts with PHA).
  
11. A requirement that for ten (10) years after the order becomes final, PHA: (a) distribute a copy of the order and Complaint to: (i) each payor that contracts with PHA for the provision of physician or hospital services; (ii) each person who

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becomes an officer, director, manager, or employee of PHA; and (iii) each newly participating physician in PHA; and (b) annually publish a copy of the order and Complaint in any official annual report or newsletter sent to all physicians who participate in it, and on its website, with such prominence and identification as is given to regularly featured articles.

12. Requirements that PHA and each Physician Respondent: (a) file periodic compliance reports with the Commission; and (b) notify the Commission of any changes that may affect compliance obligations.

13. Any other provision appropriate to correct or remedy the anticompetitive practices engaged in by PHA and the Physician Respondents.

**WHEREFORE, THE PREMISES CONSIDERED,** the Federal Trade Commission on this twenty-second day of December, 2003, issues its Complaint against Piedmont Health Alliance, Inc., Peter H. Bradshaw, M.D., S. Andrews Deekens, M.D., Daniel C. Dillon, M.D., Sanford D. Guttler, M.D., David L. Harvey, M.D., John W. Kessel, M.D., A. Gregory Rosenfeld, M.D., James R. Thompson, M.D., Robert A. Yapundich, M.D., and William Lee Young III, M.D.

Decision and Order

## **DECISION AND ORDER**

The Federal Trade Commission (“Commission”), having heretofore issued its Complaint charging Piedmont Health Alliance, Inc. (“PHA”), hereinafter sometimes referred to as “Respondent PHA,” and ten individual physicians (“Physician Respondents”), together collectively hereinafter sometimes referred to as “Respondents,” with violations of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45; and

Respondents, their attorneys, and counsel for the Commission having thereafter executed an Agreement Containing Consent Order to Cease and Desist (“Consent Agreement”), containing an admission by Respondents of all the jurisdictional facts set forth in the aforesaid draft of Complaint, a statement that the signing of said Consent Agreement is for settlement purposes only and does not constitute an admission by Respondents that the law has been violated as alleged in such Complaint, or that the facts as alleged in such Complaint, other than jurisdictional facts and the facts admitted in the Respondents’ Answer to the Complaint, are true, and waivers and other provisions as required by the Commission’s Rules; and

The Commission having thereafter withdrawn this matter from adjudication in accordance with Section 3.25 (f) of the Commission’s Rules, 16 C.F.R. § 3.25 (f), and the Commission having considered the matter and having accepted the executed Consent Agreement and placed such Consent Agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, and having duly considered the comment received from an interested person pursuant to section 2.34 of its Rules, now in further conformity with the procedure described in Commission Rule 3.25 (f), 16 C.F.R. § 3.25 (f), the Commission makes the following jurisdictional findings and issues the following Order:

## Decision and Order

1. Respondent PHA is a for-profit corporation, organized, existing, and doing business under and by virtue of the laws of the State of North Carolina, with its principal address located at 1899 Tate Boulevard, SE, Hickory, North Carolina 28602.
2. The Physician Respondents are persons who are licensed to practice medicine in the State of North Carolina, and are shareholders in PHA. Their respective names and principal addresses are as follows:
  - A. Peter H. Bradshaw, M.D., Hickory Surgical Clinic, 415 North Center Street, Suite 102, Hickory, North Carolina 28601;
  - B. S. Andrews Deekens, M.D., Morganton Family Medicine, PLLC, 115 Foothills Drive, Morganton, North Carolina 28655;
  - C. Daniel C. Dillon, M.D., P.A., 11 13<sup>th</sup> Avenue, NE, Suite 102, Hickory, North Carolina 28601;
  - D. Sanford D. Guttler, M.D., Crown Health Care, PA, d/b/a Granite Falls Primary Care Physicians, One Trade Street, Granite Falls, North Carolina 28630;
  - E. David L. Harvey, M.D., Piedmont Nephrology & Hypertension Associates, 1899 Tate Boulevard, SE, Suite 2101, Hickory, North Carolina 28602;
  - F. John W. Kessel, M.D., Fairbrook Medical Clinic, 1985 Startown Road, Hickory, North Carolina 28602;
  - G. A. Gregory Rosenfeld, M.D., Piedmont Neurosurgery, P.A., 1899 Tate Boulevard, SE, Suite 2108, Hickory, North Carolina 28602;
  - H. James R. Thompson, M.D., Caldwell Family Care Center, 212 Mulberry Street, SW, Lenoir, North Carolina 28645;

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- I. Robert A. Yapundich, M.D., Neurology Associates, P.A., 1985 Tate Boulevard, SE, Suite 600, Hickory, North Carolina 28602; and
  - J. William Lee Young III, M.D., Hickory Family Practice Associates, P.A., 52 12<sup>th</sup> Avenue, NE, Hickory, North Carolina 28601.
3. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the Respondents, and the proceeding is in the public interest.

**ORDER**

**I.**

**IT IS ORDERED** that, as used in this Order, the following definitions shall apply:

- A. “Respondent PHA” means Piedmont Health Alliance, Inc., its officers, directors, employees, agents, attorneys, representatives, successors, and assigns; the subsidiaries, divisions, groups, and affiliates controlled by it, and the respective officers, directors, employees, agents, attorneys, representatives, successors, and assigns of each.
- B. “Physician Respondents” means Peter H. Bradshaw, M.D., S. Andrews Deekens, M.D., Daniel C. Dillon, M.D., Sanford D. Guttler, M.D., David L. Harvey, M.D., John W. Kessel, M.D., A. Gregory Rosenfeld, M.D., James R. Thompson, M.D., Robert A. Yapundich, M.D., and William Lee Young III, M.D.
- C. “Respondents” means Respondent PHA and the Physician Respondents.
- D. “Group practice” means a bona fide, integrated firm in which providers practice together as partners, shareholders,

## Decision and Order

owners, members, or employees, or in which only one provider practices.

- E. “Hospital” means a health care facility licensed by any state as a hospital.
- F. “Limited Messenger Arrangement” means an arrangement pursuant to which PHA receives a contract offer from a payor, timely conveys without comment or analysis such offer to some or all of the arrangement’s participants as directed by the payor, receives from each participant his or her independent, unilateral decision to accept or reject the payor’s contract offer, and timely conveys each such response without comment or analysis to the payor.
- G. “Messenger Arrangement” means an arrangement, excluding a Limited Messenger Arrangement, pursuant to which Respondent PHA acts as a messenger, or as an agent for or on behalf of a provider, with payors regarding contracts or terms of dealing involving the providers and payors.
- H. “Participate” in an entity means (1) to be a partner, shareholder, owner, member, or employee of such entity, or (2) to provide services, agree to provide services, or offer to provide services, to a payor through such entity. This definition applies to all tenses and forms of the word “participate,” including, but not limited to, “participating,” “participated,” and “participation.”
- I. “Payor” means any person that pays, or arranges for payment, for all or any part of any provider services or hospital services for itself or for any other person. Payor includes any person that develops, leases, or sells access to networks of providers or hospitals.
- J. “Person” means both natural persons and artificial persons, including, but not limited to, corporations, unincorporated

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entities, and governments.

- K. “Physician” means a doctor of allopathic medicine (“M.D.”) or a doctor of osteopathic medicine (“D.O.”).
- L. “Preexisting contract” means a contract that was in effect on the date of the receipt by a payor that is a party to such contract of notice sent by Respondent PHA, pursuant to Paragraph VII.A.4 of this Order, of such payor’s right to terminate such contract.
- M. “Principal address” means either (1) primary business address, if there is a business address, or (2) primary residential address, if there is no business address.
- N. “Provider” means any licensed health care professional, including, but not limited to, physicians.
- O. “Qualified clinically-integrated joint arrangement” means an arrangement to provide provider services, hospital services, or both provider and hospital services, in which:
  - 1. all providers and hospitals that participate in the arrangement participate in active and ongoing programs of the arrangement to evaluate and modify the practice patterns of, and create a high degree of interdependence and cooperation among, the providers and hospitals that participate in the arrangement, in order to control costs and ensure the quality of services provided through the arrangement; and
  - 2. any agreement concerning price or other terms or conditions of dealing entered into by or within the arrangement is reasonably necessary to obtain significant efficiencies through the arrangement.
- P. “Qualified risk-sharing joint arrangement” means an arrangement to provide provider services, hospital services, or



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both provider and hospital services, in which:

1. all providers and hospitals that participate in the arrangement share substantial financial risk through their participation in the arrangement and thereby create incentives for the providers and hospitals that participate jointly to control costs and improve quality by managing the provision of provider services and hospital services, such as risk-sharing involving:
  - a. the provision of provider services and hospital services to payors at a capitated rate,
  - b. the provision of provider services and hospital services for a predetermined percentage of premium or revenue from payors,
  - c. the use of significant financial incentives (*e.g.*, substantial withholds) for providers and hospitals that participate to achieve, as a group, specified cost-containment goals, or
  - d. the provision of a complex or extended course of treatment that requires the substantial coordination of care by hospitals and providers in different specialties offering a complementary mix of services, for a fixed, predetermined price, where the costs of that course of treatment for any individual patient can vary greatly due to the individual patient's condition, the choice, complexity, or length of treatment, or other factors; and
2. any agreement concerning price or other terms or conditions of dealing entered into by or within the arrangement is reasonably necessary to obtain significant efficiencies through the arrangement.

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- Q. “Unifour Area” means the area of North Carolina that comprises Alexander, Burke, Caldwell, and Catawba Counties.

**II.**

**IT IS FURTHER ORDERED** that each Respondent, directly or indirectly, or through any corporate or other device, in connection with the provision of provider services in or affecting commerce, as “commerce” is defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44, cease and desist from:

- A. Entering into, adhering to, participating in, maintaining, organizing, implementing, enforcing, or otherwise facilitating any combination, conspiracy, agreement, or understanding between or among any providers:
1. to negotiate on behalf of any provider with any payor;
  2. to deal, refuse to deal, or threaten to refuse to deal with any payor;
  3. regarding any term, condition, or requirement upon which any provider deals, or is willing to deal, with any payor, including, but not limited to, price terms; or
  4. not to deal individually with any payor, or not to deal with any payor through any arrangement other than Respondent PHA;
- B. Exchanging or facilitating in any manner the exchange or transfer of information between or among providers concerning any provider’s willingness to deal with a payor, or the terms or conditions, including any price terms, on which the provider is willing to deal with a payor;
- C. Attempting to engage in any action prohibited by Paragraphs II.A and II.B above; and

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- D. Encouraging, suggesting, advising, pressuring, inducing, or attempting to induce any person to engage in any action that would be prohibited by Paragraphs II.A through II.C above.

**PROVIDED HOWEVER**, that nothing in this Paragraph II shall prohibit any agreement involving, or any conduct by:

1. Respondent PHA or any Physician Respondents to the extent necessary to continue to participate in the bonus plan contracts with the payors listed in Confidential Appendix A of this Order;
2. Any Physician Respondent that is reasonably necessary to form, participate in, or take any action in furtherance of a qualified risk-sharing joint arrangement or a qualified clinically-integrated joint arrangement, or that solely involves providers in the same medical group practice;
3. Respondent PHA, beginning thirty (30) months after the date this Order becomes final, and subject to the provisions of Paragraph IV of this Order, that is reasonably necessary to form, participate in, or take any action in furtherance of a qualified risk-sharing joint arrangement or a qualified clinically-integrated joint arrangement that in any way restricts the ability, or facilitates the refusal, of providers who participate in it to deal with payors on an individual basis or through any other arrangement (“exclusive qualified joint arrangement”), so long as the provider participants constitute twenty (20) percent or less of the providers in each provider specialty with active hospital staff privileges who practice in:
  - a. Catawba County, North Carolina; and
  - b. the Unifour Area;

*provided further* that, if Respondent PHA forms an exclusive qualified joint arrangement pursuant to proviso 3

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of Paragraph II of this Order, and if any provider specialty has fewer than five providers in that provider specialty, then that exclusive qualified joint arrangement may include one group practice that includes one or more providers in that specialty, on a non-exclusive basis; or

4. Respondent PHA, beginning thirty (30) months after the date this Order becomes final, and subject to the provisions of Paragraph IV of this Order, that is reasonably necessary to form, participate in, or take any action in furtherance of a qualified risk-sharing joint arrangement or a qualified clinically-integrated joint arrangement that does not restrict the ability, or facilitate the refusal, of providers who participate in it to deal with payors on an individual basis or through any other arrangement (“non-exclusive qualified joint arrangement”), so long as the provider participants constitute thirty (30) percent or less of the providers in each provider specialty with active hospital staff privileges who practice in:
  - a. Catawba County, North Carolina; and
  - b. the Unifour Area;

*provided further* that, if Respondent PHA forms a non-exclusive qualified joint arrangement pursuant to proviso 4 of Paragraph II of this Order, and if any provider specialty has fewer than four providers in that provider specialty, then that non-exclusive qualified joint arrangement may include one group practice that includes one or more providers in that specialty;

*Provided, however,* that beginning ten (10) years after the date this Order becomes final, provisos 3 and 4 of Paragraph II of this Order shall no longer apply, and thereafter nothing in Paragraph II shall prohibit any agreement involving, or any conduct by, Respondent PHA that is reasonably necessary to form, participate in, or take any action in furtherance of a

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qualified risk-sharing joint arrangement or a qualified clinically-integrated joint arrangement.

**III.**

**IT IS FURTHER ORDERED** that Respondent PHA, directly or indirectly, or through any corporate or other device, in connection with provider services in or affecting commerce, as “commerce” is defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44, cease and desist from:

- A. Preparing, maintaining, or participating in the development or preparation of any provider fee schedule;
- B. Collecting, soliciting, maintaining, or otherwise accumulating any information relating to the terms, conditions, or requirements upon which any provider deals, or is willing to deal, with a payor, including, but not limited to, price terms;
- C. Preparing or maintaining any summary or other compilation relating to the terms, conditions, or requirements upon which any provider deals, or is willing to deal, with a payor, including, but not limited to, price terms; and
- D. Encouraging, facilitating, suggesting, advising, pressuring, inducing, or attempting to induce any person to engage in any action that would be prohibited by Paragraphs III.A through III.C above, if Respondent PHA were to engage in such action.

**PROVIDED, HOWEVER**, that Paragraph III of this Order shall not apply, to the extent such conduct is reasonably necessary:

1. for Respondent PHA to continue the bonus plan contracts with payors listed in Confidential Appendix A of this Order;

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2. to the formation or operation of an exclusive qualified joint arrangement or a non-exclusive qualified joint arrangement pursuant to the provisos to Paragraph II of this Order;

**PROVIDED FURTHER** that Paragraph III.B and Paragraph III.C of this Order shall not apply to the extent that such conduct is necessary for, and undertaken solely for the purpose of:

- (1) entering into a Messenger Arrangement pursuant to Paragraph V of this Order; or
- (2) implementing information technology services in the form of practice management and electronic medical record software to group practices, and medical management services for payors.

**IV.**

**IT IS FURTHER ORDERED** that, pursuant to each exclusive qualified joint arrangement or non-exclusive qualified joint arrangement (“Arrangement”) in which Respondent PHA is a participant, Respondent PHA, for five (5) years after the date on which PHA is permitted to begin to enter into such Arrangements pursuant to provisos 3 and 4 of Paragraph II of this Order, shall notify the Secretary of the Commission in writing (“Notification”) at least sixty (60) but not more than ninety (90) days prior to:

- A. Participating in, organizing, or facilitating any discussion or understanding with or among any providers in such Arrangement relating to price or other terms or conditions of dealing with any payor; or
- B. Contacting a payor, pursuant to an Arrangement, to negotiate or enter into any agreement relating to price or other terms or conditions of dealing with any payor, on behalf of any provider in such Arrangement;

**PROVIDED, HOWEVER**, that Notification shall not be required for subsequent contacts with any payor pursuant to any Arrangement for which Notification has been given pursuant to Paragraph IV.A or Paragraph IV.B of this Order;

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**PROVIDED FURTHER:**

1. that with respect to any Notification, Respondent PHA shall include the following information:
  - a. for each provider participant, the name, address, telephone number, medical or other provider specialty, group practice, if applicable, and the name of each hospital where the provider has privileges;
  - b. a description of the Arrangement and its purpose, function, and geographic area of operation;
  - c. a description of the nature and extent of the integration and the efficiencies resulting from the Arrangement;
  - d. an explanation of how any agreement on prices, or on contract terms related to price, furthers the integration and achievement of the efficiencies resulting from the Arrangement;
  - e. a description of any procedures proposed to be implemented to limit possible anticompetitive effects resulting from the Arrangement or its activities; and
  - f. all studies, analyses, and reports that were prepared for the purpose of evaluating or analyzing competition for provider services in the Unifour Area or specifically in Catawba County, North Carolina, including, but not limited to, the market share of provider services in such market(s); and
2. if, within sixty (60) days from the Commission's receipt of the Notification, a representative of the Commission makes a written request for additional information to the Respondent PHA, then Respondent PHA shall not engage in any conduct described in Paragraph IV.A. or Paragraph IV.B of this Order prior to the expiration of thirty (30) days

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after substantially complying with such request for additional information, or such shorter waiting period as may be granted in writing from the Bureau of Competition. The expiration of any waiting period described herein without a request for additional information or without the initiation of an enforcement proceeding shall not be construed as a determination by the Commission, or its staff, that a violation of the law, or of this Order, may not have occurred. Further, receipt by the Commission from Respondent PHA of any Notification, pursuant to Paragraph IV of this Order, is not to be construed as a determination by the Commission that any such Arrangement does or does not violate this Order or any law enforced by the Commission.

**V.**

**IT IS FURTHER ORDERED** that Respondent PHA, directly or indirectly, or through any corporate or other device, cease and desist:

- A. for thirty (30) months after the date that this Order becomes final from entering into any Limited Messenger Arrangement; and
- B. for fifty-four (54) months after the date that this Order becomes final, from:
  - 1. evaluating, advising, or giving any opinion relating to contracts or terms of dealing involving providers and payors; or
  - 2. entering into any Messenger Arrangement.

**PROVIDED, HOWEVER,** that, subject to the provisions of Paragraph VI of this Order, nothing in Paragraph V of this Order shall prohibit Respondent PHA from entering into a Limited Messenger Arrangement on behalf of providers with regard to



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direct employer contracts with payors listed in Confidential Appendix B of this Order.

**VI.**

**IT IS FURTHER ORDERED** that, for three (3) years after the date that Respondent PHA enters into any Messenger Arrangement or Limited Messenger Arrangement pursuant to Paragraph V of this Order, Respondent PHA shall notify the Secretary of the Commission in writing (“Messenger Notification”) at least sixty (60) days, but no more than ninety (90) days, prior to entering into any such arrangement. The Messenger Notification shall include the identity of each proposed provider participant; the proposed geographic area in which the proposed arrangement will operate; a copy of any proposed provider participation agreement; a description of the proposed arrangement’s purpose and function; a description of any resulting efficiencies expected to be obtained through the arrangement; and a description of the procedures to be implemented to limit possible anticompetitive effects. Messenger Notification is not required for Respondent PHA’s subsequent acts pursuant to any Messenger Arrangement or Limited Messenger Arrangement for which this Messenger Notification has been given. Receipt by the Commission from Respondent PHA of any Messenger Notification, pursuant to Paragraph VI of the Order, is not to be construed as a determination by the Commission that any action described in such Messenger Notification does or does not violate this Order or any law enforced by the Commission.

**VII.**

**IT IS FURTHER ORDERED** that Respondent PHA shall:

- A. Within thirty (30) days after the date on which this Order becomes final, send a copy of this Order and the Complaint by first-class mail:

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1. with delivery confirmation, to each provider and hospital that participates in Respondent PHA;
  2. with return receipt requested, to each present officer, director, manager, and employee of Respondent PHA;
  3. with return receipt requested, to the chief executive officer of each payor with which Respondent PHA has no current contract, but with which Respondent PHA has a record of being in contact, since January 1, 1997, regarding contracting for the provision of provider services; and
  4. with delivery confirmation, and with an enclosed copy of the notice specified in:
    - a. Appendix C to this Order, to the chief executive officer of each payor with which Respondent PHA has a contract for the provision of provider services;
    - b. Appendix C to this Order, to each payor with a direct employer contract, listed at Confidential Appendix B of this Order; and
    - c. Appendix D to this Order, to each payor with a bonus plan contract, listed at Confidential Appendix A of this Order;
- B. For a period of five (5) years after the date this Order becomes final:
1. Distribute by first-class mail, return receipt requested, a copy of this Order and the Complaint to:
    - a. each provider and hospital that begins participating in Respondent PHA, and that did not previously receive a copy of this Order and the Complaint from Respondent PHA, within thirty (30) days of the day that such participation begins;

## Decision and Order

- b. each payor that contracts with Respondent PHA for the provision of provider services, and that did not previously receive a copy of this Order and the Complaint from Respondent PHA, within thirty (30) days of the day that such payor enters into such contract; and
  - c. each person who becomes an officer, director, manager, or employee of Respondent PHA, and who did not previously receive a copy of this Order and the Complaint from Respondent PHA, within thirty (30) days of the day that he or she assumes such responsibility with Respondent PHA; and
2. Annually publish a copy of this Order and the Complaint in an official annual report or newsletter sent to all providers who participate in Respondent PHA, with such prominence as is given to regularly featured articles;
- C. File a verified written report within sixty (60) days after the date on which this Order becomes final, annually thereafter for five (5) years on the anniversary of the date this Order becomes final, and at such other times as the Commission may by written notice require. Each such report shall include:
1. A detailed description of the manner and form in which Respondent PHA has complied and is complying with this Order;
  2. The name, address, and telephone number of each payor with which Respondent PHA has had any contact; and
  3. Copies of the delivery confirmations required by Paragraphs VII.A.1 and VII.A.4 of this Order, and copies of the signed return receipts required by Paragraphs VII.A.2, VII.A.3, and VII.B.1 of this Order; and

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- D. Terminate, without penalty or charge, and in compliance with any applicable laws, any preexisting contract with any payor for the provision of provider services, at the earlier of: (1) receipt by Respondent PHA of a written request from a payor to terminate such contract, or (2) six (6) months after the day the Order becomes final; *provided, however*, that the automatic termination requirement of part (2) of Paragraph VII.D of this Order does not apply to the bonus plan contracts entered into by Respondent PHA with payors listed in Confidential Appendix A of this Order; *provided further* that any payor holding a contract with Respondent PHA, other than a bonus plan contract entered into by Respondent PHA with payors listed in Confidential Appendix A of this Order, may, upon written request to Respondent PHA, extend the termination date of such contract for a period not to exceed six (6) months after the date this Order becomes final; *provided further* that any payor making such request to extend a contract retains the right, pursuant to part (1) of Paragraph VII.D of this Order, to terminate the contract at any time.

**VIII.**

**IT IS FURTHER ORDERED** that each Physician Respondent shall file a verified written report within sixty (60) days after the date on which this Order becomes final, annually thereafter for three (3) years on the anniversary of the date this Order becomes final, and at such other times as the Commission may by written notice require. Each such report shall include a detailed description of the manner and form in which each Physician Respondent has complied and is complying with this Order. Such details shall include, but are not limited to, a description of any exclusive qualified joint arrangement or any qualified joint arrangement entered into by the Physician Respondent during the reporting period.

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**IX.**

**IT IS FURTHER ORDERED** that Respondent PHA shall notify the Commission at least thirty (30) days prior to any proposed (1) dissolution of Respondent PHA, (2) acquisition, merger or consolidation of Respondent PHA, or (3) other change in Respondent PHA that may affect compliance obligations arising out of the order, including but not limited to assignment, the creation or dissolution of subsidiaries, or any other change in Respondent PHA.

**X.**

**IT IS FURTHER ORDERED** that each Respondent shall notify the Commission of any change in his or its principal address within twenty (20) days of such change in address.

**XI.**

**IT IS FURTHER ORDERED** that, for the purpose of determining or securing compliance with this Order, each Respondent shall permit any duly authorized representative of the Commission:

- A. Access, during office hours and in the presence of counsel, to inspect and copy all books, ledgers, accounts, correspondence, memoranda, calendars, and other records and documents in his or its possession, or under his or its control, relating to any matter contained in this Order; and
- B. Upon five (5) days' notice, and in the presence of counsel, and without restraint or interference from it, to interview officers, directors, or employees of the Respondent.

**XII.**

**IT IS FURTHER ORDERED** that this Order shall terminate on October 1, 2024.

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**Appendix A**

**[Redacted From Public Record Version But Incorporated By  
Reference]**

Decision and Order

**Appendix B**

**[Redacted From Public Record Version But Incorporated By  
Reference]**

Decision and Order

**Appendix C**

**Letter to payors with whom PHA currently has a contract,  
other than a bonus plan contract**

[letterhead of Respondent PHA]  
[name of payor's CEO]  
[address]

Dear \_\_\_\_\_:

Enclosed is a copy of a complaint and a decision and order ("Order") issued by the Federal Trade Commission against Piedmont Health Alliance, Inc. ("PHA"), and ten individual physicians.

Pursuant to Paragraph VII.D of the Order, PHA must allow you to terminate, upon your written request, without any penalty or charge, any contracts with PHA that are in effect at the time of your receipt of this letter.

Paragraph VII.D of the Order also provides that, if you do not terminate a contract currently in effect with PHA, the contract will terminate on the earlier of its termination or renewal date (including any automatic renewal date) or six (6) months after the date the enclosed Order becomes final. The Order became final on [appropriate date to be filled in by PHA]. However, if the contract terminates on a date prior to [appropriate date six months after Order became final to be filled in by PHA], the contract may be extended at your written request to a date no later than [appropriate date six months after Order became final to be filled in by PHA]. If you choose to extend the term of the contract, you may later terminate the contract at any time prior to [appropriate date six months after Order became final to be filled in by PHA].

Any request either to terminate or to extend the contract should be made in writing, and sent to me at the following address:  
[address].

Sincerely,



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**Appendix D**  
**Letter to payors with bonus plan contracts**

[letterhead of Respondent PHA]  
[name of payor's CEO]  
[address]

Dear \_\_\_\_\_:

Enclosed is a copy of a complaint and a decision and order ("Order") issued by the Federal Trade Commission against Piedmont Health Alliance, Inc. ("PHA"), and ten individual physicians.

Pursuant to Paragraph VII.D of the Order, PHA must allow you to terminate, upon your written request, without any penalty or charge, any contracts with PHA that are in effect at the time of your receipt of this letter.

Any request to terminate the contract should be made in writing, and sent to me at the following address: [address].

Sincerely,

Analysis

**Analysis of Agreement Containing Consent Order to Aid  
Public Comment**

The Federal Trade Commission has accepted, subject to final approval, an agreement containing a proposed consent order with Piedmont Health Alliance, Inc. (“PHA”), and ten individual physicians who are named as Respondents (“Physician Respondents”) in the complaint issued by the Commission on December 22, 2003.<sup>1</sup> The agreement settles charges that PHA and the ten Physician Respondents (together “Respondents”) violated Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, by orchestrating and facilitating agreements among PHA’s physician members to fix prices and other terms on which the physicians would deal with health plans and other purchasers of physician services (“payors”), and to refuse to deal with payors except on collectively-determined terms. On July 2, 2004, the case was withdrawn from adjudication, so that the Commission could consider a proposed consent agreement and decision and order. The proposed consent order has been placed on the public record for 30 days to receive comments from interested persons. Comments received during this period will become part of the public record. After 30 days, the Commission will review the agreement and any comments and decide whether to withdraw from the agreement or make the proposed order final.

The purpose of this analysis is to facilitate comment on the proposed order. The analysis does not constitute an official interpretation of the agreement and proposed order and does not modify their terms in any way. The proposed consent order has been entered into for settlement purposes only and does not constitute an admission by Respondents that they violated the law

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<sup>1</sup> The ten Physician Respondents (all M.D.s) are: Peter H. Bradshaw, S. Andrews Deekens, Daniel C. Dillon, Sanford D. Guttler, David L. Harvey, John W. Kessel, A. Gregory Rosenfeld, James R. Thompson, Robert A. Yapundich, and William Lee Young III.

## Analysis

or that the complaint's alleged facts – other than jurisdictional facts and facts admitted in the Respondents' answer to the complaint – are true.

**The Complaint Allegations**

PHA, a for-profit corporation, is a physician-hospital organization (“PHO”) that includes physicians, hospitals, and other licensed health care providers in Alexander, Burke, Caldwell, and Catawba counties in western North Carolina (known as the “Unifour” area). PHA includes approximately 450 physicians, representing the substantial majority of physicians in the Unifour area, and three of the five Unifour area hospitals, including Frye Regional Medical Center (“Frye”), Caldwell Memorial Hospital (“Caldwell Memorial”), and Grace Hospital (“Grace”).<sup>2</sup>

In 1993, Frye's Chief Executive Officer (“CEO”) developed a plan for a PHO that would include Frye and the physicians practicing at Frye. He hired a consultant to survey the physicians regarding what they would expect from a PHO. The consultant reported that the physicians “stated a need to form the group to negotiate with group clout and power” and “maintain their income” in anticipation of the arrival of managed care organizations in the Unifour area. Frye's CEO and Chief Operating Officer, along with eight physicians practicing at Frye, formed a steering committee responsible for establishing and organizing the PHO.

PHA was established in 1994 to facilitate physician collective

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<sup>2</sup> The Commission previously issued a separate consent order related to this case against Frye and its parent corporation, Tenet Healthcare Corporation, both of which are for-profit corporations. *In the Matter of Tenet Healthcare Corporation and Frye Regional Medical Center, Inc.*, Dkt. No. C-4106 (consent order issued January 29, 2004).

Analysis

bargaining with payors and obtain more favorable fees and other terms than PHA's physician members could obtain by dealing individually with payors. PHA established a Contracts Committee to negotiate contracts with payors on behalf of PHA's physician members, subject to approval by PHA's Board of Directors. In 1996, PHA expanded to include Caldwell Memorial and Grace, both nonprofit hospitals, and their respective medical staffs.

The Board manages and controls PHA. The Board has 14 physician directors elected by PHA's physician members, and six hospital directors – two representing each hospital member (but with only one vote per hospital member). A majority of PHA physician directors and two of the three voting hospital directors must approve each payor contract entered into on behalf of PHA's members. Since 1994, the Board voted to approve more than 50 contracts containing physician fee schedules that PHA collectively negotiated with payors.

PHA hired actuaries and other consultants to develop physician fee schedules containing price terms that PHA demanded from payors as a condition of contracting with PHA for physician services. PHA generally negotiated single-signature contracts with payors for the services of all PHA's physician members, and committed to attempt to negotiate contracts with payors that included all PHA physician members. Payors that failed to accede to PHA on price and other contract terms were denied access to PHA's physician members for inclusion in the payors' provider networks. PHA's physician members agreed to participate in all PHA's payor contracts, to accept the prices for their services that PHA negotiated on their behalf, and to terminate any individual contracts they had with a payor once PHA entered into a contract with that payor. PHA's physician members also agreed not to deal individually or through any other organization with any payor with which PHA was attempting to negotiate, or had signed, a contract jointly on behalf of PHA's members.

## Analysis

The Physician Respondents are PHA shareholders. All have been voting Board members and participated in Board decisions to approve or reject payor contracts containing fixed physician prices, authorize negotiations over the prices payors must pay for PHA physician services, authorize development of physician fee schedules for PHA's use in contracting with payors, terminate contracts between PHA and payors, and approve Contracts Committee recommendations concerning price and other payor contract terms. In addition to serving on the PHA Board, four Physician Respondents were members of the Contracts Committee, which more directly negotiated with payors over physician prices and other contract terms. The Physician Respondents and all PHA physician members are compensated for their professional medical services under fee schedules contained in PHA-negotiated contracts with payors.

In 2001, PHA prospectively adopted a new contracting method that it called a "modified messenger model." This contracting method did not affect existing contracts between PHA and payors or contracts in final stages of negotiation. Since 2001, PHA renewed or entered several payor contracts without using the "messenger model." The complaint alleges that, in setting up the "modified messenger model," PHA physician members reported to PHA the minimum price terms – *i.e.*, standing offers or "targets" – each would accept if offered by a payor. To help the physicians set their individual target fees, PHA provided each practice group with specific information about the fees that practice was receiving from several payors under existing PHA-negotiated payor contracts. PHA's physicians used these previously fixed prices in determining the prices to demand under contracts processed under PHA's new contracting method.

PHA used this contracting method with two health plans: United HealthCare of North Carolina, Inc., and Cigna HealthCare of North Carolina, Inc. PHA negotiated with each health plan over the aggregate level of payments the health plan would pay for physician services – stated as a percentage of Medicare's reimbursement for the same services. PHA also negotiated and

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agreed with United and Cigna on other price-related contract terms, such as periodic percentage increases in physician fee levels to occur at certain times. To compel the payor to accept PHA's terms, PHA confronted each payor with actual or threatened contract termination, and thus loss of its provider network, during the negotiation process. Once aggregate payment levels and terms were determined, PHA had its actuary develop fee schedules to be used under each contract. This determined how much each PHA physician would receive for specific medical procedures – in effect, dividing the “pie” that was the negotiated aggregate reimbursement amount. Only after the payor agreed to both the aggregate payment level and the fee schedule did PHA determine which physician practices “matched” the payor’s “offer” and thus would be included in the payor’s provider network under the PHA contract.

The complaint alleges that, as a result of Respondents’ conduct, prices for physician services in the Unifour area were maintained at, or increased to, artificially high prices in the Unifour area, and consumers have been deprived of the benefits of competition among physicians. By facilitating agreements among PHA member physicians to deal only on collectively-determined terms, and through PHA’s and its members’ actual or threatened refusals to deal with health plans that would not meet those terms, PHA and the Physician Respondents are alleged to have violated Section 5 of the FTC Act. PHA’s collective negotiation of fees and other competitively significant terms of dealing has not been, and is not, reasonably necessary to achieving any efficiency-enhancing integration.

### **The Proposed Consent Order**

The proposed consent order is designed to prevent continuation or recurrence of the illegal conduct charged in the complaint, and to facilitate readjustment of the market for physician services in the relevant area to one where physicians competitively determine the prices they charge to payors for medical services – without PHA’s involvement on the physicians’ behalf. The proposed

## Analysis

order prohibits PHA for a period of time from operating a “messenger model” or any other arrangement for physicians in their dealings with payors. Prompting this prohibition is, as the complaint alleges, PHA’s previous use of a self-described “messenger” contracting mechanism that failed to eliminate collective price setting and negotiation with payors over physician fees. The prohibition should enable payors to deal with physician practices, and establish prices for physician services, without the risk of cartelization through PHA. Such a period, which likely will involve multiple contracting cycles between payors and physicians, will help assure that any price information that physicians later use in participating in any messenger arrangement will reflect competitive price levels, rather than collectively negotiated prices – as allegedly was the case in PHA’s “modified messenger model.”

The proposed order allows Respondents to engage in various forms of legitimate conduct that do not improperly impair competition and that will not interfere with effective remedial relief through the proposed order. For example, the proposed order does not prohibit the Physician Respondents from participating in any legitimate financially integrated or clinically integrated joint arrangements with other physicians. PHA also is not prohibited from participating in arrangements that involve solely hospital services, or certain activities involving physician services, as specified in the proposed order. The proposed order also permits PHA to undertake activities necessary to operate certain programs, such as its information technology and medical management programs, that have procompetitive potential and do not involve physicians’ fees or other contracting terms between physicians and payors. Other parts of the proposed order are similar to orders that the Commission has issued to settle charges relating to allegedly unlawful agreements to eliminate physician competition and raise the prices of physician services.

The proposed order’s specific provisions are as follows:

The core prohibitions are contained in Paragraphs II, III, V,

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and VII. Paragraph II.A prohibits PHA and the Physician Respondents from entering into, participating in, or facilitating any agreement between or among any physicians: (1) to negotiate with payors on any physician's behalf; (2) to deal, not to deal, or threaten not to deal with payors; (3) on what terms to deal with any payor; or (4) not to deal individually with any payor, or to deal with any payor only through an arrangement involving PHA. Other parts of Paragraph II reinforce these general prohibitions. Paragraph II.B prohibits the Respondents from facilitating exchanges of information between or among physicians concerning whether, or on what terms, including price terms, they are willing to contract with a payor. Paragraph II.C bans them from attempting to engage in any action prohibited by Paragraph II.A or II.B. Paragraph II.D prohibits Respondents from inducing anyone else to engage in any action prohibited by Paragraphs II.A through II.C.

As in other Commission orders addressing health care providers' alleged collective bargaining with payors, certain kinds of potentially procompetitive agreements are excluded from the general prohibition on joint negotiations. The Physician Respondents are not prohibited from engaging in conduct that involves only physicians in their own group practice, or that is reasonably necessary to form or participate in a "qualified risk-sharing joint arrangement" or a "qualified clinically-integrated joint arrangement," as these terms are defined and have been used in prior Commission orders. Beginning no sooner than thirty (30) months after the proposed order becomes final, PHA may engage in conduct that is reasonably necessary to form or participate in such joint arrangements, subject to certain size and other limitations.

The size limitations for these allowable arrangements correspond to the safety zones for physician network joint ventures that are set forth in the joint Department of Justice and Federal Trade Commission Statements of Antitrust Enforcement



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Policy in Health Care,<sup>3</sup> and provide for different sizes depending on whether physicians' participation in the joint venture is exclusive or non-exclusive.<sup>4</sup> These size restrictions are intended to assure that any such joint arrangements involving PHA – which, as presently constituted, includes approximately three-fourths of the area's physicians – do not obtain or exercise substantial market power by involving an unduly large number of

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<sup>3</sup> U.S. Department of Justice and the Federal Trade Commission, Statements of Antitrust Enforcement Policy in Health Care at Statement 8, Part A (August 1996) (safety zones for physician network joint ventures) (available at <http://www.ftc.gov/reports/hlth3s.htm>).

<sup>4</sup> Permissible joint ventures by PHA, where the physicians participate in the arrangement on a non-exclusive basis, are generally limited to having no more than 30% of the physicians in any medical specialty practicing either in Catawba County or in the Unifour area. Permissible joint ventures by PHA, where the physicians participate in the arrangement on an exclusive basis, are generally limited to having no more than 20% of the physicians in any medical specialty practicing either in Catawba County or in the Unifour area. Catawba County contains the substantial majority of PHA's physician members, and is where most of the Unifour area's large employers, and the largest concentration of the area's population, are located. Applying the percentage limitations to both areas – Catawba County and the Unifour – avoids the possibility that a joint arrangement by PHA could have a higher percentage of Catawba County physicians, while still meeting the allowable percentage limitations for the Unifour as a whole. Despite the general size limitations, in either exclusive or non-exclusive arrangements, PHA is permitted to have non-exclusive participation by physicians in medical specialties where the limited number of such local specialists otherwise would not permit their participation within the proposed order's percentage limitations.

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area physicians.<sup>5</sup> The size restrictions apply only to physician network joint ventures undertaken by PHA. The proposed order does not affect any joint ventures undertaken by area physicians outside of PHA, or restrict the Physician Respondents or any other PHA physician members from participating in qualified risk-sharing or clinically-integrated joint arrangements outside of PHA that are larger than those that PHA is allowed to undertake.

Paragraph IV requires PHA to notify the Commission about such arrangements prior to negotiating on behalf of the arrangement's members or before those members jointly discuss any terms of dealing with a payor. Neither PHA nor the Physician Respondents are precluded from engaging in conduct that is necessary to continue PHA's preexisting "bonus plan" contracts with certain self-insured employers, which appear to involve the sharing of some financial risk among PHA's physician members. This exception does not necessarily mean that the bonus plan contracts are qualified joint arrangements as defined in the proposed order.

As defined in the proposed order, a "qualified risk-sharing joint arrangement" must satisfy two conditions. All physician and hospital participants must share substantial financial risk through the arrangement and thereby create incentives for the physician and/or hospital participants jointly to control costs and improve quality by managing the provision of services. Also, any agreement concerning price or other terms or conditions of dealing must be reasonably necessary to obtain significant

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<sup>5</sup> The safety zones in the Statements of Antitrust Enforcement Policy in Health Care do not establish upper size limits on lawful arrangements, but restricting PHA to size limits is appropriate in light of the complaint's allegations of PHA's unlawful conduct and the resulting anticompetitive effects. The size limits for qualified joint arrangements in the proposed order apply for 10 years after the order becomes final, rather than for the 20 years that apply to Paragraph II's general prohibitions.

## Analysis

efficiencies through the joint arrangement.

As defined in the proposed order, a “qualified clinically-integrated joint arrangement” also must satisfy two conditions. All physician and hospital participants must participate in active and ongoing programs to evaluate and modify their clinical practice patterns, creating a high degree of interdependence and cooperation among physicians and/or hospitals, to control costs and ensure the quality of services provided. Also, any agreement concerning price or other terms or conditions of dealing must be reasonably necessary to obtain significant efficiencies through the joint arrangement.

In the event that PHA forms a qualified risk-sharing joint arrangement or a qualified clinically-integrated joint arrangement, Paragraph IV of the proposed order requires PHA, for five years, to notify the Commission at least 60 days prior to initially contacting, negotiating, or entering into agreements with payors concerning the arrangement. Notification is not required for subsequent contacts, negotiations, or agreements with payors pursuant to any arrangement for which notice was already given under Paragraph IV. Paragraph IV sets out the information necessary to make the notification complete, and also provides the Commission with the right to obtain additional information regarding the arrangement before PHA enters into the arrangement.

Paragraph III of the proposed order prohibits PHA from preparing, maintaining, or participating in the preparation of any fee schedule regarding physician services. This requirement is a response to PHA’s alleged history, as set forth in the complaint, of having agents and consultants prepare fee schedules and using the fee schedules in negotiations with payors.

Paragraph III also prohibits PHA from collecting or maintaining information about price and other terms under which physicians deal, or are willing to deal, with payors. This addresses PHA’s alleged practices in collecting and using such

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information as part of its so-called “modified messenger model.” Paragraph III excepts from these prohibitions activities necessary to maintain preexisting bonus plan contracts or to form or operate a qualified joint arrangement permitted under Paragraph II. Paragraph III also excepts actions necessary for, and undertaken solely for the purpose of, entering messenger arrangements as permitted in Paragraph V (discussed below) or implementing information technology services (for practice management and electronic medical records software for physician practices, or for medical management services provided to payors). Implementing information technology services, which involves activities that PHA already has begun, may have significant potential for efficiency and quality enhancement for medical services, and itself does not appear to present a significant risk of being used in anticompetitive ways, particularly in light of the proposed order’s other provisions.

Paragraph V of the proposed order prohibits PHA from acting as an agent for physicians, or from entering into any type of messenger arrangement between physicians and payors, for thirty (30) months after the proposed order becomes final. It also prohibits PHA from entering into any type of messenger arrangement, other than acting as a simple transmitter of offers and responses between payors and individual physician practices, for an additional twenty-four (24) months -- *i.e.*, until fifty-four (54) months after the proposed order becomes final.<sup>6</sup>

The first “cooling off” period – of 30 months – eliminates PHA involvement between physicians and payors, to facilitate payors’ ability to deal directly with individual physician practices and increase physicians’ incentive to deal directly with payors (or deal through other arrangements that do not have PHA’s alleged

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<sup>6</sup> The time periods for these prohibitions are based on the requirement in Paragraph VII.D of the proposed order that all of PHA’s contracts, with the identified exceptions, be terminated no later than six (6) months after the date the order becomes final.

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history of fostering anticompetitive agreements). The second, 24-month-long prohibition on all but strictly limited-in-form messenger arrangements – *i.e.*, the prohibition on arrangements that might involve, for example, PHA’s collection and maintenance of price and other information on physicians’ terms of dealing – is intended to permit PHA to re-enter the physician contracting business, but with additional safeguards against recurrence of the abuses, under the guise of “modified messenger model,” that the complaint alleges. Should PHA ultimately engage in a standing offer or similar messenger arrangement, the physician services market will have had at least four and one-half years to restore -- with little or no PHA involvement -- the competitive balance allegedly lost due to the conduct charged in the complaint.

Paragraph VI of the proposed order requires PHA to provide the Commission with prior notice before entering into any messenger arrangement permitted by Paragraph V of the proposed order.

Paragraph VII requires PHA to distribute the complaint and order, within 30 days after the order becomes final: to every hospital, physician, or other provider that participates in PHA; to each officer, director, manager, and employee of PHA; and to each payor with which PHA has had any contact since January 1, 1997, but with which PHA does not currently have a contract. For a period of five years after the order becomes final, PHA also must distribute a copy of the order and complaint to new members and officials of PHA, and any new payors with which it commences doing business.

With regard to payors with which PHA currently has a contract for the provision of physician services, Paragraph VII of the proposed order contains provisions concerning the termination of the contracts, which, according to the complaint, embody price-fixed physician fees. Paragraph VII.A requires PHA to provide the payors with which it has a contract with a copy of the order and complaint, as well as a notification letter apprising the payors

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of certain contract termination rights regarding their contracts with PHA. For payors that have preexisting “bonus plan” contracts with PHA, which are listed in Confidential Appendix A to the proposed order, the notification letter informs the payors that they may terminate their existing contracts with PHA, upon written request, without any penalty or charge. With regard to payors holding contracts with PHA, other than the payors with bonus plan contracts, the notification letter likewise informs the payors that they may terminate their contracts without penalty, upon providing written request. However, the letter also apprises payors with non-bonus-plan contracts that, if they do not voluntarily terminate their contracts within six months after the order becomes final (or the contract does not reach its scheduled termination date by that time), then the contract will terminate as of six months after the order becomes final. With regard to certain employers that have preexisting, non-bonus-plan direct contracts with PHA, and which are identified in Confidential Appendix B of the proposed order, in order to help minimize any possible disruption to their health benefits programs, Paragraph V of the proposed order permits PHA to serve as a simple messenger for any subsequent contract offers by these payors to PHA’s physician members.

Termination of the contracts between PHA and payors for the provision of physician services is required to eliminate the payment to PHA’s physician members of what the complaint alleges are collectively negotiated, price-fixed fee levels. The provision allowing payors six months during which they may request voluntary termination of their contracts with PHA is intended to provide them with flexibility and facilitate their making alternative arrangements to provide the services now provided through their contracts with PHA.

The mandatory termination date also obviates the risk that any payor would face competitive disadvantage by voluntarily terminating a PHA contract – and not have a physician network in place – before rival payors have terminated their contracts. Establishing a mandatory termination date provides an incentive

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for all payors to act promptly to make alternative arrangements for a physician network before the termination date, makes clear to PHA's physician members that they promptly must begin to deal directly (or outside of PHA) with the payors if they wish to continue being in the payors' networks, and eliminates the possible disincentive for a payor to be the first to voluntarily terminate its contract with PHA because it would be the first payor in the market not to have a contracted network of physicians.

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Paragraph VII also requires PHA, for five years, annually to publish a copy of the order and complaint in a report or newsletter sent to its participating providers, and file certain compliance reports with the Commission. Paragraphs VIII, IX, and X provide for various compliance reports and notifications by PHA and the Physician Respondents. Paragraph XI obligates the Respondents to cooperate in certain ways with any Commission inquiry into their compliance with the order.

The proposed order will expire in 20 years.



Complaint

IN THE MATTER OF

**APPLIED CARD SYSTEMS, INC., ET AL.**CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT*Docket C-4125; File No. 0323040*  
*Complaint, October 6, 2004--Decision, October 6, 2004*

This consent order, among other things, prohibits Respondents Applied Card Systems, Inc., and Applied Card Systems of Pennsylvania, Inc., both debt collection firms, from communicating with any third party -- for the purpose of acquiring credit or debit cardholder location information -- more than once without a request by the third party for subsequent calls or a reasonable belief that the third party has complete or correct location information for the debtor. The order also prohibits the respondents from engaging in abusive conduct such as continued calls and the use of abusive language. In addition, the order prohibits the respondents from (1) placing collection calls after 9 p.m. and before 8 a.m. (defined as the local time of the person called); (2) placing calls to a consumer's place of employment if they have reason to know that such calls are employer-prohibited; (3) using false, deceptive, or misleading representations in collection calls; (4) collecting amounts from consumers that are not legally due; and (5) applying payments received to those accounts except as designated by consumers.

*Participants*

For the Commission: *Jessica D. Gray, Barbara E. Bolton, Shibani Baski, Cindy A. Liebes, Andrea L. Foster, and Andrew Smith.*

For the Respondents: *Richard M. Alexander, Arnold & Porter*

**COMPLAINT**

The Federal Trade Commission, having reason to believe that Applied Card Systems, Inc. and Applied Card Systems of Pennsylvania, Inc. (collectively "Respondents") have violated the provisions of the Federal Trade Commission Act, and it appearing to the Commission that this proceeding is in the public interest, alleges:

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1. Respondent Applied Card Systems, Inc. (“ACS”) is a Delaware corporation with an office and its principal place of business located at 4700 Exchange Court, Boca Raton, Florida 33431. ACS transacts or has transacted business throughout the United States.

2. Respondent Applied Card Systems of Pennsylvania, Inc. (“ACSPA”) is a Pennsylvania corporation with an office and place of business located at 50 Applied Card Way, Glenn Mills, Pennsylvania 19342. ACSPA transacts or has transacted business throughout the United States.

3. Respondents operate business enterprises that provide services to credit card companies, including, but not limited to the collection of delinquent debts from consumers throughout the United States. Respondents’ main customer is their affiliate, Cross Country Bank, a Delaware-chartered bank. For purposes of this Complaint, “delinquent debt” means any obligation or alleged obligation of a consumer to pay money that is contractually past due, arising out of a transaction in which the money, property, insurance or services which are the subject of the transaction are primarily for personal, family, or household purposes, whether or not such obligation has been reduced to judgment. The term “Consumer” means any natural person obligated or allegedly obligated to pay any debt.

4. The acts and practices of Respondents alleged in this Complaint have been in or affecting commerce, as “commerce” is defined in Section 4 of the FTC Act, 15 U.S.C. § 44.

5. Respondents process and collect moneys due on credit card accounts from the time the credit card is issued to the Consumer through the collection of delinquent accounts.

6. When collecting delinquent debts, Respondents use an automated dialing system to initiate telephone calls to Consumers. As part of this process, Respondents call third parties seeking to speak with a Consumer and/or to acquire location information concerning a Consumer. For purposes of this Complaint the term

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“Third Party” means any person or entity that is not a Consumer including, but not limited to, any parent of a non-minor Consumer, or any child, relative, neighbor, co-worker or employer of a Consumer. The term “location information” means a Consumer’s place of abode and his or her telephone number at such place, or his or her place of employment.

7. On many occasions, when Respondents call the residences of Third Parties, those Third Parties have previously informed Respondents that either they do not know the Consumer or that the Consumer does not reside with them.

8. On many other occasions, when Respondents have contacted Third Party businesses, Respondents have been informed by the Third Party business that either the Consumer is no longer an employee, that the Consumer’s employer prohibits the receipt of personal calls, or that the Consumer cannot be reached at the telephone number contacted.

9. In many instances, Respondents continued to call these Third Parties after the Third Parties have requested, orally and/or in writing, that Respondents stop such calls to a specific telephone number.

10. In many instances, in connection with the collection of delinquent debts, Respondents communicated with Third Parties for the purpose of speaking with a Consumer and/or to acquire location information about a Consumer without a reasonable belief that:

- A. An earlier response of the Third Party was erroneous or incomplete; or
- B. The Third Party now has correct or complete location information about the Consumer.

11. In many other instances, in connection with the collection of delinquent debts, Respondents have engaged in conduct the

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natural consequence of which is to annoy, abuse, or harass the Third Parties, including, but not limited to:

- A. Using obscene or profane language or language the natural consequence of which is to abuse the hearer; or
- B. Causing a telephone to ring or engaging any Third Party in telephone conversation with intent to annoy, abuse, or harass any Third Party at the called number.

12. The acts and practices of Respondents as alleged in this Complaint constitute unfair acts or practices in or affecting commerce in violation of Section 5(a) of the Federal Trade Commission Act, 15 U.S.C. § 45(a).

13. Respondents' violations of Section 5 of the FTC Act, as set forth above, are continuing and will continue absent the relief herein requested.

**THEREFORE**, the Federal Trade Commission this sixth day of October, 2004, has issued this Complaint against Respondents.

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**DECISION AND ORDER**

The Federal Trade Commission having initiated an investigation of certain acts and practices of Respondents named in the caption hereof, and the Respondents having been furnished thereafter with a copy of a draft complaint which the Bureau of Consumer Protection proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge Respondents with violations of Section 5(a) of the Federal Trade Commission Act, 15 U.S.C. § 45(a); and

Respondents, their attorneys, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by Respondents of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by Respondents that the law has been violated as alleged in such complaint, and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that the Respondents have violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent Applied Card Systems, Inc. is a Delaware corporation with an office and its principal place of business located at 4700 Exchange Court, Boca Raton, Florida 33431.
2. Respondent Applied Card Systems of Pennsylvania, Inc. is a Pennsylvania corporation with an office and place of business

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located at 50 Applied Card Way, Glenn Mills, Pennsylvania 19342.

3. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the Respondents, and the proceeding is in the public interest.

**ORDER**

**IT IS ORDERED** that for purposes of this order, the following definitions shall apply:

1. “Respondents” mean Applied Card Systems, Inc. and Applied Card Systems of Pennsylvania, Inc., their successors, assigns, officers, directors, employees and agents.

2. “Collection of debts” means any activity the principal purpose of which is to collect or attempt to collect, directly or indirectly, debts owed or due or asserted to be owed or due.

3. “Consumer” means any natural person obligated or allegedly obligated to pay any debt.

4. “Delinquent debt” means any obligation or alleged obligation of a Consumer to pay money that is contractually past due, arising out of a transaction in which the money, property, insurance or services which are the subject of the transaction are primarily for personal, family, or household purposes, whether or not such obligation has been reduced to judgment.

5. “Location information” means a Consumer’s place of abode and his or her telephone number at such place, or his or her place of employment.

6. “Third Party” means any person or entity that is not a Consumer including, but not limited to, any parent of a non-minor Consumer, or any child, relative, neighbor, co-worker or employer of a Consumer.

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**INJUNCTIVE PROVISIONS****I.**

**IT IS THEREFORE ORDERED** that Respondents, directly or through any corporation, subsidiary, division, or other device, in connection with the collection of any delinquent debt, shall not engage in any unfair or deceptive act or practice in violation of Section 5 of the FTC Act including, but not limited to:

A. Communicating with any Third Party, for the purpose of acquiring location information about the Consumer, more than once unless requested to do so by such person or unless Respondents reasonably believe that the earlier response of such person is erroneous or incomplete and that such person now has correct or complete location information.

B. Engaging in any conduct the natural consequence of which is to annoy, abuse or harass any person including, but not limited to:

1. Using obscene or profane language or language the natural consequence of which is to abuse the hearer; or
2. Causing a telephone to ring or engaging any person in telephone conversation repeatedly or continuously with intent to annoy, abuse, or harass any person at the called number.

**II.**

**IT IS FURTHER ORDERED** that Respondents, directly or through any corporation, subsidiary, division, or other device, in connection with the collection of any delinquent debt, are hereby prohibited from:

A. Communicating with any Consumer, in connection with the collection of any delinquent debt, without the prior consent of

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the Consumer given directly to Respondents or the express permission of a court of competent jurisdiction:

1. At any unusual time or place or a time or place known to be inconvenient. In the absence of knowledge of circumstances to the contrary, Respondents shall assume that the convenient time for communicating is after 8 o'clock antemeridian and before 9 o'clock postmeridian, local time of the person called; and

2. At any Consumer's place of employment if Respondents know or have reason to know that the Consumer's employer prohibits the receipt of such communication; and

3. If Respondents know the Consumer is represented by an attorney with respect to such debt and have knowledge of, or can readily ascertain from the Consumer or the Consumer's attorney, such attorney's name and address, unless the attorney fails to respond within a reasonable period of time to a communication from the Respondents or unless the attorney consents to direct communication with the Consumer. Provided, however, this provision does not prohibit Respondents from mailing, directly to the Consumer, periodic billing statements, as required by the Truth in Lending Act, 15 U.S.C. § 1637(b) and the Fair Credit Billing Act, 15 U.S.C. § § 1666-1666j. All other communication with the Consumer in violation of this part shall be suspended within a commercially reasonable period of time, not to exceed five (5) business days.

B. Communicating, except as permitted in subpart I.A., without the prior consent of the Consumer given directly to the Respondents, or the express permission of a court of competent jurisdiction, or as reasonably necessary to effectuate a post judgment judicial remedy, with any person other than a Consumer, his attorney, a consumer reporting agency if otherwise permitted by law, the creditor, the attorney of the creditor, or the



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Respondents' attorney, or any individual or business entity used by Respondents in the normal course of business for the purpose of collecting delinquent debts. For purposes of subparts II.A. and II.B., the term "Consumer" includes the Consumer's spouse, parent (if the Consumer is a minor) guardian, executor, or administrator.

C. Using any false, deceptive, or misleading representation or means including, but not limited to:

1. The false representation of the character, amount, or legal status of any debt;
2. The threat to take any action that cannot legally be taken or that is not intended to be taken; and
3. Any false representation or deceptive means to collect or attempt to collect any debt or to obtain information concerning a Consumer.

D. Collecting or attempting to collect any amount (including any interest, fee, charge, or expense incidental to the principal obligation) unless such amount is expressly authorized by the agreement creating the debt or permitted by law.

E. If any Consumer owes multiple debts and makes any single payment to Respondents with respect to such debts, applying such payment to any debt which is disputed by the Consumer. Where applicable, Respondents shall apply such payment in accordance with the Consumer's directions.

### **III. DISTRIBUTION OF ORDER BY RESPONDENTS**

**IT IS FURTHER ORDERED** that Respondents, their successors and assigns shall deliver a copy of this order to all current and future principals, officers, directors, and managers, and to all current and future employees and agents having responsibilities with respect to the subject matter of this order,

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and shall create and maintain appropriate records to evidence the delivery of this order to each such persons specified herein. Respondents shall deliver this order to current personnel within thirty (30) days after the date of service of this order, and to future personnel within thirty (30) days after the person assumes such position or responsibilities.

**IV. MONITORING COMPLIANCE OF PERSONNEL**

**IT IS FURTHER ORDERED** that for a period of three (3) years from the date this order becomes final, in connection with any business operated by Respondents which is engaged in the collection of delinquent debts, Respondents shall:

A. Take reasonable steps sufficient to monitor and ensure that all of Respondents' employees and agents engaged in the collection of delinquent debts comply with parts I and II of this order. Such steps shall include, at a minimum, the following:

1. Listening regularly to a selection of communications relating to the collection of delinquent debts made by Respondents' employees and agents to Consumers and Third Parties;
2. Establishing and following a procedure for receiving and responding to complaints received by Respondents relating to the collection of delinquent debts; and
3. Ascertaining, when a collection complaint is received by Respondents, the number and nature of complaints received regarding any employee or agent engaged in the collection of debts who is involved in the complained about transaction or communication;

B. Promptly investigate any collection complaint received by Respondents;

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C. Take appropriate corrective action with respect to any officer, manager, employee, or agent of Respondents' who, as determined by either Respondent, is not complying with this order. Corrective action may include training, warning, disciplining, or terminating such officer, manager, employee or agent; and

D. Promptly document the results of each collection complaint investigation conducted by Respondents and any corrective action taken, as set forth in part V.

**V. RECORD KEEPING PROVISIONS**

**IT IS FURTHER ORDERED** that Respondents and their successors and assigns, for a period of three (3) years from the date this order becomes final, with respect to Respondents' businesses and any other business entity owned by each Respondent that is engaged in the collection of delinquent debts, shall create, maintain, and upon request, make available to the Federal Trade Commission for inspection and copying:

A. Personnel records accurately reflecting: the name, address, and telephone number of each person engaged in the collection of delinquent debts, including any independent contractor; that person's job title or position; the date upon which the person commenced working; and the date and reason for the person's termination, if applicable;

B. Records that evidence the delivery of this order to all principals, officers, directors, managers, employees, and agents having responsibility with respect to the subject matter of this order, as required by part III;

C. Copies of all scripts, training manuals, and any other materials used by Respondents to train and evaluate the job performance of their employees engaged in the collection of delinquent debts; and

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D. Records regarding complaints relating to the collection of delinquent debts, including, but not limited to: (1) each complaint letter or other form of written communication received by Respondents; (2) telephone complaints received by Respondents from Third Parties; (3) nature of the complaint and a description of the alleged conduct, as reflected in any written records pertaining to such complaints; (4) name and position of each employee, where possible, whose conduct is the subject of the complaint; (5) disposition of any complaint, including records of all contacts with the complainant regarding the complaint; and (6) any action taken to correct alleged conduct that violates this order.

## **VI. COMPLIANCE REPORTING BY RESPONDENTS**

**IT IS FURTHER ORDERED** that Respondents and their successors and assigns shall:

A. Notify the Commission at least thirty (30) days prior to any change in the corporation(s) that may affect compliance obligations arising under this order, including but not limited to a dissolution, assignment, sale, merger, or other action that would result in the emergence of a successor corporation; the creation or dissolution of a subsidiary, parent, or affiliate that engages in any acts or practices subject to this order; the proposed filing of a bankruptcy petition; or a change in the corporate name or address. *Provided, however,* that with respect to any proposed change in the corporation(s) about which Respondents learn less than thirty (30) days prior to the date such action is to take place, Respondents shall notify the Commission as soon as practicable after obtaining such knowledge. All notices required by this part shall be sent by certified mail to the Associate Director, Division of Enforcement, Bureau of Consumer Protection, Federal Trade Commission, Washington, D.C. 20589.

B. Within sixty (60) days after the date of service of this order, and at such other times as the Federal Trade Commission may require, file with the Commission a report, in writing, setting forth

## Decision and Order

in detail the manner and form in which they have complied with this order. This report shall include, but not be limited to:

1. Any changes required to be reported pursuant to subpart A. above; and
2. Copies of the records that were created and maintained pursuant to part III to evidence Respondents' dissemination of this order.

*Provided, further*, for purposes of the compliance reporting required by this part, the Commission is authorized to communicate directly with Respondents.

## VII. SUNSET PROVISION

This order will terminate on October 6, 2024, or twenty (20) years from the date that the United States or the Federal Trade Commission files a complaint (with or without an accompanying consent decree) in federal court alleging any violation of the order, whichever comes later; *provided, however*, that the filing of such a complaint will not affect the duration of:

- A. Any part in this order that terminates in less than twenty (20) years;
- B. This order's application to any Respondent that is not named as a Respondent in such complaint; and
- C. This order if such complaint is filed after the order has terminated pursuant to this part.

*Provided, further*, that if such complaint is dismissed or a federal court rules that the Respondents did not violate any provision of the order, and the dismissal or ruling is either not appealed or upheld on appeal, then the order will terminate according to this part as though the complaint had never been filed, except that the order will not terminate between the date

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such complaint is filed and the later of the deadline for appealing such dismissal or ruling and the date such dismissal or ruling is upheld on appeal.

## Analysis

**Analysis of Proposed Consent Order to Aid Public Comment**

The Federal Trade Commission has accepted, subject to final approval, an agreement to a proposed consent order from Applied Card Systems, Inc. and Applied Card Systems of Pennsylvania, Inc. (collectively “respondents” or “ACS”).

The proposed consent order has been placed on the public record for thirty (30) days for reception of comments by interested persons. Comments received during this period will become part of the public record. After the public comment period, the Commission will again review the agreement and the comments received and will decide whether it should withdraw from the agreement and take other appropriate action or make final the agreement’s proposed order.

This matter concerns the debt collection practices of ACS in attempting to collect delinquent debt owed or allegedly owed to its affiliate, Cross Country Bank (“CCB”). The complaint alleges that respondents used unfair debt collection practices in violation of Section 5 of the Federal Trade Commission Act (“FTC Act”), 15 U.S.C. § 45. The proposed complaint alleges two counts regarding ACS’s debt collection practices. First, the complaint alleges that ACS has repeatedly called non-debtor third parties in an attempt to either speak with a CCB cardholder or get location information about a cardholder, after the third parties have informed ACS that they do not know the cardholder or that the cardholder does not live at their residence. ACS makes these repeated calls without a reasonable belief that the third parties now have correct or complete information about CCB’s cardholders. Second, the complaint alleges that ACS has engaged in conduct purposely designed to harass third parties at the number called.

The proposed consent order tracks the complaint and contains injunctive provisions designed to prevent respondents from engaging in similar acts and practices in the future. Part I of the proposed order contains two injunctive provisions. The first

Analysis

prohibits respondents from communicating with any third party, for the purpose of acquiring cardholder location information, more than once without a request by the third party for subsequent calls or a reasonable belief that the third party has complete or correct location information for the debtor. The second injunctive provision of Part I prohibits respondents from engaging in abusive conduct such as continued calls and the use of abusive language.

Part II of the proposed order contains a broad fencing-in provision that pertains to all consumers. Among other things, it bars respondents from (i) placing collection calls after 8 o'clock antemeridian and before 9 o'clock postmeridian, local time of the person called; (ii) placing calls to a consumer's place of employment if they have reason to know that such calls are employer-prohibited; (iii) using false, deceptive, or misleading representations in collection calls; (iv) collecting amounts from consumers that are not legally due; and (v) applying payments received to those accounts except as designated by consumers.

Part III of the proposed order requires the respondents to distribute copies of the order to certain company officials and employees. Parts IV through VI of the proposed order are monitoring, record keeping, and compliance provisions. Part VII is a provision "sunsetting" the order after twenty (20) years, with certain exceptions.

The purpose of this analysis is to facilitate public comment on the proposed order. It is not intended to constitute an official interpretation of the agreement and proposed order or to modify in any way their terms.



Complaint

**IN THE MATTER OF****BONZI SOFTWARE, INC.**CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT*Docket C-4126; File No. 0423016  
Complaint, October 7, 2004--Decision, October 7, 2004*

This consent order, among other things, prohibits Respondents Bonzi Software, Inc., Joe Bonzi, and Jay Bonzi from misrepresenting the extent to which their product InternetALERT -- or any other software product or service that is marketed as enhancing security -- will reduce the risk of unauthorized access into a computer. The order also prohibits the respondents from misrepresenting the extent which any such product or service will maintain, protect, or provide security features that will enhance the security or privacy of any computer -- or any data that is stored in a computer, including personally identifiable information -- and from misrepresenting the performance, benefits, or efficacy of any computer software product or service that is marketed as enhancing security or privacy. In addition, the order requires the respondents to pay refunds to current InternetALERT subscribers who opt to cancel their subscriptions.

*Participants*

For the Commission: *Laura M. Sullivan, Dean C. Forbes, Thomas B. Pahl, Mary K. Engle, and Hajime Hadeishi.*

For the Respondents: *Saro Rizzo, and Barry J. Reingold, Perkins Coie, LLP.*

**COMPLAINT**

The Federal Trade Commission, having reason to believe that Bonzi Software, Inc., a corporation, and Joe Bonzi and Jay Bonzi, individually and as officers of said corporation (“respondents”), have violated the provisions of the Federal Trade Commission Act, and it appearing to the Commission that this proceeding is in the public interest, alleges:

Complaint

1. Respondent Bonzi Software, Inc., a Delaware corporation, is a privately owned company with its principal office and place of business located at 3000 Broad Street, Suite 115, San Luis Obispo, California 93401.

Respondents Joe Bonzi and Jay Bonzi are the founders, owners, and officers of the corporate respondent. Individually, or in concert with others, they formulate, direct, and control the acts and practices of the corporate respondent, including the acts and practices alleged in this complaint.

2. The acts and practices of respondents as alleged in this complaint have been in or affecting commerce, as “commerce” is defined in Section 4 of the Federal Trade Commission Act.

3. Respondents develop, advertise, sell, license, and distribute various software products, including “InternetALERT.” InternetALERT is software that monitors Internet traffic entering a consumer’s computer and provides alerts when an attacker attempts to access the computer from the Internet without the consumer’s knowledge or permission. InternetALERT is offered for sale, sold, distributed, and licensed by respondents primarily through respondents’ Web site [www.bonzi.com](http://www.bonzi.com) at the price of \$49 for a one-year subscription.

4. Respondents promote InternetALERT software on the Internet through banner, button, and pop-up ads, which, when clicked, transfer consumers to one of several Web pages advertising the software. These click-through Web pages, or landing pages, link to the respondents’ Web site [www.bonzi.com](http://www.bonzi.com), where consumers can download InternetALERT from the Internet. Respondents also promote the software during the software’s installation process.

5. Respondents have disseminated, or have caused to be disseminated, banner, button, and pop-up advertisements for the InternetALERT software, including, but not limited to, those attached as Exhibits A through C:

Complaint

Exhibit A

Exhibit A, button ad located at [www.mallbusters.com/internet\\_alert.htm](http://www.mallbusters.com/internet_alert.htm) (as of July 3, 2003).

Exhibit B

Exhibit B, banner ad located at [www.myconsumerguide.com/internet\\_alert.htm](http://www.myconsumerguide.com/internet_alert.htm) (as of May 5, 2003).

Complaint

Exhibit C

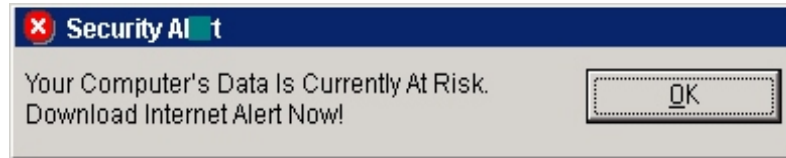


Exhibit C, pop-up ad located at [www.bonzi.com/internetalert/ia99.asp](http://www.bonzi.com/internetalert/ia99.asp) (as of April 1, 2003).

6. Respondents have disseminated, or have caused to be disseminated, Web pages, including, but not limited to, that attached as Exhibit D, containing, among others, the following statements:

Exhibit D

**InternetALERT**  
**Protect Your PC from Internet Attackers!**

**Your Computer's Data Is At Risk! (SEE BELOW.)**

Your computer's address is: [IP Address]. Every time you connect to the Internet, send e-mail, or submit any private information to a web site, you broadcast your computer's unique IP Address over the Internet. With this IP address, someone can immediately begin trying to break into your computer without you even knowing it! Until now, there has been no way of telling if this has happened or any way of stopping it! Well not anymore!

YOUR COMPUTER'S ADDRESS IS: [IP Address]

**What Can Happen To Me?**

Steal Your Credit Card & Personal Information!

Read Your E-Mail!

Complaint

Plant a Virus or Worm!

Steal Online Banking Information!

Delete files from your computer!

**InternetALERT** is an absolute ‘MUST’ for anyone connecting to the Internet! It will notify you if someone is breaking into your computer, stop them dead in their tracks, and even build a visual map showing you the Attacker’s ISP (Internet Service Provider) location! You can now connect to the Internet with the comfort and security of knowing that no one from the Internet can access your computer without your knowledge or permission!

\* \* \*

**InternetALERT** is easy-to-use! Once installed, you can go about your work without a worry. It runs silently in the background protecting you. Every time you turn on your computer, **InternetALERT** starts working automatically, only leaping into action when suspicious connection attempts are made to your computer.

\* \* \*

**Download & Protect Yourself Against Internet Attackers Now  
- \$49 (1 Year Subscription)**

For a limited time, you may now download and start protecting yourself against Internet Attackers for only \$49 per year!

\* \* \*

You're now minutes away from protecting yourself!”

Exhibit D: Web pages advertising InternetALERT entitled “Protect Yourself From Internet Intruders!,” located at [www.deals-and-links.com/internetalert.htm](http://www.deals-and-links.com/internetalert.htm) (as of July 3, 2003).

Complaint

See also [www.bonzi.com/internetalert/ia99.asp](http://www.bonzi.com/internetalert/ia99.asp) (as of April 29, 2003); [www.bonzi.com/defaultbody.htm](http://www.bonzi.com/defaultbody.htm); [www.internet-alert-pc-protection.com/index.asp?Campaign=2000](http://www.internet-alert-pc-protection.com/index.asp?Campaign=2000) (as of July 3, 2003).

7. Respondents have disseminated, or have caused to be disseminated, various statements on their Web site [www.bonzi.com](http://www.bonzi.com) during the InternetALERT software's download process, and through a message alert during the software's uninstall process, including, but not limited to, those shown in Exhibits E and F:

Exhibit E

**InternetALERT® Download**

**Make Your Computer Safe & Secure In 5 Minutes . . .**

\* \* \*

You're now minutes away from protecting your system against malicious attackers! Simply complete the secure form below and then press the 'Protect' button. You will be granted **immediate access** to the full version of InternetALERT and in minutes make your computer safe and secure against Internet attackers!

\* \* \*

Protect My System Against Attackers – Download Now!”

Exhibit E: Form entitled “InternetALERT Secure Order Form” that initiates the download process for InternetALERT software, located at <https://secure.bonzi.com/secure/securedownloadia9sub.asp> (as of July 3, 2003).

Complaint

Exhibit F**InternetAlert - WARNING**

WARNING: Your (sic) are about to Disable InternetAlert. Your computer will no longer be protected against outside harmful attacks. Are you sure you want to disable InternetAlert?

[Yes] [No]”

Exhibit F: Message displayed during the uninstall process for the InternetALERT software (as of July 3, 2003).

8. Data enter and exit a computer connected to the Internet by using gateways known as communications ports. These ports enable a computer to establish connections to other computers and to exchange data and are used to handle common network services, such as Web browser or email client services. Ports that are being used are “open” and “listening” for communications, for different periods of time, depending on the type of service they are handling at the time. Internet attackers seek to identify which ports are open on a computer through “port scanning” or other techniques, and may be able to enter a computer from the Internet by using one of a computer’s open ports.

9. InternetALERT monitors and provides alerts to consumers on certain communications ports concerning attempts to gain unauthorized access into computers. Prior to October 2003, InternetALERT automatically monitored up to eleven communications ports. Since October 2003, it has automatically monitored up to twenty-one communications ports. Consumers also may be able to manually select additional ports for monitoring by InternetALERT.

10. If an automatically selected port or manually selected port is closed at the time that InternetALERT is installed, the software will open the closed port to monitor it and provide alerts.

Complaint

11. If an automatically selected port or manually selected port is open at the time that InternetALERT is installed, InternetALERT will not monitor it.

12. Through the means described in Paragraphs 5 through 7, respondents have represented, expressly or by implication, that InternetALERT significantly reduces the risk of unauthorized access into computers and the data stored in them.

13. In truth and in fact, InternetALERT does not significantly reduce the risk of unauthorized access into computers and the data stored in them. InternetALERT does not significantly reduce the risk of unauthorized access into computers because it provides only limited protection against intrusion into computers, as described in Paragraphs 9 through 11 above. Moreover, InternetALERT does not provide other security features that can significantly reduce the risk to data stored in computers, such as features that prevent personally identifiable information stored in a computer from being sent over the Internet without a consumer's knowledge or consent, or that provide computer virus protection.

14. The acts and practices of respondents as alleged in this complaint constitute unfair or deceptive acts or practices in or affecting commerce in violation of Section 5(a) of the Federal Trade Commission Act.

THEREFORE, the Federal Trade Commission this seventh day of October, 2004, has issued this complaint against respondents.



**EXHIBIT A**



<b>X Security Alert</b>	<b>Advertisement</b>
Your Computer Is Currently Transmitting An Internet Address. With This Address, Someone Can Immediately Begin Attacking Your Computer!	
<a href="#">More Info</a>	

Shopping Online

Shop By Department

Internet Alert Download

Advertisement

**Internet ALERT**

Your System May Be Vulnerable to Internet Attackers

Download & Protect Yourself Now!

[More Info](#)

## Internet Alert

Internet Alert! Internet Alert Intruder Protection - Download Internet Alert! Internet Alert protects you from hackers and attackers. Without Internet Alert - Your Computer's Data Is At Risk! Once you sign on to Internet Alert you'll see how easy someone can grab your IP Address.

Without Internet Alert -- Every time you connect to the Internet, send e-mail, or submit any private information to a web site, you broadcast your computer's unique IP Address over the Internet. Internet Alert is a must is you spend time online!

Without Internet Alert, people can get access to your computer while you're online! What can people do with your computer information? Steal Your Credit Card & Personal Information!; Read Your E-Mail!; Plant a Virus or Worm!; Steal Online Banking Information!; Delete files from your computer!; and worse.

Internet Alert is easy-to-use! Once you download Internet Alert, you can go about your work without a worry. Internet Alert runs silently in the background protecting you. Every time you turn on your computer, Internet Alert starts working automatically, only leaping into action when suspicious connection attempts are made to your computer.

**[Click Here To Test Your PC Security With Internet Alert!](#)**

Internet Alert News

Internet Alert Sale?  
Get MallBusters News!

**Enter Email and Go!**

[Shopping Mall Home](#) | [About](#) | [Privacy](#) | [Contact](#)

[Shopping Mall Store Directory](#) | [Free Gift Reminder Service](#) | [Email This Page To a Friend](#)



**EXHIBIT B**



Search

Welcome | Special Offers  
Home | About MyConsumerGuide | Privacy Policy

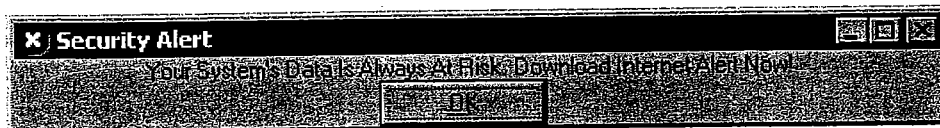
- Arts & Collectibles
- Automotive
- Baby & Kids
- Beauty
- Books & Magazines
- Clothing & Shoes
- Computer & Software
- Consumer Electronics
- Education
- Financial Services
- Flowers & Gifts
- Food & Beverages
- Hardware & Tools
- Health & Wellness
- Home & Garden
- Internet & Online
- Insurance
- Jewelry & Watches
- Kitchen & Housewares
- Movies & Music
- Office & Business
- Pet Supplies
- Sporting Goods
- Telecommunications
- Toys & Games
- Travel

## InternetALERT - Download & Protect Yourself Against Internet Attackers Now!

Protect yourself from hackers and trouble makers for just \$49! (1 Year Subscription)

[Internet Alert - Click here to go!](#)

InternetALERT is a "must-have" for anyone on the Internet! With InternetALERT you will know when someone is breaking into your computer. The downloadable program even gives you a visual map showing you the attacker's ISP (Internet Service Provider) location! With InternetALERT you can connect to the Internet with the comfort and security of knowing that no one from the Internet can access your computer without your knowledge or permission!



### MyConsumerGuide Says:

InternetALERT is an affordable solution to hackers messing with your computer files. We think \$49 for a year's service is worth the price to protect your private information from internet intruders. We hear about fraud taking place on the computer more and more these days. We think InternetALERT provides an answer to the problem that's more common than most of us would like to believe!

**Site Ease of Use:** Once you click on our links, information on InternetALERT instantly appears. The program itself is easy-to-use. Every time you turn on your computer, InternetALERT starts working automatically, only notifying you when suspicious connection attempts are made to your computer.

### Third Party Reviews:

#### Customer Testimonials:

"So far my computer system has been attacked twice, and InternetALERT has picked up on it. Both times I was able to notify the offending companies to shut down the hackers. I am VERY impressed with this software package, and will continue to look at your company for new and exciting products. Keep up the great work!" - Frank Leibly - MMR Software

"Thanks for such a great program! InternetALERT detected and disabled before any

[Email this page](#)

Rate This Merchant

Site Ease of Use



Customer Service



Overall Value



Our Bestsellers



Subscribe today and we'll keep you informed on the latest secret sales and special promotion offered by online merchants. We cover nearly all the major name Internet stores. Subscribing is easy. Simply add your email address to the box below. We keep all email address in house, and never give them to any third party! Subscribe now, save later!

Email Address:

Internet Alert - Click here to go!

harm was done. I had been hacked once before I got Internet Alert and it took weeks to get things back to normal. This time your program caught the hacker! I'm so impressed I'm going to put your link on my "cool links page" and maybe get you some business." - Mari Hetfield - NH.

"Since I downloaded InternetALERT my machine has had an attempted hack, twice. Since I have had the program less than 4 days, I wonder how many times my machine has been hacked in the past. I not only knew of the STOPPED attack, but was able to notify the right person to stop the attacker. It would be foolish for anyone who is on the internet, not to have their machine protected with your system. Please keep up the good work. It is awful there are so many bad people in the world, but wonderful that people like you, take a great part in protecting people everywhere. Thanks so much!" - Ron Combs - Very satisfied customer!

"I could not believe how many people were trying to get into my system!" - Carly Sutton

## More Company Details:

### What InternetALERT Says:

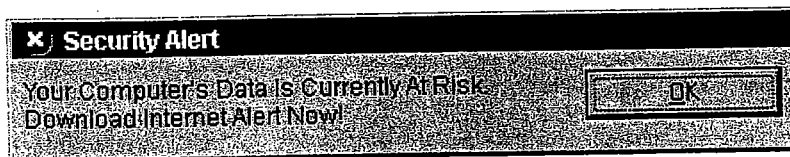
"Every time you connect to the Internet, send e-mail, or submit any private information to a web site, you broadcast your computer's unique IP Address over the Internet. With this IP address, someone can immediately begin trying to break into your computer without you even knowing it! Until now, there has been no way of telling if this has happened or any way of stopping it! Well not anymore!

InternetALERT is more than just protection against Internet Intruder's, it allows you to track down your Intruder's ISP (Internet Service Provider) contact information and report the attack. This allows you to contact the Intruder's ISP and make them aware that someone on their network has tried to attack your computer. In most cases, they have the power to find out who the Intruder is and prevent any future attacks. With the InternetALERT built in 'Attack Log', you can know the date, time, IP Address, and Port Number used by the intruder in the attack.

For a limited time, you may now download and start protecting yourself against Internet Attackers for only \$49 per year! Your InternetALERT Subscription includes:

- 1 Full Year of Protection
- 7 day a week technical support
- Future Developments - FREE!

You're now minutes away from protecting yourself!



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All Rights Reserved.

**EXHIBIT C**


Protect Yourself from Internet Intruders! - Microsoft Internet Explorer

Address: http://www.bond.com/internetalert/ie99kap.asp

Home | Games | Entertainment | Sports | News | Search...

# INTERNET ALERT

Protect Your PC from Internet Attackers!



**Someone May Be Breaking Into Your Computer Right Now (SEE BELOW)**

Your computer's address is: 65.205.42.34. Every time you browse the Internet, send e-mail, or submit any private information to a web site, you broadcast your computer's unique IP Address over the Internet. With this IP address, someone can immediately begin trying to break into your computer without you even knowing it! Until now, there has been no way of telling if this has happened or any way of stopping it! Well not anymore!

Microsoft Internet Explorer


**What Can Happen?** Your system may be vulnerable to Internet Attacks. It may be possible to break into your system and cause harmful damage. Download Internet Alert to protect your system now.

OK

- Steal Your Credit Card & Personal Information
- Read Your E-Mail
- Plant a Virus or Worm!
- Steal Online Banking Information!
- Delete files from your computer!

InternetALERT is an invaluable tool for you and your system. It will notify you if someone is trying to break in to your computer, stop them dead in their tracks, and even build a visual map showing you the Attacker's ISP (Internet Service Provider) allowing you to visually see where they are located and report them! You can now browse the Internet with the comfort and security of knowing that no one from the Internet can access your computer without your knowledge or permission!


**It's Easy...**



InternetALERT is easy-to-use! Once installed, you can go about your work without a worry. It runs silently in the background protecting you. Every time you turn on your computer, InternetALERT starts working automatically, only leaping into action when suspicious connection attempts are made to your computer.

Start | Bond | Web Deity Work | Walpack High | Protect Yourself | Internet |

**INTERNET ALERT**  
Protect Your PC from Internet Attackers!



**Someone May Be Breaking Into Your Computer Right Now (SEE BELOW)**

Your computer's address is: 65.205.42.34. Every time you browse the Internet, send e-mail, or submit any private information to a web site, you broadcast your computer's unique IP Address over the Internet. With this IP address, someone can immediately begin trying to break into your computer without you even knowing it! Until now, there has been no way of telling if this has happened or any way of stopping it! Well not anymore!


**YOUR COMPUTER'S ADDRESS IS: 65.205.42.34**

**What Can Happen To It?**

- Steal Your Credit Card & Personal Information
- Read Your E-Mail
- Plant a Virus or Worm!
- Steal Online Banking Information!
- Delete files from your computer!


InternetALERT is an invaluable tool for you and your system. It will notify you if someone is trying to break in to your computer, stop them dead in their tracks, and even build a visual map showing you the Attacker's ISP (Internet Service Provider) allowing you to visually see where they are located and report them! You can now browse the Internet with the comfort and security of knowing that no one from the Internet can access your computer without your knowledge or permission!

**It's Easy...**




InternetALERT is easy-to-use! Once installed, you can go about your work without a worry. It runs silently in the background protecting you. Every time you turn on your computer, InternetALERT starts working automatically, only leaping into action when suspicious connection attempts are made to your computer.

**Locate Attackers Even When Your Gone...**



InternetALERT is an invaluable tool for you and your system. It will notify you if someone is trying to break in to your computer, stop them dead in their tracks, and even build a visual map showing you the Attacker's ISP (Internet Service Provider) allowing you to visually see where they are located and report them! You can now browse the Internet with the comfort and security of knowing that no one from the Internet can access your computer without your knowledge or permission!

**Map Attacker's ISP Location**



InternetALERT is an invaluable tool for you and your system. It will notify you if someone is trying to break in to your computer, stop them dead in their tracks, and even build a visual map showing you the Attacker's ISP (Internet Service Provider) allowing you to visually see where they are located and report them! You can now browse the Internet with the comfort and security of knowing that no one from the Internet can access your computer without your knowledge or permission!

**What Problems Are Solved About InternetALERT...**

Can my computer system be hacked? InternetALERT is the perfect way to find out. It will detect if anyone is even able to reach the primary computer in your home or business. It will notify you of any intrusion attempts, and will continue to look at your computer for any and every possible threat. Keep the good news!

Frank LeMay, MSB Software

"Thanks for both a great program InternetALERT! Installed and disabled before any harm was done. I had been told it was better to get ahead and find out who is out there than to be hacked. This has your program on the list! It's so important the going is up and on, so we can find the good and enjoy our time here."

Jim Hedrick, IAS

"Once I downloaded InternetALERT my machine has had an attempted hack, but I don't know what the program has done & don't know how many times the machine has been hacked since then. I had only time for the FORNOC check, but now you're taking the right picture to help the situation. I would be happy to help for anyone who is out there, not to have their machine protected with you. I agree. Please look up the good news, it's a good thing to be out there and to be able to be hacked. We've installed and enjoy the app. It's a great and it protects people's information. Thanks so much!"

© Jim Carter - Very satisfied customer!

**Download & Protect Yours of Against Internet Attackers Now - FREE (1 Year Subscription)**

For a limited time, you may now download and get protection against Internet Attackers for only \$0.00 per year. Your InternetALERT subscription includes:

- 1 Full Year of Protection
- 7 Day a Week Technical Support
- Private Communications - FREE!

There has always been help provided yourself!

System Requirements:

- MS Windows 95, 98, ME, 2000, XP, NT, SP

**EXHIBIT D**



# INTERNETALERT

Protect Your PC from Internet Attackers!

## Your Computer's Data Is At Risk!

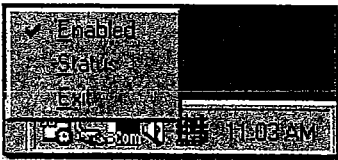
Every time you connect to the Internet, send e-mail, or submit any private information to a web site, you broadcast your computer's unique IP Address over the Internet. With this IP address, someone can immediately begin trying to break into your computer without you even knowing it! Until now, there has been no way of telling if this has happened or any way of stopping it! Well not anymore!

## What Can Happen To Me?

- Steal Your Credit Card & Personal Information!
- Read Your E-Mail!
- Plant a Virus or Worm!
- Steal Online Banking Information!
- Delete files from your computer!

InternetALERT is an absolute "MUST" for anyone connecting to the Internet! It will notify you if someone is breaking into your computer, stop them dead in their tracks, and even build a visual map showing you the Attacker's ISP (Internet Service Provider) location! You can now connect to the Internet with the comfort and security of knowing that no one from the Internet can access your computer without your knowledge or permission!

## It's Easy...



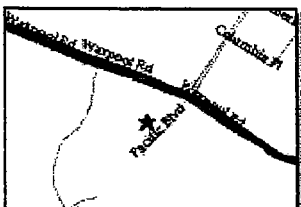
InternetALERT is easy-to-use! Once installed, you can go about your work without a worry. It runs silently in the background protecting you. Every time you turn on your computer, InternetALERT starts working automatically, only leaping into action when suspicious connection attempts are made to your computer.

## Locate Attackers Even When You're Gone...

InternetALERT is more than just protection against Internet Intruder's, it allows you to track down your Intruder's ISP (Internet Service Provider) contact information and report the attack. This allows you to contact the Intruder's ISP and make them aware that someone on their network has tried to attack your computer. In most cases, they have the power to find out who the Intruder is and prevent any future attacks. With the InternetALERT built in 'Attack Log', you can know the date, time, IP Address, and Port Number used by the Intruder in the attack.

Date/Time	Duration	IP Address	Port Number	Protocol	IP Address
Friday Apr 03 1999	10:54:12 AM	25	002.006.37.78		
Friday Apr 03 1999	10:55:13 AM	79	002.006.37.78		
Friday Apr 03 1999	10:56:43 AM	443	002.006.37.78		
Friday Apr 03 1999	10:58:04 AM	80	002.006.37.78		

## Map Attacker's ISP Location:



InternetALERT can actually track down and give you a visual map of your Intruder's ISP location, allowing you to see where your attacker came from! This allows you to see where in the world your attacker is located. NOTE: This is a map of the ISP (Internet Service Provider) that the attacker is using to get their Internet access.

**Download & Protect Yourself Against Internet Attackers Now - \$49 (1 Year Subscription.)**

**System Requirements:**

- 8MB of RAM, 5MB of Free Disk Space.
- Windows 95, 98, 2000, NT, ME, XP

**[Click here to get your InternetALERT](#)**



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**EXHIBIT E**



# Internet**ALERT**® Security Service

Make Your Computer Safe & Secure In 5 Minutes...

Your Internet**ALERT** Subscription includes:

- 1 Full Year of Protection
- 7 day a week technical support
- Future Developments - FREE!

You're now minutes away from protecting your system against malicious attackers! Simply complete the secure form below and then press the 'Protect' button. You will be granted **immediate access** to the full version of Internet**ALERT** and in minutes make your computer safe and secure against Internet attackers!



To continue, please enter your billing information below. All fields are required.

First Name:

Last Name:

Credit Card Number:

Card Number only, No spaces or dashes.

Card Expiration Date:  01 /  05

Month / Year

Cardholder's Name:

Exactly as it appears on your credit card

Card Verification Number:

CVV2/CVC2 number, 3 or 4 digits, See Examples →→

Billing Street Address:

Address that appears on your credit card statement

Billing Zip/Postal Code:

Zip/Postal code that appears on your credit card statement

E-Mail Address:

Please supply a valid, current Email Address

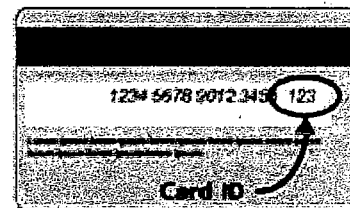
Total: \$49.00 (annual fee)

Summary:

Special Pricing is guaranteed through the end of 7/3/2003. Please Note: For uninterrupted service at the end of your subscription, you'll be automatically renewed at your current discounted rate (billed to the credit card we have on file). If you wish, you may change your automatic renewal status at anytime.

[Download Now](#)

Locating the CVV2/CVC2 number on your



Visa, MC, Discover: 3 digits on back of card



American Express: 4 digits on front of card

Windows, Microsoft Internet Explorer, and Microsoft are registered trademarks of Microsoft Corporation. Internet**ALERT** Security Service and BONZI are trademarks of BONZI Software, Inc. All rights and liabilities with respect to Internet**ALERT** Security Service belong solely to BONZI Software, Inc. Copyright © 1995 - 2003 - All Rights Reserved.

**EXHIBIT F**



**InternetALEKT - Enabled**


File View Attack Configure Help

**InternetALEKT**

Allows you to Enable and Disable InternetALEKT

Disable

**InternetAlert - WARNING**

 **WARNING:** You are about to Disable InternetAlert. Your computer will no longer be protected against outside harmful attacks. Are you sure you want to disable InternetAlert?

Yes No

**InternetAlert**

Protect Your PC From Internet Intruders!

Hide Exit

Status: InternetAlert is enabled and protecting your system.

Decision and Order

**DECISION AND ORDER**

The Federal Trade Commission having initiated an investigation of certain acts and practices of the respondents named in the caption hereof, and the respondents having been furnished thereafter with a copy of a draft of complaint which the Bureau of Consumer Protection proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge respondents with violation of the Federal Trade Commission Act; and

The respondents, their attorneys, and counsel for the Federal Trade Commission having thereafter executed an agreement containing a consent order, an admission by the respondents of all the jurisdictional facts set forth in the aforesaid draft of complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by the respondents that the law has been violated as alleged in such complaint, or that the facts as alleged in such complaint, other than jurisdictional facts, are true and waivers and other provisions as required by the Commission's Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that the respondents have violated the said Act, and that complaint should issue stating its charges in that respect, and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, now in further conformity with the procedure prescribed in Section 2.34 of its Rules, the Commission hereby issues its complaint, makes the following jurisdictional findings and enters the following order:

1. Respondent Bonzi Software, Inc. is a privately held Delaware corporation with its principal office and place of business located at 3000 Broad Street, Suite 115, San Luis Obispo, California 93401.

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2. Respondents Joe Bonzi and Jay Bonzi are owners and officers of Bonzi Software, Inc., and formulate, direct, and control the acts and practices of the corporation.

3. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the respondents, and the proceeding is in the public interest.

**ORDER**

**DEFINITIONS**

For purposes of this order, the following definitions shall apply:

1. “Personally identifiable information” or “personal information” shall mean individually identifiable information from or about an individual consumer including, but not limited to: (a) a first and last name; (b) a home or other physical address, including street name and name of city or town; (c) an email address or other online contact information, such as an instant messaging user identifier or a screen name that reveals an individual’s email address; (d) a telephone number; (e) a social security number; (f) an Internet Protocol (“IP”) address or host name that identifies an individual; (g) a persistent identifier, such as a customer number held in a “cookie” or processor serial number, that is combined with other available data that identifies an individual; or (h) any information that is combined with (a) through (g) above.

2. Unless otherwise specified, “respondents” shall mean Bonzi Software, Inc., its successors and assigns and its officers, agents, representatives, and employees, and Joe Bonzi and Jay Bonzi.

3. “Commerce” shall mean as defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44.



## Decision and Order

**I.**

**IT IS ORDERED** that respondents, directly or through any corporation, subsidiary, division, or other device, in connection with the manufacturing, packaging, labeling, advertising, promotion, offering for sale, sale, or distribution of InternetALERT or any other computer software product or service that is marketed as enhancing security, in or affecting commerce, shall not misrepresent:

- A. the extent to which any such product or service will reduce the risk of unauthorized access into such computer, or any such similar system; or
- B. the extent to which any such product or service will maintain, protect, or provide security features that will enhance the security or privacy of any such computer (or any such similar system) or any data, that is stored in a computer, or any similar system, including personally identifiable information.

**II.**

**IT IS FURTHER ORDERED** that respondents, directly or through any corporation, subsidiary, division, or other device, in connection with the manufacturing, packaging, labeling, advertising, promotion, offering for sale, sale, or distribution of any computer software product or service that is marketed as enhancing the security or privacy of any computer or similar system, in or affecting commerce, shall not misrepresent the performance, benefits, or efficacy of any such software product or service.

**III.**

**IT IS FURTHER ORDERED** that respondents shall provide refunds as follows:

Decision and Order

- A. Respondents shall send, within seven (7) days from the date of service of this order, to the last known e-mail address of each current subscriber of the InternetALERT software product exact copies of the “Refund Notification Message,” with the subject line “Important Refund Notice Concerning Your InternetALERT Subscription,” attached hereto as Attachment A. Respondents shall not include with Attachment A any other information, nor shall any other material be transmitted with Attachment A. Respondents shall give subscribers who receive Attachment A pursuant to this Part sixty (60) days to respond.
- B. Respondents shall use all reasonable commercially available means to obtain updated e-mail addresses for any returned e-mails within fifteen (15) days of receipt of such returned e-mail and shall resend Attachment A within seven (7) days of obtaining a new e-mail address for the recipient. Respondents shall not include with Attachment A any other information, nor shall any other material be transmitted with Attachment A. Respondents shall give subscribers who receive a resent Attachment A pursuant to this Part sixty (60) days to respond.
- C. Respondents shall post within seven (7) days of service of the order and, continuing for sixty (60) days maintain, on the Bonzi Software homepage, [www.bonzi.com](http://www.bonzi.com), a hyperlink to a notice in the form and format as Attachment A. Such hyperlink shall be clear and conspicuous, labeled “InternetALERT Refund Notice,” and lead directly to the notice on the click-through electronic page or other display screen or panel. Respondents shall give current subscribers who receive notice of the refund through the Bonzi Software homepage, [www.bonzi.com](http://www.bonzi.com), the opportunity to respond within sixty (60) days from the date of posting the notice required by this Part.

## Decision and Order

- D. Within seven (7) days of receiving a request for a refund, respondents shall provide current subscribers who cancel and uninstall the InternetALERT software product either (a) a check drawn on U.S. funds; or (b) a credit card refund for an amount representing the unused portion of their InternetALERT subscription calculated as of the date of acceptance of this order by the Commission for public comment. For current subscribers who request a refund by check, respondents shall mail refunds by first class mail to the physical address provided by the subscriber or, if no address is provided, to the subscriber's last known physical address.

**IV.**

**IT IS FURTHER ORDERED** that respondents shall, within seven (7) days after the date of service of this order, send by e-mail exact copies of the order to any retailer, affiliate, or other third party that advertises, promotes, offers for sale, sells, or distributes the software product InternetALERT pursuant to an agreement with respondents.

**V.**

**IT IS FURTHER ORDERED** that respondents shall, for a period of five (5) years after the last date of dissemination of any representation covered by this order, maintain and upon request make available to the Federal Trade Commission for inspection and copying:

- A. All advertisements and promotional materials containing the representation;
- B. All materials that were relied upon in disseminating the representation; and
- C. All tests, reports, studies, surveys, demonstrations, or other evidence in their possession or control that contradict,

Decision and Order

qualify, or call into question the representation, or the basis relied upon for the representation, including complaints and other communications with consumers or with governmental or consumer protection organizations.

**VI.**

**IT IS FURTHER ORDERED** that respondents shall deliver a copy of this order to all current and future principals, officers, directors, and managers, and to all current and future employees, agents, and representatives having responsibilities relating to the subject matter of this order. Respondents shall deliver this order to such current personnel within thirty (30) days after the date of service of this order, and to such future personnel within thirty (30) days after the person assumes such position or responsibilities.

**VII.**

**IT IS FURTHER ORDERED** that respondent Bonzi Software, Inc., and its successors and assigns, shall notify the Commission at least thirty (30) days prior to any change in the corporation that may affect compliance obligations arising under this order, including, but not limited to, a dissolution, assignment, sale, merger, or other action that would result in the emergence of a successor corporation; the creation or dissolution of a subsidiary, parent, or affiliate that engages in any acts or practices subject to this order; the proposed filing of a bankruptcy petition; or a change in the corporate name or address. Provided, however, that, with respect to any proposed change in the corporation about which respondent learns less than thirty (30) days prior to the date such action is to take place, respondent shall notify the Commission as soon as is practicable after obtaining such knowledge. All notices required by this Part shall be sent by certified mail to the Associate Director, Division of Enforcement, Bureau of Consumer Protection, Federal Trade Commission, Washington, D.C. 20580.

Decision and Order

**VIII.**

**IT IS FURTHER ORDERED** that respondents Joe Bonzi and Jay Bonzi for a period of ten (10) years after the date of entry of this order shall notify the Commission of: (1) the discontinuance of their current business or employment; and, (2) their affiliation with any new business or employment. The notice shall include respondents' new businesses names, addresses, and telephone numbers and a description of the nature of the business or employment and the respondents' duties and responsibilities. All notices required by this Part shall be sent by certified mail to the Associate Director, Division of Enforcement, Bureau of Consumer Protection, Federal Trade Commission, Washington, D.C. 20580.

**IX.**

**IT IS FURTHER ORDERED** that respondents shall within one hundred and twenty (120) days after service of this order, and at such other times as the Federal Trade Commission may require, file with the Commission a report, in writing, setting forth in detail the manner and form in which they have complied with this order. As part of this compliance report, respondents shall describe the consumer redress program conducted pursuant to Part III of this order. This description shall include sample copies of notifications provided to subscribers pursuant to Part III of this order and separate lists identifying (a) the name, e-mail, and physical address, and refund amount for each subscriber who was a current subscriber as of the date of service of this order; and (b) the total number of current subscribers to whom e-mail notices were sent pursuant to Part III of this order.

**X.**

This order will terminate on October 7, 2024, or twenty (20) years from the most recent date that the United States or the Federal Trade Commission files a complaint (with or without an accompanying consent decree) in federal court alleging any

Decision and Order

violation of the order, whichever comes later; provided, however, that the filing of such a complaint will not affect the duration of:

- A. Any Part in this order that terminates in less than twenty (20) years;
- B. This order's application to any respondent that is not named as a defendant in such complaint; and
- C. This order if such complaint is filed after the order has terminated pursuant to this Part.

Provided, further, that if such complaint is dismissed or a federal court rules that the respondents did not violate any provision of the order, and the dismissal or ruling is either not appealed or upheld on appeal, then the order will terminate according to this Part as though the complaint had never been filed, except that the order will not terminate between the date such complaint is filed and the later of the deadline for appealing such dismissal or ruling and the date such dismissal or ruling is upheld on appeal.

Decision and Order

**ATTACHMENT A****E-MAIL NOTIFICATION TO CURRENT SUBSCRIBERS  
OF INTERNETALERT**

**SUBJECT LINE:** Important Refund Notice Concerning Your InternetALERT Subscription

Dear [Recipient's name]:

You may be eligible to receive a partial refund from Bonzi Software, Inc. for your InternetALERT subscription.

Bonzi recently settled a dispute with the Federal Trade Commission concerning its advertisements for the InternetALERT software product. The FTC charged that InternetALERT does not significantly reduce the risk of unauthorized access into computers and the information that is stored in them because it provides only limited protection against intrusion into computers. As part of the settlement, Bonzi agreed to offer to current subscribers who cancel their InternetALERT subscriptions a refund for the amount representing the unused portion of their subscriptions.

In settling the case, Bonzi has not admitted any wrongdoing or violation of law. Nonetheless, to resolve this matter, we have agreed to discontinue making the challenged claims in the complaint and offer refunds to current subscribers.

To cancel and obtain a refund, you must respond to this e-mail by **[date 60 days from receipt of e-mail]** with a request that your InternetALERT subscription be cancelled. Bonzi will automatically credit the amount of the refund to the credit card that you used to pay for your InternetALERT subscription. If this credit card is no longer active or was renewed since you paid for your InternetALERT subscription, include with your cancellation request a mailing address to which a refund check may be sent.

Decision and Order

For more information about the FTC's settlement with Bonzi and protecting your computer, visit the web site [**Link to FTC's press release**].



## Analysis

**Analysis of Proposed Consent Order to Aid Public Comment**

The Federal Trade Commission has accepted, subject to final approval, an agreement containing a consent order from Bonzi Software, Inc., Joe Bonzi, and Jay Bonzi (“respondents”).

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 period will become part of the public record. After thirty (30) days, the Commission will again review the agreement and the comments received, and will decide whether it should withdraw from the agreement or make final the agreement’s proposed order.

This matter involves the advertising and promotion of Bonzi InternetALERT software. According to the FTC complaint, the respondents represented that Internet ALERT significantly reduces the risk of unauthorized access into computers and the data stored in them. The FTC alleges that in fact InternetALERT does not significantly reduce this risk.

The proposed consent order contains provisions designed to prevent the respondents from engaging in similar acts and practices in the future.

Part I.A. of the order prohibits the respondents from misrepresenting the extent to which InternetALERT or any other software product or service that is marketed as enhancing security will reduce the risk of unauthorized access into a computer. Part I.B. also prohibits the respondents from misrepresenting the extent which any such product or service will maintain, protect, or provide security features that will enhance the security or privacy of any computer, or any data that is stored in a computer, including personally identifiable information.

Analysis

Part II prohibits the respondents from making any misrepresentations concerning the performance, benefits, or efficacy of any computer software product or service that is marketed as enhancing security or privacy.

Part III of the order requires respondents to pay refunds to current InternetALERT subscribers who opt to cancel their subscriptions. Subscribers who cancel their subscriptions will receive from the respondents a refund that represents the unused portion of their InternetALERT subscription.

Part IV of the proposed order would require respondents to notify their retailers, affiliates, and similar third parties that advertise, promote, or sell InternetALERT to discontinue making any of the claims prohibited by the order.

Parts V through IX of the order require respondents to keep copies of relevant advertisements and materials substantiating the claims made in the advertisements; to provide copies of the order to certain of their current and future personnel; to notify the Commission of changes in corporate structure; and to file compliance reports with the Commission. Part X provides that the order will terminate after twenty (20) years under certain circumstances.

The purpose of this analysis is to facilitate public comment on the proposed order, and it is not intended to constitute an official interpretation of the agreement and proposed order or to modify in any way their terms.

Complaint

IN THE MATTER OF

**GENERAL ELECTRIC COMPANY**CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 7 OF THE CLAYTON ACT AND SEC. 5 OF THE FEDERAL TRADE  
COMMISSION ACT*Docket C-4119; File No. 0410106**Complaint, September 9, 2004--Decision, October 25, 2004*

This consent order, among other things, requires Respondent General Electric Company -- a diversified technology and services company -- to divest the nondestructive testing business of InVision -- a leading supplier of explosive detection systems to the United States Government for civil aviation security -- within six months. An accompanying Order to Hold Separate and Maintain Assets requires the respondent to preserve the business as a viable, competitive, and ongoing operation until the divestiture is achieved, and to ensure that no material confidential information is exchanged between General Electric and the business.

*Participants*

For the Commission: *Sean G. Dillon, Stephanie A. Parks, Robert R. Pickett, Michael R. Moiseyev, Daniel P. Ducore, John Yun, Jeffrey H. Fischer and Mark Frankena.*

For the Respondent: *Jonathan Gleklen, Arnold & Porter.*

**COMPLAINT**

Pursuant to the Federal Trade Commission Act and the Clayton Act, and by virtue of the authority vested in it by said Acts, the Federal Trade Commission ("Commission"), having reason to believe that Respondent General Electric Company ("GE"), a corporation subject to the jurisdiction of the Commission, has agreed to acquire InVision Technologies ("InVision"), a corporation subject to the jurisdiction of the Commission, in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act ("FTC Act"), as amended, 15 U.S.C. § 45, and it appearing to the Commission that a proceeding in respect thereof would be in the

Complaint

public interest, hereby issues its Complaint, stating its charges as follows:

**I. RESPONDENT**

1. Respondent GE is a corporation organized, existing and doing business under and by virtue of the laws of the State of New York, with its offices and principal place of business located at 3135 Easton Turnpike, Fairfield, Connecticut 06431.
2. Respondent GE is engaged in, among other things, the research, development, manufacture and sale of x-ray non-destructive testing (“NDT”) and inspection equipment, including standard x-ray cabinets, automated defect recognition-capable NDT and inspection systems (“ADR-capable x-ray systems”), and high-energy x-ray generators. NDT and inspection equipment is used in a wide range of industries to inspect the structure and tolerance of materials or identify objects inside materials without damaging the materials or impairing their future usefulness.
3. Respondent GE is, and at all times herein has been, engaged in commerce, as “commerce” is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12, and is a corporation whose business is in or affects commerce, as “commerce” is defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

**II. THE ACQUIRED COMPANY**

4. InVision is a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its offices and principal place of business located at 7151 Gateway Boulevard, Newark, CA 94560. InVision’s x-ray NDT and inspection equipment subsidiary, YXLON International X-ray GmbH, is headquartered at Essener Str. 99, Gebäude 227, D-22419, Hamburg, Germany, with its offices and principal place of business in the United States located at 3400 Gilchrist Road, Akron, Ohio 44260-1221.

## Complaint

5. InVision is engaged in, among other things, the research, development, manufacture, and sale of x-ray NDT and inspection equipment, including standard x-ray cabinets, ADR-capable x-ray systems, and high-energy x-ray generators.

6. InVision is, and at all times herein has been, engaged in commerce, as “commerce” is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12, and is a corporation whose business is in or affects commerce, as “commerce” is defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

### III. THE ACQUISITION

7. GE and InVision entered into a stock Purchase Agreement dated as of March 15, 2004 (the “Purchase Agreement”) whereby GE agreed to acquire InVision for approximately \$900 million (the “Acquisition”).

### IV. THE RELEVANT MARKETS

8. For the purposes of this Complaint, the relevant lines of commerce in which to analyze the effects of the Acquisition are:

- a. the research, development, manufacture, and sale of standard x-ray cabinets, which are multi-purpose, standardized x-ray NDT and inspection systems offered in generic configurations and consisting of an x-ray generator, an x-ray tube, a lead cabinet in which to place the object to be x-rayed, a manipulation device to maneuver the object, and a detection device;
- b. the research, development, manufacture, and sale of ADR-capable x-ray systems, which are x-ray NDT and inspection systems integrated with specialized imaging software that eliminates the need for manual inspection of objects in favor of an automated process that improves inspection quality, increases throughput and decreases labor costs; and

Complaint

c. the research, development, manufacture, and sale of high-energy x-ray generators, which are the power supplying components of x-ray NDT and inspection systems that can generate between 350 and 450 kilovolts of power.

9. For the purposes of this Complaint, the United States is the relevant geographic area in which to analyze the effects of the Acquisition in the relevant lines of commerce. Foreign suppliers of these products that have not established the necessary service and support network, brand reputation, and customer acceptance in the United States, are not effective competitors for U.S. customers.

## V. THE STRUCTURE OF THE MARKETS

10. The U.S. market for the research, development, manufacture, and sale of standard x-ray cabinets is highly concentrated. GE and InVision are the two leading suppliers of standard x-ray cabinets in the United States. The Acquisition would significantly increase concentration in the U.S. market for the research, development, manufacture, and sale of standard x-ray cabinets. After the Acquisition, GE would become the dominant supplier of standard x-ray cabinets in the United States.

11. The U.S. market for the research, development, manufacture, and sale of ADR-capable x-ray systems is highly concentrated. GE and InVision are the two leading suppliers of ADR-capable x-ray systems in the United States. The Acquisition would significantly increase concentration in the U.S. market for the research, development, manufacture, and sale of ADR-capable x-ray systems. After the Acquisition, GE would eliminate the only other viable supplier of ADR-capable x-ray systems to U.S. customers, leading to a virtual merger to monopoly.

12. The U.S. market for the research, development, manufacture, and sale of high-energy x-ray generators is highly concentrated. GE and InVision are the two leading suppliers of high-energy x-ray generators in the United States. The

## Complaint

Acquisition would significantly increase concentration in the U.S. market for the research, development, manufacture, and sale of high-energy x-ray generators. With the Acquisition, GE would be the dominant supplier of high-energy x-ray generators in the United States.

**VI. ENTRY CONDITIONS**

13. Entry into each of the relevant markets is a difficult and time-consuming process because of, among other things, the time and cost associated with (a) researching and developing standard x-ray cabinets, ADR-capable x-ray systems, and high-energy x-ray generators; (b) establishing a service and support network; and (c) developing the necessary brand reputation and customer acceptance in each of these markets.

14. New entry into any of the relevant markets sufficient to deter or counteract the anticompetitive effects described in Paragraph 17 is unlikely to occur because the costs of entry into any of the relevant markets are high relative to the potential sales opportunities available to an entrant.

15. New entry into any of the relevant markets sufficient to deter or counteract the anticompetitive effects described in Paragraph 17 would not occur in a timely manner because it would take over two years for an entrant to accomplish the steps required for entry and to achieve a significant market impact.

16. Expansion by smaller competitors in any of the relevant markets sufficient to deter or counteract the anticompetitive effects described in Paragraph 17 is unlikely to occur in a timely manner because of, among other things, the time and cost associated with (a) establishing an effective service and support network; and (b) developing the necessary brand reputation and customer acceptance in each of these markets.

Complaint

## VII. EFFECTS OF THE ACQUISITION

17. The effects of the Acquisition, if consummated, may be substantially to lessen competition and to tend to create a monopoly in the relevant markets in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the FTC Act, as amended, 15 U.S.C. § 45, in the following ways, among others:

- a. by eliminating actual, direct, and substantial competition between GE and InVision in the U.S. market for the research, development, manufacture, and sale of standard x-ray cabinets, thereby: (i) increasing the likelihood that GE would unilaterally exercise market power in this market; (ii) reducing existing incentives to improve product quality or to pursue further innovation in this market; and (iii) increasing the likelihood that standard x-ray cabinet customers would be forced to pay higher prices;
- b. by eliminating actual, direct, and substantial competition between GE and InVision in the U.S. market for the research, development, manufacture, and sale of ADR-capable x-ray systems, thereby: (i) increasing the likelihood that GE would unilaterally exercise market power in this market; (ii) reducing existing incentives to improve product quality or to pursue further innovation in this market; and (iii) increasing the likelihood that ADR-capable x-ray system customers would be forced to pay higher prices; and
- c. by eliminating actual, direct, and substantial competition between GE and InVision in the U.S. market for the research, development, manufacture, and sale of high-energy x-ray generators, thereby: (i) increasing the likelihood that GE would unilaterally exercise market power in this market; (ii) reducing existing incentives to improve product quality or to pursue further innovation in this market; and (iii) increasing the likelihood that high-energy x-ray generator customers would be forced to pay higher prices.



## Complaint

**VIII. VIOLATIONS CHARGED**

18. The Purchase Agreement described in Paragraph 7 constitutes a violation of Section 5 of the FTC Act, as amended, 15 U.S.C. § 45.

19. The Acquisition described in Paragraph 7, if consummated, would constitute a violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the FTC Act, as amended, 15 U.S.C. § 45.

WHEREFORE, THE PREMISES CONSIDERED, the Federal Trade Commission on this ninth day of September, 2004, issues its Complaint against said Respondent.

Decision and Order

## **DECISION AND ORDER**

The Federal Trade Commission (“Commission”) having initiated an investigation of the proposed acquisition by Respondent General Electric Company (“GE”), hereinafter referred to as “Respondent,” of InVision Technologies, Inc. (“InVision”), and Respondent having been furnished thereafter with a copy of a draft of Complaint that the Bureau of Competition proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge Respondent with violations of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45; and

Respondent, its attorneys, and counsel for the Commission having thereafter executed an Agreement Containing Consent Orders (“Consent Agreement”), containing an admission by Respondent of all the jurisdictional facts set forth in the aforesaid draft of Complaint, a statement that the signing of said Consent Agreement is for settlement purposes only and does not constitute an admission by Respondent that the law has been violated as alleged in such Complaint, or that the facts as alleged in such Complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission’s Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that Respondent has violated the said Acts if it consummated the acquisition, and that a Complaint should issue stating its charges in that respect, and having thereupon issued its Complaint and an Order to Hold Separate and Maintain Assets (“Hold Separate Order” attached to this Order as Appendix I), and having accepted the executed Consent Agreement and placed such Consent Agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, and having duly considered the comments received from an interested person pursuant to section 2.34 of the Rules, now in further conformity with the procedure

## Decision and Order

described in Commission Rule 2.34, 16 C.F.R. § 2.34, the Commission hereby makes the following jurisdictional findings and issues the following Decision and Order (“Order”):

1. Respondent General Electric Company is a corporation organized, existing and doing business under and by virtue of the laws of the State of New York, with its office and principal place of business located at 3135 Easton Turnpike, Fairfield, Connecticut 06431.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of Respondent, and the proceeding is in the public interest.

**ORDER****I.**

**IT IS ORDERED** that, as used in this Order, the following definitions shall apply:

- A. “GE” or “Respondent” means General Electric Company, its directors, officers, employees, agents, attorneys, representatives, predecessors, successors, and assigns; its joint ventures, subsidiaries, divisions, groups and affiliates controlled by General Electric Company (including, but not limited to, the GE Inspection Technologies business of General Electric Company), and the respective directors, officers, employees, agents, attorneys, representatives, predecessors, successors, and assigns of each.
- B. “InVision” means InVision Technologies, Inc., a corporation organized, existing, and doing business under and by virtue of the laws of Delaware, with its offices and principal place of business located at 7151 Gateway Boulevard, Newark, California 94560; and joint ventures, subsidiaries, divisions, groups, and affiliates controlled by InVision.

Decision and Order

- C. “YXLON” means YXLON International X-ray GmbH (Germany), YXLON International Inc. (Akron, Ohio); YXLON International Holding GmbH (Germany); YXLON International A/S (Copenhagen); YXLON International KK (Tokyo); and YXLON International CT GmbH (Hattingen), wholly-owned subsidiaries of InVision; and joint ventures, subsidiaries, divisions, groups, and affiliates controlled by such subsidiaries.
- D. “Commission” means the Federal Trade Commission.
- E. “Acquirer” means any entity that receives the prior approval of the Commission to acquire the X-Ray NDT Business pursuant to Paragraph II or III of this Order.
- F. “Acquisition” means the proposed acquisition of all of the outstanding stock of InVision by Respondent pursuant to the Agreement and Plan of Merger dated March 15, 2004, by and among InVision, Respondent and Jet Acquisition Sub, Inc.
- G. “Acquisition Date” means the date the Acquisition is consummated.
- H. “Confidential Business Information” means all information owned by, or in the possession or control of, InVision that is not in the public domain related to X-Ray NDT Products.
- I. “Divestiture Agreement” means any agreement that receives the prior approval of the Commission between Respondent and an Acquirer (or between a trustee appointed pursuant to Paragraph III of this Order and an Acquirer) related to the X-Ray NDT Business required to be divested pursuant to Paragraph II or III of this Order.
- J. “Divestiture Trustee” means the trustee appointed by the Commission pursuant to Paragraph III of this Order.

## Decision and Order

- K. “Effective Date of Divestiture” means the date on which Respondent (or a Divestiture Trustee) divests to the Acquirer the X-Ray NDT Business completely and as required by Paragraph II or III of this Order.
- L. “Governmental Entity” means any Federal, state, local or non-U.S. government or any court, legislature, governmental agency or governmental commission or any judicial or regulatory authority of any government.
- M. “Hold Separate Trustee” means the person appointed pursuant to Paragraph II of the Hold Separate Order in this matter.
- N. “NDT” means non-destructive testing.
- O. “NDT Product” means any non-destructive testing equipment or system, excluding medical and explosive detection products and systems, used for the examination of materials and components without damaging or destroying them.
- P. “Non-NDT Product” means any product, other than X-Ray NDT Products, researched, developed, manufactured, used or sold by InVision.
- Q. “X-Ray NDT” or “X-Ray NDT Product” means NDT that uses X-Ray (using film-based systems, non-film-based systems and digital imaging systems) or computed radiography as the inspection modality.
- R. “X-Ray NDT Business” means YXLON, X-Ray NDT Documents, X-Ray NDT Intellectual Property, X-Ray NDT Software, X-Ray NDT Manufacturing Equipment, and all of InVision’s operations and businesses related to X-Ray NDT Products, including, but not limited to the production and manufacturing, inventory, real property, marketing, advertising, promotion, contracts, distribution, sale or after-sales support related to X-Ray NDT Products.

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- S. “X-Ray NDT Documents” means all documents (including, but not limited to, computer files, electronic mail, and written, recorded, and graphic materials) possessed or owned by InVision related to X-Ray NDT Products, including, but not limited to, the following specified documents: reports relating to the research and development of X-Ray NDT Products or of any materials used in the research, development, manufacture, marketing or sale of X-Ray NDT Products; all market research data and market intelligence reports; customer information; all records relating to employees that accept employment with the Acquirer (excluding any personnel records the transfer of which is prohibited by applicable law); all records, including customer lists, sales force call activity reports, vendor lists, sales data, reimbursement data, manufacturing records, manufacturing processes, and supplier lists; all data contained in laboratory notebooks relating to X-Ray NDT Products; all diagrams and schematics relating to X-Ray NDT Products; all analytical and quality control data; and all correspondence with governmental agencies relating to X-Ray NDT Products, but excluding (i) all tax returns, financial statements, and working papers of InVision relating to Non-NDT Products; and (ii) documents and other information subject to attorney-client privilege relating to Non-NDT Products; *PROVIDED, HOWEVER*, that, if a document required to be produced pursuant to this Paragraph also contains information that is not related to the X-Ray NDT Products, Respondent need not produce that information to the extent it is contained within a discrete segment of the document that otherwise must be produced. *PROVIDED FURTHER*, that the Acquirer shall be allowed access to redacted copies of such documents otherwise excluded by this Paragraph to the extent they relate to X-Ray NDT Products.
- T. “X-Ray NDT Employees” means all of those individuals employed by YXLON or InVision (irrespective of the portion of working time involved) with any responsibility

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for the research, design, development, engineering, manufacturing, distributing, marketing, sales, or after-sales service and support of X-Ray NDT Products worldwide within the eighteen (18) month period immediately prior to the Effective Date of Divestiture.

U. “X-Ray NDT Intellectual Property” means all of the following possessed or owned by InVision related to X-Ray NDT:

1. X-Ray NDT Patents;
2. X-Ray NDT Trademarks;
3. X-Ray NDT Trade Dress;
4. X-Ray NDT Manufacturing Technology;
5. X-Ray NDT Scientific and Regulatory Material; and
6. rights to sue and recover damages or obtain injunctive relief for infringement, dilution, misappropriation, violation or breach of any of the foregoing.

V. “X-Ray NDT Manufacturing Equipment” means all of YXLON’s and InVision’s rights and ownership in equipment, machines, and computers, and all parts, information, files, diagrams, schematics, instructions, software, and hardware related thereto, used in the manufacture, quality assurance and quality control, and packaging of X-Ray NDT.

W. “X-Ray NDT Manufacturing Technology” means all technology, trade secrets, know-how, diagrams, schematics, software, calibrations, inventions, practices, proprietary algorithms, testing techniques, methods and other confidential or proprietary information related to the manufacture, quality assurance and quality control, and packaging of X-Ray NDT Products owned or used by

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InVision, including, but not limited to, manufacturing records, sampling records, standard operating procedures and batch records related to the manufacturing process, and supplier lists.

- X. “X-Ray NDT Patents” means all patents, patent applications and statutory invention registrations, in each case possessed or owned by InVision relating to X-Ray NDT Products, including all reissues, divisions, continuations, continuations-in-part, supplementary protection certificates, extensions and reexaminations thereof, all inventions disclosed therein, all rights therein provided by international treaties and conventions, and all rights to obtain and file for patents and registrations thereto in the world, related to the manufacture, use, sale, service, research or development of X-Ray NDT Products.
- Y. “X-Ray NDT Scientific and Regulatory Material” means all technological, scientific, chemical, and electrical materials and information related to X-Ray NDT owned or used by InVision and all rights thereto, in any and all jurisdictions.
- Z. “X-Ray NDT Software” means computer programs, including all software implementations of algorithms, models, and methodologies whether in source code or object code form, databases and compilations, including any and all data and collections of data, all documentation, including user manuals and training materials, related to any X-Ray NDT Products distributed, marketed, manufactured, or sold by or on behalf of InVision; *PROVIDED, HOWEVER*, that “X-Ray NDT Software” does not include software that is readily purchasable or licensable and which has not been modified in a manner material to the use or function thereof (other than through user preference settings).
- AA. “X-Ray NDT Trade Dress” means all trade dress of X-Ray NDT Products distributed, marketed, or sold by or on behalf of InVision, including, but not limited to, domain



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names and internet sites, product packaging associated with the sale of X-Ray NDT Products worldwide and the lettering of such X-Ray NDT trade names or brand names.

- BB. “X-Ray NDT Trademarks” means all trademarks, trade names and brand names including registrations and applications for registration thereof (and all renewals, modifications, and extensions thereof) and all common law rights, and the goodwill symbolized thereby and associated therewith, for X-Ray NDT researched, developed, distributed, marketed, or sold by or on behalf of InVision.

## II.

**IT IS FURTHER ORDERED** that:

- A. Respondent shall divest the X-Ray NDT Business absolutely and in good faith, at no minimum price, within six (6) months from the date Respondent executed the Agreement Containing Consent Orders.
- B. Respondent shall divest the X-Ray NDT Business to an acquirer that receives the prior approval of the Commission and only in a manner that receives the prior approval of the Commission.
- C. Until the Effective Date of Divestiture of the X-Ray NDT Business, Respondent shall take such actions as are necessary to maintain the viability and marketability of the X-Ray NDT Business and to prevent the destruction, removal, wasting, deterioration, or impairment of the X-Ray NDT Business, except for ordinary wear and tear.
- D. Nothing in this Order shall prohibit Respondent from entering into an agreement with the Acquirer of the X-Ray NDT Business, at the Acquirer’s option, in which the Respondent receives:

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1. a license to use X-Ray NDT Intellectual Property in a field of use that excludes X-Ray NDT; and
2. the right to use the YXLON name for a transitional period of time on Non-NDT Products that were manufactured and sold by YXLON.

E. Respondent shall:

1. not interfere, directly or indirectly, with the hiring or employing by the Acquirer of X-Ray NDT Employees, and shall remove any impediments or incentives within the control of Respondent and InVision that may deter these employees from accepting employment with the Acquirer, including, but not limited to, any non-compete provisions of employment or other contracts with Respondent or InVision that would affect the ability or incentive of those individuals to be employed by the Acquirer. In addition, Respondent shall not make any counteroffer to an X-Ray NDT Employee who receives a written offer of employment from the Acquirer;
2. provide all X-Ray NDT Employees with reasonable financial incentives to continue in their positions until the Effective Date of Divestiture. Such incentives shall include, but are not limited to, a continuation of all employee benefits, including regularly scheduled raises and bonuses and a vesting of all pension benefits (as permitted by law and for those X-Ray NDT Employees covered by a pension plan), offered by Respondent until the Effective Date of Divestiture;
3. not, for a period of two (2) years following the Effective Date of Divestiture, directly or indirectly, solicit or otherwise attempt to induce any employees of the Acquirer having any responsibility related to the X-Ray NDT Business to terminate their employment relationship with the Acquirer. *PROVIDED, HOWEVER*, that Respondent may:

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- a. advertise for employees in newspapers, trade publications or other media not targeted specifically at X-Ray NDT Employees; or
- b. hire X-Ray NDT Employees who apply for employment with Respondent, as long as such employees were not solicited by Respondent in violation of this Paragraph II.E;

*PROVIDED, HOWEVER*, that this Paragraph II.E. shall not prohibit Respondent from making offers of employment to or employing any X-Ray NDT Employee after the Effective Date of Divestiture where the Acquirer has notified Respondent in writing that the Acquirer does not intend to make an offer of employment to that employee.

- F. Prior to the Effective Date of Divestiture, Respondent shall secure all consents and waivers from all private entities that are necessary for the divestiture of the X-Ray NDT Business to the Acquirer, and for the continued research, development, manufacture, sale, service, marketing or distribution of X-Ray NDT Products by the Acquirer.
- G. Respondent shall not use, directly or indirectly, any Confidential Business Information (other than as necessary to comply with requirements of this Order) related to the research, development, engineering, manufacture, use, distribution, cost, pricing, supply marketing, sale or after-sale servicing of X-Ray NDT Products, and shall not disclose or convey such Confidential Business Information, directly or indirectly, to any person except the Acquirer, the Hold Separate Trustee, and the Divestiture Trustee, if appointed; *PROVIDED, HOWEVER*, this provision shall not apply to any Confidential Business Information related to X-Ray NDT Products that Respondent can demonstrate to the Commission that Respondent obtained without the assistance of InVision prior to the Effective Date of Divestiture.

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- H. Respondent shall, to the extent permissible under applicable laws and as a condition of continued employment post-divestiture, require that each employee of Respondent with access to any Confidential Business Information related to the X-Ray NDT Business sign a confidentiality agreement pursuant to which such employee shall be required to maintain all such Confidential Business Information strictly confidential, including the nondisclosure of such information to all other employees, executives or other personnel of Respondent (other than as necessary to comply with the requirements of this Order). *PROVIDED, HOWEVER, that:*
1. Respondent may use such information only to the extent necessary to defend or prosecute claims relating to assets or liabilities that are retained by Respondent after the Acquisition Date.
  2. This Paragraph II.H. shall not apply to any Confidential Business Information related to X-Ray NDT Products that Respondent can demonstrate to the Commission that Respondent obtained without the assistance of InVision prior to the Effective Date of Divestiture.
- I. The purpose of the divestiture of the X-Ray NDT Business is to ensure the continued operation of the X-Ray NDT Business in the same manner in which it was engaged from the date the Consent Agreement is signed until the date Respondent divests the X-Ray NDT Business to an Acquirer, and to remedy the lessening of competition resulting from the Acquisition as alleged in the Commission's Complaint.

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**III.****IT IS FURTHER ORDERED** that:

- A. If Respondent has not fully complied with the obligations to divest the X-Ray NDT Business as required by Paragraph II of this Order, the Commission may appoint a Divestiture Trustee to divest the X-Ray NDT Business in a manner that satisfies the requirements of Paragraph II. In the event that the Commission or the Attorney General brings an action pursuant to § 5(l) of the Federal Trade Commission Act, 15 U.S.C. § 45(l), or any other statute enforced by the Commission, Respondent shall consent to the appointment of a Divestiture Trustee in such action to divest the X-Ray NDT Business. Neither the appointment of a Divestiture Trustee nor a decision not to appoint a Divestiture Trustee under this Paragraph III shall preclude the Commission or the Attorney General from seeking civil penalties or any other relief available to it, including a court-appointed Divestiture Trustee, pursuant to § 5(l) of the Federal Trade Commission Act, or any other statute enforced by the Commission, for any failure by Respondent to comply with this Order.
- B. The Commission shall select the Divestiture Trustee, subject to the consent of Respondent, which consent shall not be unreasonably withheld. The Divestiture Trustee shall be a person with experience and expertise in acquisitions and divestitures. If Respondent has not opposed, in writing, including the reasons for opposing, the selection of any proposed Divestiture Trustee within ten (10) days after notice by the staff of the Commission to Respondent of the identity of any proposed Divestiture Trustee, Respondent shall be deemed to have consented to the selection of the proposed Divestiture Trustee.
- C. Not later than ten (10) days after the appointment of a Divestiture Trustee, Respondent shall execute a trust agreement that, subject to the prior approval of the

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Commission, transfers to the Divestiture Trustee all rights and powers necessary to permit the Divestiture Trustee to effect the divestiture required by this Order.

- D. If a Divestiture Trustee is appointed by the Commission or a court pursuant to this Paragraph III, Respondent shall consent to the following terms and conditions regarding the Divestiture Trustee's powers, duties, authority, and responsibilities:
1. Subject to the prior approval of the Commission, the Divestiture Trustee shall have the exclusive power and authority to divest the X-Ray NDT Business.
  2. The Divestiture Trustee shall have one (1) year after the date the Commission approves the trust agreement described herein to accomplish the divestiture, which shall be subject to the prior approval of the Commission. If, however, at the end of the one (1) year period, the Divestiture Trustee has submitted a plan of divestiture or believes that the divestiture can be achieved within a reasonable time, the divestiture period may be extended by the Commission; *PROVIDED, HOWEVER*, the Commission may extend the divestiture period only two (2) times.
  3. Subject to any demonstrated legally recognized privilege, the Divestiture Trustee shall have full and complete access to the personnel, books, records and facilities related to the relevant assets that are required to be divested by this Order and to any other relevant information, as the Divestiture Trustee may request. Respondent shall develop such financial or other information as the Divestiture Trustee may request and shall cooperate with the Divestiture Trustee. Respondent shall take no action to interfere with or impede the Divestiture Trustee's accomplishment of the divestiture. Any delays in divestiture caused by Respondent shall extend the time for divestiture under this Paragraph III in

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an amount equal to the delay, as determined by the Commission.

4. The Divestiture Trustee shall use commercially reasonable best efforts to negotiate the most favorable price and terms available in each contract that is submitted to the Commission, subject to Respondent's absolute and unconditional obligation to divest expeditiously and at no minimum price. The divestiture shall be made in the manner and to an acquirer as required by this Order;

*PROVIDED, HOWEVER*, if the Divestiture Trustee receives bona fide offers from more than one acquiring entity, and if the Commission determines to approve more than one such acquiring entity, the Divestiture Trustee shall divest to the acquiring entity selected by Respondent from among those approved by the Commission;

*PROVIDED FURTHER*, that Respondent shall select such entity within five (5) days after receiving notification of the Commission's approval.

5. The Divestiture Trustee shall serve, without bond or other security, at the cost and expense of Respondent, on such reasonable and customary terms and conditions as the Commission or a court may set. The Divestiture Trustee shall have the authority to employ, at the cost and expense of Respondent, such consultants, accountants, attorneys, investment bankers, business brokers, appraisers, and other representatives and assistants as are necessary to carry out the Divestiture Trustee's duties and responsibilities. The Divestiture Trustee shall account for all monies derived from the divestiture and all expenses incurred. After approval by the Commission of the account of the Divestiture Trustee, including fees for the Divestiture Trustee's services, all remaining monies shall be paid at the direction of the Respondent, and the Divestiture

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Trustee's power shall be terminated. The compensation of the Divestiture Trustee shall be based at least in significant part on a commission arrangement contingent on the divestiture of all of the relevant assets that are required to be divested by this Order.

6. Respondent shall indemnify the Divestiture Trustee and hold the Divestiture Trustee harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Divestiture Trustee's duties, including all reasonable fees of counsel and other expenses incurred in connection with the preparation for, or defense of, any claim, whether or not resulting in any liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from misfeasance, gross negligence, willful or wanton acts, or bad faith by the Divestiture Trustee.
  7. The Divestiture Trustee shall have no obligation or authority to operate or maintain the relevant assets required to be divested by this Order.
  8. The Divestiture Trustee shall report in writing to Respondent and to the Commission every sixty (60) days concerning the Divestiture Trustee's efforts to accomplish the divestiture.
  9. Respondent may require the Divestiture Trustee and each of the Divestiture Trustee's consultants, accountants, attorneys and other representatives and assistants to sign a customary confidentiality agreement; *PROVIDED, HOWEVER*, such agreement shall not restrict the Divestiture Trustee from providing any information to the Commission.
- E. If the Commission determines that a Divestiture Trustee has ceased to act or failed to act diligently, the Commission may appoint a substitute Divestiture Trustee in the same manner as provided in this Paragraph III.



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- F. The Commission or, in the case of a court-appointed Divestiture Trustee, the court, may on its own initiative or at the request of the Divestiture Trustee issue such additional orders or directions as may be necessary or appropriate to accomplish the divestiture required by this Order.
- G. The Divestiture Trustee appointed pursuant to Paragraph III of this Order may be the same Person appointed as Hold Separate Trustee pursuant to the relevant provisions of the Order to Hold Separate in this matter.

**IV.**

**IT IS FURTHER ORDERED** that within thirty (30) days after the date this Order becomes final, and every sixty (60) days thereafter until Respondent has fully complied with Paragraphs II and III of this Order, Respondent shall submit to the Commission a verified written report setting forth in detail the manner and form in which it intends to comply, is complying, and has complied with this Order. Respondent shall submit at the same time a copy of its report concerning compliance with this Order to the Hold Separate Trustee, if any Hold Separate Trustee has been appointed pursuant to the Hold Separate Order in this matter. Respondent shall include in its reports, among other things that are required from time to time, a full description of the efforts being made to comply with the relevant Paragraphs of the Order, including a description of all substantive contacts or negotiations related to the divestiture of the relevant assets and the identity of all parties contacted. Respondent shall include in its reports copies of all written communications to and from such parties, all internal memoranda, and all reports and recommendations concerning completing the obligations.

**V.**

**IT IS FURTHER ORDERED** that Respondent shall notify the Commission at least thirty (30) days prior to any proposed (1)

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dissolution of the Respondent, (2) acquisition, merger or consolidation of Respondent, or (3) any other change in the Respondent that may affect compliance obligations arising out of the order, including but not limited to assignment and the creation or dissolution of subsidiaries.

**VI.**

**IT IS FURTHER ORDERED** that, for the purpose of determining or securing compliance with this Order, and subject to any legally recognized privilege, and upon written request with reasonable notice, Respondent shall permit any duly authorized representative of the Commission:

- A. access, during office hours of Respondent and in the presence of counsel, to all facilities and access to inspect and copy all books, ledgers, accounts, correspondence, memoranda and all other records and documents in the possession or under the control of Respondent related to compliance with this Order; and
- B. upon five (5) days' notice to Respondent and without restraint or interference from Respondent, to interview officers, directors, or employees of Respondent, who may have counsel present, regarding such matters.

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**ORDER TO HOLD SEPARATE AND MAINTAIN ASSETS**

The Federal Trade Commission (“Commission”), having initiated an investigation of the proposed acquisition by Respondent General Electric Company hereinafter referred to as “Respondent,” of InVision Technologies, Inc. (“InVision”), and Respondent having been furnished thereafter with a draft Complaint that the Bureau of Competition proposed to present to the Commission for its consideration and that, if issued by the Commission, would charge Respondent with violations of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45; and

Respondent, its attorneys, and counsel for the Commission having thereafter executed an Agreement Containing Consent Orders (“Consent Agreement”), containing an admission by Respondent of all the jurisdictional facts set forth in the aforesaid draft of Complaint, a statement that the signing of said Consent Agreement is for settlement purposes only and does not constitute an admission by Respondent that the law has been violated as alleged in such Complaint, or that the facts as alleged in such Complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission’s Rules; and

The Commission, having thereafter considered the matter and having determined that it had reason to believe that Respondent has violated the said Acts, and that a Complaint should issue stating its charges in that respect, and having such Consent Agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, now in further conformity with the procedure described in Commission Rule 2.34, 16 C.F.R. § 2.34, the Commission hereby makes the following jurisdictional findings and issues this Order to Hold Separate and Maintain Assets (“Hold Separate Order”).

1. Respondent General Electric Company is a corporation organized, existing and doing business under and by virtue of the

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laws of the State of New York, with its office and principal place of business located at 3135 Easton Turnpike, Fairfield, Connecticut 06431.

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of Respondent, and the proceeding is in the public interest.

**I.**

**IT IS ORDERED** that, as used in this Hold Separate Order, the following definitions shall apply:

- A. “GE” means General Electric Company, its directors, officers, employees, agents, attorneys, representatives, predecessors, successors, and assigns; its joint ventures, subsidiaries, divisions, groups and affiliates controlled by General Electric Company (including, but not limited to, the GE Inspection Technologies business of General Electric Company), and the respective directors, officers, employees, agents, attorneys, representatives, predecessors, successors, and assigns of each.
- B. “InVision” means InVision Technologies, Inc., a corporation organized, existing, and doing business under and by virtue of the laws of Delaware, with its offices and principal place of business located at 7151 Gateway Boulevard, Newark, California 94560; and joint ventures, subsidiaries, divisions, groups, and affiliates controlled by InVision.
- C. “YXLON” means YXLON International X-ray GmbH (Germany), YXLON International Inc. (Akron, Ohio); YXLON International Holding GmbH (Germany); YXLON International A/S (Copenhagen); YXLON International KK

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(Tokyo); and YXLON International CT GmbH (Hattingen), wholly-owned subsidiaries of InVision; and joint ventures, subsidiaries, divisions, groups, and affiliates controlled by such subsidiaries.

- D. “Respondent” means GE, individually, and the Person resulting from the Acquisition.
- E. “Commission” means the Federal Trade Commission.
- F. “Acquirer” means any entity that receives the prior approval of the Commission to acquire the X-Ray NDT Business pursuant to Paragraph II or III of this Order.
- G. “Acquisition” means the proposed acquisition of all of the outstanding stock of InVision by Respondent pursuant to the Agreement and Plan of Merger dated March 15, 2004, by and among InVision, Respondent and Jet Acquisition Sub, Inc.
- H. “Acquisition Date” means the date the Acquisition is consummated.
- I. “Effective Date of Divestiture” means the date on which Respondent (or a Divestiture Trustee) divests to the Acquirer the X-Ray NDT Business completely and as required by Paragraph II or III of the Decision and Order in this matter.
- J. “Held Separate Business” means the X-Ray NDT Business and X-Ray NDT Employees.
- K. “Hold Separate Period” means the time period during which the Hold Separate Order is in effect, which shall begin no later than ten (10) days after the date the Hold Separate Order becomes final and terminate pursuant to Paragraph V. hereof.

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- L. “Material Confidential Information” means competitively sensitive or proprietary information not independently known to a Person from sources other than the Person to which the information pertains, and includes, but is not limited to, all customer lists, price lists, marketing methods, patents, technologies, processes, or other trade secrets. The Held Separate Business shall be considered a Person separate from Respondent (as defined in this Hold Separate Order and the Decision and Order) for this purpose.
- M. “NDT” means non-destructive testing.
- N. “NDT Product” means any non-destructive testing equipment or system, excluding medical and explosive detection products and systems, used for the examination of materials and components without damaging or destroying them.
- O. “Person” means any individual, partnership, firm, trust, association, corporation, joint venture, unincorporated organization, or other business or governmental entity.
- P. “X-Ray NDT” or “X-Ray NDT Product” means NDT that uses X-Ray (using film-based systems, non-film-based systems and digital imaging systems) or computed radiography as the inspection modality.
- Q. “X-Ray NDT Business” means YXLON, X-Ray NDT Documents, X-Ray NDT Intellectual Property, X-Ray NDT Software, X-Ray NDT Manufacturing Equipment, and all of InVision’s operations and businesses related to X-Ray NDT Products, including, but not limited to the production and manufacturing, inventory, real property, marketing, advertising, promotion, contracts, distribution, sale or after-sales support related to X-Ray NDT Products.
- R. “X-Ray NDT Documents” means all documents (including, but not limited to, computer files, electronic mail, and

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written, recorded, and graphic materials) possessed or owned by InVision related to X-Ray NDT Products, including, but not limited to, the following specified documents: reports relating to the research and development of X-Ray NDT Products or of any materials used in the research, development, manufacture, marketing or sale of X-Ray NDT Products; all market research data and market intelligence reports; customer information; all records relating to employees that accept employment with the Acquirer (excluding any personnel records the transfer of which is prohibited by applicable law); all records, including customer lists, sales force call activity reports, vendor lists, sales data, reimbursement data, manufacturing records, manufacturing processes, and supplier lists; all data contained in laboratory notebooks relating to X-Ray NDT Products; all diagrams and schematics relating to X-Ray NDT Products; all analytical and quality control data; and all correspondence with governmental agencies relating to X-Ray NDT Products, but excluding (i) all tax returns, financial statements, and working papers of InVision relating to Non-NDT Products; and (ii) documents and other information subject to attorney-client privilege relating to Non-NDT Products; *PROVIDED, HOWEVER*, that, if a document required to be produced pursuant to this Paragraph also contains information that is not related to the X-Ray NDT Products, Respondent need not produce that information to the extent it is contained within a discrete segment of the document that otherwise must be produced. *PROVIDED FURTHER*, that the Acquirer shall be allowed access to redacted copies of such documents otherwise excluded by this Paragraph to the extent they relate to X-Ray NDT Products.

- S. “X-Ray NDT Employees” means all of those individuals employed by YXLON or InVision (irrespective of the portion of working time involved) with any responsibility for the research, design, development, engineering, manufacturing, distributing, marketing, sales, or after-sales

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service and support of X-Ray NDT Products worldwide within the eighteen (18) month period immediately prior to the Effective Date of Divestiture.

- T. “X-Ray NDT Intellectual Property” means all of the following possessed or owned by InVision related to X-Ray NDT:
1. X-Ray NDT Patents;
  2. X-Ray NDT Trademarks;
  3. X-Ray NDT Trade Dress;
  4. X-Ray NDT Manufacturing Technology;
  5. X-Ray NDT Scientific and Regulatory Material; and
  6. rights to sue and recover damages or obtain injunctive relief for infringement, dilution, misappropriation, violation or breach of any of the foregoing.
- U. “X-Ray NDT Manufacturing Equipment” means all of YXLON’s and InVision’s rights and ownership in equipment, machines, and computers, and all parts, information, files, diagrams, schematics, instructions, software, and hardware related thereto, used in the manufacture, quality assurance and quality control, and packaging of X-Ray NDT.
- V. “X-Ray NDT Manufacturing Technology” means all technology, trade secrets, know-how, diagrams, schematics, software, calibrations, inventions, practices, proprietary algorithms, testing techniques, methods and other confidential or proprietary information related to the manufacture, quality assurance and quality control, and packaging of X-Ray NDT Products owned or used by InVision, including, but not limited to, manufacturing



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records, sampling records, standard operating procedures and batch records related to the manufacturing process, and supplier lists.

- W. “X-Ray NDT Patents” means all patents, patent applications and statutory invention registrations, in each case possessed or owned by InVision relating to X-Ray NDT Products, including all reissues, divisions, continuations, continuations-in-part, supplementary protection certificates, extensions and reexaminations thereof, all inventions disclosed therein, all rights therein provided by international treaties and conventions, and all rights to obtain and file for patents and registrations thereto in the world, related to the manufacture, use, sale, service, research or development of X-Ray NDT Products.
- X. “X-Ray NDT Scientific and Regulatory Material” means all technological, scientific, chemical, and electrical materials and information related to X-Ray NDT owned or used by InVision, and all rights thereto, in any and all jurisdictions.
- Y. “X-Ray NDT Software” means computer programs, including all software implementations of algorithms, models, and methodologies whether in source code or object code form, databases and compilations, including any and all data and collections of data, all documentation, including user manuals and training materials, related to any X-Ray NDT Products distributed, marketed, or sold by or on behalf of InVision; *PROVIDED, HOWEVER*, that “X-Ray NDT Software” does not include software that is readily purchasable or licensable and which has not been modified in a manner material to the use or function thereof (other than through user preference settings).
- Z. “X-Ray NDT Trade Dress” means all trade dress of X-Ray NDT Products distributed, marketed, or sold by or on behalf of InVision, including, but not limited to, domain names

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and internet sites, product packaging associated with the sale of X-Ray NDT Products worldwide and the lettering of such X-Ray NDT trade names or brand names.

- AA. “X-Ray NDT Trademarks” means all trademarks, trade names and brand names including registrations and applications for registration thereof (and all renewals, modifications, and extensions thereof) and all common law rights, and the goodwill symbolized thereby and associated therewith, for X-Ray NDT researched, developed, distributed, marketed, or sold by or on behalf of InVision.

## II.

**IT IS FURTHER ORDERED** that:

- A. During the Hold Separate Period, Respondent shall hold the Held Separate Business separate, apart, and independent as required by this Hold Separate Order and shall vest the Held Separate Business with all rights, powers, and authority necessary to conduct its business; Respondent shall not exercise direction or control over, or influence directly or indirectly, the Held Separate Business or any of its operations, or the Hold Separate Trustee, except to the extent that Respondent must exercise direction and control over the Held Separate Business as is necessary to assure compliance with this Hold Separate Order, the Consent Agreement, and with all applicable laws, including, in consultation with the Hold Separate Trustee, continued oversight of the Held Separate Business’s compliance with policies and standards concerning the safety, health, and environmental aspects of its operations and the integrity of its financial controls; and Respondent shall have the right to defend any legal claims, investigations or enforcement actions threatened or brought against any Held Separate Business.

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- B. Until the Effective Date of Divestiture, Respondent shall take such actions as are necessary to maintain the viability and marketability of the Held Separate Business to prevent the destruction, removal, wasting, deterioration, or impairment of any of the assets, except for ordinary wear and tear.
- C. The purposes of this Hold Separate Order are to: (1) preserve the Held Separate Business as a viable, competitive, and ongoing business independent of Respondent until the divestiture required by the Decision and Order is achieved; (2) assure that no Material Confidential Information is exchanged between Respondent and the Held Separate Business, except in accordance with the provisions of this Hold Separate Order; (3) prevent interim harm to competition pending the relevant divestitures and other relief; and (4) help remedy any anticompetitive effects of the proposed Acquisition.
- D. Respondent shall hold the Held Separate Business separate, apart, and independent on the following terms and conditions:
1. Mr. Hartmut G. Grossmann shall serve as Hold Separate Trustee, pursuant to the agreement executed by the Hold Separate Trustee and Respondent and attached as Confidential Appendix A (“Trustee Agreement”).
    - a. The Trustee Agreement shall require that, no later than one (1) day after the Acquisition Date, Respondent transfer to the Hold Separate Trustee all rights, powers, and authorities necessary to permit the Hold Separate Trustee to perform his/her duties and responsibilities, pursuant to this Hold Separate Order and consistent with the purposes of the Decision and Order.

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- b. No later than one (1) day after the Acquisition Date, Respondent shall, pursuant to the Trustee Agreement, transfer to the Hold Separate Trustee all rights, powers, and authorities necessary to permit the Hold Separate Trustee to perform his/her duties and responsibilities, pursuant to this Hold Separate Order and consistent with the purposes of the Decision and Order.
- c. The Hold Separate Trustee shall have the responsibility, consistent with the terms of this Hold Separate Order and the Decision and Order, for monitoring the organization of the Held Separate Business; for managing the Held Separate Business through the Manager; for maintaining the independence of the Held Separate Business; and for monitoring Respondent's compliance with its obligations pursuant to this Hold Separate Order and the Decision and Order.
- d. The Hold Separate Trustee shall have full and complete access to all personnel, books, records, documents and facilities of the Held Separate Business or to any other relevant information as the Hold Separate Trustee may reasonably request including, but not limited to, all documents and records kept by Respondent in the ordinary course of business that relate to the Held Separate Business. Respondent shall develop such financial or other information as the Hold Separate Trustee may request and shall cooperate with the Hold Separate Trustee. Respondent shall take no action to interfere with or impede the Hold Separate Trustee's ability to monitor Respondent's compliance with this Hold Separate Order and the Consent Agreement or otherwise to perform his/her duties and responsibilities consistent with the terms of this Hold Separate.

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- e. The Hold Separate Trustee shall have the authority to employ, at the cost and expense of Respondent, such consultants, accountants, attorneys, and other representatives and assistants as are reasonably necessary to carry out the Hold Separate Trustee's duties and responsibilities.
- f. The Commission may require the Hold Separate Trustee to sign an appropriate confidentiality agreement relating to Commission materials and information received in connection with performance of the Hold Separate Trustee's duties.
- g. Respondent may require the Hold Separate Trustee to sign a confidentiality agreement prohibiting the disclosure of any Material Confidential Information gained as a result of his or her role as Hold Separate Trustee to anyone other than the Commission.
- h. Thirty (30) days after the Hold Separate Order becomes final, and every thirty (30) days thereafter until the Hold Separate Order terminates, the Hold Separate Trustee shall report in writing to the Commission concerning the efforts to accomplish the purposes of this Hold Separate Order. Included within that report shall be the Hold Separate Trustee's assessment of the extent to which the businesses comprising the Held Separate Business are meeting (or exceeding) their projected goals as are reflected in operating plans, budgets, projections or any other regularly prepared financial statements.
- i. If the Hold Separate Trustee ceases to act or fails to act diligently and consistent with the purposes of this Hold Separate Order, the Commission may appoint a substitute Hold Separate Trustee consistent with the terms of this paragraph, subject to the consent of Respondent, which consent shall not be unreasonably

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withheld. If Respondent has not opposed, in writing, including the reasons for opposing, the selection of the substitute Hold Separate Trustee within five (5) days after notice by the staff of the Commission to Respondent of the identity of any substitute Hold Separate Trustee, Respondent shall be deemed to have consented to the selection of the proposed substitute trustee. Respondent and the substitute Hold Separate Trustee shall execute a Trustee Agreement, subject to the approval of the Commission, consistent with this paragraph.

2. No later than one (1) day after the Acquisition Date, Respondent shall enter into a management agreement with, and transfer all rights, powers, and authorities necessary to manage and maintain the Held Separate Business, to Joseph M. Kosanetzky, Ph.D., the current Chief Executive of YXLON International X-Ray GmbH (“Manager”).
  - a. In the event that Dr. Kosanetzky ceases to act as Manager, then Respondent shall select a substitute Manager, subject to the approval of the Commission, and transfer to the substitute Manager all rights, powers and authorities necessary to permit the substitute Manager to perform his/her duties and responsibilities, pursuant to this Hold Separate Order.
  - b. The Manager shall report directly and exclusively to the Hold Separate Trustee and shall manage the Held Separate Business independently of the management of Respondent. The Manager shall not be involved, in any way, in the operations of the other businesses of Respondent during the term of this Hold Separate Order.
  - c. The Manager shall have no financial interests affected by Respondent’s revenues, profits or profit margins,

## Order

except that the Manager's compensation for managing the Held Separate Business may include economic incentives dependent on the financial performance of the Held Separate Business if there are also sufficient incentives for the Manager to operate the Held Separate Business at no less than current rates of operation (including, but not limited to, current rates of production and sales) and to achieve the objectives of this Hold Separate Order.

- d. The Manager shall make no material changes in the present operation of the Held Separate Business except with the approval of the Hold Separate Trustee, in consultation with the Commission staff.
- e. The Manager shall have the authority, with the approval of the Hold Separate Trustee, to remove X-Ray NDT Employees and replace them with others of similar experience or skills. If any person ceases to act or fails to act diligently and consistent with the purposes of this Hold Separate Order, the Manager, in consultation with the Hold Separate Trustee, may request Respondent to, and Respondent shall, appoint a substitute person, which person the Manager shall have the right to approve.
- f. In addition to those X-Ray NDT Employees within the Held Separate Business, the Manager may employ such Persons as are reasonably necessary to assist the Manager in managing the Held Separate Business.
- g. The Hold Separate Trustee shall be permitted, in consultation with the Commission staff, to remove the Manager for cause. Within fifteen (15) days after such removal of the Manager, Respondent shall appoint a replacement Manager, subject to the approval of the

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Commission, on the same terms and conditions as provided in Paragraph II.D.2 of this Hold Separate Order.

3. The Held Separate Business shall be staffed with sufficient employees to maintain the viability and competitiveness of the Held Separate Business. To the extent that any X-Ray NDT Employees leave or have left the Held Separate Business prior to the Effective Date of Divestiture, the Manager, with the approval of the Hold Separate Trustee, may replace departing or departed employees with persons who have similar experience and expertise or determine not to replace such departing or departed employees.
4. In connection with support services or products not included within the Held Separate Business, Respondent and InVision shall continue to provide, or offer to provide, the same support services to the Held Separate Business as are being provided to such business interest by Respondent and InVision as of the date the Consent Agreement is signed by Respondent. For any services or products that Respondent and InVision may provide to the Held Separate Business, Respondent may charge no more than the same price they charge others for the same services or products. Respondent's or InVision's personnel providing such services or products must retain and maintain all Material Confidential Information of the Held Separate Business on a confidential basis, and, except as is permitted by this Hold Separate Order, such persons shall be prohibited from providing, discussing, exchanging, circulating, or otherwise furnishing any such information to or with any person whose employment involves any of Respondent's or InVision's businesses, other than the Held Separate Business. Such personnel shall also execute confidentiality agreements prohibiting the disclosure of any Material Confidential Information of the Held Separate Business.



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- a. Respondent and InVision shall offer to the Held Separate Business any services and products that Respondent or InVision provided to their other businesses directly or through third party contracts, or that they have provided directly or through third party contracts to the businesses constituting the Held Separate Business at any time since January 1, 2003. The Held Separate Business may, at the option of the Manager with the approval of the Hold Separate Trustee, obtain such services and products from Respondent or InVision. The services and products that Respondent or InVision shall offer the Held Separate Business shall include, but shall not be limited to, the following:
- (1) Human resources administrative services, including but not limited to payroll processing, labor relations support, pension administration, and health benefits;
  - (2) Environmental health and safety services, which are used to develop corporate policies and insure compliance with federal and state regulations and corporate policies;
  - (3) Preparation of tax returns;
  - (4) Audit services;
  - (5) Information systems, which constructs, maintains, and supports all computer systems;
  - (6) Processing of accounts payable;
  - (7) Technical support;
  - (8) Finance and financial accounting services;

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- (9) Procurement of supplies;
  - (10) Procurement of goods and services utilized in the ordinary course of business by the Held Separate Business; and
  - (11) Legal services;
- b. the Held Separate Business shall have, at the option of the Manager with the approval of the Hold Separate Trustee, the ability to acquire services and products from third parties unaffiliated with Respondent or InVision.
5. Respondent shall cause the Hold Separate Trustee, the Manager, and each X-Ray NDT Employee having access to Material Confidential Information to submit to the Commission a signed statement that the individual will maintain the confidentiality required by the terms and conditions of this Hold Separate Order. These individuals must retain and maintain all Material Confidential Information relating to the Held Separate Business on a confidential basis and, except as is permitted by this Hold Separate Order, such persons shall be prohibited from providing, discussing, exchanging, circulating, or otherwise furnishing any such information to or with any other person whose employment involves any of Respondent's businesses other than the Held Separate Business. These persons shall not be involved in any way in the management, production, distribution, sale, marketing, or financial operations of the competing products of Respondent.
  6. No later than five (5) days after the Acquisition Date, Respondent shall establish written procedures, subject to the approval of the Hold Separate Trustee, covering the management, maintenance, and independence of the Held

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Separate Business consistent with the provisions of this Hold Separate Order.

7. No later than five (5) days after the date this Hold Separate Order becomes final, Respondent shall circulate to employees of the Held Separate Business and to Respondent's employees who are responsible for the development, manufacture and sale of NDT products, a notice of this Hold Separate Order and the Consent Agreement.
8. The Hold Separate Trustee and the Manager shall serve, without bond or other security, at the cost and expense of Respondent, on reasonable and customary terms commensurate with the person's experience and responsibilities.
9. Respondent shall indemnify the Hold Separate Trustee and Manager and hold each harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Hold Separate Trustee's or the Manager's duties, including all reasonable fees of counsel and other expenses incurred in connection with the preparation for, or defense of any claim, whether or not resulting in any liability, except to the extent that such liabilities, losses, damages, claims, or expenses result from misfeasance, gross negligence, willful or wanton acts, or bad faith by the Hold Separate Trustee or the Manager.
10. Respondent shall provide the Held Separate Business with sufficient financial resources:
  - a. as are appropriate in the judgment of the Hold Separate Trustee to operate the Held Separate Business as it is currently operated;

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- b. to perform all maintenance to, and replacements of, the assets of the Held Separate Business;
- c. to carry on existing and planned capital projects and business plans; and
- d. to maintain the viability, competitive vigor, and marketability of the Held Separate Business.

Such financial resources to be provided to the Held Separate Business shall include, but shall not be limited to, (i) general funds, (ii) capital, (iii) working capital, and (iv) reimbursement for any operating losses, capital losses, or other losses; *PROVIDED, HOWEVER*, that, consistent with the purposes of the Decision and Order, the Manager may reduce in scale or pace any capital or research and development project, or substitute any capital or research and development project for another of the same cost.

11. Respondent shall not, during the Hold Separate Period, offer X-Ray NDT Employees positions with Respondent. The Acquirer shall have the option of offering employment to any X-Ray NDT Employees. Respondent shall not interfere with the employment, by the Acquirer of such employees; shall not offer any incentive to such employees to decline employment with the Acquirer or to accept other employment with the Respondent; and shall remove any impediments that may deter such employees from accepting employment with the Acquirer including, but not limited to, any non-compete or confidentiality provisions of employment or other contracts that would affect the ability of such employees to be employed by the Acquirer, and the payment, or the transfer for the account of the employee, of all current and accrued bonuses, pensions and other current and accrued benefits to which such employees would

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otherwise have been entitled had they remained in the employment of the Respondent.

12. For a period of two (2) years commencing on the Effective Date of Divestiture, Respondent shall not employ or make offers of employment to X-Ray NDT Employees who have accepted offers of employment with the Acquirer unless the individual's employment has been terminated by the Acquirer.
13. Except for the Manager, X-Ray NDT Employees, and support services employees involved in providing services to the Held Separate Business pursuant to Paragraph II.D.4., and except to the extent provided in Paragraph II.A., Respondent shall not permit any other of its employees, officers, or directors to be involved in the operations of the Held Separate Business.
14. Respondent shall assure that X-Ray NDT Employees receive, during the Hold Separate Period, their salaries, all current and accrued bonuses, pensions and other current and accrued benefits to which those employees would otherwise have been entitled.
15. Respondent's employees (excluding support services employees involved in providing support to the Held Separate Business pursuant to Paragraph II.D.4.) shall not receive, or have access to, or use or continue to use any Material Confidential Information of the Held Separate Business not in the public domain except:
  - a. as required by law;
  - b. to the extent that necessary information is exchanged in the course of consummating the Acquisition;

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- c. in negotiating agreements to divest assets pursuant to the Consent Agreement and engaging in related due diligence;
- d. in complying with this Hold Separate Order or the Consent Agreement;
- e. in overseeing compliance with policies and standards concerning the safety, health and environmental aspects of the operations of the Held Separate Business and the integrity of the Held Separate Business's financial controls;
- f. in defending legal claims, investigations or enforcement actions threatened or brought against or related to the Held Separate Business; or
- g. in obtaining legal advice.

Nor shall the Manager or X-Ray NDT Employees receive or have access to, or use or continue to use, any Material Confidential Information not in the public domain about Respondent and relating to Respondent's businesses, except such information as is necessary to maintain and operate the Held Separate Business. Respondent may receive aggregate financial and operational information relating to the Held Separate Business only to the extent necessary to allow Respondent to comply with the requirements and obligations of the laws of the United States and other countries, and to prepare consolidated financial reports, tax returns, reports required by securities laws, and personnel reports. Any such information that is obtained pursuant to this subparagraph shall be used only for the purposes set forth in this subparagraph.

16. Respondent and the Held Separate Business shall jointly implement, and at all times during the Hold Separate Period maintain in operation, a system, as

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approved by the Hold Separate Trustee, of access and data controls to prevent unauthorized access to or dissemination of Material Confidential Information of the Held Separate Business, including, but not limited to, the opportunity by the Hold Separate Trustee, on terms and conditions agreed to with Respondent, to audit Respondent's networks and systems to verify compliance with this Hold Separate Order.

### III.

**IT IS FURTHER ORDERED** that Respondent shall notify the Commission at least thirty (30) days prior to any proposed (1) dissolution of the Respondent, (2) acquisition, merger or consolidation of Respondent, or (3) any other change in the Respondent that may affect compliance obligations arising out of this Hold Separate Order, including but not limited to assignment and the creation or dissolution of subsidiaries.

### IV.

**IT IS FURTHER ORDERED** that, for the purpose of determining or securing compliance with this Hold Separate Order, and subject to any legally recognized privilege, and upon written request with reasonable notice to Respondent made to their principal United States offices, Respondent shall permit any duly authorized representative of the Commission:

- A. Access, during office hours of Respondent and in the presence of counsel, to all facilities, and access to inspect and copy all books, ledgers, accounts, correspondence, memoranda and all other records and documents in the possession or under the control of Respondent relating to any matters contained in this Hold Separate Order; and
- B. Upon five (5) days' notice to Respondent and without restraint or interference from Respondent, to interview

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officers, directors, or employees of Respondent, who may have counsel present, regarding any such matters.

**V.**

**IT IS FURTHER ORDERED** that this Hold Separate Order shall terminate at the earlier of:

- A. three (3) business days after the Commission withdraws its acceptance of the Consent Agreement pursuant to the provisions of Commission Rule 2.34, 16 C.F.R. § 2.34; or
- B. the day after the Effective Date of Divestiture required by the Consent Agreement.

**CONFIDENTIAL APPENDIX A**

**HOLD SEPARATE TRUSTEE AGREEMENT**

**[Public Record Version, With Confidential Exhibits C and D  
Redacted, But Incorporated By Reference]**



Analysis

**Analysis of Agreement Containing Consent Orders to Aid  
Public Comment****I. Introduction**

The Federal Trade Commission has accepted, subject to final approval, an Agreement Containing Consent Orders from General Electric Company, which is designed to remedy the anticompetitive effects resulting from GE's acquisition of InVision Technologies, Inc. Under the terms of the Consent Agreement, GE will be required to divest InVision's nondestructive testing ("NDT") business, including InVision's YXLON NDT subsidiaries, within six months after the date GE signed the Consent Agreement. The Consent Agreement also includes an Order to Hold Separate and Maintain Assets that requires GE to preserve the YXLON NDT business as a viable, competitive, and ongoing operation until the divestiture is achieved.

The proposed Consent Agreement has been placed on the public record for thirty (30) days to solicit comments from interested persons. Comments received during this period will become part of the public record. After thirty (30) days, the Commission will again review the proposed Consent Agreement and the comments received and will decide whether it should withdraw from the proposed Consent Agreement or make it final.

Pursuant to a stock purchase agreement dated March 15, 2004, GE proposes to acquire InVision ("Proposed Acquisition"). The total value of the Proposed Acquisition is approximately \$900 million. The Commission's Complaint alleges that the Proposed Acquisition, if consummated, would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, by lessening competition in the U.S. market for the research, development, manufacture, and sale of certain types of x-ray NDT and inspection equipment, specifically: (1) standard x-ray cabinets, (2) x-ray NDT and inspection systems equipped with

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automated defect recognition software (“ADR-capable x-ray systems”), and (3) x-ray generators capable of producing energy levels higher than 350 kilovolts (“high-energy x-ray generators”).

## **II. The Parties**

GE is a diversified technology and services company headquartered in Fairfield, Connecticut. GE is made up of a broad range of primary business units, each with its own divisions. GE Infrastructure, the business unit that proposes to acquire InVision, oversees the operations of GE’s security and sensing, water technologies, and automation enterprises. Another business unit of GE, GE Inspection Technologies, designs, manufactures, and sells various NDT and inspection equipment, including x-ray, ultrasound and eddy current equipment under the Seifert, Pantak, Krautkramer and Hocking brand names. GE Inspection Technologies is headquartered in Hürth, Germany. The company’s NDT and inspection products serve customers in the aerospace, energy, petrochemical and automotive industries.

Headquartered in Newark, California, InVision is the leading supplier of explosive detection systems (“EDS”) to the U.S. government for civil aviation security. InVision’s EDS devices are used at airports for screening checked passenger baggage. InVision also offers industrial NDT and inspection equipment through its YXLON subsidiary. YXLON, headquartered in Hamburg, Germany, was acquired by InVision in 2003. YXLON designs, manufactures and sells x-ray NDT and inspection equipment for use in a wide range of industries, including the aerospace, automotive, and security industries.

## **III. X-Ray NDT and Inspection Equipment**

GE and InVision, through its YXLON subsidiary, are the two largest suppliers of x-ray NDT and inspection equipment in the United States. X-ray NDT and inspection equipment includes, among other products: (1) standard x-ray cabinets; (2) ADR-capable x-ray systems; and (3) high-energy x-ray generators. X-

## Analysis

ray NDT and inspection equipment is used to inspect the structure and tolerance of materials, or identify objects inside materials, without damaging the materials or impairing their future usefulness.

Standard x-ray cabinets are x-ray NDT and inspection systems with generic configurations and uniform prices. Standard x-ray cabinets are multi-purpose inspection systems, as opposed to customized systems that are designed for particular customer needs, or application-specific x-ray systems utilized for specific tasks such as tire or airbag inspection. A single standard x-ray cabinet is capable of inspecting a variety of products as diverse as, for example, metal die-castings, turbine engine parts, steel components, plastics and ceramics.

ADR-capable x-ray systems are inspection systems that utilize automated defect recognition, or ADR, software that completely automates the inspection process. Unlike traditional x-ray NDT and inspection systems that require a manual operator, ADR-capable x-ray systems eliminate the need to make subjective human decisions regarding the objects being inspected. The benefits of ADR-capable x-ray systems for customers are improved inspection quality, increased throughput and decreased labor costs.

High-energy x-ray generators are components of x-ray NDT and inspection systems that generate the power needed to produce an x-ray beam and display an x-ray image. There are different categories of x-ray generators that are distinguished by the amount of power they can produce. High-energy x-ray generators produce levels of power sufficient for x-rays to penetrate dense materials, such as steel, that other types of x-ray generators cannot produce.

Manufacturers and end users in a variety of industries use standard x-ray cabinets, ADR-capable x-ray systems, and high-energy x-ray generators for quality control and safety purposes. Purchasers of these products purchase the type of x-ray NDT and

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inspection equipment that is best-suited for their application and, because of the unique performance characteristics of each type of equipment, there is little opportunity to switch to alternative equipment. In fact, even a price increase of five to ten percent for standard x-ray cabinets, ADR-capable x-ray systems, or high-energy x-ray generators would not likely cause a significant number of customers for these products to switch to any alternative product.

The United States is the appropriate geographic market for standard x-ray cabinets, ADR-capable x-ray systems, and high-energy x-ray generators in which to analyze the competitive effects of the Proposed Acquisition. Because x-ray NDT and inspection equipment frequently needs to be serviced and repaired to ensure proper operation, customers purchase from suppliers with local service and support networks. Furthermore, customers purchase from companies with a proven reputation for accurate and reliable equipment, and are reluctant to switch to a new company that does not have a proven track record for providing such service and support. Foreign suppliers that have not established the necessary service and support networks, brand reputation, and customer acceptance in the United States are not effective competitors for U.S. customers and would not be able to constrain a price increase for standard x-ray cabinets, ADR-capable x-ray systems, or high-energy x-ray generators in the United States.

The U.S. markets for standard x-ray cabinets, ADR-capable x-ray systems, and high-energy x-ray generators are all highly concentrated. GE and InVision are the two largest suppliers in each of these markets. If the Proposed Acquisition is consummated, GE would become the dominant supplier in each of these markets. For many customers, GE and InVision are the top two choices when considering a supplier of standard x-ray cabinets, ADR-capable x-ray systems, or high-energy x-ray generators. By eliminating competition between these two leading suppliers, the Proposed Acquisition would allow GE to unilaterally exercise market power, thereby increasing the

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likelihood that purchasers of standard x-ray cabinets, ADR-capable x-ray systems, and high-energy x-ray generators would be forced to pay higher prices and that innovation in these markets would decrease.

Significant impediments to new entry exist in the U.S. markets for x-ray NDT and inspection equipment. First, a new entrant would need to devote significant time and expense researching and developing a product. Second, a new entrant must undertake the lengthy and costly process of establishing a track record of reliability for its product. This track record is critical to customers because x-ray NDT and inspection equipment is relied upon to ensure the quality, performance, and safety of their products. Finally, a new supplier of standard x-ray cabinets, ADR-capable x-ray systems, and high-energy x-ray generators would have to spend a great deal of time and money to develop a broad service and support network upon which customers can rely. For these reasons, new entry into the markets for standard x-ray cabinets, ADR-capable x-ray systems, and high-energy x-ray generators is not likely to occur in a timely manner even if prices increased substantially after the Proposed Acquisition. Additionally, new entry into these markets is unlikely because the costs of entering these markets are too high relative to the limited sales opportunities available to new entrants.

#### **IV. The Consent Agreement**

The Consent Agreement effectively remedies the Proposed Acquisition's anticompetitive effects in the U.S. markets for the research, development, manufacture, and sale of standard x-ray cabinets, ADR-capable x-ray systems, and high-energy x-ray generators by requiring GE to divest InVision's YXLON NDT business. Pursuant to the Consent Agreement, GE is required to divest the YXLON NDT business, including the YXLON NDT subsidiaries, to a buyer, at no minimum price, within six (6) months from the date GE signed the Consent Agreement. The acquirer of the YXLON NDT business must receive the prior approval of the Commission. The Commission's goal in

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evaluating possible purchasers of divested assets is to ensure that the competitive environment that existed prior to the acquisition is maintained. A proposed acquirer of divested assets must not itself present competitive problems.

Should GE fail to accomplish the divestiture within the time and in the manner required by the Consent Agreement, the Commission may appoint a trustee to divest these assets. If approved, the trustee would have the exclusive power and authority to accomplish the divestiture within six (6) months of being appointed, subject to any necessary extensions by the Commission. The Consent Agreement requires GE to provide the trustee with access to information related to the YXLON NDT business as necessary to fulfill his or her obligations.

The Order to Hold Separate and Maintain Assets that is included in the Consent Agreement requires that GE hold separate and maintain the viability of the YXLON NDT business as a competitive operation until the business is transferred to the Commission-approved acquirer. Furthermore, it contains measures designed to ensure that no material confidential information is exchanged between GE and the YXLON NDT business (except as otherwise provided in the Consent Agreement) and provisions designed to prevent interim harm to competition in each x-ray NDT and inspection equipment market pending divestiture. The Order to Hold Separate and Maintain Assets provides that the Commission may appoint a Hold Separate Trustee who is charged with the duty of monitoring GE's compliance with the Consent Agreement. Pursuant to that Order, the Commission has appointed Hartmut G. Grossmann of H. Grossmann Consulting LLC as Hold Separate Trustee to oversee the YXLON NDT business prior to its divestiture and to ensure that GE complies with its obligations under the Consent Agreement. Mr. Grossmann, who holds law degrees from both the United States and Germany, has more than 25 years of experience advising and managing companies both inside and outside of Germany. He has held several key management positions, including chief counsel, managing director, and chief

## Analysis

operating officer, and during his professional career has developed experience related to corporate governance, litigation, business integration and restructuring, and regulatory compliance matters.

In order to ensure that the Commission remains informed about the status of the YXLON NDT business pending divestiture, and about the efforts being made to accomplish the divestiture, the Consent Agreement requires GE to file periodic reports with the Commission until the divestiture is accomplished.

The purpose of this analysis is to facilitate public comment on the Consent Agreement, and is not intended to constitute an official interpretation of the proposed Decision and Order or the Order to Maintain Assets, or to modify their terms in any way.

Complaint

IN THE MATTER OF

**ENTERPRISE PRODUCTS PARTNERS L.P., ET AL.**

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 7 OF THE CLAYTON ACT AND SEC. 5 OF THE FEDERAL TRADE  
COMMISSION ACT

*Docket C-4123; File No. 0410039*

*Complaint, September 29, 2004--Decision, November 23, 2004*

This consent order, among other things, requires Respondent Enterprise Products Partners L.P. – a publicly traded limited partnership that provides midstream energy services to customers throughout the Southeastern and Midwestern United States – and Respondent Dan L. Duncan, the ultimate parent entity of Enterprise to divest their interest in one of two competing pipelines (the Stingray/Triton pipeline system or the High Island Offshore System and its East Breaks lateral) that transport natural gas from the West Central Deepwater region of the Gulf of Mexico, in which water depths exceed 1,000 feet. The order also requires the respondents to divest their interest in one of two competing underground propane storage and terminaling facilities serving the Dixie Pipeline in Hattiesburg, Mississippi. An accompanying Order to Hold Separate and Maintain Assets requires the respondents to ensure the continuing viability, marketability, and competitiveness of the foregoing assets - and to ensure that they operate independently from Enterprise and GulfTerra - until the required divestitures are effected.

*Participants*

For the Commission: *Frank Lipson, Marc Schneider, Elizabeth D. Kaiser, Natasha Allen, John V. Lacci, Phillip L. Broyles, Daniel P. Ducore, Mark Williams, Peter Guly, Jeffrey H. Fischer and Mark Frankena.*

For the Respondents: *Neil Imus.*

**COMPLAINT**

Pursuant to the provisions of the Federal Trade Commission Act and the Clayton Act, and by virtue of the authority vested in it by said Acts, the Federal Trade Commission, having reason to believe that Respondent Enterprise Products Partners L.P., and Respondent Dan L. Duncan entered into a series of agreements



## Complaint

with GulfTerra Energy Partners L.P. and others to merge Enterprise Products Partners L.P. and GulfTerra Energy Partners L.P., all such parties being subject to the jurisdiction of the Federal Trade Commission, in violation of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, and that such merger, if consummated, would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, and that a proceeding in respect thereof would be in the public interest, hereby issues its complaint, stating its charges as follows:

**I. THE RESPONDENTS**

1. Respondent Enterprise Products Partners L.P. ("Respondent Enterprise") is a publicly traded limited partnership organized and doing business under the laws of the State of Delaware with its executive offices at 2727 North Loop West in Houston, Texas 77008. Enterprise Products GP, LLC ("Enterprise GP") is the general partner of Enterprise and is responsible for its day-to-day management and operations.
2. Respondent Enterprise is engaged, among other things, in the pipeline transportation of natural gas, and the transportation, fractionation, and storage of natural gas liquids, such as ethane and propane.
3. Respondent Enterprise at all times relevant herein has been and is now engaged in commerce as "commerce" is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. 12, and is a partnership whose business is in or affecting commerce as "commerce" is defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.
4. Respondent Dan L. Duncan ("Respondent Duncan"), a natural person, is the ultimate parent entity of Respondent Enterprise. Mr. Duncan owns or controls 100 percent of Enterprise Products GP, LLC and 48.8 percent of the limited

Complaint

partnership units in Respondent Enterprise. His offices are located at 2727 North Loop West, in Houston, Texas 77008.

5. Respondent Duncan at all times relevant herein has been and is now engaged in commerce as "commerce" is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. 12, and is an individual whose business is in or affecting commerce as "commerce" is defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

## II. THE MERGER PARTNER

6. GulfTerra Energy Partners L.P. ("GulfTerra") is a limited partnership, organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its principal place of business located at 4 Greenway Plaza, Houston, Texas 77046. El Paso Corporation owns 31.1 percent of the limited partnership units of GulfTerra LP. El Paso Corporation also owns 50 percent of the membership interest in, and manages the day-to-day operations of, GulfTerra's general partner.
7. GulfTerra is engaged, among other things, in the pipeline transportation of natural gas, and the transportation, fractionation, and storage of natural gas liquids, such as ethane and propane.

## III. THE TRANSACTION

8. On December 15, 2003, Respondent Enterprise and GulfTerra agreed to merge to form the second largest publicly traded energy partnership, with an enterprise value of approximately \$13 billion.

## IV. THE RELEVANT MARKETS

9. For purposes of this Complaint, the relevant lines of commerce in which to analyze the effects of the merger are:

## Complaint

- a. the pipeline transportation of natural gas; and
  - b. propane storage and terminaling services.
10. For purposes of this Complaint, the relevant geographic areas in which to analyze the effects of the merger with respect to the pipeline transportation of natural gas are portions of the following United States Department of Interior Minerals Management Service areas in the Gulf of Mexico: East Breaks, Garden Banks, Keithley Canyon, and Alaminos Canyon (“West Central Deepwater”) of the Gulf of Mexico.
  11. For purposes of this Complaint, the relevant geographic areas in which to analyze the effects of the merger with respect to propane storage and terminaling services is Hattiesburg, Mississippi.

**V. THE STRUCTURE OF THE MARKETS**

12. The relevant markets are highly concentrated whether measured by Herfindahl-Hirschman Indices (“HHI”) or two-firm or four-firm concentration ratios.
13. Respondents and GulfTerra are actual competitors in the relevant markets.

**VI. BARRIERS TO ENTRY**

14. Entry into the relevant markets is costly, difficult and unlikely because of, among other things, the substantial sunk cost needed to construct the assets required for entry.

**VII. EFFECTS OF THE MERGER**

15. The effect of the merger may be to substantially lessen competition, or to tend to create a monopoly in the relevant markets set forth above, in violation of Section 7

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of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, in the following ways, among others:

- a. By eliminating direct competition between Respondents and GulfTerra in the relevant markets;
- b. By enhancing the likelihood of collusion or coordinated action between or among the remaining firms in the pipeline transportation of natural gas from the West Central Deepwater of the Gulf of Mexico;
- c. By enhancing the likelihood that Respondents would unilaterally exercise market power in the pipeline transportation of natural gas from the West Central Deepwater of the Gulf of Mexico;
- d. By enhancing the likelihood of collusion or coordinated action between or among the remaining firms in the market for propane storage and terminaling services in Hattiesburg, Mississippi; and
- e. By increasing the likelihood that customers would be forced to pay higher prices for propane storage and terminaling services and pipeline transportation of natural gas in the relevant geographic areas.

**VIII. VIOLATION CHARGED**

16. The merger agreement described in Paragraph 8 constitutes a violation of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45.
17. The merger described in Paragraph 8, if consummated, would constitute a violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45.

## Complaint

WHEREFORE, THE PREMISES CONSIDERED, the Federal Trade Commission on this twenty-ninth day of September, 2004, issues its complaint against said respondents.

Decision and Order

## **DECISION AND ORDER**

The Federal Trade Commission (“Commission”) having initiated an investigation of the proposed merger of Respondent Enterprise Products Partners, L.P., which is controlled by Respondent Dan L. Duncan, hereinafter collectively referred to as “Respondents,” with GulfTerra Energy Partners, L.P. (“GulfTerra”) and GulfTerra Energy Company, LLC (“GulfTerra GP”) and Respondents having been furnished thereafter with a draft of Complaint that the Bureau of Competition proposed to present to the Commission for its consideration and, that, if issued by the Commission, would charge Respondents with violations of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45; and

Respondents, their attorneys, and counsel for the Commission having thereafter executed an Agreement Containing Consent Orders (“Consent Agreement”), containing an admission by Respondents of all the jurisdictional facts set forth in the aforesaid draft of Complaint, a statement that the signing of said Consent Agreement is for settlement purposes only and does not constitute an admission by Respondents that the law has been violated as alleged in such Complaint, or that the facts as alleged in such Complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission’s Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that Respondents have violated the said Acts, and that a Complaint should issue stating its charges in that respect, and having thereupon issued its Complaint and an Order to Hold Separate and Maintain Assets (“Hold Separate Order”), and having accepted the executed Consent Agreement and placed such Consent Agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, and having duly considered the comment received from an interested person pursuant to section 2.34 of its Rules, now in further conformity with the procedure described in Commission Rule 2.34, 16 C.F.R. § 2.34, the

## Decision and Order

Commission hereby makes the following jurisdictional findings and issues the following Decision and Order (“Order”):

1. Respondent Enterprise Product Partners L.P. is a publicly traded limited partnership organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 2727 North Loop West, Houston, Texas 77008.
2. Respondent Dan L. Duncan is an individual with his office and principal place of business located at 2727 North Loop West, Houston Texas 77008.
3. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of Respondents, and the proceeding is in the public interest.

**ORDER****I.**

**IT IS ORDERED** that, as used in this Order, the following definitions shall apply:

- A. “Duncan” means Dan L. Duncan, a natural person, all partnerships, joint ventures, subsidiaries, divisions, groups and affiliates controlled by Mr. Dan L. Duncan, including, but not limited to, Enterprise Products Company, Dan Duncan L.L.C., Enterprise Products GP, LLC, and Enterprise Product Partners L.P., and the respective partners, directors, officers, employees, agents, attorneys, representatives, predecessors, successors, and assigns of each.
- B. “Enterprise” means Enterprise Products Partners L.P., a publicly traded limited partnership, its partners, directors, officers, employees, agents, attorneys, representatives, predecessors, successors, and assigns; its joint ventures, subsidiaries, divisions, groups and affiliates controlled by

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Enterprise Products Partners L.P., and the respective partners, directors, officers, employees, agents, attorneys, representatives, predecessors, successors, and assigns of each.

- C. “El Paso” means El Paso Corporation, an international energy company organized and doing business under the laws of the State of Delaware with its executive offices at 1001 Louisiana Street, Houston, Texas 77002.
- D. “GulfTerra” means GulfTerra Energy Partners, L.P., a publicly traded limited partnership, organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its principal place of business located at 4 Greenway Plaza, Houston, Texas 77046.
- E. “GulfTerra GP” means GulfTerra Energy Company, LLC, a limited liability company organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its principal place of business located at 4 Greenway Plaza, Houston, Texas 77046. El Paso controls GulfTerra GP.
- F. “Commission” means the Federal Trade Commission.
- G. “Divestiture Trustee” means any trustee appointed by the Commission pursuant to Paragraph IV. of this Order.
- H. “Duncan Group” means (i) Dan L. Duncan and all joint ventures, subsidiaries, divisions, groups, affiliates, agents and representatives controlled by him, and (ii) Enterprise Products Partners L.P. and all joint ventures, subsidiaries, divisions, groups, affiliates, agents and representatives controlled by it.
- I. “Effective Date of Pipeline Divestiture” means the date on which Respondents (or a Divestiture Trustee) divest to the Pipeline Acquirer the Starfish Pipeline Interest or



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HIOS/East Breaks Assets completely and as required by Paragraphs II. or IV. of this Order.

- J. “Effective Date of Propane Divestiture” means the date on which Respondents (or a Divestiture Trustee) divest to the Propane Acquirer the Enterprise Propane Storage Interest or the Enterprise Petal LPG Storage Facility completely and as required by Paragraphs III. or IV. of this Order.
- K. “Enterprise Propane Monitor” means the person appointed pursuant to Paragraph IV. of the Hold Separate Order.
- L. “Enterprise Propane Storage Interest” means all of Enterprise’s and Duncan’s interests in the propane storage and terminaling facility located 18 Chappell Hill Road, Petal, Mississippi 39465, in Forrest County, Mississippi, that are jointly owned with Dynegy Midstream Services, L.P. (“Dynegy”) including, but not limited to, all of Enterprise’s and Duncan’s interests in:
1. five propane salt dome storage wells with a combined usable capacity of approximately 5.6 million barrels;
  2. existing easements and rights of way;
  3. odorizing facilities;
  4. related facilities required for the operation of the propane storage facilities including, but not limited to: product pumps, a brine pond and brine pumping facilities, pipelines, pipeline pumps, pipeline injection facilities and related equipment, buildings, equipment, machinery, fixtures and other appurtenances;
  5. truck, rail, and pipeline facilities, including truck and rail racks, for the receipt and delivery of propane stored in the wells;
  6. approximately 115 acres of land located in Forrest County, Mississippi;

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7. all licenses, permits, contracts, agreements, and understandings relating to the ownership and operation of the facility.

M. “Enterprise Petal LPG Storage Facility” means all of Respondent’s 100 percent interest in the Petal LPG Storage Facility located at 1364 Highway 11 North, Petal, Mississippi 39464, in Forrest County, Mississippi, including, but not limited to:

1. nine LPG salt dome storage wells, seven of which are active with a combined usable capacity of approximately seven million barrels and two of which are not currently in service;
2. two brine production wells and one brine disposal well;
3. truck, rail and pipeline facilities, including truck and rail racks, for the receipt and delivery of product stored in the wells;
4. odorizing facilities;
5. existing easements and rights of way held by Respondent for operation of the Enterprise Petal LPG Storage Facility;
6. related facilities required for the operation of the LPG storage facilities including, but not limited to, product pumps, a brine pond and brine pumping facilities, dehydrators, pipelines, pipeline injection pumps and related facilities and equipment, tanks, buildings, equipment, machinery, fixtures and other appurtenances;
7. approximately 115 acres of land located in Forrest County, Mississippi; and

## Decision and Order

8. all licenses, permits, contracts, agreements, and understandings relating to the ownership and operation of the facility.
- N. “Governmental Entity” means any Federal, state, local or non-U.S. government or any court, legislature, governmental agency or governmental commission or any judicial or regulatory authority of any government.
- O. “Held Separate Businesses” means the Starfish Pipeline Interest and the Enterprise Propane Storage Interest.
- P. “HIOS/East Breaks Assets” means all of GulfTerra’s assets, properties, information or technology, businesses and goodwill (tangible and intangible), contracts, licenses, permits, options, agreements and understandings, records, rights, titles, and interests in or relating to the ownership or physical or commercial operation of:
1. HIOS Pipeline, a 204-mile natural gas pipeline system located in the western Gulf of Mexico, extending from within the West Cameron Area into the High Island South Addition Area. HIOS Pipeline provides transportation services subject to regulation of the Federal Energy Regulatory Commission; and
  2. East Breaks Gathering System, an 86-mile natural gas gathering system located in the western Gulf of Mexico, extending from within the High Island South Addition Area into the Alaminos Canyon Area.
- Q. “Hold Separate Monitors” means the Starfish Monitor and the Enterprise Propane Monitor.
- R. “Hold Separate Period” means the time period during which the Hold Separate Order is in effect, which shall begin no later than five (5) days after the date the Hold Separate Order becomes final and terminate as provided in the Hold Separate Order in this matter.

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- S. “Merger” means the proposed merger of Enterprise with GulfTerra and GulfTerra GP pursuant to and as described in (i) the Merger Agreement dated December 15, 2003, as amended, by and among Enterprise Products Partners L.P., Enterprise Products GP, LLC, Enterprise Products Management LLC, GulfTerra Energy Partners L.P., and GulfTerra Energy Company, LLC; and (ii) the Parent Company Agreement dated December 15, 2003, as amended, by and among (a) El Paso Corporation, Sabine River Investors I, L.L.C., Sabine River Investors II, L.L.C., El Paso EPN Investments, L.L.C., and GulfTerra GP Holding Company, and (b) Respondent, Enterprise Products GP, LLC, and Enterprise Products GTM, LLC.
- T. “Merger Date” means the date the Merger is consummated.
- U. “Material Confidential Information” means competitively sensitive or proprietary information not independently known to a Person from sources other than the Person to which the information pertains, and includes, but is not limited to, all customer lists, price lists, cost information, marketing methods, patents, technologies, processes, or other trade secrets. The individual Held Separate Businesses shall be considered Persons separate from Respondents (as defined in the Hold Separate Order in this matter and the Order) for this purpose.
- V. “Person” means any individual, partnership, association, company or corporation.
- W. “Pipeline Acquirer” means any entity that receives the prior approval of the Commission to acquire the Starfish Pipeline Interest or the HIOS/East Breaks Assets pursuant to Paragraphs II. or IV. of this Order.
- X. “Pipeline Divestiture Agreement” means any agreement that receives the prior approval of the Commission between Respondents and a Pipeline Acquirer (or between a

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Divestiture Trustee and a Pipeline Acquirer) related to the Starfish Pipeline Interest or the HIOS/East Breaks Assets required to be divested pursuant to Paragraphs II. or IV. of this Order.

- Y. “Propane Acquirer” means any entity that receives the prior approval of the Commission to acquire the Enterprise Propane Storage Interest or Enterprise Petal LPG Storage Facility pursuant to Paragraphs III. or IV. of this Order.
- Z. “Propane Divestiture Agreement” means any agreement that receives the prior approval of the Commission between Respondents and a Propane Acquirer (or between a Divestiture Trustee and a Propane Acquirer) related to the Enterprise Propane Storage Interest or the Enterprise Petal LPG Storage Facility required to be divested pursuant to Paragraphs III. or IV. of this Order.
- AA. “Starfish” means Starfish Pipeline Company, LLC, a limited liability company owned equally by Shell Gas Transmission, LLC (“Shell”) and Respondents. Starfish includes the Stingray Pipeline System, a 325-mile pipeline comprised of four segments serving the West Central Deepwater, the Triton (Gunnison) lateral pipeline, a 41-mile extension from the Stingray Pipeline in the Garden Banks section of the West Central Deepwater, and the West Cameron Dehydration Company located at Holly Beach, Cameron Parish, Louisiana. Shell is the 50 percent owner of Starfish and operates the Stingray and Triton pipelines and the West Cameron Dehydration Company.
- BB. “Starfish Monitor” means the person appointed pursuant to Paragraph III. of the Hold Separate Order.
- CC. “Starfish Pipeline Interest” means all of Respondent Enterprise’s and Respondent Duncan’s interests in the Starfish Pipeline Company, LLC.

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DD. "West Central Deepwater" means a quadrilateral shaped area of the Gulf of Mexico cornered by and including the following blocks (as those areas and blocks are defined by the Mineral Management Service of the United States Department of Interior): East Breaks Area Block 111, Garden Banks Area Block 60, Keithley Canyon Area Block 984, and Alaminos Canyon Area Block 947.

**II.**

**IT IS FURTHER ORDERED** that:

- A. Respondents shall divest either:
1. the Starfish Pipeline Interest absolutely and in good faith, at no minimum price, by March 31, 2005; or
  2. the HIOS/East Breaks Assets absolutely and in good faith, at no minimum price, by March 31, 2005.
- B. Respondents shall divest the Starfish Pipeline Interest or the HIOS/East Breaks Assets to an acquirer that receives the prior approval of the Commission and only in a manner that receives the prior approval of the Commission.
- C. Until the Effective Date of Pipeline Divestiture, Respondents shall take such actions as are necessary to maintain the viability and marketability of the Starfish Pipeline Interest and the HIOS/East Breaks Assets and to prevent the destruction, removal, wasting, deterioration, or impairment of the Starfish Pipeline Interest and the HIOS/East Breaks Assets, except for ordinary wear and tear.
- D. Prior to the Effective Date of Pipeline Divestiture, Respondents shall secure all consents and waivers, including rights of approval and rights of first refusal, from all private and Governmental Entities that are necessary for the divestiture of the Starfish Pipeline Interest or the

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HIOS/East Breaks Assets to the Pipeline Acquirer, including, but not limited to, any consents or waivers required from Shell or its successor with respect to Starfish.

- E. The purposes of this Order with respect to the divestiture of the Starfish Pipeline Interest or the HIOS/East Breaks Assets are: (1) to ensure the continuation of Starfish or the HIOS/East Breaks Assets as going concerns in the same manner in which each conducted business as of the date the Consent Agreement is signed until the Effective Date of Pipeline Divestiture, and (2) to remedy the lessening of competition resulting from the Merger as alleged in the Commission's Complaint.

**III.**

**IT IS FURTHER ORDERED** that:

- A. Respondents shall divest either:
1. the Enterprise Propane Storage Interest absolutely and in good faith, at no minimum price, on or before December 31, 2004; or
  2. the Enterprise Petal LPG Storage Facility absolutely and in good faith, at no minimum price, on or before December 31, 2004.
- B. Respondents shall divest the Enterprise Propane Storage Interest or the Enterprise Petal LPG Storage Facility to a Propane Acquirer that receives the prior approval of the Commission and only in a manner that receives the prior approval of the Commission.
- C. Until the Effective Date of Propane Divestiture, Respondents shall take such actions as are necessary to maintain the viability and marketability of the Enterprise Propane Storage Interest and the Enterprise Petal LPG Storage Facility and to prevent the destruction, removal,

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wasting, deterioration, or impairment of the Enterprise Propane Storage Interest and the Enterprise Petal LPG Storage Facility, except for ordinary wear and tear.

- D. Prior to the Effective Date of Propane Divestiture, Respondents shall secure all consents and waivers, including rights of approval and rights of first refusal, from all private and Governmental Entities that are necessary for the divestiture of the Enterprise Propane Storage Interest or the Enterprise Petal LPG Storage Facility to a Propane Acquirer, including, but not limited to, any consents or waivers required from Dynegy with respect to the Enterprise Propane Storage Interest.
- E. The purpose of this Order with respect to the divestiture of the Enterprise Propane Interest or the Enterprise Petal LPG Storage Facility is (1) to ensure the continuation of Enterprise Propane Interest or the Enterprise Petal LPG Storage Facility as going concerns in the same manner in which each conducted business as of the date the Consent Agreement is signed until the Effective Date of Propane Divestiture, and (2) to remedy the lessening of competition resulting from the Merger as alleged in the Commission's Complaint.

**IV.**

**IT IS FURTHER ORDERED** that:

- A. If Respondents have not fully complied with the obligations to divest:
1. the Starfish Pipeline Interest or the HIOS/East Breaks Assets as required by Paragraph II. of this Order, the Commission may appoint a Divestiture Trustee to divest the Starfish Pipeline Interest or the HIOS/East Breaks Assets in a manner that satisfies the requirements of Paragraph II.



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2. the Enterprise Propane Storage Interest or the Enterprise Petal LPG Storage Facility as required by Paragraph III. of this Order, the Commission may appoint a Divestiture Trustee to divest the Enterprise Propane Storage Interest or the Enterprise Petal LPG Storage Facility in a manner that satisfies the requirements of Paragraph III.

In the event that the Commission or the Attorney General brings an action pursuant to § 5(l) of the Federal Trade Commission Act, 15 U.S.C. § 45(l), or any other statute enforced by the Commission, Respondents shall consent to the appointment of a Divestiture Trustee in such action to divest the Starfish Pipeline Interest or the HIOS/East Breaks Assets, or the Enterprise Propane Storage Interest or the Enterprise Petal LPG Storage Facility. Neither the appointment of a Divestiture Trustee nor a decision not to appoint a Divestiture Trustee under this Paragraph IV. shall preclude the Commission or the Attorney General from seeking civil penalties or any other relief available to it, including a court-appointed Divestiture Trustee, pursuant to § 5(l) of the Federal Trade Commission Act, or any other statute enforced by the Commission, for any failure by Respondents to comply with this Order. The Commission may appoint different Divestiture Trustees to accomplish the divestitures required by Paragraphs II. and III. of this Order.

- B. The Commission shall select the Divestiture Trustee, subject to the consent of Respondents, which consent shall not be unreasonably withheld. The Divestiture Trustee shall be a person with experience and expertise in acquisitions and divestitures. If Respondents have not opposed, in writing, including the reasons for opposing, the selection of any proposed Divestiture Trustee within ten (10) days after notice by the staff of the Commission to Respondents of the identity of any proposed Divestiture Trustee, Respondents shall be deemed to have consented to the selection of the proposed Divestiture Trustee.

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- C. Not later than ten (10) days after the appointment of a Divestiture Trustee, Respondents shall execute a trust agreement that, subject to the prior approval of the Commission, transfers to the Divestiture Trustee all rights and powers necessary to permit the Divestiture Trustee to effect the divestitures required by this Order.
- D. If a Divestiture Trustee is appointed by the Commission or a court pursuant to this Paragraph IV., Respondents shall consent to the following terms and conditions regarding the Divestiture Trustee's powers, duties, authority, and responsibilities:
1. Subject to the prior approval of the Commission, the Divestiture Trustee shall, as required, have the exclusive power and authority to divest (i) the Starfish Pipeline Interest or the HIOS/East Breaks Assets, such option to be in his sole discretion (subject to Paragraph IV.D.4., below) and (ii) the Enterprise Propane Storage Interest or the Enterprise Propane Facility, such option to be in his sole discretion (subject to Paragraph IV.D.4., below).
  2. The Divestiture Trustee shall have one (1) year after the date the Commission approves the trust agreement described herein to accomplish the divestiture or divestitures, which shall be subject to the prior approval of the Commission. If, however, at the end of the one (1) year period, the Divestiture Trustee has submitted a plan of divestiture or believes that the divestiture or divestitures can be achieved within a reasonable time, the divestiture period or periods may be extended by the Commission; *PROVIDED, HOWEVER*, the Commission may extend the divestiture period only two (2) times.
  3. Subject to any demonstrated legally recognized privilege, the Divestiture Trustee shall have full and complete access to the personnel, books, records and facilities related to the relevant assets that are required to be divested by this Order and to any other relevant

## Decision and Order

information, as the Divestiture Trustee may request. Respondents shall develop such financial or other information as the Divestiture Trustee may request and shall cooperate with the Divestiture Trustee. Respondents shall take no action to interfere with or impede the Divestiture Trustee's accomplishment of the divestiture. Any delays in divestiture caused by Respondents shall extend the time for divestiture under this Paragraph IV. in an amount equal to the delay, as determined by the Commission.

4. The Divestiture Trustee shall use commercially reasonable best efforts to negotiate the most favorable price and terms available in each contract that is submitted to the Commission, subject to Respondents' absolute and unconditional obligation to divest expeditiously and at no minimum price. The divestiture or divestitures shall be made in the manner and to an acquirer as required by this Order;

*PROVIDED, HOWEVER*, if the Divestiture Trustee receives bona fide offers from more than one acquiring entity, and if the Commission determines to approve more than one such acquiring entity, the Divestiture Trustee shall divest to the acquiring entity selected by Respondents from among those approved by the Commission;

*PROVIDED FURTHER, HOWEVER*, that Respondents shall select such entity within five (5) days after receiving notification of the Commission's approval.

5. The Divestiture Trustee shall serve, without bond or other security, at the cost and expense of Respondents, on such reasonable and customary terms and conditions as the Commission or a court may set. The Divestiture Trustee shall have the authority to employ, at the cost and expense of Respondents, such consultants, accountants, attorneys, investment bankers, business brokers, appraisers, and other representatives and

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assistants as are necessary to carry out the Divestiture Trustee's duties and responsibilities. The Divestiture Trustee shall account for all monies derived from the divestiture and all expenses incurred. After approval by the Commission of the account of the Divestiture Trustee, including fees for the Divestiture Trustee's services, all remaining monies shall be paid at the direction of the Respondents, and the Divestiture Trustee's power shall be terminated. The compensation of the Divestiture Trustee shall be based at least in significant part on a commission arrangement contingent on the divestiture of all of the relevant assets that are required to be divested by this Order.

6. Respondents shall indemnify the Divestiture Trustee and hold the Divestiture Trustee harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Divestiture Trustee's duties, including all reasonable fees of counsel and other expenses incurred in connection with the preparation for, or defense of, any claim, whether or not resulting in any liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from misfeasance, gross negligence, willful or wanton acts, or bad faith by the Divestiture Trustee.
7. The Divestiture Trustee shall have no obligation or authority to operate or maintain the relevant assets required to be divested by this Order.
8. The Divestiture Trustee shall act in a fiduciary capacity for the benefit of the Commission.
9. The Divestiture Trustee shall report in writing to Respondents and to the Commission every sixty (60) days concerning the Divestiture Trustee's efforts to accomplish the divestiture.

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10. Respondents may require the Divestiture Trustee and each of the Divestiture Trustee's consultants, accountants, attorneys and other representatives and assistants to sign a customary confidentiality agreement; *PROVIDED, HOWEVER*, such agreement shall not restrict the Divestiture Trustee from providing any information to the Commission.
- E. If the Commission determines that a Divestiture Trustee has ceased to act or failed to act diligently, the Commission may appoint a substitute Divestiture Trustee in the same manner as provided in this Paragraph IV.
- F. The Commission or, in the case of a court-appointed Divestiture Trustee, the court, may on its own initiative or at the request of the Divestiture Trustee issue such additional orders or directions as may be necessary or appropriate to accomplish the divestiture required by this Order.
- G. The Divestiture Trustee(s) appointed pursuant to Paragraph IV. of this Order may be the same Person appointed as Starfish Monitor or the Enterprise Propane Monitor pursuant to the relevant provisions of the Hold Separate Order in this matter.

**V.****IT IS FURTHER ORDERED** that:

- A. For a period of two (2) years following the Effective Date of Pipeline Divestiture and the Effective Date of Propane Divestiture, respectively, Respondents shall not employ or make offers of employment to:
  1. the Starfish Monitor, unless the Starfish Pipeline Interest is not divested; and,
  2. the Enterprise Propane Monitor, unless the Enterprise Propane Storage Interest is not divested.

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- B. For a period of two (2) years following the Effective Date of Pipeline Divestiture and the Effective Date of Propane Divestiture, respectively, Respondents shall not employ or make offers of employment to the employees of the Starfish Pipeline Interest, its HIOS/East Breaks Assets, the Enterprise Petal LPG Storage Facility, and the Enterprise Propane Storage Interest, if
1. those entities are divested pursuant to this Order;
  2. the employees had access to Material Confidential Information; and
  3. the employment or offer of employment involved managing, operating, or planing for a business that competes with those entities divested pursuant to this Order.
- C. Respondents shall not, prior to the Effective Date of Pipeline Divestiture or the Effective Date of Propane Divestiture, directly or indirectly, offer, promise, guarantee, or enter into any agreement or understanding with the Starfish Monitor or the Enterprise Propane Monitor that any one of them will be employed by Respondents after divestiture of the interest or assets monitored by that person.

**VI.**

**IT IS FURTHER ORDERED** that for a period of ten (10) years from the date this Order becomes final, the Duncan Group shall not, without providing advance written notification to the Commission in the manner described in this Paragraph VI., directly or indirectly:

- A. Acquire any stock, share capital, equity or other interest in any concern, corporate or non-corporate, other than acquisitions in Duncan or Enterprise, (i) that owns a salt dome storage cavern within Forrest County, Mississippi

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used, either at the time of such acquisition or within the two years preceding such acquisition (and still suitable for use), to store propane; or (ii) that owns a pipeline within West Central Deepwater used for the transportation of natural gas.

- B. Acquire (i) any salt dome storage cavern within Forrest County, Mississippi, used, either at the time of such acquisition or within the two years preceding such acquisition (and still suitable for use), to store propane or (ii) any pipeline within the West Central Deepwater used for the transportation of natural gas; or
- C. Manage or operate (i) any salt dome storage cavern within Forrest County, Mississippi, used, either at the time of such acquisition or within the two years preceding such acquisition (and still suitable for use), to store propane or (ii) any pipeline within the West Central Deepwater used for the transportation of natural gas, unless such storage cavern or pipeline is owned by Duncan or Enterprise.

Said notification shall be given on the Notification and Report Form set forth in the Appendix to Part 803 of Title 16 of the Code of Federal Regulations as amended (herein referred to as “the Notification”), and shall be prepared and transmitted in accordance with the requirements of that part, except that no filing fee will be required for any such notification, notification shall be filed with the Secretary of the Commission, notification need not be made to the United States Department of Justice, and notification is required only of Respondents and not of any other party to the transaction. Respondents shall provide the Notification to the Commission at least thirty days prior to consummating the transaction (hereinafter referred to as the “first waiting period”). If, within the first waiting period, representatives of the Commission make a written request for additional information or documentary material (within the meaning of 16 C.F.R. § 803.20), Respondents shall not consummate the transaction until thirty days after submitting such additional information or documentary material. Early

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termination of the waiting periods in this paragraph may be requested and, where appropriate, granted by letter from the Bureau of Competition.

*PROVIDED, HOWEVER*, that prior notification shall not be required by this paragraph for a transaction for which Notification is required to be made, and has been made, pursuant to Section 7A of the Clayton Act, 15 U.S.C. § 18a.

*PROVIDED, FURTHER, HOWEVER*, that prior notification shall not be required by this paragraph for an acquisition, if the Respondents acquire no more than one percent of the outstanding securities or other equity interest in an entity described in subparagraphs VI.A. or VI.B.

**VII.**

**IT IS FURTHER ORDERED** that within thirty (30) days after the date this Order becomes final, and every sixty (60) days thereafter until Respondents have fully complied with Paragraphs II., III., and IV. of this Order, Respondents shall submit to the Commission a verified written report setting forth in detail the manner and form in which they intend to comply, are complying, and have complied with this Order. Respondents shall submit at the same time a copy of their reports concerning compliance with this Order to the Divestiture Trustee or the Monitor, if any Divestiture Trustee has been appointed pursuant to this Order or if any Monitor has been appointed pursuant to the Hold Separate Order in this matter. Respondents shall include in their reports, among other things that are required from time to time, a full description of the efforts being made to comply with the relevant Paragraphs of the Order, including a description of all substantive contacts or negotiations related to the divestiture of the relevant assets and the identity of all parties contacted. Respondents shall include in their reports copies of all written communications to and from such parties, all internal memoranda, and all reports and recommendations concerning completing the obligations.



Decision and Order

**VIII.**

**IT IS FURTHER ORDERED** that Respondents shall notify the Commission at least thirty (30) days prior to any proposed (1) dissolution of the Respondents, (2) acquisition, merger or consolidation of Respondents, or (3) any other change in the Respondents that may affect compliance obligations arising out of the Order, including but not limited to, assignment and the creation or dissolution of subsidiaries.

**IX.**

**IT IS FURTHER ORDERED** that, for the purpose of determining or securing compliance with this Order, and subject to any legally recognized privilege, and upon written request with reasonable notice, Respondents shall permit any duly authorized representative of the Commission:

- A. access, during office hours of Respondents and in the presence of counsel, to all facilities and access to inspect and copy all books, ledgers, accounts, correspondence, memoranda and all other records and documents in the possession or under the control of Respondents related to compliance with this Order; and
- B. upon five (5) days' notice to Respondents and without restraint or interference from Respondents, to interview officers, directors, or employees of Respondents, who may have counsel present, regarding such matters.

Order

**ORDER TO HOLD SEPARATE AND MAINTAIN ASSETS**

The Federal Trade Commission (“Commission”) having initiated an investigation of the proposed merger of Respondent Enterprise Products Partners, L.P., which is controlled by Respondent Dan L. Duncan, hereinafter collectively referred to as “Respondents”, with GulfTerra Energy Partners, L.P. (“GulfTerra”) and GulfTerra Energy Company, LLC (“GulfTerra GP”) and Respondents having been furnished thereafter with a draft of Complaint that the Bureau of Competition proposed to present to the Commission for its consideration and, which, if issued by the Commission, would charge Respondents with violations of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45; and

Respondents, their attorneys, and counsel for the Commission having thereafter executed an Agreement Containing Consent Orders (“Consent Agreement”), containing an admission by Respondents of all the jurisdictional facts set forth in the aforesaid draft of Complaint, a statement that the signing of said Consent Agreement is for settlement purposes only and does not constitute an admission by Respondents that the law has been violated as alleged in such Complaint, or that the facts as alleged in such Complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission’s Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that Respondents have violated the said Acts, and that a Complaint should issue stating its charges in that respect, and having determined to accept the executed Agreement Containing Consent Orders and having placed such Consent Agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, now in further conformity with the procedure described in Commission Rule 2.34, 16 C.F.R. § 2.34, the Commission hereby issues its Complaint, makes the following jurisdictional findings and issues this Order to Hold Separate and Maintain Assets (“Hold Separate Order”):

## Order

1. Respondent Enterprise Products Partners L.P. is a publicly traded, limited partnership organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 2727 North Loop West, Houston, Texas 77008.
2. Respondent Dan L. Duncan is an individual with his office and principal place of business located at 2727 North Loop West, Houston, Texas 77008.
3. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of Respondents, and the proceeding is in the public interest.

**ORDER****I.**

**IT IS ORDERED** that, as used in this Hold Separate Order, the following definitions shall apply:

- A. "Duncan" means Dan L. Duncan, a natural person, all partnerships, joint ventures, subsidiaries, divisions, groups and affiliates controlled by Dan L. Duncan, including, but not limited to, Enterprise Products Company, Dan Duncan L.L.C., Enterprise Products GP, LLC, and Enterprise Product Partners L.P., and the respective partners, directors, officers, employees, agents, attorneys, representatives, predecessors, successors, and assigns of each.
- B. "Enterprise" means Enterprise Products Partners L.P., a publicly traded limited partnership, its partners, directors, officers, employees, agents, attorneys, representatives, predecessors, successors, and assigns; all joint ventures, subsidiaries, divisions, groups and affiliates controlled by Enterprise Products Partners L.P., and the respective partners, directors, officers, employees, agents, attorneys, representatives, predecessors, successors, and assigns of each.

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- C. “El Paso” means El Paso Corporation, an international energy company organized and doing business under the laws of the State of Delaware with its executive offices at 1001 Louisiana Street, Houston, Texas 77002.
- D. “GulfTerra” means GulfTerra Energy Partners, L.P., a publicly traded limited partnership, organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its principal place of business located at 4 Greenway Plaza, Houston, Texas 77046.
- E. “GulfTerra GP” means GulfTerra Energy Company, LLC, a limited liability company organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its principal place of business located at 4 Greenway Plaza, Houston, Texas 77046. El Paso controls GulfTerra GP.
- F. “Commission” means the Federal Trade Commission.
- G. “Divestiture Trustee” means any trustee appointed by the Commission pursuant to Paragraph IV of the Decision and Order in this matter.
- H. “Effective Date of Pipeline Divestiture” means the date on which Respondents (or a Divestiture Trustee) divest to the Pipeline Acquirer the Starfish Pipeline Interest or HIOS/East Breaks Assets completely and as required by Paragraphs II or IV of the Decision and Order in this matter.
- I. “Effective Date of Propane Divestiture” means the date on which Respondents (or a Divestiture Trustee) divest to the Propane Acquirer the Enterprise Propane Storage Interest or the Enterprise Petal LPG Storage Facility completely and as required by Paragraphs III or IV of the Decision and Order in this matter.

## Order

- J. “Enterprise Propane Storage Interest” means all of Enterprise’s and Duncan’s interests in the propane storage and terminaling facility located at 18 Chappell Hill Road, Petal, Mississippi 39465, in Forrest County, Mississippi, that are jointly owned with Dynegy Midstream Services, L.P. (“Dynegy”) including, but not limited to, all of Enterprise’s and Duncan’s interests in:
1. five propane salt dome storage wells with a combined usable capacity of approximately 5.6 million barrels;
  2. existing easements and rights of way;
  3. odorizing facilities;
  4. related facilities required for the operation of the propane storage facilities including, but not limited to: product pumps, a brine pond and brine pumping facilities, pipelines, pipeline pumps, pipeline injection facilities and related equipment, buildings, equipment, machinery, fixtures and other appurtenances;
  5. truck, rail, and pipeline facilities, including truck and rail racks, for the receipt and delivery of propane stored in the wells;
  6. approximately 115 acres of land located in Forrest County, Mississippi;
  7. all licenses, permits, contracts, agreements, and understandings relating to the ownership and operation of the facility.
- K. “Enterprise Petal LPG Storage Facility” means all of Respondent’s 100 percent interest in the Petal LPG Storage Facility located at 1364 Highway 11 North, Petal, Mississippi 39464, in Forrest County, Mississippi, including, but not limited to:

Order

1. nine LPG salt dome storage wells, seven of which are active with a combined usable capacity of approximately seven million barrels and two of which are not currently in service;
  2. two brine production wells and one brine disposal well;
  3. truck, rail and pipeline facilities, including truck and rail racks, for the receipt and delivery of product stored in the wells;
  4. odorizing facilities;
  5. existing easements and rights of way held by Respondents for operation of the Enterprise Petal LPG Storage Facility;
  6. related facilities required for the operation of the LPG storage facilities including, but not limited to, product pumps, a brine pond and brine pumping facilities, dehydrators, pipelines, pipeline injection pumps and related facilities and equipment, tanks, buildings, equipment, machinery, fixtures and other appurtenances;
  7. approximately 115 acres of land located in Forrest County, Mississippi; and
  8. all licenses, permits, contracts, agreements, and understandings relating to the ownership and operation of the facility.
- L. "Governmental Entity" means any Federal, state, local or non-U.S. government or any court, legislature, governmental agency or governmental commission or any judicial or regulatory authority of any government.
- M. "Held Separate Businesses" means the Starfish Pipeline Interest and the Enterprise Propane Storage Interest.

## Order

- N. “HIOS/East Breaks Assets” means all of GulfTerra’s assets, properties, information or technology, businesses and goodwill (tangible and intangible), contracts, licenses, permits, options, agreements and understandings, records, rights, titles, and interests in or relating to the ownership or physical or commercial operation of:
1. HIOS Pipeline, a 204-mile natural gas pipeline system located in the western Gulf of Mexico, extending from within the West Cameron Area into the High Island South Addition Area. HIOS Pipeline provides transportation services subject to regulation of the Federal Energy Regulatory Commission; and
  2. East Breaks Gathering System, an 86-mile natural gas gathering system located in the western Gulf of Mexico, extending from within the High Island South Addition Area into the Alaminos Canyon Area.
- O. “Enterprise Propane Monitor” means the person appointed pursuant to Paragraph IV of this Hold Separate Order.
- P. “Hold Separate Period” means the time period during which the Hold Separate Order is in effect, which shall begin no later than five (5) days after the date the Hold Separate Order becomes final and terminate pursuant to Paragraph VII hereof.
- Q. “Material Confidential Information” means competitively sensitive or proprietary information not independently known to a Person from sources other than the Person to which the information pertains, and includes, but is not limited to, all customer lists, price lists, cost information, marketing methods, patents, technologies, processes, or other trade secrets. The individual Held Separate Businesses shall be considered Persons separate from Respondents (as defined in this Hold Separate Order and the Decision and Order in this matter) for this purpose.

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- R. “Merger” means the proposed merger of Enterprise with GulfTerra and GulfTerra GP pursuant to and as described in (i) the Merger Agreement dated December 15, 2003, as amended, by and among Enterprise Products Partners L.P., Enterprise Products GP, LLC, Enterprise Products Management LLC, GulfTerra Energy Partners L.P., and GulfTerra Energy Company, LLC; and (ii) the Parent Company Agreement dated December 15, 2003, as amended, by and among (a) El Paso Corporation, Sabine River Investors I, L.L.C., Sabine River Investors II, L.L.C., El Paso EPN Investments, L.L.C., and GulfTerra GP Holding Company, and (b) Respondents, Enterprise Products GP, LLC, and Enterprise Products GTM, LLC.
- S. “Merger Date” means the date the Merger is consummated.
- T. “Person” means any individual, partnership, association, company or corporation.
- U. “Pipeline Acquirer” means any entity that receives the prior approval of the Commission to acquire the Starfish Pipeline Interest or the HIOS/East Breaks Assets pursuant to Paragraphs II or IV of the Decision and Order in this matter.
- V. “Pipeline Divestiture Agreement” means any agreement that receives the prior approval of the Commission between Respondents and a Pipeline Acquirer (or a Divestiture Trustee and a Pipeline Acquirer) related to the Starfish Pipeline Interest or the HIOS/East Breaks Assets required to be divested pursuant to Paragraphs II or IV of the Decision and Order in this matter.
- W. “Propane Acquirer” means any entity that receives the prior approval of the Commission to acquire the Enterprise Propane Storage Interest or Enterprise Petal LPG Storage Facility pursuant to Paragraphs II or IV of the Decision and Order in this matter.



## Order

- X. "Propane Divestiture Agreement" means any agreement that receives the prior approval of the Commission between Respondents and a Propane Acquirer (or a Divestiture Trustee and a Propane Acquirer) related to the Enterprise Propane Storage Interest or the Enterprise Petal LPG Storage Facility required to be divested pursuant to Paragraphs III or IV of the Decision and Order in this matter.
- Y. "Starfish" means Starfish Pipeline Company, LLC, a limited liability company owned by Shell Gas Transmission, LLC ("Shell") and Respondents. Starfish includes the Stingray Pipeline System, a 325-mile pipeline comprised of four segments serving the West Central Deepwater, the Triton (Gunnison) lateral pipeline, a 41 mile extension from the Stingray Pipeline in the Garden Banks section of the West Central Deepwater, and the West Cameron Dehydration Company located at Holly Beach, Cameron Parish, Louisiana. Shell is a 50 percent owner of Starfish and operates the Stingray and Triton pipelines and the West Cameron Dehydration Company.
- Z. "Starfish Pipeline Interest" means all of Respondent Enterprise's and Respondent Duncan's interests in the Starfish Pipeline Company, LLC.
- AA. "Starfish Monitor" means the person appointed pursuant to Paragraph III of this Hold Separate Order.
- BB. "West Central Deepwater" means a quadrilateral shaped area of the Gulf of Mexico cornered by and including the following blocks (as those areas and blocks are defined by the Mineral Management Service of the United States Department of Interior): East Breaks Area Block 111, Garden Banks Area Block 60, Keithley Canyon Area Block 984, and Alaminos Canyon Area Block 947.

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**II.**

**IT IS FURTHER ORDERED** that:

A. During the Hold Separate Period, Respondents:

1. shall hold the Starfish Pipeline Interest separate, apart, and independent of Respondents and GulfTerra as required by this Hold Separate Order and shall vest the Starfish Pipeline Interest with all rights, powers, and authority necessary to conduct its business;
2. shall not exercise direction or control over, or influence directly or indirectly, the Starfish Pipeline Interest or any of its operations, or the Starfish Monitor except to the extent that Respondents and GulfTerra must exercise such direction and control over the Starfish Pipeline Interest as is necessary to assure compliance with this Hold Separate Order, the Consent Agreement, and with all applicable laws, including, in consultation with the Starfish Monitor, continued oversight of the Starfish Pipeline Interest's compliance with policies and standards concerning the safety, health, and environmental aspects of its operations and the integrity of its financial controls; and Respondents shall have the right to defend any legal claims, investigations or enforcement actions threatened or brought against the Starfish Pipeline Interest.
3. shall hold the Enterprise Propane Storage Interest separate, apart, and independent of Respondents and GulfTerra as required by this Hold Separate Order and shall vest the Enterprise Propane Storage Interest with all rights, powers, and authority necessary to conduct its business;
4. shall not exercise direction or control over, or influence directly or indirectly, the Enterprise Propane Storage Interest or any of its operations, or the Enterprise

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Propane Monitor except to the extent that Respondents must exercise direction and control over the Enterprise Propane Storage Interest as is necessary to assure compliance with this Hold Separate Order, the Consent Agreement, and with all applicable laws, including, in consultation with the Enterprise Propane Monitor, continued oversight of the Enterprise Propane Storage Interest's compliance with policies and standards concerning the safety, health, and environmental aspects of its operations and the integrity of its financial controls; and Respondents shall have the right to defend any legal claims, investigations or enforcement actions threatened or brought against the Enterprise Propane Storage Interest.

- B. Until the Effective Date of Pipeline Divestiture and the Effective Date of Propane Divestiture, respectively, Respondents shall take such actions as are necessary to maintain the viability and marketability of the Held Separate Businesses, HIOS/East Breaks Assets, and the Enterprise Petal LPG Storage Facility, to prevent the destruction, removal, wasting, deterioration, or impairment of any of the assets, except for ordinary wear and tear.
- C. The purposes of this Hold Separate Order are: (1) to preserve the Held Separate Businesses as viable, competitive, and ongoing businesses, independent of the Respondents and GulfTerra until the divestitures required by the Decision and Order are achieved; (2) to preserve HIOS/East Breaks Assets and the Enterprise Petal LPG Storage Facility as viable, competitive, and ongoing businesses independent of the Held Separate Businesses until the divestitures required by the Decision and Order are achieved; (3) to assure that no Material Confidential Information is exchanged between Respondents, GulfTerra, and the Held Separate Businesses, except in accordance with the provisions of this Hold Separate Order; (4) to prevent interim harm to competition pending the required divestitures and other relief; and (5) to help remedy the

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lessening of competition resulting from the Merger as alleged in the Commission's Complaint.

**III.**

**IT IS FURTHER ORDERED** that Respondents shall hold the Starfish Pipeline Interest separate, apart, and independent from the Respondents and GulfTerra on the following terms and conditions.

A. Mr. Richard J. Black, 7600 West Tidwell, Suite 705, Houston, Texas, shall serve as Starfish Monitor, pursuant to the agreement executed by the Starfish Monitor and Respondents and attached as Confidential Appendix A ("Starfish Monitor Agreement").

1. The Starfish Monitor Agreement shall require that, no later than either ten (10) days after the Hold Separate Order is final or one (1) day after the Merger Date, whichever is earlier, Respondents shall transfer to the Starfish Monitor all rights, powers, and authorities necessary to permit the Starfish Monitor to perform his/her duties and responsibilities, pursuant to this Hold Separate Order and consistent with the purposes of the Decision and Order.
2. No later than either ten (10) days after the date the Hold Separate Order becomes final or one (1) day after the Merger Date, whichever is earlier, Respondents shall, pursuant to the Starfish Monitor Agreement, transfer to the Starfish Monitor all rights, powers, and authorities necessary to permit the Starfish Monitor to perform his/her duties and responsibilities, pursuant to this Hold Separate Order and consistent with the purposes of the Decision and Order.
3. The Starfish Monitor shall have the responsibility, consistent with the terms of this Hold Separate Order and the Decision and Order, for monitoring the organization

## Order

of the Starfish Pipeline Interest; for managing the Starfish Pipeline Interest; for maintaining the independence of the Starfish Pipeline Interest; and for monitoring Respondents' compliance with its obligations pursuant to this Hold Separate Order and the Decision and Order.

4. The Starfish Monitor shall have full and complete access to all personnel, books, records, documents and facilities of the Starfish Pipeline Interest or to any other relevant information as the Starfish Monitor may reasonably request including, but not limited to, all documents and records kept by Respondents and GulfTerra in the ordinary course of business that relate to the Starfish Pipeline Interest. Respondents and GulfTerra shall develop such financial or other information as the Starfish Monitor may request and shall cooperate with the Starfish Monitor. Respondents shall take no action to interfere with or impede the Starfish Monitors' ability to monitor Respondents' compliance with this Hold Separate Order and the Consent Agreement or otherwise to perform their duties and responsibilities consistent with the terms of this Hold Separate Order.
5. The Starfish Monitor shall have the authority to employ, at the cost and expense of Respondents, such consultants, accountants, attorneys, and other representatives and assistants as are reasonably necessary to carry out the Starfish Monitor's duties and responsibilities.
6. The Starfish Monitor shall act in a fiduciary capacity for the benefit of the Commission.
7. The Commission may require the Starfish Monitor to sign an appropriate confidentiality agreement relating to Commission materials and information received in connection with performance of the Starfish Monitor's duties.

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8. Respondents and GulfTerra may require the Starfish Monitor to sign a confidentiality agreement prohibiting the disclosure of any Material Confidential Information gained as a result of his/her role as Starfish Monitor to anyone other than the Commission.
9. Thirty (30) days after the Starfish Monitor receives the rights, powers, and authorities pursuant to this Paragraph III, and every thirty (30) days thereafter until the Hold Separate Order terminates, the Starfish Monitor shall report in writing to the Commission concerning the efforts to accomplish the purposes of this Hold Separate Order. Included within each report shall be the Starfish Monitor's assessment of the extent to which the business comprising the Starfish Pipeline Interest is meeting (or exceeding) its projected goals as are reflected in operating plans, budgets, projections or any other regularly prepared financial statements.
10. If the Starfish Monitor ceases to act or fails to act diligently and consistent with the purposes of this Hold Separate Order, the Commission may appoint a substitute Starfish Monitor consistent with the terms of this paragraph, subject to the consent of Respondents, which consent shall not be unreasonably withheld. If Respondents have not opposed, in writing, including the reasons for opposing, the selection of the substitute Starfish Monitor within five (5) days after notice by the staff of the Commission to Respondents of the identity of any substitute Starfish Monitor Respondents shall be deemed to have consented to the selection of the proposed substitute monitor. Respondents and the substitute Starfish Monitor shall execute a new monitor agreement, subject to the approval of the Commission, consistent with this paragraph.

## Order

- B. The Starfish Pipeline Interest shall be staffed with sufficient employees to maintain the viability and competitiveness of the Starfish Pipeline Interest. To the extent that any employees leave or have left the Starfish Pipeline Interest prior to the Effective Date of Pipeline Divestiture, the Starfish Monitor may replace departing or departed employees with persons who have similar experience and expertise or determine not to replace such departing or departed employees.
- C. In connection with support services or products not included within the Starfish Pipeline Interest, Respondents shall continue to provide, or offer to provide, the same support services to the Starfish Pipeline Interest as are being provided to each such business interest by Respondents as of the date the Consent Agreement is signed by Respondents. For any services or products that Respondents may provide to the Starfish Pipeline Interest, Respondents may charge no more than the lowest price they charge any of their other internal subsidiaries or divisions for the same services or products. Respondents' personnel providing such services or products must retain and maintain all Material Confidential Information of the Starfish Pipeline Interest on a confidential basis, and, except as is permitted by this Hold Separate Order, such persons shall be prohibited from providing, discussing, exchanging, circulating, or otherwise furnishing any such information to or with any person whose employment involves any of Respondents' or GulfTerra's businesses, other than the Starfish Pipeline Interest. Such personnel shall also execute confidentiality agreements prohibiting the disclosure of any Material Confidential Information of the Starfish Pipeline Interest.
1. Respondents shall offer to the Starfish Pipeline Interest any services and products that Respondents provided to their other businesses directly or through third party contracts, or that they have provided directly or through third party contracts to the businesses constituting the

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Starfish Pipeline Interest at any time since January 1, 2003. The Starfish Pipeline Interest may, at the option of the individual Starfish Monitor, obtain such services and products from Respondents. The services and products that Respondents shall offer the Starfish Pipeline Interest shall include, but shall not be limited to, the following:

- a. Human resources administrative services, including but not limited to payroll processing, labor relations support, pension administration, and health benefits;
  - b. Environmental health and safety services, which develops corporate policies and insures compliance with federal and state regulations and corporate policies;
  - c. Preparation of tax returns;
  - d. Audit services;
  - e. Information systems, which constructs, maintains, and supports all computer systems;
  - f. Processing of accounts payable;
  - g. Technical support;
  - h. Finance and financial accounting services;
  - i. Procurement of supplies;
  - j. Procurement of goods and services utilized in the ordinary course of business by the Held Separate Businesses; and
  - k. Legal services.
2. the Starfish Pipeline Interest shall have, at the option of the Starfish Monitor, the ability to acquire services and



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products from third parties unaffiliated with Respondents.

- D. Respondents shall cause the Starfish Monitor and each employee having access to Material Confidential Information to submit to the Commission a signed statement that the individual will maintain the confidentiality required by the terms and conditions of this Hold Separate Order. These individuals must retain and maintain all Material Confidential Information relating to the Starfish Pipeline Interest on a confidential basis and, except as is permitted by this Hold Separate Order, such persons shall be prohibited from providing, discussing, exchanging, circulating, or otherwise furnishing any such information to or with any other person who is employed by, or is involved in the management of, any of Respondents' businesses other than the Starfish Pipeline Interest. These persons shall not be involved in any way in the management, production, distribution, sale, marketing, or financial operations of the competing businesses of Respondents.
- E. No later than either twelve (12) days after the date this Hold Separate Order becomes final or three (3) days after the Merger Date, whichever is earlier, Respondents shall establish written procedures, subject to the approval of the Starfish Monitor, covering the management, maintenance, and independence of Starfish Pipeline Interest consistent with the provisions of this Hold Separate Order.
- F. No later than either twelve (12) days after the date this Hold Separate Order becomes final or three (3) days after the Merger Date, whichever is earlier, Respondents shall circulate to employees of the Starfish Pipeline Interest and to Respondents' and GulfTerra's employees, a notice of this Hold Separate Order and the Consent Agreement.
- G. The Starfish Monitor shall serve, without bond or other security, at the cost and expense of Respondents, on

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reasonable and customary terms commensurate with the person's experience and responsibilities. The Starfish Monitor shall act in a fiduciary capacity for the benefit of the Commission.

- H. Respondents shall indemnify the Starfish Monitor and hold him/her harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of Starfish Monitor's duties, including all reasonable fees of counsel and other expenses incurred in connection with the preparation for, or defense of any claim, whether or not resulting in any liability, except to the extent that such liabilities, losses, damages, claims, or expenses result from misfeasance, gross negligence, willful or wanton acts, or bad faith by the Starfish Monitor.
- I. Respondents shall provide the Starfish Pipeline Interest with sufficient financial resources:
  - 1. as are appropriate in the judgment of the Starfish Monitor to operate the Starfish Pipeline Interest as it is currently operated;
  - 2. to perform all maintenance to, and replacements of, the assets of the Starfish Pipeline Interest;
  - 3. to carry on existing and planned capital projects and business plans; and
  - 4. to maintain the viability, competitive vigor, and marketability of the Starfish Pipeline Interest;

Such financial resources to be provided to the Starfish Pipeline Interest shall include, but shall not be limited to, (a) general funds, (b) capital, (c) working capital, and (d) reimbursement for any operating losses, capital losses, or other losses; provided, however, that, consistent with the purposes of the Decision and Order, the Starfish Monitor may reduce in scale or pace any capital or research and

## Order

development project, or substitute any capital or research and development project for another of the same cost.

- J. Respondents and GulfTerra shall not, during the Hold Separate Period up until the Pipeline Divestiture Agreement is signed, enter into any agreements, offer, promise, or otherwise guarantee the Starfish Monitor and employees of Respondents or GulfTerra who are responsible for the management or operation of the Starfish Pipeline Interest or the HIOS/East Breaks Assets positions with Respondents or GulfTerra. The Pipeline Acquirer shall have the option of offering employment to any Starfish Pipeline Interest's employees. Respondents and GulfTerra shall not interfere with the employment, by the Pipeline Acquirer, of such employees; shall not offer any incentive to such employees to decline employment with the Pipeline Acquirer or to accept other employment with the Respondents or GulfTerra; and shall remove any impediments that may deter such employees from accepting employment with the Pipeline Acquirer including, but not limited to, any non-compete or confidentiality provisions of employment or other contracts that would affect the ability of such employees to be employed by the Pipeline Acquirer, and the payment, or the transfer for the account of the employee, of all current and accrued bonuses, pensions and other current and accrued benefits to which such employees would otherwise have been entitled had they remained in the employment of the Respondents or GulfTerra.
- K. Except for the Starfish Monitor, the Starfish Pipeline Interest's employees, and support services employees involved in providing services to the Held Separate Starfish Pipeline Interest pursuant to this Paragraph III, and except to the extent provided in Paragraph II.A, Respondents shall not permit any other of its employees, officers, or directors to be involved in the operations of the Starfish Pipeline Interest.

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- L. Respondents and GulfTerra shall assure that Starfish Pipeline Interest employees receive, during the Hold Separate Period, their salaries, all current and accrued bonuses, pensions and other current and accrued benefits to which those employees would otherwise have been entitled.
- M. Respondents, GulfTerra, and GulfTerra's and Respondents' employees (excluding support services employees involved in providing support to the Starfish Pipeline Interest pursuant to this Paragraph III) shall not receive, or have access to, or use or continue to use any Material Confidential Information of the Starfish Pipeline Interest not in the public domain except:
1. as required by law;
  2. to the extent that necessary information is exchanged in the course of consummating the Merger;
  3. in negotiating agreements to divest assets pursuant to the Consent Agreement and engaging in related due diligence;
  4. in complying with this Hold Separate Order or the Consent Agreement;
  5. in overseeing compliance with policies and standards concerning the safety, health and environmental aspects of the operations of the Starfish Pipeline Interest and the integrity of the Starfish Pipeline Interest's financial controls;
  6. in defending legal claims, investigations or enforcement actions threatened or brought against or related to the Starfish Pipeline Interest; or
  7. in obtaining legal advice.

## Order

Nor shall the Starfish Monitor or the Starfish Pipeline Interest's employees receive or have access to, or use or continue to use, any Material Confidential Information not in the public domain about Respondents, except such information as is necessary to maintain and operate the Starfish Pipeline Interest. Respondents may receive aggregate financial and operational information relating to the Starfish Pipeline Interest only to the extent necessary to allow Respondents to comply with the requirements and obligations of the laws of the United States and other countries, and to prepare consolidated financial reports, tax returns, reports required by securities laws, and personnel reports. Any such information that is obtained pursuant to this subparagraph shall be used only for the purposes set forth in this subparagraph.

- N. Respondents and the Starfish Pipeline Interest shall jointly implement, and at all times during the Hold Separate Period maintain in operation, a system, as approved by the Starfish Monitor, of access and data controls to prevent unauthorized access to or dissemination of Material Confidential Information of the Starfish Pipeline Interest, including, but not limited to, the opportunity by the Starfish Monitor, on terms and conditions agreed to with Respondents, to audit Respondents' networks and systems to verify compliance with this Hold Separate Order.

**IV.**

**IT IS FURTHER ORDERED** that Respondents shall hold the Enterprise Propane Storage Interest separate, apart, and independent from the Respondents and GulfTerra on the following terms and conditions:

- A. Mr. Richard J. Black, 7600 West Tidwell, Suite 705, Houston, Texas, shall serve as Enterprise Propane Monitor, pursuant to the agreement executed by the Enterprise Propane Monitor and Respondents and attached as

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Confidential Appendix C (“Enterprise Propane Monitor Agreement”).

1. The Enterprise Propane Monitor Agreement shall require that, no later than either ten (10) days after the Hold Separate Order is final or one (1) day after the Merger Date, whichever is earlier, Respondents shall transfer to the Enterprise Propane Monitor all rights, powers, and authorities necessary to permit the Enterprise Propane Monitor to perform his/her duties and responsibilities, pursuant to this Hold Separate Order and consistent with the purposes of the Decision and Order.
2. No later than either ten (10) days after the date the Hold Separate Order becomes final or one (1) day after the Merger Date, whichever is earlier, Respondents shall, pursuant to the Enterprise Propane Monitor Agreement, transfer to the Enterprise Propane Monitor all rights, powers, and authorities necessary to permit the Enterprise Propane Monitor to perform his/her duties and responsibilities, pursuant to this Hold Separate Order and consistent with the purposes of the Decision and Order.
3. The Enterprise Propane Monitor shall have the responsibility, consistent with the terms of this Hold Separate Order and the Decision and Order, for monitoring the organization of the Enterprise Propane Storage Interest; for managing the Enterprise Propane Storage Interest; for maintaining the independence of the Enterprise Propane Storage Interest; and for monitoring Respondents’ compliance with its obligations pursuant to this Hold Separate Order and the Decision and Order.
4. The Enterprise Propane Monitor shall have full and complete access to all personnel, books, records, documents and facilities of the Enterprise Propane Storage Interest or to any other relevant information as the Enterprise Propane Monitor may reasonably request including, but not limited to, all documents and records

## Order

kept by Respondents and GulfTerra in the ordinary course of business that relate to the Enterprise Propane Storage Interest. Respondents and GulfTerra shall develop such financial or other information as the Enterprise Propane Monitor may request and shall cooperate with the Enterprise Propane Monitor. Respondents shall take no action to interfere with or impede the Enterprise Propane Monitors' ability to monitor Respondents' compliance with this Hold Separate Order and the Consent Agreement or otherwise to perform their duties and responsibilities consistent with the terms of this Hold Separate Order.

5. The Enterprise Propane Monitor shall have the authority to employ, at the cost and expense of Respondents, such consultants, accountants, attorneys, and other representatives and assistants as are reasonably necessary to carry out the Enterprise Propane Monitor's duties and responsibilities.
6. The Enterprise Propane Monitor shall act in a fiduciary capacity for the benefit of the Commission.
7. The Commission may require the Enterprise Propane Monitor to sign an appropriate confidentiality agreement relating to Commission materials and information received in connection with performance of the Enterprise Propane Monitor's duties.
8. Respondents and GulfTerra may require the Enterprise Propane Monitor to sign a confidentiality agreement prohibiting the disclosure of any Material Confidential Information gained as a result of his/her role as Enterprise Propane Monitor to anyone other than the Commission.
9. Thirty (30) days after the Enterprise Propane Monitor receives the rights, powers, and authorities pursuant to this Paragraph IV, and every thirty (30) days thereafter

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until the Hold Separate Order terminates, the Enterprise Propane Monitor shall report in writing to the Commission concerning the efforts to accomplish the purposes of this Hold Separate Order. Included within each report shall be the Enterprise Propane Monitor's assessment of the extent to which the business comprising the Enterprise Propane Storage Interest is meeting (or exceeding) its projected goals as are reflected in operating plans, budgets, projections or any other regularly prepared financial statements.

10. If the Enterprise Propane Monitor ceases to act or fails to act diligently and consistent with the purposes of this Hold Separate Order, the Commission may appoint a substitute Enterprise Propane Monitor consistent with the terms of this paragraph, subject to the consent of Respondents, which consent shall not be unreasonably withheld. If Respondents have not opposed, in writing, including the reasons for opposing, the selection of the substitute Enterprise Propane Monitor within five (5) days after notice by the staff of the Commission to Respondents of the identity of any substitute Enterprise Propane Monitor Respondents shall be deemed to have consented to the selection of the proposed substitute monitor. Respondents and the substitute Enterprise Propane Monitor shall execute a new monitor agreement, subject to the approval of the Commission, consistent with this paragraph.
- B. The Enterprise Propane Storage Interest shall be staffed with sufficient employees to maintain the viability and competitiveness of the Enterprise Propane Storage Interest. To the extent that any employees leave or have left the Enterprise Propane Storage Interest prior to the Effective Date of Pipeline Divestiture, the Enterprise Propane Monitor may replace departing or departed employees with persons who have similar experience and expertise or



## Order

determine not to replace such departing or departed employees.

- C. In connection with support services or products not included within the Enterprise Propane Storage Interest, Respondents shall continue to provide, or offer to provide, the same support services to the Enterprise Propane Storage Interest as are being provided to each such business interest by Respondents as of the date the Consent Agreement is signed by Respondents. For any services or products that Respondents may provide to the Enterprise Propane Storage Interest, Respondents may charge no more than the lowest price they charge any of their other internal subsidiaries or divisions for the same services or products. Respondents' personnel providing such services or products must retain and maintain all Material Confidential Information of the Enterprise Propane Storage Interest on a confidential basis, and, except as is permitted by this Hold Separate Order, such persons shall be prohibited from providing, discussing, exchanging, circulating, or otherwise furnishing any such information to or with any person whose employment involves any of Respondents' or GulfTerra's businesses, other than the Enterprise Propane Storage Interest. Such personnel shall also execute confidentiality agreements prohibiting the disclosure of any Material Confidential Information of the Enterprise Propane Storage Interest.
1. Respondents shall offer to the Enterprise Propane Storage Interest any services and products that Respondents provided to their other businesses directly or through third party contracts, or that they have provided directly or through third party contracts to the businesses constituting the Enterprise Propane Storage Interest at any time since January 1, 2003. The Enterprise Propane Storage Interest may, at the option of the individual Enterprise Propane Monitor, obtain such services and products from Respondents. The services and products that Respondents shall offer the Enterprise

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Propane Storage Interest shall include, but shall not be limited to, the following:

- a. Human resources administrative services, including but not limited to payroll processing, labor relations support, pension administration, and health benefits;
  - b. Environmental health and safety services, which develops corporate policies and insures compliance with federal and state regulations and corporate policies;
  - c. Preparation of tax returns;
  - d. Audit services;
  - e. Information systems, which constructs, maintains, and supports all computer systems;
  - f. Processing of accounts payable;
  - g. Technical support;
  - h. Finance and financial accounting services;
  - i. Procurement of supplies;
  - j. Procurement of goods and services utilized in the ordinary course of business by the Held Separate Businesses; and
  - k. Legal services.
2. the Enterprise Propane Storage Interest shall have, at the option of the Enterprise Propane Monitor, the ability to acquire services and products from third parties unaffiliated with Respondents.
- D. Respondents shall cause the Enterprise Propane Monitor and each employee having access to Material Confidential

## Order

Information to submit to the Commission a signed statement that the individual will maintain the confidentiality required by the terms and conditions of this Hold Separate Order. These individuals must retain and maintain all Material Confidential Information relating to the Enterprise Propane Storage Interest on a confidential basis and, except as is permitted by this Hold Separate Order, such persons shall be prohibited from providing, discussing, exchanging, circulating, or otherwise furnishing any such information to or with any other person who is employed by, or is involved in the management of, any of Respondents' businesses other than the Enterprise Propane Storage Interest. These persons shall not be involved in any way in the management, production, distribution, sale, marketing, or financial operations of the competing businesses of Respondents.

- E. No later than either twelve (12) days after the date this Hold Separate Order becomes final or three (3) days after the Merger Date, whichever is earlier, Respondents shall establish written procedures, subject to the approval of the Enterprise Propane Monitor, covering the management, maintenance, and independence of Enterprise Propane Storage Interest consistent with the provisions of this Hold Separate Order.
- F. No later than either twelve (12) days after the date this Hold Separate Order becomes final or three (3) days after the Merger Date, whichever is earlier, Respondents shall circulate to employees of the Enterprise Propane Storage Interest and to Respondents' and GulfTerra's employees, a notice of this Hold Separate Order and the Consent Agreement.
- G. The Enterprise Propane Monitor shall serve, without bond or other security, at the cost and expense of Respondents, on reasonable and customary terms commensurate with the person's experience and responsibilities. The Enterprise

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Propane Monitor shall act in a fiduciary capacity for the benefit of the Commission.

- H. Respondents shall indemnify the Enterprise Propane Monitor and hold him/her harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of Enterprise Propane Monitor's duties, including all reasonable fees of counsel and other expenses incurred in connection with the preparation for, or defense of any claim, whether or not resulting in any liability, except to the extent that such liabilities, losses, damages, claims, or expenses result from misfeasance, gross negligence, willful or wanton acts, or bad faith by the Enterprise Propane Monitor.
- I. Respondents shall provide the Enterprise Propane Storage Interest with sufficient financial resources:
1. as are appropriate in the judgment of the Enterprise Propane Monitor to operate the Enterprise Propane Storage Interest as it is currently operated;
  2. to perform all maintenance to, and replacements of, the assets of the Enterprise Propane Storage Interest;
  3. to carry on existing and planned capital projects and business plans; and
  4. to maintain the viability, competitive vigor, and marketability of the Enterprise Propane Storage Interest;

Such financial resources to be provided to the Enterprise Propane Storage Interest shall include, but shall not be limited to, (a) general funds, (b) capital, (c) working capital, and (d) reimbursement for any operating losses, capital losses, or other losses; provided, however, that, consistent with the purposes of the Decision and Order, the Enterprise Propane Monitor may reduce in scale or pace any capital or research and development project, or

## Order

substitute any capital or research and development project for another of the same cost.

- J. Respondents and GulfTerra shall not, during the Hold Separate Period up until the Propane Divestiture Agreement is signed, enter into any agreements, offer, promise, or otherwise guarantee the Enterprise Propane Monitor and employees of Respondents or GulfTerra who are responsible for the management or operation of the Enterprise Propane Storage Interest or the Enterprise Petal LPG Storage Facility positions with Respondents or GulfTerra. The Propane Acquirer shall have the option of offering employment to any Enterprise Propane Storage Interest's employees. Respondents and GulfTerra shall not interfere with the employment, by the Propane Acquirer, of such employees; shall not offer any incentive to such employees to decline employment with the Propane Acquirer or to accept other employment with the Respondents or GulfTerra; and shall remove any impediments that may deter such employees from accepting employment with the Propane Acquirer including, but not limited to, any non-compete or confidentiality provisions of employment or other contracts that would affect the ability of such employees to be employed by the Propane Acquirer, and the payment, or the transfer for the account of the employee, of all current and accrued bonuses, pensions and other current and accrued benefits to which such employees would otherwise have been entitled had they remained in the employment of the Respondents or GulfTerra.
- K. Except for the Enterprise Propane Monitor, the Enterprise Propane Storage Interest's employees, and support services employees involved in providing services to the Held Separate Enterprise Propane Storage Interest pursuant to this Paragraph IV., and except to the extent provided in Paragraph II.A., Respondents shall not permit any other of its employees, officers, or directors to be involved in the operations of the Enterprise Propane Storage Interest.

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- L. Respondents and GulfTerra shall assure that Enterprise Propane Storage Interest employees receive, during the Hold Separate Period, their salaries, all current and accrued bonuses, pensions and other current and accrued benefits to which those employees would otherwise have been entitled.
- M. Respondents, GulfTerra, and GulfTerra's and Respondents' employees (excluding support services employees involved in providing support to the Enterprise Propane Storage Interest pursuant to this Paragraph IV.) shall not receive, or have access to, or use or continue to use any Material Confidential Information of the Enterprise Propane Storage Interest not in the public domain except:
1. as required by law;
  2. to the extent that necessary information is exchanged in the course of consummating the Merger;
  3. in negotiating agreements to divest assets pursuant to the Consent Agreement and engaging in related due diligence;
  4. in complying with this Hold Separate Order or the Consent Agreement;
  5. in overseeing compliance with policies and standards concerning the safety, health and environmental aspects of the operations of the Enterprise Propane Storage Interest and the integrity of the Enterprise Propane Storage Interest's financial controls;
  6. in defending legal claims, investigations or enforcement actions threatened or brought against or related to the Enterprise Propane Storage Interest; or
  7. in obtaining legal advice.
- Nor shall the Enterprise Propane Monitor or the Enterprise Propane Storage Interest's employees receive or have

## Order

access to, or use or continue to use, any Material Confidential Information not in the public domain about Respondents, except such information as is necessary to maintain and operate the Enterprise Propane Storage Interest. Respondents may receive aggregate financial and operational information relating to the Enterprise Propane Storage Interest only to the extent necessary to allow Respondents to comply with the requirements and obligations of the laws of the United States and other countries, and to prepare consolidated financial reports, tax returns, reports required by securities laws, and personnel reports. Any such information that is obtained pursuant to this subparagraph shall be used only for the purposes set forth in this subparagraph.

- N. Respondents and the Enterprise Propane Storage Interest shall jointly implement, and at all times during the Hold Separate Period maintain in operation, a system, as approved by the Enterprise Propane Monitor, of access and data controls to prevent unauthorized access to or dissemination of Material Confidential Information of the Enterprise Propane Storage Interest, including, but not limited to, the opportunity by the Enterprise Propane Monitor, on terms and conditions agreed to with Respondents, to audit Respondents' networks and systems to verify compliance with this Hold Separate Order.

## V.

**IT IS FURTHER ORDERED** that Respondents shall notify the Commission at least thirty (30) days prior to any proposed (1) dissolution of the Respondents, (2) acquisition, merger or consolidation of Respondents, or (3) any other change in the Respondents that may affect compliance obligations arising out of the order, including but not limited to assignment and the creation or dissolution of subsidiaries.

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**VI.**

**IT IS FURTHER ORDERED** that for the purpose of determining or securing compliance with this Hold Separate Order, and subject to any legally recognized privilege, and upon written request with reasonable notice to Respondents made to their principal United States offices, Respondents shall permit any duly authorized representative of the Commission:

- A. Access, during office hours of Respondents and in the presence of counsel, to all facilities, and access to inspect and copy all books, ledgers, accounts, correspondence, memoranda and all other records and documents in the possession or under the control of Respondents relating to any matters contained in this Hold Separate Order; and
- B. Upon five (5) days' notice to Respondents and without restraint or interference from Respondents, to interview partners, officers, directors, or employees of Respondents, who may have counsel present, regarding any such matters.

**VII.**

**IT IS FURTHER ORDERED** that this Hold Separate Order shall terminate:

- A. With regard to the Starfish Pipeline Interest at the earlier of:
  - 1. three (3) business days after the Commission withdraws its acceptance of the Consent Agreement pursuant to the provisions of Commission Rule 2.34, 16 C.F.R. § 2.34; or
  - 2. the day after the Effective Date of Pipeline Divestiture required by the Decision and Order in this matter; or
  - 3. at such other time as the Commission otherwise directs that this Hold Separate Order is terminated.



## Order

- B. With regard to the Enterprise Propane Storage Interest, at the earlier of:
1. three (3) business days after the Commission withdraws its acceptance of the Consent Agreement pursuant to the provisions of Commission Rule 2.34, 16 C.F.R. § 2.34; or
  2. the day after the Effective Date of Propane Divestiture required by the Decision and Order in this matter; or
  3. at such other time as the Commission otherwise directs that this Hold Separate Order is terminated.

Order

**Confidential Appendix A: Starfish Monitor Agreement  
[Redacted From Public Record Version But Incorporated By  
Reference]**

**Confidential Appendix C: Enterprise Propane Monitor  
Agreement  
[Redacted From Public Record Version But Incorporated By  
Reference]**

## Analysis

**Analysis of Proposed Consent Order to Aid Public Comment**

The Federal Trade Commission (“Commission”) has accepted, subject to final approval, an Agreement Containing Consent Orders (“Consent Agreement”) from Enterprise Products Partners L.P. (“Enterprise”) and Dan L. Duncan (“Duncan”), the ultimate parent entity of Enterprise. (Enterprise and Duncan are hereinafter referred to collectively as “Respondents.”) The Consent Agreement contains a Decision and Order (“Consent Order”) that is designed to remedy the anticompetitive effects of the proposed merger between Enterprise and GulfTerra Energy Partners L.P. (“GulfTerra”). Under the terms of the Consent Agreement, Respondents must divest (1) their interest in one of two competing pipelines that transport natural gas from the deepwater regions of the Gulf of Mexico and (2) their interest in one of two competing underground propane storage and terminaling facilities serving the Dixie Pipeline in Hattiesburg, Mississippi. The Consent Agreement also contains an Order to Hold Separate and to Maintain Assets (“Hold Separate Order”) which, among other things, is designed to preserve the viability, marketability and competitiveness of the assets to be divested under the proposed Consent Order.

The proposed Consent Agreement has been placed on the public record for thirty days for receipt of comments by interested persons. Comments received during this period will become part of the public record. After thirty days, the Commission will again review the Consent Agreement and any comments received and will decide whether it should withdraw from the agreement or make final the agreement’s proposed Consent Order.

**I. THE COMPLAINT**

Pursuant to certain agreements dated December 15, 2003 (as amended,) Enterprise, a publicly traded limited partnership that provides midstream energy services to customers throughout the Southeastern and Midwestern United States, proposes to merge with GulfTerra in a transaction that will create a midstream

Analysis

energy partnership with an estimated enterprise value of approximately \$13 billion. The Commission's complaint ("Complaint") alleges that the proposed merger would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, in the markets for (1) pipeline transportation of natural gas from the West Central Deepwater region of the Gulf of Mexico ("West Central Deepwater" market) and (2) propane storage and terminaling services in Hattiesburg, Mississippi. The West Central Deepwater region of the Gulf of Mexico encompasses the East Breaks, Garden Banks, Keithley Canyon and Alaminos Canyon areas in the Gulf of Mexico, areas defined by the United States Department of Interior Minerals Management Service. These areas are in the "deepwater" part of the Gulf of Mexico farther from shore, in which water depths exceed 1000 feet. The proposed Consent Agreement would remedy the alleged violations by restoring the lost competition that would result from the merger in each of these markets.

## **II. THE CONSENT AGREEMENT**

### **A. Pipeline Transportation of Natural Gas**

The Gulf of Mexico accounts for nearly one quarter of the natural gas supplies in the United States. Natural gas producers ship their production out of the Gulf of Mexico to the Gulf Coast via pipelines. Enterprise and GulfTerra are direct and substantial competitors in the market for pipeline transportation of natural gas from the West Central Deepwater.

Enterprise owns a 50 percent ownership interest in the Starfish Pipeline Company, LLC ("Starfish"), which owns the Stingray/Triton pipeline system in the West Central Deepwater market. Shell Gas Transmission ("Shell") owns the remaining 50 percent interest in Starfish and exercises operational and management control over the Starfish assets. However, because the operating agreement provides that Enterprise must approve any commercial gas transportation agreements proposed by Shell

## Analysis

with respect to Starfish, Enterprise effectively controls the competitive decisions of Starfish and the Stingray/Triton pipeline system. GulfTerra owns the High Island Offshore System (“HIOS”) and its accompanying East Breaks lateral, which compete directly for pipeline transportation business in the West Central Deepwater market with Starfish’s Stingray/Triton pipeline system.

The West Central Deepwater market is highly concentrated. The assets controlled wholly or in part by GulfTerra and Enterprise account for two of the three pipelines providing natural gas pipeline transportation services to the market. Combined, these two pipeline systems would control 60 percent of the natural gas pipeline capacity in the West Central Deepwater market. The proposed merger would substantially increase industry concentration in this already highly concentrated market. Moreover, new entry into the pipeline transportation of natural gas from the West Central Deepwater market entails substantial sunk costs and is highly unlikely to constrain any post-merger exercise of market power by Respondents in the relevant market. By eliminating the actual, direct, and substantial competition that exists between Enterprise and GulfTerra in this market, the proposed merger would be substantially likely to cause significant competitive harm to producers of natural gas who must purchase pipeline transportation services in the West Central Deepwater market.

The proposed Consent Order remedies the merger’s alleged anticompetitive effects in the West Central Deepwater market by requiring that Respondents divest either (1) their 50 percent interest in Starfish, (the “Starfish Interest”) or (2) the HIOS/East Breaks pipeline system, (the “HIOS/East Breaks Assets.”) If Respondents fail to divest either of these competing pipeline assets on or before March 31, 2005, the Commission may appoint a Divestiture Trustee to divest either of the above referenced pipeline assets.

Analysis

## **B. Propane Storage and Terminaling Services**

Propane is used as a heating fuel during the winter months in much of the Southeastern United States. Propane marketers generally purchase propane from the major supply sources in Texas and Louisiana and ship that propane eastward over the Dixie Pipeline System (“Dixie”), the only common carrier propane pipeline in the Southeast. Because of certain physical and capacity constraints on Dixie west of Baton Rouge, Louisiana, the segments of Dixie west of Baton Rouge are often full (capacity constrained) during the winter months. Therefore, propane shippers along Dixie often must purchase propane during the spring and summer (non-peak) seasons, ship it eastward on Dixie and store the propane at locations east of Baton Rouge, such as Hattiesburg, Mississippi (“Hattiesburg”). This enables these propane marketers to access Dixie’s unconstrained capacity during the winter months to meet the peak demand of their customers for heating fuel.

Hattiesburg is the site of massive, naturally occurring underground salt domes, which when leached out, provide economic storage capacity for propane. The salt domes and associated terminaling facilities located at Hattiesburg receive propane from Dixie during the non-peak months and then re-inject propane into Dixie during the winter heating season. Dixie shippers and other propane marketers pay significant fees to the owners of propane storage facilities for the right to store propane at Hattiesburg and inject it into Dixie. Enterprise and GulfTerra are direct and substantial competitors in providing propane storage and terminaling services in Hattiesburg. Enterprise currently owns a 50 percent undivided interest in a propane storage and terminaling facility located in Hattiesburg (with Dynegy Midstream Services, L.P. owning the other 50 percent interest.) Enterprise also owns a 100 percent interest in a second propane storage facility located in nearby Petal, Mississippi. GulfTerra currently owns and operates a wholly owned propane storage and terminaling facility in Hattiesburg.

## Analysis

The market for propane storage and terminaling services in Hattiesburg is highly concentrated, with Enterprise and GulfTerra currently controlling approximately 53 percent of propane storage capacity in that market. The proposed merger would leave Respondents with an ownership interest in three of the four propane storage and terminaling facilities located in Hattiesburg and substantially increase concentration in an already highly concentrated market. Entry into the market for propane storage and terminaling services requires substantial sunk costs and such entry is highly unlikely in response to a post-merger increase in propane storage and terminaling fees at Hattiesburg. By eliminating the actual, direct, and substantial competition that exists between Enterprise and GulfTerra in the relevant market, the proposed merger would be substantially likely to cause significant competitive harm to propane marketers who would likely incur increased prices and fees for propane storage and terminaling services in Hattiesburg. These increased costs would likely be passed on to propane customers supplied from Hattiesburg.

The proposed Consent Order remedies the alleged anticompetitive effect of this merger in the propane storage and terminaling services market in Hattiesburg by requiring that Respondents divest either (1) their undivided 50 percent interest in the facility Enterprise co-owns with Dynegy, (the "Enterprise Propane Storage Interest,") or (2) their wholly owned Hattiesburg propane storage facility, (the "Enterprise Petal LPG Storage Facility.") If Respondents fail to divest either of these competing propane storage and terminaling assets on or before December 31, 2004, the Commission may appoint a Divestiture Trustee to divest either of the above referenced assets. The December 31, 2004 deadline for the divestiture of the specified propane storage and terminaling assets of Respondents at Hattiesburg is designed to assure that a new owner of the divested assets will be in place prior to the 2005-06 propane storage contract season, which begins in April 2005.

Analysis

The Commission believes that divestiture by Respondents of their partially owned assets in each market to a Commission-approved purchaser would restore competition in each of the two markets potentially affected by the merger. However, as certain third parties have contractual rights that may impact on Respondents' ability to transfer such partially owned assets, or that may affect or delay the timing of any such transfer, the proposed Consent Order gives Respondents the option of divesting either their partially owned assets or their wholly owned assets in each relevant market by the dates specified in the proposed Consent Order.

### **III. THE HOLD SEPARATE ORDER**

Because the Consent Agreement would allow the merger to proceed prior to the completion of each of the required divestitures, the Consent Agreement contains a Hold Separate Order covering the Starfish Interest and the Enterprise Propane Storage Interest. The purpose of the Hold Separate Order is to ensure that the Starfish Interest and the Enterprise Storage Propane Interest operate independently from Enterprise and GulfTerra pending the divestitures required under the proposed Consent Order. The Hold Separate Order is also intended to ensure the continuing viability, marketability, and competitiveness of these partially owned assets until they are divested.

The Commission has appointed Richard J. Black as a monitor to oversee the management and operations of the Starfish Interest and the Enterprise Propane Storage Interest until the divestitures required by the Consent Order are complete. Mr. Black has more than 15 years of relevant experience in the midstream energy services business, including experience in pipeline transportation of natural gas in the deepwater regions of the Gulf of Mexico and in the marketing and sale of natural gas liquids.

To assure that the Commission remains informed about the status of the required divestitures, the proposed Consent Order



## Analysis

requires Respondents to file reports with the Commission periodically until the divestitures required under the Consent Order are accomplished. The Hold Separate Order will remain in effect until the Respondents or the Divestiture Trustee successfully divests the assets required to be divested under the Consent Order.

The purpose of this analysis is to facilitate public comment on the Consent Agreement. This analysis is not intended to constitute an official interpretation of the Consent Agreement, nor is it intended to modify its terms in any way.

Complaint

IN THE MATTER OF

**MAGELLAN MIDSTREAM PARTNERS, L.P., ET AL.**

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 7 OF THE CLAYTON ACT AND SEC. 5 OF THE FEDERAL TRADE  
COMMISSION ACT

*Docket C-4122; File No. 0410164*

*Complaint, September 28, 2004--Decision, November 23, 2004*

This consent order, among other things, requires Respondent Magellan Midstream Partners, L.P. -- a partnership primarily engaged in the storage, transportation, and distribution of refined petroleum products and ammonia -- to divest an Oklahoma City refined petroleum products terminal it acquired from Respondent Shell Oil Company to a Commission-approved buyer, at no minimum price and within six months. The order also requires Respondent Shell Oil Company -- a diversified energy company engaged in manufacturing, refining, distributing, transporting, terminaling, and marketing numerous petroleum products -- to ensure the interim viability of the subject terminal by, among other things, using the terminal for all its branded and unbranded refined petroleum product requirements in the Oklahoma City Metropolitan Area until three months after the terminal is divested. An accompanying Order to Hold Separate and Maintain Assets requires the respondents to take steps designed to ensure that the terminal will be maintained separately and apart from Magellan pending divestiture.

*Participants*

For the Commission: *Dennis F. Johnson, Mary N. Lehner, Phillip L. Broyles, Elizabeth A. Piotrowski, John D. Simpson, Louis Silvia, Jr., and Mark Frankena.*

For the Respondents: *Tom D. Smith, Jones Day and Charles W. Corddry III.*

**COMPLAINT**

Pursuant to the provisions of the Federal Trade Commission Act and the Clayton Act, and by virtue of the authority vested in it by said Acts, the Federal Trade Commission ("FTC" or "Commission"), having reason to believe that Respondents Magellan Midstream Partners, L.P. ("Magellan") and Shell Oil

## Complaint

Company (“Shell”) (collectively “Respondents”) have entered into an agreement pursuant to which Magellan proposes to acquire certain refined petroleum product assets from Shell, that such agreement violates Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, and that such agreement and acquisition, if consummated, would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, and that a proceeding in respect thereof would be in the public interest, hereby issues its complaint, stating its charges as follows:

**I. THE PARTIES*****Magellan Midstream Partners, L.P.***

1. Respondent Magellan is a partnership organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business at Magellan GP, LLC, P.O. Box 22186, Tulsa, Oklahoma 74121.
2. Respondent Magellan is, and at all times relevant herein has been, engaged in the storage, terminaling, distribution and pipeline transportation of refined petroleum products, including gasoline, diesel fuel, and other light petroleum products.
3. Respondent Magellan is, and at all times relevant herein has been, engaged in commerce as “commerce” is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12, and is a partnership as that term is used in Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45.

***Shell Oil Company***

4. Respondent Shell is a corporation organized, existing and doing business under and by virtue of the laws of the state of Delaware, with its office and principal place of business located at 910 Louisiana Street, Houston, Texas 77002.

Complaint

5. Respondent Shell is, and at all times relevant herein has been, a diversified energy company engaged, either directly or through affiliates, in the business of manufacturing, refining, distributing, transporting, terminaling, and marketing petroleum products, including gasoline, diesel fuel, jet fuel, base oil, motor oil, lubricants, petrochemicals, and other petroleum products.
6. Respondent Shell is, and at all times relevant herein has been, engaged in commerce as “commerce” is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12, and is a corporation whose business is in or affecting commerce as “commerce” is defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

## II. THE PROPOSED ACQUISITION

7. Pursuant to a purchase and sale agreement dated June 23, 2004, Magellan plans to acquire from Shell certain refined petroleum products pipelines, tankage and terminal assets in the Midwest United States, including a refined petroleum product terminal that serves the Oklahoma City, Oklahoma Metropolitan Area.

## III. TRADE AND COMMERCE

### *A. Relevant Product Market*

8. Refined petroleum product terminals are specialized facilities that provide temporary storage for gasoline, diesel fuel, and other light petroleum products. Terminals receive deliveries typically from pipelines or marine vessels, store the products in large tanks, and redeliver them into tank trucks for ultimate delivery to retail gasoline stations or other buyers. There are no substitutes for petroleum product terminals for providing such terminaling services.

## Complaint

9. A relevant line of commerce in which to evaluate the effects of this acquisition is the terminaling of gasoline, diesel fuel, and other light petroleum products.

***B. Relevant Geographic Market***

10. Magellan and Shell each own a petroleum product terminal that supplies gasoline, diesel fuel, and other light petroleum products to buyers in the Oklahoma City Metropolitan Area. Buyers of gasoline, diesel fuel and other light petroleum products in the Oklahoma City Metropolitan Area, such as gasoline marketers and others, have no effective alternative to terminals located within the Oklahoma City Metropolitan Area. Because of costs and delivery logistics, terminals located outside the Oklahoma City Metropolitan Area are too far away to supply buyers in that area.
11. A relevant section of the country in which to evaluate the effects of this acquisition is the Oklahoma City Metropolitan Area.

***C. Market Structure***

12. The market for terminaling services in the Oklahoma City Metropolitan Area is highly concentrated and would become significantly more highly concentrated as a result of this acquisition. The pre-merger Herfindahl-Hirschman Index is more than 3,100, and would increase by more than 1,200 points to a level exceeding 4,300.

***D. Entry Conditions***

13. Entry into the market for terminaling services in the Oklahoma City Metropolitan Area is difficult and would not be timely, likely or sufficient to prevent the anticompetitive effects that are likely to result from the proposed acquisition. Constructing a new terminal is subject to significant regulatory and supply constraints, and would

Complaint

require substantial time to accomplish. As a result, new entry would not be sufficient to constrain the anticompetitive effects that are likely to result from this acquisition.

**IV. ANTICOMPETITIVE EFFECTS**

14. Magellan and Shell are actual competitors in the supply of terminaling services for gasoline, diesel fuel, and other light petroleum products in the Oklahoma City Metropolitan Area.
15. The effect of the proposed acquisition, if consummated, may be substantially to lessen competition in the supply of terminaling services for gasoline, diesel fuel, and other light petroleum products in the Oklahoma City Metropolitan Area in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, in the following ways, among others:
  - a. by eliminating direct competition between Magellan and Shell in the supply of terminaling services in the Oklahoma City Metropolitan Area; and
  - b. by increasing the likelihood of, or facilitating, collusion or coordinated interaction in the relevant market;

each of which increases the likelihood that the prices of gasoline, diesel fuel, and other light petroleum products will increase in the relevant market.

**V. STATUTES VIOLATED**

16. Magellan's proposed acquisition of terminaling assets from Shell violates Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, and would, if consummated, violate Section 7 of the Clayton Act, as

## Complaint

amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45.

WHEREFORE, THE PREMISES CONSIDERED, the Federal Trade Commission on this twenty-eighth day of September, 2004, issues its complaint against said Respondents.

Decision and Order

## **DECISION AND ORDER**

The Federal Trade Commission (“Commission”), having initiated an investigation of the proposed acquisition by Respondent Magellan Midstream Partners, L.P. (“Magellan”) of certain refined product pipeline and terminaling assets from Respondent Shell Oil Company (“Shell”) (collectively “Respondents”), and Respondents having been furnished thereafter with a copy of a draft of Complaint that the Bureau of Competition proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge Respondents with violations of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45; and

Respondents, their attorneys, and counsel for the Commission having thereafter executed an Agreement Containing Consent Orders (“Consent Agreement”), containing an admission by Respondents of all the jurisdictional facts set forth in the aforesaid draft of Complaint, a statement that the signing of said Consent Agreement is for settlement purposes only and does not constitute an admission by Respondents that the law has been violated as alleged in such Complaint, or that the facts as alleged in such Complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission’s Rules; and

The Commission, having thereafter considered the matter and having determined that it had reason to believe that Respondents have violated the said Acts, and that a Complaint should issue stating its charges in that respect, and having thereupon issued its Complaint and an Order to Hold Separate and Maintain Assets (“Hold Separate”) and having accepted the executed Consent Agreement and placed such Consent Agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, and having duly considered the comment received from an interested person pursuant to section 2.34 of its Rules, now in further conformity with the procedure described in Commission Rule 2.34, 16 C.F.R. § 2.34, the



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Commission hereby makes the following jurisdictional findings and issues the following Decision and Order (“Order”):

1. Respondent Magellan Midstream Partners, L.P., is a publicly-traded limited partnership, organized, existing, and doing business under and by virtue of the laws of the state of Delaware, with its office and principal place of business located at Magellan GP, LLC, P.O. Box 22186, Tulsa, Oklahoma 74121.

2. Respondent Shell Oil Company is a corporation organized, existing and doing business under and by virtue of the laws of the state of Delaware, with its office and principal place of business located at 910 Louisiana Street, Houston, Texas 77002.

3. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of Respondents, and the proceeding is in the public interest.

**ORDER****I.**

**IT IS ORDERED** that, as used in this Order, the following definitions shall apply:

- A. “Magellan” means Magellan Midstream Partners, L.P., its partners, directors, officers, employees, agents, representatives, predecessors, successors, and assigns (including but not limited to Magellan GP, LLC); its joint ventures, subsidiaries, divisions, groups and affiliates controlled by Magellan, and the respective directors, officers, employees, agents, representatives, predecessors, successors, and assigns of each.
- B. “Shell” means Shell Oil Company, its directors, officers, employees, agents, representatives, predecessors, successors, and assigns; its joint ventures, subsidiaries, divisions, groups and affiliates controlled by Shell; and the

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respective partners, directors, officers, employees, agents, representatives, successors, and assigns of each.

- C. “Acquirer” means a Person that receives the prior approval of the Commission to acquire the Oklahoma City Terminal pursuant to Paragraph II. of this Order.
- D. “Acquisition” means the proposed acquisition by Magellan of certain refined petroleum assets from Shell pursuant to a Purchase and Sale Agreement dated June 23, 2004, including but not limited to the Oklahoma City Terminal.
- E. “Closing Date” means the date on which Magellan (or a trustee) and an Acquirer close on a transaction to divest the Oklahoma City Terminal as required by Paragraph II. of this Order.
- F. “Commission” means the Federal Trade Commission.
- G. “Oklahoma City Metropolitan Area” means the Oklahoma City Metropolitan Statistical Area as defined by the U.S. Office of Management and Budget as of the date Respondents execute the Consent Agreement in this matter.
- H. “Oklahoma City Terminal” means all assets relating to Shell’s refined petroleum product storage and distribution terminal located in Oklahoma City (Del City), Oklahoma, including but not limited to:
1. All of Shell’s rights, title, and interest in and to all tangible or intangible assets that are located at, or used in connection with Terminating at, the Oklahoma City Terminal, including but not limited to:
    - a. real estate, including existing rights of way and easements;
    - b. storage tanks;

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- c. local connector pipelines;
  - d. loading and unloading racks, equipment and facilities;
  - e. inventory, equipment, pumps, compressors, machinery, fixtures, tools, and spare parts; and
  - f. offices, buildings, and warehouses;
2. An exclusive right to all intellectual property used solely in the operation of the terminal, and a non-exclusive license to all other intellectual property acquired by or transferred to Magellan as part of the Acquisition and necessary for the operation of the terminal;
  3. All governmental licenses and permits used in the operation of the terminal and transferred to Magellan as part of the Acquisition;
  4. All storage, throughput, and Terminaling contracts, and all other contracts, agreements or understandings relating to the terminal or its operation; and
  5. All books, records, and files.
- I. "Person" means any individual, partnership, firm, trust, association, corporation, joint venture, unincorporated organization, or other business or governmental entity.
  - J. "Respondents" means Magellan and Shell, individually and collectively.
  - K. "Terminaling" means the services performed by a facility that provides temporary storage of refined petroleum products received via pipeline, marine vessel, tank trucks, rail, or transport trailers, and the re-delivery of refined

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petroleum products from storage tanks into tank trucks, rail cars, transport trailers, or pipelines.

**II.**

**IT IS FURTHER ORDERED** that:

- A. Respondent Magellan shall divest the Oklahoma City Terminal absolutely and in good faith, at no minimum price, within six (6) months from the date Magellan executed the Consent Agreement.
- B. Respondent Magellan shall divest the Oklahoma City Terminal only to an Acquirer that receives the prior approval of the Commission and only in a manner that receives the prior approval of the Commission.
- C. Respondent Shell shall cooperate with and shall not interfere with Respondent Magellan's efforts to divest the Oklahoma City Terminal.
- D. For a period of not less than three (3) months after the Closing Date, Respondent Shell shall utilize the Oklahoma City Terminal for Terminaling services for all of its branded and unbranded refined petroleum product requirements in the Oklahoma City Metropolitan Area.
- E. Prior to three (3) months after the Closing Date, Respondents shall not enter into or maintain, or attempt to enter into or maintain, any agreement or understanding relating to the movement or transfer of Shell's refined petroleum products volume from the Oklahoma City Terminal to any other Terminaling facility owned, leased or operated by Magellan, and shall not discuss or negotiate with each other any potential agreement or understanding relating to such movement or transfer.

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- F. In the event that Respondent Magellan is unable to satisfy all conditions necessary to divest any intangible asset, Respondent Magellan shall: (1) with respect to permits, licenses or other rights granted by governmental authorities (other than patents), provide such assistance as the Acquirer may reasonably request in the Acquirer's efforts to obtain comparable permits, licenses or rights, and (2) with respect to other intangible assets (including patents and contractual rights), substitute equivalent assets or arrangements, subject to the prior approval of the Commission. A substituted asset or arrangement will not be deemed to be equivalent unless it enables the terminal to perform the same function at the same or less cost.
- G. The purpose of this Paragraph II is to ensure the continued use of the Oklahoma City Terminal in the same business in which it was engaged at the time of the announcement of the proposed Acquisition, to ensure that the Acquirer of the Oklahoma City Terminal has an opportunity to enter into a Terminaling agreement with Shell for the volumes at the Oklahoma City Terminal, and to remedy the lessening of competition in the Terminaling of gasoline, diesel fuel, and other refined petroleum products resulting from the proposed Acquisition, as alleged in the Commission's Complaint.

**III.****IT IS FURTHER ORDERED** that:

- A. If Respondent Magellan has not divested the Oklahoma City Terminal, absolutely and in good faith, as required by Paragraph II. of this Order, the Commission may appoint a trustee to divest the Oklahoma City Terminal in a manner that satisfies the requirements of Paragraph II. of this Order. In the event that the Commission or the Attorney General brings an action pursuant to § 5(*J*) of the Federal Trade Commission Act, 15 U.S.C. § 45(*J*), or any other statute

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enforced by the Commission, Respondent Magellan shall consent to the appointment of a trustee in such action to divest the Oklahoma City Terminal in accordance with the terms of this Order. Neither the appointment of a trustee nor a decision not to appoint a trustee under this Paragraph shall preclude the Commission or the Attorney General from seeking civil penalties or any other relief available to it, including a court-appointed trustee, pursuant to § 5(l) of the Federal Trade Commission Act, or any other statute enforced by the Commission, for any failure by Respondent Magellan to comply with this Order.

- B. The Commission shall select the trustee, subject to the consent of Respondent Magellan, which consent shall not be unreasonably withheld. The trustee shall be a person with experience and expertise in acquisitions and divestitures. If Respondent Magellan has not opposed, in writing, including the reasons for opposing, the selection of any proposed trustee within ten (10) days after notice by the staff of the Commission to Respondent Magellan of the identity of any proposed trustee, Respondent Magellan shall be deemed to have consented to the selection of the proposed trustee.
- C. Within ten (10) days after appointment of a trustee, Respondent Magellan shall execute a trust agreement that, subject to the prior approval of the Commission, transfers to the trustee all rights and powers necessary to permit the trustee to effect the divestiture required by this Order.
- D. If a trustee is appointed by the Commission or a court pursuant to this Order, Respondents shall consent to the following terms and conditions regarding the trustee's powers, duties, authority, and responsibilities:
  - 1. Subject to the prior approval of the Commission, the trustee shall have the exclusive power and authority to

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divest the Oklahoma City Terminal as required by this Order.

2. The trustee shall have twelve (12) months from the date the Commission approves the trust agreement described herein to accomplish the divestiture, which shall be subject to the prior approval of the Commission. If, however, at the end of the twelve (12) month period, the trustee has submitted a divestiture plan or believes that the divestiture can be achieved within a reasonable time, the divestiture period may be extended by the Commission; *provided, however*, the Commission may extend the divestiture period for no more than two (2) additional periods of twelve (12) months each.
3. The trustee shall have full and complete access to the personnel, books, records, and facilities related to the Oklahoma City Terminal and to any other relevant information, as the trustee may request. Respondents shall develop such financial or other information as the trustee may request and shall cooperate with the trustee. Respondents shall take no action to interfere with or impede the trustee's accomplishment of the divestiture. Respondents shall cooperate with the efforts of the trustee to divest the Oklahoma City Terminal. Any delays in divestiture caused by Respondents shall extend the time for divestiture under this Paragraph III. in an amount equal to the delay, as determined by the Commission.
4. The trustee shall use commercially reasonable best efforts to negotiate the most favorable price and terms available in each contract that is submitted to the Commission, subject to Respondent Magellan's absolute and unconditional obligation to divest expeditiously and at no minimum price. The divestiture shall be made only in a manner that receives the prior approval of the Commission and only to an Acquirer that receives the

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prior approval of the Commission; *provided, however*, if the trustee receives bona fide offers from more than one acquiring entity, and if the Commission determines to approve more than one such acquiring entity, the trustee shall divest to the acquiring entity selected by Respondent Magellan from among those approved by the Commission; *provided further, however*, that Respondent Magellan shall select such entity within five (5) days of receiving notification of the Commission's approval.

5. The trustee shall serve, without bond or other security, at the cost and expense of Respondent Magellan, on such reasonable and customary terms and conditions as the Commission may set. The trustee shall have the authority to employ, at the cost and expense of Respondent Magellan, such consultants, accountants, attorneys, investment bankers, business brokers, appraisers, and other representatives and assistants as are necessary to carry out the trustee's duties and responsibilities. The trustee shall account for all monies derived from the divestiture and all expenses incurred. After approval by the Commission, of the account of the trustee, including fees for the trustee's services, all remaining monies shall be paid at the direction of Respondent Magellan, and the trustee's power shall be terminated. The compensation of the trustee shall be based at least in significant part on a commission arrangement contingent on the divestiture of the Oklahoma City Terminal as required by this Order.
6. Respondent Magellan shall indemnify the trustee and hold the trustee harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the trustee's duties, including all reasonable fees of counsel and other expenses incurred in connection with the preparation for, or defense of, any claim, whether or not resulting in any



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- liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from misfeasance, gross negligence, willful or wanton acts, or bad faith by the trustee.
7. The trustee shall have no obligation or authority to operate or maintain the Oklahoma City Terminal.
  8. The trustee shall act in a fiduciary capacity for the benefit of the Commission.
  9. The trustee shall report in writing to the Commission every sixty (60) days concerning the trustee's efforts to accomplish the divestiture.
  10. Respondent Magellan may require the trustee and each of the trustee's consultants, accountants, attorneys, and other representatives and assistants to sign a customary confidentiality agreement; *provided, however*, such agreement shall not restrict the trustee from providing any information to the Commission.
- E. If the Commission determines that a trustee has ceased to act or failed to act diligently, the Commission may appoint a substitute trustee in the same manner as provided in this Paragraph III.
- F. The Commission may on its own initiative or at the request of the trustee issue such additional orders or directions as may be necessary or appropriate to accomplish the divestiture required by this Order.

**IV.**

**IT IS FURTHER ORDERED** that within thirty (30) days after the initial report is required to be filed pursuant to the Agreement Containing Consent Orders in this matter, and every sixty (60) days thereafter until Respondents have fully complied

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with Paragraph II. of this Order, each Respondent shall submit to the Commission a verified written report setting forth in detail the manner and form in which it intends to comply, is complying, and has complied with this Order. Each Respondent shall include in its reports, among other things that are required from time to time, a full description of the efforts being made to comply with the relevant Paragraphs of the Order, including a description of all substantive contacts or negotiations related to the divestiture of the relevant assets and the identity of all parties contacted. Each Respondent shall include in its reports copies of all written communications to and from such parties, all internal memoranda, and all reports and recommendations concerning its obligations under this Order.

**V.**

**IT IS FURTHER ORDERED** that each Respondent shall notify the Commission at least thirty (30) days prior to (1) any proposed dissolution of that Respondent, (2) any proposed acquisition, merger or consolidation of that Respondent, or (3) any other change in that Respondent that may affect compliance obligations arising out of this Order, including but not limited to assignment, the creation or dissolution of subsidiaries, or any other change in that Respondent.

**VI.**

**IT IS FURTHER ORDERED** that, for the purpose of determining or securing compliance with this Order, and subject to any legally recognized privilege, and upon written request with reasonable notice to either Respondent, each Respondent shall permit any duly authorized representative of the Commission:

- A. Access, during office hours of that Respondent and in the presence of counsel, to all facilities and access to inspect and copy all books, ledgers, accounts, correspondence, memoranda, and all other records and documents in the

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possession or under the control of that Respondent related to compliance with this Order; and

- B. Upon five (5) days' notice to that Respondent and without restraint or interference from that Respondent, to interview officers, directors, or employees of that Respondent, who may have counsel present, regarding such matters.

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### **ORDER TO HOLD SEPARATE AND MAINTAIN ASSETS**

The Federal Trade Commission (“Commission”), having initiated an investigation of the proposed acquisition by Respondent Magellan Midstream Partners, L.P. (“Magellan”) of certain refined product pipeline and terminaling assets from Respondent Shell Oil Company (“Shell”) (collectively “Respondents”), and Respondents having been furnished thereafter with a copy of a draft of Complaint that the Bureau of Competition proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge Respondents with violations of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45; and

Respondents, their attorneys, and counsel for the Commission having thereafter executed an Agreement Containing Consent Orders (“Consent Agreement”), containing an admission by Respondents of all the jurisdictional facts set forth in the aforesaid draft of Complaint, a statement that the signing of said Consent Agreement is for settlement purposes only and does not constitute an admission by Respondents that the law has been violated as alleged in such Complaint, or that the facts as alleged in such Complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission’s Rules; and

The Commission having thereafter considered the matter and having determined that it had reason to believe that Respondents have violated the said Acts, and that a Complaint should issue stating its charges in that respect, and having determined to accept the executed Consent Agreement and to place such Consent Agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, now in further conformity with the procedure described in Commission Rule 2.34, 16 C.F.R. § 2.34, the Commission hereby issues its Complaint, makes the following jurisdictional findings, and issues this Order to Hold Separate and Maintain Assets (“Hold Separate”):

1. Respondent Magellan Midstream Partners, L.P., is a publicly-traded limited partnership organized, existing, and doing business under and by virtue of the laws of the state of Delaware, with its office and principal place of business located at Magellan GP, LLC, P.O. Box 22186, Tulsa, Oklahoma 74121.

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2. Respondent Shell Oil Company is a corporation organized, existing and doing business under and by virtue of the laws of the state of Delaware, with its office and principal place of business located at 910 Louisiana Street, Houston, Texas 77002.

3. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of Respondents, and the proceeding is in the public interest.

**ORDER****I.**

**IT IS ORDERED** that, as used in this Order to Hold Separate and Maintain Assets, the following definitions shall apply:

- A. “Magellan” means Magellan Midstream Partners, L.P., its partners, directors, officers, employees, agents, representatives, predecessors, successors, and assigns (including but not limited to Magellan GP, LLC); its joint ventures, subsidiaries, divisions, groups and affiliates controlled by Magellan; and the respective partners, directors, officers, employees, agents, representatives, successors, and assigns of each.
- B. “Shell” means Shell Oil Company, its directors, officers, employees, agents, representatives, predecessors, successors, and assigns; its joint ventures, subsidiaries, divisions, groups and affiliates controlled by Shell; and the respective partners, directors, officers, employees, agents, representatives, successors, and assigns of each.
- C. “Acquirer” means a Person that receives the prior approval of the Commission to acquire the Oklahoma City Terminal pursuant to Paragraph II. of the Decision and Order.
- D. “Acquisition” means the proposed acquisition by Magellan of certain refined petroleum assets from Shell pursuant to a Purchase and Sale Agreement dated June 23, 2004, including but not limited to the Oklahoma City Terminal.
- E. “Closing Date” means the date on which Magellan (or a trustee) and an Acquirer close on a transaction to divest the

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Oklahoma City Terminal as required by Paragraph II. of the Decision and Order in this matter.

- F. “Commission” means the Federal Trade Commission.
- G. “Confidential Business Information” means all information that is not in the public domain, including but not limited to information relating to marketing, transportation, terminaling, distribution, plans, costs, pricing, supply, sales, or sales support.
- H. “Decision and Order” means:
1. until the issuance and service of a final Decision and Order by the Commission, the proposed Decision and Order contained in the Consent Agreement in this matter; and
  2. following the issuance and service of a final Decision and Order by the Commission, the final Decision and Order issued by the Commission.
- I. “Held Separate Business” means the Oklahoma City Terminal and all Held Separate Employees.
- J. “Held Separate Employees” means all full-time, part-time, or contract employees whose duties relate primarily to the Oklahoma City Terminal.
- K. “Hold Separate Period” means the time period during which the Hold Separate is in effect, which shall begin as of the date the Acquisition occurs and terminate pursuant to Paragraph VI. hereof.
- L. “Hold Separate Trustee” means the Person appointed to act as the Hold Separate Trustee pursuant to Paragraph II. hereof.
- M. “Oklahoma City Metropolitan Area” means the Oklahoma City Metropolitan Statistical Area as defined by the U.S. Office of Management and Budget as of the date Respondents execute the Consent Agreement in this matter.
- N. “Oklahoma City Terminal” means all assets relating to Shell’s refined petroleum product storage and distribution

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terminal located in Oklahoma City (Del City), Oklahoma, including but not limited to:

1. All of Shell's rights, title, and interest in and to all tangible or intangible assets that are located at, or used in connection with Terminaling at, the Oklahoma City Terminal, including but not limited to:
    - a. real estate, including existing rights of way and easements;
    - b. storage tanks;
    - c. local connector pipelines;
    - d. loading and unloading racks, equipment and facilities;
    - e. inventory, equipment, pumps, compressors, machinery, fixtures, tools, and spare parts; and
    - f. offices, buildings, and warehouses;
  2. An exclusive right to all intellectual property used solely in the operation of the terminal, and a non-exclusive license to all other intellectual property acquired by or transferred to Magellan as part of the Acquisition and necessary for the operation of the terminal;
  3. All governmental licenses and permits used in the operation of the terminal and transferred to Magellan as part of the Acquisition;
  4. All storage, throughput, and Terminaling contracts, and all other contracts, agreements or understandings relating to the terminal or its operation; and
  5. All books, records, and files.
- O. "Person" means any individual, partnership, firm, trust, association, corporation, joint venture, unincorporated organization, or other business or governmental entity.
- P. "Respondents" means Magellan and Shell, individually and collectively.

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Q. “Terminaling” means the services performed by a facility that provides temporary storage of refined petroleum products received via pipeline, marine vessel, tank trucks, rail, or transport trailers, and the re-delivery of refined petroleum products from storage tanks into tank trucks, rail cars, transport trailers, or pipelines.

**II.**

**IT IS FURTHER ORDERED that:**

- A. Until the Closing Date, Respondents shall take such actions as are necessary to maintain the viability, marketability, and competitiveness of the Held Separate Business, and shall prevent the destruction, removal, wasting, deterioration, sale, disposition, transfer, or impairment of the Held Separate Business or assets related thereto, except for ordinary wear and tear.
- B. During the Hold Separate Period, Respondent Magellan shall:
1. hold the Held Separate Business separate, apart, and independent as required by this Hold Separate, and vest the Held Separate Business with all rights, powers, and authority necessary to conduct its business;
  2. maintain all insurance necessary for the Held Separate Business, including but not limited to general and product liability insurance and property and casualty insurance; and
  3. not exercise direction or control over, or influence directly or indirectly, the Held Separate Business or any of its operations, or the Hold Separate Trustee, except to the extent that Respondent Magellan must exercise direction and control over the Held Separate Business as is necessary to assure compliance with this Hold Separate, the Decision and Order, and all applicable laws.
- C. Respondent Magellan shall hold the Held Separate Business separate, apart, and independent on the following terms and conditions:



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1. Immediately upon consummation of the Acquisition, Respondent Magellan shall enter into a management agreement with Shell in the form attached hereto as Appendix A whereby Shell will manage the Held Separate Business for the duration of the Hold Separate Period, and Magellan will transfer to Shell all rights, powers, and authorities necessary to manage and maintain the Held Separate Business.
  - a. Respondent Shell shall report directly and exclusively to the Hold Separate Trustee relating to the operation of the Held Separate Business and shall manage the Held Separate Business independently from Respondent Magellan's other operations.
  - b. Respondent Shell shall continue to provide or contract to provide, or offer to provide or contract to provide, the same services to the Held Separate Business as are being provided to the Held Separate Business by Respondent Shell or other persons as of the date the Consent Agreement is signed by Respondents.
  - c. The services that Respondent Shell shall offer the Held Separate Business shall include, but shall not be limited to, the following:
    - (1) federal and state regulatory policy development and compliance;
    - (2) human resources and administrative services, including but not limited to procurement and administration of employee benefits;
    - (3) environmental, health and safety services, including but not limited to services to develop policies and insure compliance with federal and state regulations and corporate policies;
    - (4) financial accounting services;
    - (5) preparation of tax returns;
    - (6) audit services;
    - (7) technical support and engineering services;

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- (8) information technology support services;
- (9) processing of accounts payable and accounts receivable;
- (10) billing and collection services;
- (11) payroll processing;
- (12) security clearance services;
- (13) compliance with import and export controls; and
- (14) legal services.

*Provided, however,* that Respondent Shell's personnel providing such services must retain and maintain all Confidential Business Information of the Held Separate Business on a confidential basis, and, except as permitted by this Hold Separate, such Persons shall be prohibited from providing, discussing, exchanging, circulating, or otherwise furnishing any such information to or with any Person employed by Magellan or whose employment relates to any of Magellan's businesses, other than the Held Separate Business. Such personnel who have or may have access to Confidential Business Information shall also execute confidentiality agreements prohibiting the disclosure of any Confidential Business Information of the Held Separate Business.

- d. The Held Separate Business shall have, at the option of the Hold Separate Trustee, the ability to acquire services, including but not limited to those listed in Paragraph II.C.1.c. above, from third parties unaffiliated with Respondents.
2. David Ownby of FTI Consulting shall serve as Hold Separate Trustee, pursuant to the agreement executed by the Hold Separate Trustee and Respondent Magellan and attached as Confidential Appendix B to this Hold Separate ("Trustee Agreement").

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- a. The Trustee Agreement shall require that, no later than five (5) days after this Hold Separate becomes final, Respondent Magellan shall transfer to the Hold Separate Trustee all rights, powers, and authorities necessary to permit the Hold Separate Trustee to perform his/her duties and responsibilities, pursuant to this Hold Separate and consistent with the purposes of the Decision and Order.
- b. No later than five (5) days after this Hold Separate becomes final, Respondent Magellan shall, pursuant to the Trustee Agreement, transfer to the Hold Separate Trustee all rights, powers, and authorities necessary to permit the Hold Separate Trustee to perform his/her duties and responsibilities, pursuant to this Hold Separate and consistent with the purposes of the Decision and Order.
- c. The Hold Separate Trustee shall have the responsibility, consistent with the terms of this Hold Separate and the Decision and Order, for monitoring (i) the management of the Held Separate Business by Shell, (ii) the maintenance of the independence of the Held Separate Business, and (iii) Respondents' compliance with their obligations pursuant to this Hold Separate and the Decision and Order.
- d. Subject to all applicable laws and regulations, the Hold Separate Trustee shall have full and complete access to all personnel, books, records, documents and facilities of the Held Separate Business and to any other relevant information as the Hold Separate Trustee may reasonably request, including but not limited to all documents and records kept by Respondents in the ordinary course of business that relate to the Held Separate Business. Respondents shall develop such financial or other information as the Hold Separate Trustee may reasonably request and shall cooperate with the Hold Separate Trustee. Respondents shall take no action to interfere with or impede the Hold Separate Trustee's ability to monitor Respondents' compliance with this Hold Separate and the Decision and Order or otherwise to perform his/her duties and responsibilities consistent with the terms of this Hold Separate.

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- e. The Hold Separate Trustee shall have the authority to employ, at Magellan's cost and expense, such consultants, accountants, attorneys, and other representatives and assistants as are reasonably necessary to carry out the Hold Separate Trustee's duties and responsibilities.
- f. The Hold Separate Trustee shall serve, without bond or other security, at Magellan's cost and expense, on reasonable and customary terms commensurate with the Hold Separate Trustee's experience and responsibilities.
- g. Respondent Magellan shall indemnify the Hold Separate Trustee and hold him or her harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Hold Separate Trustee's duties, including all reasonable fees of counsel and other expenses incurred in connection with the preparation for, or defense of, any claim, whether or not resulting in any liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from misfeasance, gross negligence, willful or wanton acts or omissions, or bad faith by the Hold Separate Trustee, or the respective agents.
- h. The Commission may require the Hold Separate Trustee to sign an appropriate confidentiality agreement relating to materials and information received from the Commission in connection with performance of the Hold Separate Trustee's duties.
- i. Respondents may require the Hold Separate Trustee to sign an appropriate confidentiality agreement prohibiting the disclosure of any Confidential Business Information gained as a result of his/her role as Hold Separate Trustee to anyone other than the Commission.
- j. The Hold Separate Trustee shall act in a fiduciary capacity for the benefit of the Commission.
- k. Thirty (30) days after the Hold Separate becomes final, and every thirty (30) days thereafter until the Hold Separate terminates, the Hold Separate Trustee

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shall report in writing to the Commission concerning the efforts to accomplish the purposes of this Hold Separate.

1. If the Hold Separate Trustee ceases to act or fails to act diligently and consistent with the purposes of this Hold Separate, the Commission may appoint a substitute Hold Separate Trustee consistent with the terms of this paragraph, subject to the consent of Respondent Magellan, which consent shall not be unreasonably withheld. If Respondent Magellan has not opposed, in writing, including the reasons for opposing, the selection of the substitute Hold Separate Trustee within five (5) days after notice by the staff of the Commission to Magellan of the identity of any substitute Hold Separate Trustee, Magellan shall be deemed to have consented to the selection of the proposed substitute trustee. Magellan and the substitute Hold Separate Trustee shall execute a trustee agreement, subject to the approval of the Commission, consistent with this paragraph.
3. Respondents shall staff the Held Separate Business with sufficient employees to maintain the viability, marketability, and competitiveness of the Held Separate Business, including but not limited to the Held Separate Employees. To the extent that any employees of the Held Separate Business leave or have left the Held Separate Business prior to the Closing Date, Respondent Shell – in consultation with the Hold Separate Trustee – may replace departing or departed employees with Persons who have similar experience and expertise or determine not to replace such departing or departed employees.
4. Respondents shall:
  - a. not later than forty-five (45) days before the Closing Date, (i) provide to the Acquirer a list of all Held Separate Employees; (ii) allow the Acquirer to interview any Held Separate Employee; and (iii) in compliance with all laws, allow the Acquirer to inspect the personnel files and other documentation relating to such Held Separate Employees;

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- b. not later than thirty (30) days before the Closing Date, provide an opportunity for the Acquirer, (i) to meet personally, and outside the presence or hearing of any employee or agent of Respondents, with any one or more of the Held Separate Employees; and (ii) to make offers of employment to any one or more of the Held Separate Employees;
  - c. not directly or indirectly interfere with the Acquirer's offer of employment to any one or more of the Held Separate Employees, not directly or indirectly attempt to persuade any one or more of the Held Separate Employees to decline any offer of employment from the Acquirer, and not offer any incentive to any Held Separate Employee to decline employment with the Acquirer;
  - d. irrevocably waive any legal or equitable right to deter any Held Separate Employee from accepting employment with the Acquirer, including but not limited to waiving any non-compete or confidentiality provisions of employment or other contracts with Respondents that relate to the Oklahoma City Terminal;
  - e. not interfere with the employment by the Acquirer of any Held Separate Employee; and
  - f. continue employee benefits to Held Separate Employees until the Closing Date, including regularly scheduled or merit raises and bonuses, regularly scheduled vesting of all pension benefits, and reimbursement of relocation expenses.
5. For a period of one (1) year from the Closing Date, Respondents shall not, directly or indirectly, solicit, induce, or attempt to solicit or induce any Held Separate Employees who have accepted offers of employment with the Acquirer to terminate their employment relationship with the Acquirer; *provided, however*, a violation of this provision will not occur if: (1) the individual's employment has been terminated by the Acquirer, (2) Respondents advertise for employees in newspapers, trade publications, or other media not

## Order

- targeted specifically at the employees, or (3) Respondents hire employees who apply for employment with Respondents, as long as such employees were not solicited by Respondents in violation of this paragraph.
6. For a period of six (6) months from the Closing Date, Respondents shall not employ or make offers of employment to any Held Separate Employee who has accepted offers of employment with the Acquirer unless any such individual's employment has been terminated by the Acquirer.
  7. Except for Held Separate Employees and employees involved in the provision of services to the Held Separate Business pursuant to Paragraph II.C.1.c., and except to the extent provided in Paragraph II.A., Respondents shall not permit any other of its employees, officers, or directors to be involved in the operations of the Held Separate Business.
  8. Respondents shall cause the Hold Separate Trustee and each employee of the Held Separate Business having access to Confidential Business Information to submit to the Commission a signed statement that the individual will maintain the confidentiality required by the terms and conditions of this Hold Separate. These individuals must retain and maintain all Confidential Business Information relating to the Held Separate Business on a confidential basis and, except as is permitted by this Hold Separate, such individuals shall be prohibited from providing, discussing, exchanging, circulating, or otherwise furnishing, directly or indirectly, any such information to or with any other Person whose employment relates to any of Respondent Magellan's businesses other than the Held Separate Business. These individuals shall not be involved in any way in the management, production, distribution, sale, marketing, or financial operations of the competing products or services of Respondent Magellan.
  9. No later than five (5) days after the date this Hold Separate becomes final, Respondents shall circulate to employees of the Held Separate Business and to Respondent Magellan's employees who are responsible for the provision of Terminaling services in the

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Oklahoma City Metropolitan Area, a notice of this Hold Separate and Consent Agreement, in the form attached hereto as Appendix C.

10. Magellan's employees (excluding the Held Separate Employees and employees involved in the provision of services to the Held Separate Business pursuant to Paragraph II.C.1.c.) shall not receive, have access to, or use or continue to use any Confidential Business Information of the Held Separate Business except:
  - a. as required by law; and
  - b. to the extent that necessary information is exchanged:
    - (1) in the course of consummating the Acquisition;
    - (2) in negotiating agreements to divest assets pursuant to the Consent Agreement and engaging in related due diligence;
    - (3) in complying with the Hold Separate or the Consent Agreement;
    - (4) in overseeing compliance with policies and standards concerning the safety, health and environmental aspects of the operations of the Held Separate Business and the integrity of the financial controls of the Held Separate Business;
    - (5) in defending legal claims, investigations or enforcement actions threatened or brought against or related to the Held Separate Business; or
    - (6) in obtaining legal advice.

Nor shall the Held Separate Employees receive, have access to, or use or continue to use, any Confidential Business Information about Respondent Magellan and relating to Respondent Magellan's businesses, except such information as is necessary to maintain and operate the Held Separate Business. Magellan may receive aggregate financial and operational information relating to the Held Separate Business only to the extent necessary to allow Magellan to prepare consolidated financial reports, tax



## Order

returns, reports required by securities laws, and personnel reports. Any such information that is obtained pursuant to this paragraph shall be used only for the purposes set forth in this paragraph.

11. Respondents and the Held Separate Business shall jointly implement, and at all times during the Hold Separate Period maintain in operation, a system, as approved by the Hold Separate Trustee, of access and data controls to prevent unauthorized access to or dissemination of Confidential Business Information of the Held Separate Business.
12. During the Hold Separate Period, Respondent Magellan shall provide the Held Separate Business with sufficient financial resources:
  - a. as are appropriate in the judgment of Respondent Shell, subject to the approval of the Hold Separate Trustee, to operate the Held Separate Business at no less than current rates of operation;
  - b. to perform all reasonable maintenance to, and replacements of, the assets of the Held Separate Business;
  - c. to carry on existing and planned capital projects and business plans for the Held Separate Business; and
  - d. to maintain the viability, marketability, and competitiveness of the Held Separate Business.

Such financial resources to be provided to the Held Separate Business shall include, but shall not be limited to, (i) general funds, (ii) capital, (iii) working capital, and (iv) reimbursement for any operating losses, capital losses, or other losses; *provided, however*, that, consistent with the purposes of the Decision and Order, the Hold Separate Trustee may substitute any capital or research and development project for another of the same cost.

- D. Notwithstanding the requirements of Paragraph II.C.1. above, if the Commission appoints a trustee to divest the Oklahoma City Terminal pursuant to Paragraph III. of the Decision and Order, Shell may terminate the management

Order

agreement required by Paragraph II.C.1. of this Order. If Shell determines to terminate the management agreement required by paragraph II.C.1. above:

1. Shell shall give ninety (90) days' prior written notice to the Commission of its intention to terminate the management agreement.
2. Magellan shall, prior to Shell's termination of the management agreement, enter into a substitute management agreement with a substitute manager, subject to the prior approval of the Hold Separate Trustee, whereby such substitute manager will manage the Held Separate Business for the duration of the Hold Separate Period, and Magellan shall transfer to the substitute manager all rights, powers, and authorities necessary to manage and maintain the Held Separate Business.
  - a. The substitute manager shall report directly and exclusively to the Hold Separate Trustee relating to the operation of the Held Separate Business and shall manage the Held Separate Business independently from Respondent Magellan's other operations.
  - b. Magellan shall provide or contract to provide, or offer to provide or contract to provide, the same services to the Held Separate Business as are being provided to the Held Separate Business by Respondent Shell or other persons as of the date the Consent Agreement is signed by Respondents.
  - c. The services that Magellan shall offer the Held Separate Business shall include, but shall not be limited to, the following:
    - (1) federal and state regulatory policy development and compliance;
    - (2) human resources and administrative services, including but not limited to procurement and administration of employee benefits;
    - (3) environmental, health and safety services, including but not limited to services to develop policies and

## Order

insure compliance with federal and state regulations and corporate policies;

- (4) financial accounting services;
- (5) preparation of tax returns;
- (6) audit services;
- (7) technical support and engineering services;
- (8) information technology support services;
- (9) processing of accounts payable and accounts receivable;
- (10) billing and collection services;
- (11) payroll processing;
- (12) security clearance services;
- (13) compliance with import and export controls; and
- (14) legal services.

*Provided, however,* Respondent Magellan's personnel providing such services must retain and maintain all Confidential Business Information of the Held Separate Business on a confidential basis, and, except as permitted by this Hold Separate, such Persons shall be prohibited from using such Confidential Business Information in connection with their responsibilities to Magellan, and from providing, discussing, exchanging, circulating, or otherwise furnishing any such information to or with any other Person employed by Magellan or whose employment relates to any of Magellan's businesses, other than the Held Separate Business. Such personnel who have or may have access to Confidential Business Information shall also execute confidentiality agreements prohibiting the disclosure of any Confidential Business Information of the Held Separate Business.

- d. Respondent Shell's personnel involved in providing services to the Held Separate Business who may have

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or may have had access to Confidential Business Information of the Held Separate Business must continue to maintain all Confidential Business Information of the Held Separate Business on a confidential basis, and, except as permitted by this Hold Separate, such Persons shall be prohibited from using such Confidential Business Information in any way inconsistent with the requirements of this Hold Separate.

- e. The Held Separate Business shall have, at the option of the Hold Separate Trustee, the ability to acquire services, including but not limited to those listed in Paragraph II.D.2.c. above, from third parties unaffiliated with Respondents.
- E. The purposes of this Hold Separate are to: (1) preserve the Held Separate Business as a viable, competitive, and ongoing business independent of Respondent Magellan until the divestiture required by the Decision and Order is achieved; (2) assure that no Confidential Business Information is exchanged between Respondent Magellan and the Held Separate Business, except in accordance with the provisions of this Hold Separate; and (3) prevent interim harm to competition pending the divestiture of the Held Separate Business.

**III.**

**IT IS FURTHER ORDERED** that, beginning thirty (30) days after the initial report is required to be filed pursuant to the Agreement Containing Consent Orders in this matter, and every sixty (60) days thereafter until Respondents have fully complied with their obligations pursuant to this Hold Separate, each Respondent shall submit to the Commission a verified written report setting forth in detail the manner and form in which it intends to comply, is complying, and has complied with Paragraph II. of this Hold Separate. Each Respondent shall include in its reports, among other things that are required from time to time, a full description of the efforts being made to comply with this Hold Separate, including copies of all written and electronic communications to and from the parties, all internal memoranda, and all reports and recommendations concerning its obligations under this Hold Separate.

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**IV.**

**IT IS FURTHER ORDERED** that each Respondent shall notify the Commission at least thirty (30) days prior to (1) any proposed dissolution of that Respondent, (2) any proposed acquisition, merger or consolidation of that Respondent, or (3) any other change in that Respondent that may affect compliance obligations arising out of this Hold Separate, including but not limited to assignment, the creation or dissolution of subsidiaries, or any other change in that Respondent.

**V.**

**IT IS FURTHER ORDERED** that, for the purposes of determining or securing compliance with this Hold Separate, and subject to any legally recognized privilege, and upon written request with reasonable notice to either Respondent, each Respondent shall permit any duly authorized representatives of the Commission:

- A. Access, during office hours of that Respondent and in the presence of counsel, to all facilities and access to inspect and copy all books, ledgers, accounts, correspondence, memoranda, and all other records and documents in the possession or under the control of that Respondent relating to compliance with this Hold Separate; and
- B. Upon five (5) days' notice to that Respondent and without restraint or interference from that Respondent, to interview officers, directors, or employees of that Respondent, who may have counsel present, regarding such matters.

**VI.**

**IT IS FURTHER ORDERED** that this Hold Separate shall terminate on the earlier of:

- A. Three (3) business days after the Commission withdraws its acceptance of the Consent Agreement pursuant to the provisions of Commission Rule 2.34, 16 C.F.R. § 2.34; or
- B. The day after the divestiture of the Oklahoma City Terminal, as described in and required by the Decision and Order, is completed.

Order

**Confidential Appendix B: Trustee Agreement**  
**[Redacted From Public Record Version But Incorporated By**  
**Reference]**

## Analysis

**Analysis of Proposed Agreement Containing Consent Orders  
to Aid Public Comment**

The Federal Trade Commission, subject to its final approval, has accepted for public comment an Agreement Containing Consent Orders (“Agreement”) with Magellan Midstream Partners, L.P. (“Magellan”) and Shell Oil Company (“Shell”) to resolve the anticompetitive effects alleged in the Complaint issued by the Commission concerning Magellan’s acquisition of certain pipeline and terminal assets from Shell.

By purchase and sale agreement dated June 23, 2004, Magellan plans to acquire a package of Midwest pipelines and terminals from Shell. Included in the assets being acquired is a refined petroleum products terminal in Oklahoma City, Oklahoma, that supplies light petroleum products, including gasoline and diesel fuel. Magellan already owns and operates another refined petroleum products terminal in Oklahoma City, and the proposed acquisition would substantially increase concentration in the terminaling of light petroleum products in the Oklahoma City Metropolitan Area. The Agreement requires that Magellan divest the terminal acquired from Shell to a Commission-approved buyer.

The Agreement has been placed on the public record for 30 days for interested persons to comment. Comments received during this 30 day period will become part of the public record. After 30 days, the Commission will again review the Agreement and the comments received and will decide whether it should withdraw the Agreement or make the Agreement final.

**I. The Parties**

Magellan is a publicly traded limited partnership that is owned 64% by public shareholders, and 36% by Magellan Midstream Holdings, L.P. (which in turn is owned 50% by Madison Dearborn Partners and 50% by Carlyle Group/Riverstone Holdings). Magellan is primarily engaged in the storage,

Analysis

transportation, and distribution of refined petroleum products and ammonia. Its assets include a petroleum products pipeline and terminal system that serves the Mid-continent region of the United States, marine terminals along the Gulf Coast and near the New York Harbor, inland petroleum products terminals located principally in the southeastern United States, and a pipeline system for ammonia in the Mid-continent region. For the year ending December 31, 2003, Magellan had total annual revenues of approximately \$485 million and total assets of nearly \$1.2 billion.

Shell Oil Company is the United States operating entity for the Royal Dutch/Shell Group of companies, which ultimately is owned 60% by Royal Dutch Petroleum Company of the Netherlands and 40% by The Shell Transport and Trading Company, p.l.c. of the United Kingdom (collectively referred to as "Shell"). Shell is one of the largest integrated petroleum companies in the world, and is engaged in virtually all aspects of the energy business, including exploration, production, refining, transportation, distribution, and marketing. For the year ending December 31, 2003, Shell reported total gross revenues of more than \$268 billion and total assets of approximately \$124 billion.

## **II. The Commission's Complaint**

The Commission's Complaint charges that Magellan's agreement to acquire the Oklahoma City refined products terminal from Shell violates Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, and would, if consummated, violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45.

The Complaint alleges that a relevant line of commerce in which to evaluate the effects of this acquisition is the terminaling of gasoline, diesel fuel, and other light petroleum products. Refined petroleum product terminals are specialized facilities that provide temporary storage for gasoline, diesel fuel, and other light



## Analysis

petroleum products. Depending on their location, terminals receive deliveries from pipelines or marine vessels, store the products in large tanks, and redeliver them into tank trucks for ultimate delivery to retail gasoline stations or other buyers. There are no substitutes for petroleum terminals for providing such terminaling services.

The Complaint alleges that a relevant section of the country in which to evaluate the effects of this acquisition is the Oklahoma City Metropolitan Area. Buyers of gasoline, diesel fuel, and other light petroleum products in the Oklahoma City Metropolitan Area, such as gasoline marketers and others, have no effective alternative to terminals located within the Oklahoma City Metropolitan Area. Because of costs and delivery logistics, terminals located outside the Oklahoma City Metropolitan Area are too far away to supply buyers in that area.

The Complaint charges that Magellan and Shell are actual and potential competitors in the supply of terminaling services for gasoline, diesel fuel, and other light petroleum products in the Oklahoma City Metropolitan Area. Magellan and Shell have two of only a very limited number of terminals that can serve the Oklahoma City area. According to the Complaint, the market for terminaling services in the Oklahoma City Metropolitan Area is highly concentrated and would become significantly more highly concentrated as a result of this acquisition. Even if a terminal located 40 miles outside of Oklahoma City is included, the pre-merger Herfindahl-Hirschman Index is more than 3,100, and would increase by more than 1,200 points to a level exceeding 4,300. The Complaint further maintains that entry into the relevant market is not likely and if entry did occur, it would be neither timely nor sufficient to prevent or mitigate the anticompetitive effects of the acquisition.

The Complaint further charges that the proposed acquisition, if consummated, may substantially lessen competition in the supply of terminaling services for gasoline, diesel fuel, and other light petroleum products in the Oklahoma City Metropolitan Area.

Analysis

Specifically, the acquisition would (1) eliminate direct competition between Magellan and Shell in the supply of terminaling services in the Oklahoma City Metropolitan Area, and (2) increase the likelihood of, or facilitate, collusion or coordinated interaction in the relevant market, each of which increases the likelihood that the prices of gasoline, diesel fuel, and other light petroleum products will increase in the relevant market.

**III. Terms of the Decision and Order and Order to Hold Separate and Maintain Assets**

The Decision and Order (“Proposed Order”) effectively remedies the acquisition’s alleged anticompetitive effects by requiring Magellan to divest the overlapping Shell terminal assets. The Shell Oklahoma City terminal is to be divested to a Commission-approved buyer and in a manner approved by the Commission.

The Proposed Order requires that Magellan divest the Shell terminal, at no minimum price, within six months after Magellan signs the Agreement, to a buyer approved by the Commission. The Proposed Order includes several additional provisions to ensure the interim viability of the subject terminal, to ensure that the acquirer has an opportunity to enter into an agreement with Shell for the Shell volumes at the terminal, and to remedy the lessening of competition resulting from the proposed acquisition. In particular, the Proposed Order requires Shell to utilize the subject terminal for all of its branded and unbranded refined petroleum product requirements in the Oklahoma City Metropolitan Area until three months after divestiture of the terminal. It further prohibits Shell and Magellan until three months after divestiture from entering into or maintaining, or attempting to enter into or maintain, any agreement or understanding relating to the movement or transfer of Shell’s refined petroleum products volume from the subject terminal to any other terminaling facility owned, leased, or operated by Magellan. The order further prohibits Shell and Magellan from

## Analysis

discussing or negotiating with each other any potential agreement or understanding relating to such movement or transfer.

The Proposed Order also provides that should Magellan be unable to satisfy all conditions necessary to divest any intangible asset, Magellan will: (1) with respect to permits, licenses or other rights granted by governmental authorities (other than patents), provide such assistance as the acquirer may reasonably request in the acquirer's efforts to obtain comparable permits, licenses or rights, and (2) with respect to other intangible assets (including patents and contractual rights), substitute equivalent assets or arrangements, subject to the prior approval of the Commission. A substituted asset or arrangement will not be deemed to be equivalent unless it enables the terminal to perform the same function at the same or less cost.

The Proposed Order further provides that if the subject terminal has not been divested within the allotted time, a trustee may be appointed to sell the terminal to a buyer approved by the Commission.

Other paragraphs of the Proposed Order contain provisions regarding compliance reports, notification of changes that may affect compliance, and access to materials that may be necessary to monitor compliance.

The Order to Hold Separate and Maintain Assets ("Hold Separate Order") contains provisions designed to ensure that the Oklahoma City terminal at issue will be maintained separately and apart from Magellan pending divestiture.

The Hold Separate Order provides that Magellan will hold the terminal assets separate from its other businesses and continue to maintain the terminal assets during the period prior to divestiture. Paragraph II also provides that pending divestiture Magellan will contract with Shell for Shell to manage the terminal independently from Magellan's other operations. Shell will report directly and exclusively to a hold separate trustee with respect to

Analysis

the operation of the terminal. Shell is required to keep confidential business information related to the terminal from Magellan employees, except as permitted by the Hold Separate Order.

Other paragraphs of the Hold Separate Order contain provisions regarding compliance reports, notification of changes that may affect compliance, and access to materials that may be necessary to monitor compliance.

The Hold Separate Order terminates on the earlier of two dates, either (1) three business days after the Commission withdraws its acceptance of the consent agreement, or (2) the day after the divestiture of the Oklahoma City terminal, as described in and required by the Proposed Order, is completed.

#### **IV. Opportunity For Public Comment**

By accepting the Agreement, 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 Agreement, including the proposed divestiture, to aid the Commission in its determination of whether it should make the Agreement final. This analysis is not intended to constitute an official interpretation of the Agreement or modify the terms of the Agreement in any way.

Complaint

## IN THE MATTER OF

**BUCKEYE PARTNERS, L.P., ET AL.**CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 7 OF THE CLAYTON ACT AND SEC. 5 OF THE FEDERAL TRADE  
COMMISSION ACT*Docket C-4127; File No. 0410162**Complaint, December 17, 2004--Decision, December 17, 2004*

This consent order, among other things, requires Respondent Buckeye Partners, L.P. -- a partnership engaged in the storage, terminaling, and pipeline transportation of refined petroleum products, including gasoline and diesel fuel -- to provide prior notification to the Commission of an acquisition of any interest in a Shell refined petroleum terminal in Niles, Michigan, for a period of ten years. The order also requires Respondent Shell Oil Company -- a diversified energy company engaged in manufacturing, refining, distributing, transporting, terminaling, and marketing numerous petroleum products -- to provide prior notification to the Commission of a sale or transfer of any interest in the Niles terminal, for a period of ten years.

*Participants*

For the Commission: *Lesli C. Esposito, Elizabeth D. Kaiser, Brian J. Telpner, Phillip L. Broyles, Naomi Licker, Elizabeth A. Piotrowski, John Yun, Christopher Taylor and Mark Frankena.*

For the Respondent: *Stephen C. Muther, Marc G. Schildkraut, and Charles W. Corddry III.*

**COMPLAINT**

Pursuant to the provisions of the Federal Trade Commission Act and the Clayton Act, and by virtue of the authority vested in it by said Acts, the Federal Trade Commission ("FTC" or "Commission"), having reason to believe that Respondents Buckeye Partners, L.P. ("Buckeye") and Shell Oil Company ("Shell") (collectively "Respondents") entered into an agreement pursuant to which Buckeye proposed to acquire certain refined petroleum product assets from Shell, that such agreement violates Section 5 of the Federal Trade Commission Act, as amended, 15

Complaint

U.S.C. § 45, and that such agreement and acquisition, if consummated, would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, and that a proceeding in respect thereof would be in the public interest, hereby issues its complaint, stating its charges as follows:

**I. THE RESPONDENTS**

***Buckeye Partners, L.P.***

1. Respondent Buckeye is a partnership organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business at 5 Radnor Corporate Center, Suite 500, 100 Matsonford Road, Radnor, Pennsylvania 19087.
2. Respondent Buckeye is, and at all times relevant herein has been, engaged in the storage, terminaling and pipeline transportation of refined petroleum products, including gasoline, diesel fuel, and other light petroleum products.
3. Respondent Buckeye is, and at all times relevant herein has been, engaged in commerce as “commerce” is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12, and is a partnership as that term is used in Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45.

***Shell Oil Company***

4. Respondent Shell is a corporation organized, existing and doing business under and by virtue of the laws of the state of Delaware, with its office and principal place of business located at 910 Louisiana Street, Houston, Texas 77002.
5. Respondent Shell is, and at all times relevant herein has been, a diversified energy company engaged, either directly or through affiliates, in the business of manufacturing, refining,

## Complaint

distributing, transporting, terminaling, and marketing petroleum products, including gasoline, diesel fuel, jet fuel, base oil, motor oil, lubricants, petrochemicals, and other petroleum products.

6. Respondent Shell is, and at all times relevant herein has been, engaged in commerce as “commerce” is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12, and is a corporation whose business is in or affecting commerce as “commerce” is defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

## II. THE PROPOSED ACQUISITIONS

7. Pursuant to a Purchase and Sale Agreement dated June 30, 2004, Respondent Buckeye agreed to buy from Respondent Shell certain refined petroleum products pipelines, tankage and terminal assets in the Midwest United States (“First Proposed Acquisition”), including a refined petroleum product terminal that serves the areas within a 50-mile radius of Niles, Michigan (“Niles Area”).
8. After being advised by Commission staff of potential competitive issues and concerns in connection with Buckeye acquiring Shell’s terminal in Niles in the First Proposed Acquisition, Respondents withdrew their HSR filing.
9. Respondents informed Staff of their intention to initiate a second acquisition (“Second Proposed Acquisition”), which would include all of the assets of the First Proposed Acquisition except for the Shell terminal in Niles.
10. Respondent Buckeye has expressed a continued interest in acquiring the Shell terminal in Niles after completion of the Second Proposed Acquisition.
11. Respondent Shell has expressed a continued interest in selling its Niles terminal to Respondent Buckeye or another

Complaint

third party after completion of the Second Proposed Acquisition.

**III. TRADE AND COMMERCE**

***A. Relevant Product Market***

12. Refined petroleum product terminals are specialized facilities that provide temporary storage for gasoline, diesel fuel, and other light petroleum products. Terminals receive deliveries from pipelines or marine vessels, store the products in large tanks, and redeliver them into tank trucks for ultimate delivery to retail gasoline stations or other buyers. There are no substitutes for petroleum terminals for providing such terminaling services.
13. A relevant line of commerce in which to evaluate the effects of this acquisition is the terminaling of gasoline, diesel fuel, and other light petroleum products.

***B. Relevant Geographic Market***

14. Respondents each own a petroleum product terminal that supplies gasoline, diesel fuel, and other light petroleum products to buyers in the Niles Area. Buyers of gasoline, diesel fuel and other light petroleum products in the Niles Area, such as gasoline marketers and others, may have no effective alternative to terminals located within the Niles Area. Because of costs and delivery logistics, terminals located outside the Niles Area may be too far away to supply buyers in that area.
15. A relevant section of the country in which to evaluate the effects of this acquisition may be as small as the Niles Area.



Complaint

***C. Market Structure***

16. The market for terminaling services in the Niles Area is highly concentrated and would become significantly more highly concentrated if the First Proposed Acquisition had been consummated. The pre-merger Herfindahl-Hirschman Index for the First Proposed Acquisition was 2,800, and would have increased by 800 points to 3600 had the First Proposed Acquisition been consummated. The Second Proposed Acquisition results in no change in market concentration in the Niles Area because it does not involve the acquisition of Shell's terminal in Niles.

***D. Entry Conditions***

17. Entry into the market for terminaling services in the Niles Area is difficult and would not be timely, likely or sufficient to prevent the anticompetitive effects that are likely to result from the proposed merger. Constructing a new terminal is subject to significant regulatory and supply constraints, and would require substantial time to accomplish. As a result, new entry would not be sufficient to constrain the anticompetitive effects that are likely to result from this acquisition.

**IV. EFFECTS OF THE PROPOSED ACQUISITION**

18. Respondents Buckeye and Shell are actual and potential competitors in the supply of terminaling services for gasoline, diesel fuel, and other light petroleum products in the Niles Area.
19. The First Proposed Acquisition, if consummated, would likely have led to a substantial lessening of competition in the supply of terminaling services for gasoline, diesel fuel, and other light petroleum products in the Niles Areas. The First Proposed Acquisition does and would demonstrate these effects in the following ways, among others:

Complaint

- a. by eliminating direct competition between Buckeye and Shell in the supply of terminaling services in the Niles Areas; and
- b. by increasing the likelihood of, or facilitating, collusion or coordinated interaction between the remaining competitors in the relevant market;

each of which increases the likelihood that the prices of gasoline, diesel fuel, and other light petroleum products will increase in the relevant market.

**V. STATUTES VIOLATED**

20. Buckeye's agreement to acquire petroleum product assets from Shell, as originally proposed in the First Proposed Acquisition, may violate Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, and may have, if consummated, violated Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18.

WHEREFORE, THE PREMISES CONSIDERED, the Federal Trade Commission on this seventeenth day of December, 2004, issues its complaint against said Respondents.

Decision &amp; Order

**DECISION AND ORDER**

The Federal Trade Commission (“Commission”), having initiated an investigation of the proposed acquisition by Respondent Buckeye Partners, L.P. (“Buckeye”), of certain refined petroleum products pipeline and terminaling assets from Respondent Shell Oil Company (“Shell”) (collectively “Respondents”), and Respondents having been furnished thereafter with a copy of a draft of Complaint that the Bureau of Competition proposed to present to the Commission for its consideration and which, if issued by the Commission, would charge Respondents with violations of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45; and

Respondents, their attorneys, and counsel for the Commission having thereafter executed an Agreement Containing Consent Order (“Consent Agreement”), containing an admission by Respondents of all the jurisdictional facts set forth in the aforesaid draft of Complaint, a statement that the signing of said Consent Agreement is for settlement purposes only and does not constitute an admission by Respondents that the law has been violated as alleged in such Complaint, or that the facts as alleged in such Complaint, other than jurisdictional facts, are true, and waivers and other provisions as required by the Commission’s Rules; and

The Commission, having thereafter considered the matter and having determined that it had reason to believe that Respondents have violated the said Acts, and that a Complaint should issue stating its charges in that respect, and having accepted the executed Consent Agreement and placed such Consent Agreement on the public record for a period of thirty (30) days for the receipt and consideration of public comments, and having duly considered the comment received from an interested person pursuant to section 2.34 of its Rules, now in further conformity with the procedure described in Commission Rule 2.34, 16 C.F.R. § 2.34, the Commission hereby makes the following jurisdictional findings and issues the following Decision and Order (“Order”):

Decision & Order

1. Respondent Buckeye Partners, L.P., is a publicly-traded limited partnership, organized, existing, and doing business under and by virtue of the laws of the state of Delaware, with its office and principal place of business located at 5 Corporate Center, Suite 500, 100 Matsonford Road, Radnor, Pennsylvania 19087.

2. Respondent Shell Oil Company is a corporation, organized, existing, and doing business under and by virtue of the laws of the state of Delaware, with its office and principal place of business located at 910 Louisiana Street, Houston, Texas 77002.

3. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of Respondents, and the proceeding is in the public interest.

**ORDER**

**I.**

**IT IS ORDERED** that, as used in this Order, the following definitions shall apply:

- A. “Buckeye” means Buckeye Partners, L.P., its partners, directors, officers, employees, agents, representatives, predecessors, successors, and assigns; its joint ventures, subsidiaries, divisions, groups and affiliates controlled by Buckeye, and the respective directors, officers, employees, agents, representatives, predecessors, successors, and assigns of each.
- B. “Shell” means Shell Oil Company, its directors, officers, employees, agents, representatives, predecessors, successors, and assigns; its joint ventures, subsidiaries, divisions, groups and affiliates controlled by Shell; and the respective partners, directors, officers, employees, agents, representatives, successors, and assigns of each.

## Decision &amp; Order

- C. “Acquisition” means the proposed acquisition by Buckeye of certain refined petroleum products pipeline and terminaling assets from Shell pursuant to a Purchase and Sale Agreement dated June 30, 2004, as amended to exclude the Niles Terminal.
- D. “Commission” means the Federal Trade Commission.
- E. “Niles Terminal” means Shell’s refined petroleum product storage and distribution terminal located in Niles, Michigan.
- F. “Person” means any individual, partnership, firm, trust, association, corporation, joint venture, unincorporated organization, or other business or governmental entity.
- G. “Respondents” means Buckeye and Shell, individually and collectively.

**II.****IT IS FURTHER ORDERED** that:

- A. For a period of ten (10) years from the date this Order becomes final, Respondent Buckeye shall not acquire, directly or indirectly, any interest in the Niles Terminal, in connection with the Acquisition or otherwise, without prior written notification to the Commission before consummating any such transaction.

The prior written notification required by this Paragraph shall be given on the Notification and Report Form set forth in the Appendix to Part 803 of Title 16 of the Code of Federal Regulations as amended (hereinafter referred to as the “Notification”), and shall be prepared and transmitted in accordance with the requirements of that part, except that no filing fee will be required for any such Notification, Notification shall be filed with the Secretary of the Commission, Notification need not be made to the United

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States Department of Justice, and Notification is required only of Respondent Buckeye and not of any other party to the transaction, unless otherwise expressly required by this Order. Respondent Buckeye shall provide the Notification to the Secretary of the Commission at least thirty (30) days prior to consummating any such transaction (hereinafter referred to as the “first waiting period”). If, within the first waiting period, representatives of the Commission make a written request for additional information or documentary material (within the meaning of 16 C.F.R. § 803.20), Respondent Buckeye shall not consummate the transaction until thirty (30) days after submitting such additional information or documentary material. Early termination of the waiting periods in this Paragraph may be requested and, where appropriate, granted by letter from the Commission’s Bureau of Competition; *provided, however*, that Respondent Buckeye shall not be required to provide prior notification pursuant to this paragraph of a transaction for which notification is required to be made, and has been made, pursuant to Section 7A of the Clayton Act, 15 U.S.C. § 18a.

- B. For a period of ten (10) years from the date this Order becomes final, Respondent Shell shall not sell, transfer or otherwise convey, directly or indirectly, any interest in the Niles Terminal to any Person, in connection with the Acquisition or otherwise, without prior written notification to the Commission before consummating any such transaction.

The prior written notification required by this Paragraph shall be given on the Notification and Report Form set forth in the Appendix to Part 803 of Title 16 of the Code of Federal Regulations as amended (hereinafter referred to as the “Notification”), and shall be prepared and transmitted in accordance with the requirements of that part, except that no filing fee will be required for any such Notification, Notification shall be filed with the Secretary of the Commission, Notification need not be made to the United

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States Department of Justice, and Notification is required only of Respondent Shell and not of any other party to the transaction, unless otherwise expressly required by this Order. Respondent Shell shall provide the Notification to the Secretary of the Commission at least thirty (30) days prior to consummating any such transaction (hereinafter referred to as the “first waiting period”). If, within the first waiting period, representatives of the Commission make a written request for additional information or documentary material (within the meaning of 16 C.F.R. § 803.20), Respondent Shell shall not consummate the transaction until thirty (30) days after submitting such additional information or documentary material. Early termination of the waiting periods in this Paragraph may be requested and, where appropriate, granted by letter from the Commission’s Bureau of Competition; *provided, however*, that Respondent Shell shall not be required to provide prior notification pursuant to this paragraph of a transaction for which notification is required to be made, and has been made, pursuant to Section 7A of the Clayton Act, 15 U.S.C. § 18a.

**III.**

**IT IS FURTHER ORDERED** that one (1) year from the date this Order becomes final, annually for the next nine (9) years on the anniversary of the date this Order becomes final, and at other times as the Commission may require, Respondents shall file a verified written report with the Commission setting forth in detail the manner and form in which it has complied and is complying with Paragraph II. of this Order.

**IV.**

**IT IS FURTHER ORDERED** that each Respondent shall notify the Commission at least thirty (30) days prior to any proposed (1) dissolution of that Respondent, (2) acquisition, merger or consolidation of that Respondent, or (3) any other change in that Respondent that may affect compliance obligations

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arising out of this Order, including but not limited to assignment, the creation or dissolution of subsidiaries, or any other change in that Respondent.

**V.**

**IT IS FURTHER ORDERED** that, for the purpose of determining or securing compliance with this Order, and subject to any legally recognized privilege, and upon written request with reasonable notice to either Respondent, Respondents shall permit any duly authorized representative of the Commission:

- A. Access, during office hours of that Respondent and in the presence of counsel, to all facilities and access to inspect and copy all books, ledgers, accounts, correspondence, memoranda, and all other records and documents in the possession or under the control of that Respondent related to compliance with this Order; and
- B. Upon five (5) days' notice to that Respondent and without restraint or interference from that Respondent, to interview officers, directors, or employees of that Respondent, who may have counsel present, regarding such matters.



## Analysis

**Analysis of Proposed Agreement Containing Consent Order  
to Aid Public Comment**

The Federal Trade Commission, subject to its final approval, has accepted for public comment an Agreement Containing Consent Order (“Proposed Order”) with Buckeye Partners, L.P. (“Buckeye”) and Shell Oil Company (“Shell”), which is designed to guard against possible anticompetitive effects that could result from the transaction, as originally proposed.

On June 30, 2004, Buckeye and Shell entered into a Purchase and Sale Agreement in which Buckeye proposed to acquire a package of refined petroleum pipeline and terminal assets from Shell for approximately \$530 million. Included in the assets to be acquired was a Shell refined petroleum terminal in Niles, Michigan. In response to competitive concerns raised by staff, the parties subsequently proposed a modified transaction that excludes the Niles, Michigan terminal from the assets to be acquired. The Proposed Order, if accepted by the Commission, would settle charges that the acquisition, as originally proposed, may have substantially lessened competition in the market for the terminaling of gasoline, diesel fuel, and other light petroleum products in the area within fifty miles of Niles, Michigan.

The Proposed Order has been placed on the public record for thirty days for interested persons to comment. Comments received during this thirty day period will become part of the public record. After thirty days, the Commission will again review the Proposed Order and the comments received and will decide whether it should withdraw the Proposed Order or make the Proposed Order final.

**The Proposed Complaint**

Buckeye is a partnership engaged in the storage, terminaling, and pipeline transportation of refined petroleum products, including gasoline, diesel fuel, and other light petroleum products. Shell is a diversified energy company engaged directly and

Analysis

through its subsidiaries in the business of manufacturing, refining, distributing, transporting, terminaling, and marketing a range of petroleum products, including gasoline, diesel fuel, jet fuel, base oil, motor oil, lubricants, petrochemicals, and other petroleum products.

The proposed complaint alleges that a relevant line of commerce in which to evaluate the effects of Buckeye's proposed acquisition is the market for terminaling of gasoline, diesel fuel, and other light petroleum products, and a relevant geographic market may be as small as the area within a fifty-mile radius of Niles, Michigan ("Niles Area"). The proposed complaint further alleges that market for terminaling services in the Niles Area is highly concentrated and that, had the original proposed acquisition been consummated, concentration in that market would have increased by 800 points, as measured by the Herfindahl-Hirschman Index. The acquisition as modified would not change market concentration in the Niles Area because it does not involve the acquisition of Shell's Niles terminal. The proposed complaint also alleges that entry into the terminaling services market in the Niles Area is difficult and would not be timely, likely, or sufficient to deter or counteract the anticompetitive effects of the original proposed acquisition.

The proposed complaint alleges that the acquisition, if consummated as originally proposed, may have led to a substantial lessening of competition in the supply of terminaling services for gasoline, diesel, and other light petroleum products in the Niles Area. The acquisition as originally proposed may have substantially increased concentration in a market that is already highly concentrated. The complaint further alleges competitive harm could result from the elimination of direct competition between Buckeye and Shell in the supply of terminaling services in the Niles Area, and from the increased likelihood of collusion or coordinated interaction between the remaining competitors in the relevant market.

Analysis

**Terms of the Proposed Consent Order**

The Proposed Order requires Buckeye to provide prior notification to the Commission of an acquisition of any interest in the Niles terminal, for a period of ten years. The Proposed Order requires Shell to provide prior notification to the Commission of a sale or transfer of any interest in the Niles terminal, for a period of ten years. These provisions require Buckeye and Shell to comply with premerger notification and waiting periods similar to those found in the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a. (“HSR”).

Consistent with the Commission’s Statement of Policy Concerning Prior Approval and Prior Notice Provisions, 60 Fed. Reg. 39,745 (Aug. 3, 1995), the Proposed Order ensures that the Commission will have the appropriate mechanism to review a proposed sale of the Niles terminal by Shell, or a proposed acquisition of the Niles terminal by Buckeye, that may raise antitrust concerns but would not be reportable under HSR. The Proposed Order affords the Commission the opportunity to guard against such potentially anticompetitive transactions.

By accepting the Proposed Order, subject to final approval, the Commission anticipates that the competitive problem alleged in the Complaint will be resolved. The purpose of this analysis is to invite public comment concerning the Proposed Order to aid the Commission in its determination of whether it should make final the Proposed Order contained in the agreement. This analysis is not intended to constitute an official interpretation of the Proposed Order or to modify its terms in any way.

Complaint

IN THE MATTER OF

**ASPEN TECHNOLOGY, INC.**

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATIONS OF  
SEC. 7 OF THE CLAYTON ACT AND SEC. 5 OF THE  
FEDERAL TRADE COMMISSION ACT

*Docket 9310; File No. 0210153*

*Complaint, August 3, 2003--Decision, December 20, 2004*

This consent order, among other things, requires Respondent Aspen Technology, Inc. -- a developer and worldwide supplier of manufacturing, engineering, and supply chain simulation computer software, used by the refining, oil and gas, petrochemical, chemical, pharmaceutical, and other process manufacturing industries, and by engineering and construction companies that support those industries -- to divest its integrated software business to Bentley Systems, Inc. The order also requires the respondent to divest its batch and continuous process engineering software business to a Commission-approved buyer, and -- in the event that the divested software infringes specific intellectual property rights -- to indemnify the buyer, and either to procure for the buyer the right to continue to use the software, or to modify or replace the software so that it does not infringe the third party's intellectual property rights.

*Participants*

For the Commission: *Peter Richman, Vadim M. Brusser, Lesli C. Esposito, Dennis F. Johnson, Mary N. Lehner, Naomi Licker, Daniel Ducore, Phillip L. Broyles and Mark Frankena.*

For the Respondent: *George S. Cary, David I. Gelfand, Mark W. Nelson, Jeremy J. Calsyn, and Tanya N. Dunne, Cleary, Gottlieb, Steen & Hamilton.*

**COMPLAINT**

The Federal Trade Commission ("Commission"), having reason to believe that Aspen Technology, Inc. ("AspenTech"), a corporation subject to the jurisdiction of the Commission, acquired Hyprotech Ltd., ("Hyprotech"), in violation of Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C.

## Complaint

§ 45 and Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18; and that a proceeding by the Commission in respect thereof would be in the public interest, hereby issues its complaint, stating its charges as follows:

**I. Respondent AspenTech**

1. Respondent AspenTech is a for-profit corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its principal place of business located at Ten Canal Park, Cambridge, Massachusetts 02141.
2. AspenTech is a developer and worldwide supplier of manufacturing, engineering, and supply chain simulation computer software, including non-linear process engineering simulation software used by the refining, oil & gas, petrochemical, specialty chemical, air separation, pharmaceutical, fine chemical and other process manufacturing industries and by engineering and construction companies to support those industries. AspenTech has long offered steady state and dynamic process engineering simulation software under the Aspen Plus trade name and a suite of complementary products within its Aspen Engineering Suite. In fiscal year 2002, AspenTech reported an \$83.5 million loss on revenues of over \$320 million.
3. Respondent AspenTech is, and at all times relevant herein has been, engaged in commerce as defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12, and is a corporation whose business is in or affects commerce as defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 44.

**II. The Acquisition of Hyprotech**

4. Prior to the acquisition by Respondent, Hyprotech was a wholly-owned operating division of AEA Technology plc., a corporation organized, existing and doing business under and

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by virtue of the laws of the United Kingdom. Hyprotech was headquartered in Calgary, Canada, with offices in the United States and other parts of the world.

5. Since its founding in 1976, Hyprotech had been a developer and worldwide supplier of manufacturing, engineering and supply chain simulation computer software, including nonlinear process engineering simulation software used by the refining, oil & gas, petrochemical, specialty chemical, air separation, pharmaceutical, fine chemical and other process manufacturing industries and by engineering and construction companies to support those industries. Hyprotech offered steady state and dynamic process engineering simulation software under the HYSYS trade name and a suite of complementary products within its HYSYS engineering suite of products. In fiscal year 2002, Hyprotech had revenues of approximately \$68.5 million.
6. On or about May 31, 2002, Respondent acquired Hyprotech for approximately \$106 million (“the Acquisition”). The transaction was not reportable under the Hart-Scott-Rodino Act.

### III. Trade and Commerce

7. Process industries are those in which a chemical continuous or batch process is used to produce intermediate or finished consumer products. Continuous process industries include hydrocarbon, chemical and air separation industries. Batch process industries include the pharmaceutical and fine chemical industries.
8. Flowsheet simulation software, using non-linear variables, mathematically models a process, creating a virtual plant on a personal computer. Flowsheet programs are the backbone of process simulation and optimization software. The flowsheet, using established chemical engineering properties or “1<sup>st</sup> Principles,” accurately predicts what happens in a process unit

## Complaint

or system. Through a graphical interface, the flowsheet allows its user to take into account the process units in a plant, the dynamics between units and the chemistry of the processed materials. Such computer simulations improve engineering design, reduce capital investment, lower the cost of inputs and optimize production levels and potentially shorten the time to market for new products.

9. There are two fundamental types of flowsheets: steady-state and dynamic. Steady-state flowsheets model a process at one point in time; they are snapshots of a plant operating at its intended optimum. Aspen Plus (AspenTech), HYSYS.Process (Hyprotech) and Pro/II (Simulation Sciences (SimSci)) are the most widely used steady-state flowsheets to model continuous process industries. In dynamic simulation, the flowsheet models the same variables as the steady state simulation, adding the ability to measure the effect of changes over time. A flowsheet with dynamic capabilities can model start-ups, shutdowns, upsets and changes that occur in a continuous process over time. Aspen Plus with Aspen Dynamics and HYSYS with the dynamic option are the two leading dynamic simulators for continuous process industries. Both Aspen Dynamics and the HYSYS dynamic option require customers to purchase the steady-state flowsheet to access the dynamic.
10. Flowsheets are designed to rigorously represent the processes that they simulate. The mathematic rigor necessary to model reactions and interactions in the process industries makes these programs very slow to solve any given question. For this reason, they have limited utility in solving plant-wide optimization exercises. Prior to the Acquisition, next-generation flowsheet solutions – non-linear simulators that can solve whole plant optimization questions in an economically reasonable time-frame – were in commercial release and on-going development by Hyprotech and AspenTech.

Complaint

11. Batch process simulation is the modeling of processes that entail a single production run with a finite beginning and end. With a batch process, a manufacturer combines a set of ingredients in a single piece of equipment that performs multiple tasks to arrive at a finished substance. Batch process differs from continuous process in that continuous process experiences an ongoing flow of inputs and outputs. Batch flowsheet simulation software is essentially continuous flowsheet simulation tailored expressly for batch processes. Batch process software is particularly suited to pharmaceutical and fine chemical production. Prior to the Acquisition, BatchPlus from AspenTech was the leading batch simulator ahead of the BaSYS suite from Hyprotech.
12. Many customers of flowsheet simulation software have operations in multiple process industries and therefore license software for more than one industry. For example, many engineering and construction companies design both hydrocarbon process plants and chemical plants. Those companies license flowsheet software for both industries. Other engineering and construction companies may be engaged in only one discrete industry and thus license flowsheet software for only that industry. For example, some engineering and construction companies are involved solely in air separation and license flowsheet software for only that industry. However, there are large, vertically integrated companies that license software that is used in all parts of hydrocarbon and chemical processes. Whether they license software for application to many process industries or one specialized industry, there are still only three companies that license the necessary software: AspenTech, Hyprotech and SimSci.
13. Integrated engineering software gathers information generated from process engineering software and allows users to store, update and retrieve data depending on their needs. The software allows for the more efficient use of process engineering tools. Prior to the Acquisition,



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AspenTech's Zyqad was the leading application for these uses and Hyprotech's integrated engineering product, AXSYS, was in development and ready for release to committed buyers.

14. Prior to the Acquisition, competition between AspenTech and Hyprotech to develop, license and support continuous and batch process engineering simulation flowsheet software and integrated engineering software was direct and vigorous and helped to hold down prices and to promote product innovation.

#### **IV. Relevant Product Markets**

15. Relevant product markets in which to assess the likely effects of the Acquisition are:
  - a. continuous process engineering simulation flowsheet software for process industries;
  - b. continuous process engineering simulation flowsheet software for upstream oil and gas process industries;
  - c. continuous process engineering simulation flowsheet software for downstream refining process industries;
  - d. continuous process engineering simulation flowsheet software for chemical process industries;
  - e. continuous process engineering simulation flowsheet software for air separation process industries;
  - f. batch process engineering simulation flowsheet software for process industries; and
  - g. Integrated engineering software for process industries.

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### **V. Relevant Geographic Market**

16. The relevant geographic market in which to assess the likely effects of the Acquisition in each of the relevant product markets is the world.

### **VI. Concentration**

17. Each of the relevant product markets is highly concentrated.
18. Prior to the Acquisition, AspenTech and Hyprotech were direct and actual competitors in the development, license and support of continuous and batch process engineering simulation flowsheet software in each of the relevant product markets. AspenTech and Hyprotech competed with each other on price and service, and competed through innovation to provide software that would enhance the efficiency and performance of customers' process plants.
19. The Acquisition combined the two most significant and closest competitors providing continuous process engineering simulation flowsheet software. AspenTech documents admit a share post-acquisition between 67% and 80% of the continuous process flowsheet market. The Acquisition may create a worldwide dominant firm in continuous process engineering simulation flowsheet software.
20. The Acquisition combined the two most significant and closest competitors providing continuous process engineering simulation flowsheet software to upstream oil and gas process industries. The Acquisition may create a worldwide dominant firm in continuous process engineering simulation flowsheet software for upstream oil and gas process industries.
21. The Acquisition combined the two most significant and closest competitors providing continuous process

## Complaint

engineering simulation flowsheet software to downstream refining process industries. The Acquisition may create a worldwide dominant firm in continuous process engineering simulation flowsheet software for downstream refining process industries.

22. The Acquisition combined the two most significant and closest competitors providing continuous process engineering simulation flowsheet software to chemical process industries. The Acquisition may create a worldwide dominant firm in continuous process engineering simulation flowsheet software for chemical process industries.
23. The Acquisition combined the two most significant and closest competitors providing continuous process engineering simulation flowsheet software to air separation process industries. The Acquisition may create a worldwide dominant firm in continuous process engineering simulation flowsheet software for air separation process industries.
24. The Acquisition combined the two largest and closest competitors providing batch process engineering simulation flowsheet software. The Acquisition may create a worldwide dominant firm in batch process engineering simulation flowsheet software.
25. Prior to the Acquisition, AspenTech and Hyprotech were direct and actual competitors in the development, license and support of integrated engineering software for process industries. AspenTech and Hyprotech competed with each other on price and service, and competed through innovation to provide software that would enhance the efficiency and performance of customers' process plants.
26. The Acquisition combined the two firms providing integrated engineering software for process industries. The Acquisition may create a worldwide dominant firm in integrated engineering software for process industries.

Complaint

27. At the time of the Acquisition, Respondent, Hyprotech and SimSci were the only providers of a substantial, if not complete, set of features and capabilities in process engineering simulation software. SimSci had been losing market share to Hyprotech and AspenTech since the mid-1990s.

**VII. Conditions of Entry**

28. Entry into the licensing, sale, development and enhancement of the relevant product markets would not be timely, likely or sufficient in its magnitude, character and scope to deter or counteract anticompetitive effects of the Acquisition. Customers consider supplier reputation key to purchase decisions in each of the relevant markets. Customers are reluctant to engage the services of a new entrant because of the potential economic loss associated with simulation software bugs and potential loss of legacy data. Entry is difficult because of the substantial cost and time needed to develop, validate and establish a reputation for reliability.

**VIII. Anticompetitive Effects of the Acquisition**

29. The Acquisition may substantially lessen competition in the following ways, among others:
- a. it eliminates actual, direct and substantial competition between AspenTech and Hyprotech, which both had the ability and incentive to compete, and before the acquisitions did compete, on price and product development and enhancements;
  - b. it increases the level of concentration in the relevant markets;

## Complaint

- c. it eliminates price competition between AspenTech and Hyprotech and may lead to reduced price competition, leading to increased prices;
- d. it eliminates innovation competition between AspenTech and Hyprotech and may lead to reduced innovation competition, withholding or delaying product development and enhancements;
- e. it enhances AspenTech's power to raise prices above a competitive level;
- f. it may give AspenTech market power in the relevant markets;
- g. it may allow AspenTech unilaterally to exercise market power in the relevant markets, through the combination of AspenTech and Hyprotech, the two closest competitors on price and innovation;
- h. it prevents other suppliers of process engineering or supply chain software from acquiring Hyprotech and increasing competition; and
- i. it creates a single entity that could undermine the ability of open standard setting organizations to decrease barriers to entry, thereby limiting innovation and third-party entry to provide niche applications except with AspenTech approval.

**IX. Violation Charged**

- 30. The allegations contained in paragraphs 1 through 29 are repeated and realleged as though fully set forth here.
- 31. The effect of the Acquisition may be substantially to lessen competition or tend to create a monopoly in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the FTC Act, as amended, 15 U.S.C. § 45.

Complaint

32. Respondent's acquisition of Hyprotech will continue to cause, absent the relief described in the attached Notice of Contemplated Relief, the anticompetitive effects identified above.

**NOTICE**

Proceedings on the charges asserted against you in this complaint will be held before an Administrative Law Judge ("ALJ") of the Federal Trade Commission, under Part 3 of the Commission's Rules of Practice, 16 C.F.R. § 3.1 *et seq.* A copy of Part 3 of the Rules is enclosed with this complaint.

You may file an answer to this complaint. Any such answer must be filed within 20 days after service of the complaint on you. If you contest the complaint's allegations of fact, your answer must concisely state the facts constituting each ground of defense, and must specifically admit, deny, explain, or disclaim knowledge of each fact alleged in the complaint. You will be deemed to have admitted any allegations of the complaint that you do not so answer.

If you elect not to contest the allegations of fact set forth in the complaint, your answer shall state that you admit all of the material allegations to be true. Such an answer shall constitute a waiver of hearings as to the facts alleged in the complaint and, together with the complaint, will provide a record basis on which the ALJ will file an initial decision containing appropriate findings and conclusions and an appropriate order disposing of the proceeding. Such an answer may, however, reserve the right to submit proposed findings and conclusions and the right to appeal the initial decision to the Commission under Section 3.52 of the Commission's Rules of Practice.

If you do not answer within the specified time, you waive your right to appear and contest the allegations of the complaint. The ALJ is then authorized, without further notice to you, to find that

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the facts are as alleged in the complaint and to enter an initial decision and a cease and desist order.

The ALJ will schedule an initial prehearing scheduling conference to be held not later than 14 days after the last answer is filed by any party named as a respondent in the complaint. Unless otherwise directed by the ALJ, the scheduling conference and further proceedings will take place at the Federal Trade Commission, 600 Pennsylvania Avenue, N.W., Washington, D.C. 20580. Rule 3.21(a) requires a meeting of the parties' counsel as early as practicable before the prehearing scheduling conference, and Rule 3.31(b) obligates counsel for each party, within 5 days of receiving a respondent's answer, to make certain initial disclosures without awaiting a formal discovery request.

A hearing on the complaint will begin on November 6, 2003, in Room 532, or such other date as determined by the ALJ. At the hearing, you will have the right to contest the allegations of the complaint and to show cause why a cease and desist order should not be entered against you.

**NOTICE OF CONTEMPLATED RELIEF**

Should the Commission conclude from the record developed in any adjudicative proceedings in this matter that the acquisition challenged in this proceeding violates Section 7 of the Clayton Act, as amended, or Section 5 of the Federal Trade Commission Act, as amended, the Commission may order such relief against respondent as is supported by the record and is necessary and appropriate. Such relief may include, but is not limited to, an order to:

1. Cease and desist from any action to effect the acquisition or continued holding by AspenTech of any assets or businesses of Hyprotech.
2. Rescind the acquisition.

Complaint

3. Reestablish two distinct and separate, viable and competing businesses, one of which shall be divested by AspenTech to a buyer acceptable to the Commission, engaged in the design, license and continued development and support of all of the lines of commerce alleged in the complaint, including but not limited to:
  - a. divesting all Hyprotech software, intellectual property, contract rights, and other assets for the operation of such business, including but not limited to all Hyprotech applications, features, enhancements, and library functions for all operating systems and computer platforms, source code, object libraries, executable programs, model development, test problems, test results, development support software, trade secrets, trademarks, patents, know-how, interfaces with complementary software, APIs, manuals, guides, reports, and other documentation;
  - b. divesting, replacing and reconstituting all research and development, improvements to existing products and new products developed by AspenTech or Hyprotech, and such other businesses as necessary to ensure each of their viability and competitiveness in the lines of commerce alleged in the complaint and each possessed;
  - c. reconstituting and divesting customer contracts; and
  - d. facilitating the acquirers' recruitment of Respondent's employees, including but not limited to providing employee lists, personnel files, opportunities to interview and negotiate with the acquirers, eliminating any restriction on or disincentives to accepting employment with the acquirers, and providing incentives for such employees to accept employment with the acquirers.
4. Destroy any copies of Hyprotech intellectual property, including source code and executable code.



## Complaint

5. Prohibit the use of any Hyprotech competitive or technological information gained since the Acquisition.
6. Cease and desist from any horizontal agreements with competitors to prevent or deter standard setting organizations from adopting standards to benefit consumers of products covered under the appropriate standards; provided that no relief shall require the competing companies to participate in any standard setting activity.
7. For a defined period, not restrict, preclude or influence a supplier of complementary software or services from dealing with the acquirers or the acquirers' products.
8. Provide such other or additional relief as is necessary to ensure the creation of one or more viable, competitive independent entities to compete against AspenTech in the manufacture and sale of relevant products with features and capabilities at least equal to those offered by Hyprotech prior to the Acquisition.
9. Require AspenTech to provide the Commission with notice in advance of the acquisition of the assets or securities of, or any other combination with, any person engaged in the manufacture or sale of any relevant product.

WHEREFORE, THE PREMISES CONSIDERED, the Federal Trade Commission on this sixth day of August, 2003, issues its complaint against said Respondent.

Decision and Order

## **DECISION AND ORDER**

The Federal Trade Commission (“Commission”) having heretofore issued its complaint charging Aspen Technology, Inc. (“Respondent”), with violations of Section 5 of the Federal Trade Commission Act, as amended, and Section 7 of the Clayton Act, as amended, and Respondent having been served with a copy of that complaint, together with a notice of contemplated relief, and Respondent having answered the complaint denying said charges but admitting the jurisdictional allegations set forth therein; and

The Respondent, its attorneys, and counsel for the Commission having thereafter executed an agreement containing a consent order, an admission by the Respondent of all the jurisdictional facts set forth in the complaint, a statement that the signing of said agreement is for settlement purposes only and does not constitute an admission by Respondent that the law has been violated as alleged in such complaint, or that the facts as alleged in such complaint, other than jurisdictional facts, are true and waivers and other provisions as required by the Commission’s Rules; and

The Secretary of the Commission having thereafter withdrawn the matter from adjudication in accordance with § 3.25(c) of its Rules; and

The Commission having thereafter considered the matter and having thereupon accepted the executed consent agreement and placed such agreement on the public record for a period of thirty (30) days, now in conformity with the procedure prescribed in § 3.25(f) of its Rules, the Commission hereby makes the following jurisdictional findings and enters the following Order:

1. Aspen Technology, Inc., is a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its principal place of business located at Ten Canal Park, Cambridge, Massachusetts 02141.

## Decision and Order

2. The Federal Trade Commission has jurisdiction of the subject matter of this proceeding and of the Respondent, and the proceeding is in the public interest.

**ORDER****I.**

**IT IS ORDERED** that, as used in this Order, the following definitions shall apply:

- A. “AspenTech” or “Respondent” means Aspen Technology, Inc., its directors, officers, employees, agents, representatives, predecessors, successors, and assigns; its joint ventures, subsidiaries, divisions, groups and affiliates controlled by Aspen Technology, Inc., and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.
- B. “Acquisition” means Respondent’s acquisition of Hyprotech on or about May 31, 2002.
- C. “AEA Partnership Agreement” means the AXSYS.Integrity Development Partnership Agreement, dated July 26, 2001, between AEA Technology plc, and Respondent under which AEA Technology plc, licenses Integrity Modules, as defined therein, to Respondent.
- D. “AXSYS” means AXSYS collaborative engineering Software and other products for collaborative engineering and knowledge management for plant engineering and design automation including but not limited to AXSYS.Engine, AXSYS.Process, AXSYS.Integrity, AXSYS.Server, and PlantSchema and the associated Interfaces.

Decision and Order

E. "AXSYS Assets" means the following:

1. all of Respondent's interests in and rights to all Software and other products (including all development work in process for existing and proposed or terminated products) comprising the AXSYS collaborative engineering and knowledge management software solution for plant engineering and design automation, including but not limited to:
  - a. AXSYS.Engine, AXSYS.Process, AXSYS.Integrity, AXSYS.Server, and PlantSchema; and
  - b. all associated Interfaces, including but not limited to process, sizing, and costing interfaces;
2. all inventories (including but not limited to all inventories of finished AXSYS products and all development work) of the AXSYS Business, and the computer equipment listed in Schedule 1.2 of the Bentley Purchase Agreement;
3. a copy of all books, records, and financial files relating to the AXSYS Business;
4. all rights to all licenses, license agreements, and customer contracts described in Section 4.10 of the Disclosure Statement of the Bentley Purchase Agreement, including the AEA Partnership Agreement;
5. all Owned Intellectual Property Rights used solely in the operation of AXSYS Business;
6. a non-exclusive right to all Owned Intellectual Property Rights used both in AXSYS and in other of Respondent's Software and other products;
7. rights to all Licensed Intellectual Property Rights necessary to the operation of the AXSYS Business;

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*provided, however,* that, after divestiture to the Commission-approved Acquirer, Respondent shall not be responsible for payment of any fees or charges associated with the Commission-approved Acquirer's use of the Licensed Intellectual Property;

8. for material relating solely to the AXSYS Business, all marketing and sales materials used anywhere in the world, including but not limited to all advertising materials, training materials (including all electronic files of training materials), sales materials (including product data, price lists, and mailing lists), promotional and marketing materials, marketing information, educational materials, competitor information (including research data, market intelligence reports, and statistical programs), customer information (including customer sales information, customer lists, customer files, customer contact information, and customer support log data bases), sales forecasting models, Website content, and advertising and display materials; *provided, however,* that Respondent may retain a copy of such material to the extent necessary for tax, accounting, or legal purposes, including as required by applicable laws and regulations; and
9. for material relating both to the AXSYS Business and to other of Respondent's businesses, a copy of all marketing and sales materials used anywhere in the world to the extent such materials relate to the AXSYS Business, including but not limited to all advertising materials, training materials (including all electronic files of training materials), sales materials (including product data, price lists, and mailing lists), promotional and marketing materials, marketing information, educational materials, competitor information (including research data, market intelligence reports, and statistical programs), customer information (including customer sales information, customer lists, customer files,

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customer contact information, and customer support log data bases), sales forecasting models, Website content, and advertising and display materials.

“AXSYS Assets” shall not include:

1. items listed in Schedule 1.3 of the Bentley Purchase Agreement;
  2. except to the extent used solely in the AXSYS Business, business names, registered and unregistered trademarks, service marks, trade names, logos, Internet domain names, and corporate names and applications, registrations and renewals related thereto (or portions thereof), and associated goodwill;
  3. rights to third-party Intellectual Property that the Commission-approved Acquirer either has or obtains independent of its acquisition of the AXSYS Assets;
  4. any other of Respondent’s products that Interface with AXSYS; and
  5. contracts for support and maintenance services with customers who have not consented, or because of contractual constraints cannot consent, to the assignment of the contract to the Commission-approved Acquirer; *provided, however*, that if the Commission-approved Acquirer provides maintenance relating to AXSYS to these customers, then Respondent shall transfer all such maintenance payments due pursuant to the contracts to the Commission-approved Acquirer.
- F. “AXSYS Business” means the business of researching, developing, designing, marketing, selling, licensing, providing, maintaining, servicing, supporting, improving, enhancing, and updating AXSYS.

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- G. “Bentley” means Bentley Systems, Incorporated, a corporation organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its offices and principal place of business located at 685 Stockton Drive, Exton, PA, 19341.
- H. “Bentley Purchase Agreement” means the Asset Purchase Agreement by and among Bentley Systems, Incorporated, and Respondent, dated May 22, 2004, and includes all schedules, exhibits, and ancillary agreements, attached as Confidential Appendix B.
- I. “CAPE-OPEN Standards,” “CAPE-OPEN Thermo and Units Standards,” and “CAPE-OPEN Thermo Standard” mean the uniform standards for interfacing process modeling software components developed specifically for the design and operation of chemical processes developed by CAPE-OPEN, currently operating as the CAPE-OPEN Laboratories Network (“CO-LaN”), a Standard-Setting Organization in the process simulation and optimization industry.
- J. “Commission” means the Federal Trade Commission.
- K. “Commission-approved Acquirer” means (1) any acquirer of the Engineering Software Assets approved by the Commission pursuant to Paragraphs II. or VI. of this Order, or (2) any acquirer of the AXSYS Assets approved by the Commission pursuant to Paragraphs III. or VI. of this Order, including Bentley.
- L. “Defect” means a material error in programming logic or documentation in the Hyprotech Process Engineering Simulation Software attributable to Respondent that prevents the performance of a principal computing function as set forth in Respondent’s published specifications for the Hyprotech Process Engineering Simulation Software.

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- M. “Delivered Intellectual Property” means Intellectual Property relating to the Hyprotech Process Engineering Simulation Software that is transferred pursuant to this Order, in the form such software is delivered by Respondent to the Commission-approved Acquirer of the Engineering Software Assets as of the date of delivery (without modification of any kind by any Person other than Respondent).
- N. “Divestiture Agreement” means any agreement or agreements approved by the Commission pursuant to which Respondent or a trustee divests assets as required by this Order.
- O. “Engineering Software Assets” means OTS Assets and Hyprotech Process Engineering Simulation Software Assets.
- P. “Hyprotech” means Hyprotech, Ltd., which, prior to May 31, 2002, was a wholly-owned operating division of AEA Technology plc, a corporation organized, existing, and doing business under and by virtue of the laws of the United Kingdom and, subsequent to the Acquisition, became a wholly-owned subsidiary of Respondent, and includes all subsidiaries.
- Q. “Hyprotech Process Engineering Simulation Software” means the Hyprotech family of products, which includes the products and interfaces sold or licensed under the HYSYS name and the related batch process development, conceptual engineering, heat exchanger and hydraulics software identified in Appendix A(1), but shall not include the products identified in Appendix A(2).
- R. “Hyprotech Process Engineering Simulation Software Assets” means the following:



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1. all of Respondent's interests in and rights to all Software and other products (including all development work in process for existing and proposed or terminated products) comprising Hyprotech Process Engineering Simulation Software;
2. all Owned Intellectual Property Rights used solely in the operation of the Hyprotech Process Engineering Simulation Software Business;
3. a non-exclusive right to all Owned Intellectual Property Rights used both in Hyprotech Process Engineering Simulation Software and other of Respondent's Software and other products;
4. rights to all Licensed Intellectual Property Rights relating to Software embedded in Hyprotech Process Engineering Simulation Software; *provided, however,* that, after divestiture to the Commission-approved Acquirer, Respondent shall not be responsible for payment of any fees or charges associated with the Commission-approved Acquirer's use of the Licensed Intellectual Property;
5. a license to use trademarks owned by Respondent to the Hyprotech Process Engineering Simulation Software products for a period of one (1) year from the date of divestiture of the Hyprotech Process Engineering Simulation Software Assets;
6. a copy of all marketing and sales materials used anywhere in the world to the extent such materials relate to the Hyprotech Process Engineering Simulation Software Business, including but not limited to all advertising materials, training materials (including all electronic files of training materials), sales materials, promotional and marketing materials, marketing information, educational materials, Website content, and

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advertising and display materials; and

7. a list of all Hyprotech Process Engineering Simulation Software customers as of the date of the Acquisition and, if different, as of the date of divestiture of the Hyprotech Process Engineering Simulation Software Assets, including the name and address of the customer; the name of a contact person, and his or her mailing address, e-mail address, and telephone number; the products licensed or serviced; and the termination date of the customer's contract.

“Hyprotech Process Engineering Simulation Software Assets” shall not include:

1. any business names, registered and unregistered trademarks, service marks, trade names, logos, Internet domain names, and corporate names and applications, registrations and renewals related thereto (or portions thereof), and associated goodwill;
  2. any other of Respondent's products that Interface with Hyprotech Process Engineering Simulation Software;
  3. rights to third-party Intellectual Property that the Commission-approved Acquirer either has or obtains independent of its acquisition of the Hyprotech Process Engineering Simulation Software Assets; and
  4. materials related to the pricing or discounting of Hyprotech Process Engineering Simulation Software, including but not limited to pricing or discount lists, plans, policies, practices, forecasts, strategies, or analyses.
- S. “Hyprotech Process Engineering Simulation Software Business” means the business of researching, developing, designing, marketing, selling, licensing, providing,

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maintaining, supporting, improving, and updating Hyprotech Process Engineering Simulation Software.

- T. “Intellectual Property” means all of the following throughout the world:
1. all patents, patent applications and patent disclosures and utility models, together with all re-issuances, continuations, continuations-in-part, revisions, extensions, and re-examinations thereof;
  2. copyrightable works, copyrights and applications, registrations and renewals related thereto;
  3. know-how, trade secrets, improvements, designs, techniques, and processes;
  4. business names, registered and unregistered trademarks, service marks, trade names, logos, Internet domain names, and corporate names and applications, registrations and renewals related thereto (or portions thereof), and associated goodwill; and
  5. all other intellectual property rights of a proprietary nature, including but not limited to derivative rights.
- U. “Interface” means (1) (as a noun) the language and codes that two independent Software applications use to communicate with each other and with the hardware; and (2) (as a verb) to connect with or interact with by means of the language and codes that two independent Software applications use to communicate with each other and with the hardware.
- V. “Licensed Intellectual Property Rights” means all of Respondent’s sublicensable interests in and rights to Intellectual Property that is licensed to Respondent by any third person pursuant to an agreement under which

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Respondent has the right to grant a sublicense to a Commission-approved Acquirer.

- W. “New Product” means any product, technology, innovation, or module that is not available from Respondent as part of its standard support and maintenance agreements.
- X. “OTS Assets” means the following:
1. all of Respondent’s interests in and rights to all Software and other products (including all development work in process for existing and proposed or terminated products) and associated Interfaces identified in Appendix A(3);
  2. all inventories (including but not limited to all inventories of finished products and all development work relating to the products identified in Appendix A(3)) of the OTS Business, and the equipment and other tangible personal property necessary to the operation of the OTS Business;
  3. a copy of all books, records, and financial files relating to the OTS Business;
  4. all customer contracts relating solely to the OTS Business;
  5. subcontracted rights to perform and receive payment for all operator training services and Software (and only to the extent such rights to perform and receive payments are for operator training services and Software) included in customer contracts that also include rights to perform and receive payment for other of Respondent’s Software or other products;
  6. all Owned Intellectual Property Rights used solely in the

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- operation of the OTS Business;
7. a non-exclusive right to all Owned Intellectual Property Rights used both in the Software and other products  
  
described in Paragraph I.X.1 and in other of Respondent's Software and other products;
  8. rights to all Licensed Intellectual Property Rights necessary to the operation of the OTS Business; *provided, however,* that, after divestiture to the Commission-approved Acquirer, Respondent shall not be responsible for payment of any fees or charges associated with the Commission-approved Acquirer's use of the Licensed Intellectual Property;
  9. for material relating solely to the OTS Business, all marketing and sales materials used anywhere in the world, including but not limited to all advertising materials, training materials (including all electronic files of training materials), sales materials (including product data, price lists, and mailing lists), promotional and marketing materials, marketing information, educational materials, competitor information (including research data, market intelligence reports, and statistical programs), customer information (including customer sales information, customer lists, customer files, customer contact information, and customer support log data bases), sales forecasting models, Website content, and advertising and display materials; *provided, however,* that Respondent may retain a copy of such material to the extent necessary for tax, accounting, or legal purposes, including as required by applicable laws and regulations; and
  10. for material relating both to the OTS Business and to other of Respondent's businesses, a copy of all marketing and sales materials used anywhere in the

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world to the extent such materials relate to the OTS Business, including but not limited to all advertising materials, training materials (including all electronic files of training materials), sales materials (including product data, price lists, and mailing lists), promotional and marketing materials, marketing information, educational materials, competitor information (including research data, market intelligence reports, and statistical programs), customer information (including customer sales information, customer lists, customer files, customer contact information, and customer support log data bases), sales forecasting models, Website content, and advertising and display materials.

“OTS Assets” shall not include:

1. rights to third-party Intellectual Property that the Commission-approved Acquirer either has or obtains independent of its acquisition of the OTS Assets;
  2. any of Respondent’s other products that Interface with the Software and other products described in Paragraph I.X.1.; and
  3. except to the extent used solely in the OTS Business, business names, registered and unregistered trademarks, service marks, trade names, logos, Internet domain names, and corporate names and applications, registrations and renewals related thereto (or portions thereof), and associated goodwill.
- Y. “OTS Business” means Respondent’s business of researching, developing, designing, marketing, licensing, selling, providing, maintaining, servicing, supporting, improving, enhancing, and updating software and providing services to the extent used for the development and implementation of a computer system connected to a

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real or emulated distributed control system that simulates by use of dynamic simulation models the performance and reactions of a designated process plant for the training of process plant operators.

- Z. “Owned Intellectual Property Rights” means all of Respondent’s interests in and rights to Intellectual Property that is owned by Respondent.
- AA. “Person” means any natural person, partnership, corporation, company, association, trust, joint venture or other business or legal entity, including any governmental agency.
- BB. “Release” means the following: (1) new versions of a Software product and related documentation with new features and/or significant enhancements or (2) revisions to a version of a Software product and related documentation with changes and/or Defect corrections, which, in each case, AspenTech makes generally available to its customers as part of its standard support and maintenance services without any separate charge. “Release” shall not include “New Product.”
- CC. “Software” means any type of computer code, including but not limited to, source code, object code, executable programs, software scripts, modules, add-ons, patches, bug fixes, library functions, object libraries, test programs, testing and quality control information (including lists of known bugs), test results, regression test software, enhancements, customization, development tools, development environments, and proprietary programming languages.
- DD. “Specified Proceedings” means the following:
1. the arbitration proceeding pending in London before Philip Naughton, or his successor, between KBC

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Advanced Technologies plc and KBC Advanced Technologies, Inc., on the one hand, and AEA Technology plc, Hyprotech, Ltd., and Hyprotech, Inc., on the other hand, for which an award was issued on or about April 22, 2004; and

2. any governmental proceedings, and any orders or judgments issued in connection with the above proceeding, relating to or arising out of such arbitration, including without limitation the Interlocutory Order signed and filed on or about May 7, 2004 in the matter captioned *KBC Advanced Technologies plc and KBC Advanced Technologies, Inc. v. AEA Technology plc, Hyprotech, Ltd., and Hyprotech, Inc.* pending before the District Court of Harris County, Texas, Cause No. 2002-44783.

EE. “Standard-Setting Organization” means any formal group, organization, association, membership or stock corporation, or other entity that, through voluntary participation of interested or affected parties, is engaged in the development, promulgation, promotion or monitoring of product or process standards for the process simulation and optimization industry, or any segment thereof, anywhere in the world.

FF. “Third-party Developer” means an entity, other than Respondent, the Commission-approved Acquirer of the AXSYS Assets, or their respective customers, that is engaged in the development of Software for process industries.

GG. “Zyqad” means the AspenTech software that integrates front-end engineering processes with the management of process data and knowledge.



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**II.****IT IS FURTHER ORDERED** that:

A. Respondent shall either:

1. (a) divest the Engineering Software Assets, absolutely and in good faith, and at no minimum price, only to an acquirer that receives the prior approval of the Commission and only in a manner that receives the prior approval of the Commission, no later than ninety (90) days after this Order becomes final; and (b) submit to the Commission, pursuant to Rule 2.41(f) of the Commission's Rules of Practice, a complete application (including an executed purchase agreement) for approval of the divestiture required by Paragraph II., no later than five (5) days after this Order becomes final; or
2. if Respondent has not submitted to the Commission a complete application in compliance with Paragraph II.A.1. above, divest the Engineering Software Assets, absolutely and in good faith, and at no minimum price, no later than sixty (60) days after this Order becomes final, only to an acquirer that receives the prior approval of the Commission and only in a manner that receives the prior approval of the Commission;

*provided, however,* that Respondent shall have a right to obtain from the Commission-approved Acquirer: (1) for any purpose, a perpetual, world-wide, royalty-free right to prepare derivative works of, modify, enhance, improve, maintain, support, make, have made, use, develop, reproduce, demonstrate, promote, sell, offer to sell, distribute, transmit, and import Hyprotech Process Engineering Simulation Software products (in source code form, object code form, executable code form, or any other applicable form) and all Owned Intellectual Property used solely in the operation of the Hyprotech Process

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Engineering Simulation Software Business; and (2) for any purpose other than the OTS Business, a perpetual, world-wide, royalty-free right to prepare derivative works of, modify, enhance, improve, maintain, support, make, have made, use, develop, reproduce, demonstrate, promote, sell, offer to sell, distribute, transmit, and import MUSIC and OTISS (in source code form, object code form, executable code form, or any other applicable form).

- B. Any Divestiture Agreement between Respondent and the Commission-approved Acquirer shall be deemed incorporated into this Order, and any failure by Respondent to comply with any term of such Divestiture Agreement shall constitute a failure to comply with this Order.
  
- C. Prior to the date of divestiture of the Engineering Software Assets to the Commission-approved Acquirer, Respondent shall secure all consents, approvals, and waivers from all Persons (other than Respondent or the Commission-approved Acquirer) that are necessary for the divestiture of the Engineering Software Assets to the Commission-approved Acquirer or for the continued use, development, designing, enhancement, improvement, production, licensing, sale, marketing, distribution, or servicing of the Engineering Software Assets by the Commission-approved Acquirer. In the event that Respondent is unable to satisfy all conditions necessary to divest any intangible asset as contemplated in this Order, Respondents shall: (1) with respect to permits, licenses, or other rights granted by governmental authorities (other than patents), provide such assistance as the Commission-approved Acquirer may reasonably request in the Commission-approved Acquirer's efforts to obtain comparable permits, licenses or rights, and (2) with respect to all other intangible assets, including but not limited to Software, Intellectual Property (including patents), or contractual rights, substitute functionally equivalent assets or arrangements, subject to the approval of the Commission.

## D. Respondent shall:

1. for two (2) years following the date of divestiture of the Engineering Software Assets, at no additional cost to the Commission-approved Acquirer of the Engineering Software Assets, provide the Commission-approved Acquirer with all Releases (in source, object, and executable code form and including all related documentation) for Respondent's Hyprotech Process Engineering Simulation Software. Respondent shall ship Releases in source, object, and executable code form to the Commission-approved Acquirer of the Engineering Software Assets on or before the same date as Respondent ships such Releases to Respondent's manufacturing vendor for mass production of such Releases; *provided, however*, that, notwithstanding the above, Respondent shall provide any Releases, the sole purpose of which is to correct Defects, to the Commission-approved Acquirer of the Engineering Software Assets on or before the same date that such Releases are provided to Respondent's customers; and
  2. no later than fourteen (14) days after the end of the two-year period described in Paragraph II.D.1, deliver to the Commission-approved Acquirer of the Engineering Software Assets a copy of the Releases for Respondent's Hyprotech Process Engineering Simulation Software in source, object, and executable code form that are under development by Respondent as such Releases exist on the second anniversary of the date of divestiture of the Engineering Software Assets.
- E. For two (2) years following the date of divestiture of the Engineering Software Assets, Respondent shall provide to the Commission-approved Acquirer of the Engineering Software Assets, upon reasonable notice and at reasonable times and levels, personnel, information, assistance, advice

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or training relating to Hyprotech Process Engineering Simulation Software as necessary or appropriate to effectuate the purposes of this Order. Respondent shall not charge the Commission-approved Acquirer of the Engineering Software Assets more than Respondent's own direct, out-of-pocket expenses of labor and travel in providing such services, not including overhead or administrative expenses.

- F. Respondent shall, for a period of two (2) years from the date of divestiture of the Engineering Software Assets:
1. allow any customer who uses Hyprotech Process Engineering Simulation Software, without penalty, to:
    - a. modify its current agreements with Respondent to allow for renewal of annual software maintenance and support with respect to less than the complete range of products covered by the current agreements and to allocate fees for the products remaining in the agreement on a pro rata basis, to enable such customer to deal with the Commission-approved Acquirer; and
    - b. obtain additional copies of Software from the Commission-approved Acquirer of the Engineering Software Assets without effecting a termination of an existing license agreement or maintenance and support services agreement with Respondent with respect to Software licensed by Respondent; *provided, however,* that Respondent shall not be under any obligation to provide maintenance and support services with respect to software licensed to customers by the Commission-approved Acquirer.
  2. remove any license impediment or grant any requisite intellectual property rights to allow the Commission-approved Acquirer of the Engineering Software Assets:

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- a. to provide software maintenance and support services for Software that has been installed by Respondent; and/or
  - b. upon expiration of the customer's license agreement with Respondent, to grant new licenses to the Hyprotech Process Engineering Simulation Software installed on its computers without requiring the deletion and re-installation of such Software.
- G. Respondent shall, within fourteen (14) days after the date of the divestiture of the Hyprotech Process Engineering Simulation Software Assets:
1. provide notice either by electronic mail or by first class mail to all of Respondent's customers of Hyprotech Process Engineering Simulation Software of their rights as set forth in this Paragraph II.; such notice to the Hyprotech Process Engineering Simulation Software Customers shall be made by means of a letter in the form of Appendix C to this Order; and
  2. and for a period of six (6) months from the date of posting, post a notice, prominently displayed in the top portion of Respondent's home page of its web site, immediately below any header information, that provides a link to the complete copy of the complaint and Order in this matter in Adobe Portable Document Format.
- H. Respondent shall indemnify the Commission-approved Acquirer of the Engineering Software Assets in respect of, and hold the Commission-approved Acquirer of the Engineering Software Assets harmless against, any and all liabilities, monetary damages, fines, fees, penalties, costs, and expenses incurred or suffered by the Commission-approved Acquirer of the Engineering Software Assets from any claims, liabilities, or obligations relating to or arising out of the Specified Proceedings, including any

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claims that would restrict, or attempt to restrict, the use of the Engineering Software Assets.

- I. In the event that the use of the Delivered Intellectual Property by the Commission-approved Acquirer is held in the Specified Proceedings to infringe any intellectual property rights of a party to the Specified Proceedings (or constitute the misappropriation of a trade secret of a party to the Specified Proceedings) and the use of such Delivered Intellectual Property is enjoined, or Respondent or the Commission-approved Acquirer of the Engineering Software Assets reasonably believes that it is likely to be found to infringe or constitute a misappropriation or likely to be enjoined, then Respondent shall, at its sole cost and expense, either (at the option of Respondent):
  1. procure from a party to the Specified Proceedings the right for the Commission-approved Acquirer of the Engineering Software Assets (and its then-existing, and any future, licensees) to (or to continue to) design, sell, offer for sale, manufacture, reproduce, distribute, develop, modify, create derivative works of, display, perform, import, export, and use the Delivered Intellectual Property;
  2. modify such Delivered Intellectual Property so that it becomes non-infringing or no longer constitutes a misappropriation or otherwise falls outside the subject matter of the Specified Proceedings, without affecting the basic functionality of such Delivered Intellectual Property; or
  3. replace the applicable Delivered Intellectual Property with a new item that does not infringe or constitute a misappropriation or otherwise falls outside the subject matter of the Specified Proceedings, and that is functionally equivalent to the applicable Delivered Intellectual Property.

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- J. Notwithstanding anything to the contrary in Paragraphs II.H. and II.I., Respondent shall have no obligation or liability under Paragraphs II.H. or II.I. for any claim of infringement arising from:
1. any combination of the Delivered Intellectual Property with any other product or technology not supplied by Respondent, where such infringement would not have occurred but for such combination;
  2. the adaptation or modification of the Delivered Intellectual Property by any Person other than a Person employed by Respondent at the time of the adaptation or modification, where such infringement would not have occurred but for such adaptation or modification;
  3. the use of the Delivered Intellectual Property in an application for which it was not designed or intended, where such infringement would not have occurred but for such use; or
  4. a claim based on intellectual property rights (other than the Delivered Intellectual Property) owned by the Commission-approved Acquirer of the Engineering Software Assets or any of its Affiliates.
- K. The purpose of the divestiture of the Engineering Software Assets is to allow the Commission-approved Acquirer to engage in the continued development and licensing of Hyprotech Process Engineering Simulation Software and to remedy the lessening of competition as alleged in the Commission's complaint in the markets for: (1) continuous process engineering simulation flowsheet software for process industries and smaller markets contained therein, and (2) batch process engineering simulation flowsheet software for process industries.

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**III.**

**IT IS FURTHER ORDERED** that:

- A. Respondent shall divest the AXSYS Assets to Bentley, absolutely and in good faith, no later than ten (10) days after the Commission places the Agreement Containing Consent Order on the public record (but no earlier than the day after the Commission places the Agreement Containing Consent Order on the public record), pursuant to and in accordance with the Bentley Purchase Agreement (which agreement shall not vary or contradict, or be construed to vary or contradict, the terms of this Order, it being understood that nothing in this Order shall be construed to reduce any rights or benefits of Bentley pursuant to the Bentley Purchase Agreement or to reduce any obligations of Respondent under such agreement).
- B. If, at the time the Commission determines to make this Order final, the Commission notifies Respondent in writing that Bentley is not an acceptable purchaser of the AXSYS Assets or that the manner in which the divestiture was accomplished is not acceptable, then, after receipt of such written notification, Respondent shall:
1. immediately notify Bentley of the notice received from the Commission;
  2. effect a termination of the Divestiture Agreement, a rescission of the acquisition, and a transfer of the AXSYS Assets no later than ten (10) business days from the date of receipt of the Commission's notice; and
  3. divest the AXSYS Assets, absolutely and in good faith at no minimum price, to an acquirer that receives the prior approval of the Commission and in a manner that receives the prior approval of the Commission no later than six (6) months from the date of receipt of the Commission's notice.



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- C. Unless the Commission rejects it pursuant to Paragraph III.B., the Bentley Purchase Agreement, attached as Confidential Appendix B and made a part of this Order, shall be incorporated by reference into this Order, and failure by Respondent to comply with any term of the Bentley Purchase Agreement (or other Divestiture Agreement, as applicable) shall constitute a failure to comply with this Order.
- D. Prior to the date of divestiture of the AXSYS Assets to the Commission-approved Acquirer, Respondent shall secure all consents, approvals, and waivers from all Parties (other than Respondent or the Commission-approved Acquirer) that are necessary for the divestiture of the AXSYS Assets to the Commission-approved Acquirer or for the continued use, development, enhancement, improvement, production, sale, marketing, distribution, or servicing of the AXSYS Assets by the Commission-approved Acquirer. In the event that Respondent is unable to satisfy all conditions necessary to divest any intangible asset, Respondents shall: (1) with respect to permits, licenses, or other rights granted by governmental authorities (other than patents), provide such assistance as the Commission-approved Acquirer may reasonably request in the Commission-approved Acquirer's efforts to obtain comparable permits, licenses or rights, and (2) with respect to all other intangible assets, including but not limited to Software, Intellectual Property (including patents), or contractual rights, substitute functionally equivalent assets or arrangements, subject to the approval of the Commission.
- E. For a period of five (5) years from the date of divestiture of the AXSYS Assets, Respondent shall provide to the Commission-approved Acquirer of the AXSYS Assets access to all Releases (and all related data and documentation) of Respondent's products (including

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Respondent's process simulators) that Interface with any AXSYS product, at least as early as, and on at least as favorable terms as, offered by Respondent to any Third-party Developer.

- F. Respondent shall provide to the Commission-approved Acquirer of the AXSYS Assets support on all Interfaces to Respondent's products relating to the AXSYS products on the following terms:
1. for a period of two (2) years following the date of divestiture of the AXSYS Assets to the Commission-approved Acquirer, at no cost; and
  2. thereafter, for a period of not less than the maximum duration of any term license assumed by the Commission-approved Acquirer, on at least as favorable terms as offered by Respondent to any Third-party Developer.
- G. Respondent shall, within fourteen (14) days after the date of the divestiture of the AXSYS Assets, provide notice either by electronic mail or by first class mail to all customers of Respondent with license rights to AXSYS or Zyqad by means of a letter in the form of Appendix D to this Order. Respondents shall attach to or enclose in that notice a complete copy of the complaint and Order in this matter.
- H. The purpose of the divestiture is to ensure the continued use and development of the AXSYS Assets in the same business in which the AXSYS Assets were used prior to the acquisition by Respondent and to remedy the lessening of competition alleged in the Commission's complaint in the market for integrated engineering software for process industries.

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**IV.**

**IT IS FURTHER ORDERED** that, for a period of five (5) years from the date of divestiture of the Engineering Software Assets:

- A. Respondent shall maintain technical standards with respect to Respondent's Hyprotech Process Engineering Simulation Software to provide:
  1. compatibility of HYSYS cases so that HYSYS cases created with Version 3.2 of HYSYS will be compatible with all additional and subsequent versions of HYSYS released by Respondent; and
  2. support for:
    - a. version 1.0 of the CAPE-OPEN Thermo and Units Standards;
    - b. upgrading HYSYS to CAPE-OPEN Thermo Standard 1.1;
    - c. new versions of the CAPE-OPEN Thermo and Units Standards as new versions become available; and
    - d. new CAPE-OPEN Standards on Math solvers and Reactors.
- B. Respondent shall publish, and make available on an unrestricted basis:
  1. all Interfaces for HYSYS and Aspen Plus, completely and accurately, no later than ten (10) days after the date of divestiture of the Hyprotech Process Engineering Simulation Software Assets for Interfaces in existence as of the date of divestiture of the Hyprotech Process Engineering Simulation Software Assets; and

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2. thereafter, any new Interfaces for HYSYS and Aspen Plus, completely and accurately, no later than ten (10) days after Respondent distributes Releases of HYSYS and Aspen Plus.
- C. Respondent shall provide support for all published Interfaces in the same manner and on terms comparable to those that, as of the date this Order becomes final, Respondent offers to third parties, including but not limited to cooperating with Third-party Developers to resolve any questions, issues, or problems that arise in connection with any published Interface.
- D. Respondent shall not enter into or enforce any agreement with any competitor that has the purpose of impeding or obstructing the conduct or organizational structure of any Standard-Setting Organization, which agreement has not been explicitly disclosed to the members of that Standard-Setting Organization, and that is inconsistent with the purpose of Paragraphs II.K. and III.H. of this Order.

**V.**

**IT IS FURTHER ORDERED** that:

- A. Respondent shall, not later than ten (10) days after execution of the Divestiture Agreement:
1. provide to the Commission-approved Acquirers a list of all non-clerical employees of the AXSYS Business, the OTS Business, or Hyprotech, as applicable, who were employed by Respondent as of the date of execution of the Divestiture Agreement or who were employed by Respondent any time within the three (3) years prior to the date this Order becomes final;

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2. to the extent permissible under applicable laws, and for a period of six (6) months from the date of divestiture of the AXSYS Assets or the Engineering Software Assets, as applicable, allow each Commission-approved Acquirer to inspect the personnel files and other documentation relating to such employees; and
  3. and for a period of six (6) months from the date of divestiture of the AXSYS Assets or the Engineering Software Assets, as applicable, provide an opportunity for each Commission-approved Acquirer:
    - a. to meet personally, and outside the presence or hearing of any employee or agent of Respondent, with any one or more of the employees of the AXSYS Business, the OTS Business, or Hyprotech, as applicable; and
    - b. to make offers of employment to any one or more of these employees.
- B. For a period of six (6) months from the date of divestiture of the AXSYS Assets or the Engineering Software Assets, as applicable:
1. Respondent shall not interfere with the employment by a Commission-approved Acquirer of any employee of the AXSYS Business, the OTS Business, or Hyprotech;
  2. Respondent shall not offer any incentive to employees of the AXSYS Business, the OTS Business, or Hyprotech to decline employment with a Commission-approved Acquirer or to accept other employment with Respondent; and
  3. Respondent shall remove any impediments that may deter employees of the AXSYS Business, the OTS Business, or Hyprotech from accepting employment with

Decision and Order

a Commission-approved Acquirer or that may interfere with the ability of such employee to accept employment with a Commission-approved Acquirer, including but not limited to waiving any confidentiality or non-compete provisions of employment or other contracts with Respondent that would affect the ability of those individuals to be employed by a Commission-approved Acquirer.

- C. Respondent shall continue all employee benefits, including regularly scheduled raises, bonuses, and vesting of pension benefits (as permitted by law), offered by Respondent to employees of the AXSYS Business, the OTS Business, or Hyprotech until, for the employees of the AXSYS Business, the date of the divestiture of the AXSYS Assets; and, for the employees of the OTS Business and Hyprotech, until the date of the divestiture of the Engineering Software Assets.
- D. Respondent shall not, for two (2) years following the date of the divestiture of the AXSYS Assets and the Engineering Software Assets, directly or indirectly, solicit, induce, or attempt to solicit or induce any employees of Respondent who have accepted offers of employment with a Commission-approved Acquirer to terminate their employment relationship with the Commission-approved Acquirer unless such individual is no longer employed by the Commission-approved Acquirer; *provided, however*, it is not a violation of this provision if: (1) Respondent advertises for employees in newspapers, trade publications or other media not targeted specifically at the employees, or (2) Respondent hires employees who apply for employment with Respondent, as long as such employees were not solicited by Respondent in violation of this Paragraph.

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**VI.****IT IS FURTHER ORDERED** that:

- A. If Respondent has not divested, absolutely and in good faith and with the Commission's prior approval, the Engineering Software Assets within the time and in the manner required by Paragraph II.A. of this Order, or the AXSYS Assets within the time and in the manner required by Paragraphs III.A. or III.B. of this Order, the Commission may appoint a trustee to accomplish either or both divestitures, at no minimum price. In the event that the Commission or the Attorney General brings an action pursuant to Section 5(*l*) of the Federal Trade Commission Act, 15 U.S.C. § 45(*l*), or any other statute enforced by the Commission, Respondent shall consent to the appointment of a trustee in such action. Neither the appointment of a trustee nor a decision not to appoint a trustee under this Paragraph shall preclude the Commission or the Attorney General from seeking civil penalties or any other relief available to it, including a court-appointed trustee, pursuant to Section 5(*l*) of the Federal Trade Commission Act, or any other statute enforced by the Commission, for any failure by Respondent to comply with this Order.
- B. If a trustee is appointed by the Commission or a court pursuant to Paragraph VI.A. of this Order, Respondent shall consent to the following terms and conditions regarding the trustee's powers, duties, authority, and responsibilities:
1. The Commission shall select the trustee, subject to the consent of Respondent, which consent shall not be unreasonably withheld. The trustee shall be a person with experience and expertise in acquisitions and divestitures. If Respondent has not opposed, in writing, including the reasons for opposing, the selection of any proposed trustee within ten (10) days after receipt of written notice by the staff of the Commission to

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Respondent of the identity of any proposed trustee, Respondent shall be deemed to have consented to the selection of the proposed trustee.

2. Subject to the prior approval of the Commission, the trustee shall have the exclusive power and authority to divest the AXSYS Assets and/or the Engineering Software Assets.
3. Within ten (10) days after appointment of the trustee, Respondent shall execute a trust agreement that, subject to the prior approval of the Commission, transfers to the trustee all rights and powers necessary to permit the trustee to effect either or both of the divestitures required by this Order.
4. The trustee shall have twelve (12) months from the date the Commission approves the trust agreement described in Paragraph VI.B.3. to accomplish either or both of the divestitures. If, however, at the end of the twelve-month period, the trustee has submitted a plan of divestiture or believes that divestiture can be achieved within a reasonable time, the divestiture period may be extended by the Commission, provided, however, the Commission may extend the period for no more than two (2) additional periods of twelve (12) months each.
5. The trustee shall have full and complete access to the personnel, books, records, and facilities related to the AXSYS Assets or the Engineering Software Assets or to any other relevant information, as the trustee may request. Respondent shall develop such financial or other information as such trustee may reasonably request and shall cooperate with the trustee. Respondent shall take no action to interfere with or impede the trustee's accomplishment of either or both of the divestitures. Any delays in divestiture caused by Respondent shall extend the time for divestiture under this Paragraph in an



## Decision and Order

amount equal to the delay, as determined by the Commission.

6. The trustee shall use his or her best efforts to negotiate the most favorable price and terms available in each contract that is submitted to the Commission, subject to Respondent's absolute and unconditional obligation to divest expeditiously at no minimum price. Either or both of the divestitures shall be made only in a manner that receives the prior approval of the Commission, and only to an acquirer that receives the prior approval of the Commission. Provided, however, that in connection with a particular divestiture, if the trustee receives bona fide offers from more than one acquiring entity, and if the Commission determines to approve more than one such acquiring entity and to allow the Respondent to choose from among them, then the trustee shall divest such assets to the acquiring entity or entities selected by Respondent from among those approved by the Commission; provided further, however, that Respondent shall select such entity within five (5) days of receiving notification of the Commission's approval.
7. The trustee shall serve, without bond or other security, at the cost and expense of Respondent, on such reasonable and customary terms and conditions as the Commission may set. The trustee shall have the authority to employ, at the cost and expense of Respondent, such consultants, accountants, attorneys, investment bankers, business brokers, appraisers, and other representatives and assistants as are necessary to carry out the trustee's duties and responsibilities. The trustee shall account for all monies derived from the divestiture and all expenses incurred. After approval by the Commission of the account of the trustee, including fees for his or her services, all remaining monies shall be paid at the direction of Respondent, and the trustee's power shall be terminated. The trustee's compensation shall be based at

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least in significant part on a commission arrangement contingent on the trustee's divesting the AXSYS Assets or the Engineering Software Assets.

8. Respondent shall indemnify the trustee and hold the trustee harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the trustee's duties, including all reasonable fees of counsel and other expenses incurred in connection with the preparation for or defense of any claim, whether or not resulting in any liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from misfeasance, gross negligence, willful or wanton acts, or bad faith by the trustee.
9. If the trustee ceases to act or fails to act diligently, a substitute trustee shall be appointed in the same manner as provided in Paragraph VI.A. of this Order.
10. The Commission may on its own initiative or at the request of the trustee issue such additional orders or directions as may be necessary or appropriate to accomplish the divestiture required by this Order.
11. The trustee shall have no obligation or authority to operate or maintain the AXSYS Assets or the Engineering Software Assets.
12. The trustee shall report in writing to the Commission every thirty (30) days concerning the trustee's efforts to accomplish the divestitures required by this Order.

**VII.**

**IT IS FURTHER ORDERED** that, until the divestitures of the AXSYS Assets and of the Engineering Software Assets are completed, Respondent shall not cause, and will use commercially reasonable efforts to avoid, the wasting, deterioration, or loss of

## Decision and Order

the AXSYS Assets or the Engineering Software Assets, nor shall Respondent sell, transfer, or encumber the AXSYS Assets or the Engineering Software Assets.

**VIII.****IT IS FURTHER ORDERED** that:

- A. Within thirty (30) days after the date this Order becomes final, and every sixty (60) days thereafter until Respondent has complied with its obligations pursuant to Paragraphs II.A., II.C., II.G., III.A., III.B., III.D., III.G., V.A., V.B., V.C., VI., and VII. of this Order, and at such other times as the Commission may require, Respondent shall file a verified written report with the Commission setting forth in detail the manner and form in which it has complied and is complying with the above-listed paragraphs of this Order.
- B. Within thirty (30) days after the date this Order becomes final, and, if later, within thirty (30) days after each divestiture required by Paragraphs II. and III. are completed, and then annually for two (2) years after each divestiture required by Paragraphs II. and III. are completed, Respondent shall file a verified written report with the Commission setting forth in detail the manner and form in which it has complied and is complying with Paragraphs II.D., II.E., II.F., III.F., and V.D.,
- C. Within thirty (30) days after the date this Order becomes final, one year from the date this Order becomes final, and then annually for four (4) years thereafter, Respondent shall file a verified written report with the Commission setting forth in detail the manner and form in which it has complied and is complying with Paragraphs II.H., II.I. II.J., III.E., and IV.A.-D.

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**IX.**

**IT IS FURTHER ORDERED** that Respondent shall notify the Commission at least thirty (30) days prior to any proposed (1) dissolution of the Respondent, (2) acquisition, merger or consolidation of Respondent, or (3) any other change in the Respondent that may affect compliance obligations arising out of this Order, including but not limited to assignment or the creation or dissolution of subsidiaries.

**X.**

**IT IS FURTHER ORDERED** that, for the purpose of determining or securing compliance with this Order, upon written request, Respondent shall permit any duly authorized representative of the Commission:

- A. Access, during office hours and in the presence of counsel, to all facilities and access to inspect and copy all books, ledgers, accounts, correspondence, memoranda and other records and documents in the possession or under the control of Respondent relating to any matters contained in this Order; and
- B. Upon five (5) days' notice to Respondent and without restraint or interference from it, to interview officers, directors, employees, independent contractors, or agents of Respondent, who may have counsel present, relating to any matters contained in this Order.

**XII.**

**IT IS FURTHER ORDERED** that this Order shall terminate on December 20, 2014.

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**Appendix A(1)****Hyprotech Process Engineering Simulation Software**

HYSYS

HYSYS Dynamics Option

MASSBAL

HYSYS Amines Interface

HYSYS for Ammonia Plants Interface

HYSYS Upstream Interface

HYSYS OLGAS Transient Interface

HYSYS OLGAS 3-Phase Interface

HYSYS OLGAS Interface

HYSYS OLI Interface

PIPESIM Interface

HYSYS PIPESYS Interface

HYSYS RTO Offline Interface

HYSYS RTO Online Interface

HYSYS Synetix Reactor Models Interface

HYSYS Synetix Reactor Models DYCAT Interface

COMThermo

BDK

Hyprotech Explorer

Hyprotech Server

DISTIL

HX- Net

ACOL

APLE

FIHR

FRAN

MUSE

PIPE

PPDS Package Interface

TASC-Thermal

TASC-Mechanical

ProFES 2P Erosion Option

ProFES 2P Tran

ProFES 2P Wax Option

ProFES 3P Tran

ProFES Tranflo

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**Appendix A(2)**

**Excluded Hyprotech Process Engineering Simulation**

**Software**

HYSYS Upstream Steady-State Option

HYSYS Upstream Dynamics Option

SULSIM

HYPROPIII

BatchCAD

HYSYS Pipesim Net Option

HYSYS UREA++ Option

FLARENET

TICP

Harwell Math Library

Proconex SX006

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**Appendix A(3)****Operator Training Software**

OTISS	Steady State Report Generation Spreadsheet
MUSIC	Stream Checker Spreadsheet
AMCL Translator - Desktop	T3 TDC Emulation
Bailey Infi90 Link	TDC_Builder
CIMIO Link	TDC3000 Functions
CL Tracer	Tdcomd
Column Builder	TriconImp
CONCERT	Visio Graphics Generation Kit
CONTRALTO	VPC-Honeywell - AMCL add on
CPGEN	VPC-Honeywell TDC3000 Web update system
Cplink	Web enablement of Melody tools
CrEdit Macros	Xeng
Cslink	Xstation
Custom Hard Panel Links	Yocomd-HP
Datatracker	Yocomd-NT
Deltcomd	ZOE
diffpara	Alarm Manager
DMC Ref File Generator	Automated Training Exercises
Dmccomd	Command Channel
Engineering Spreadsheet	CS3000 offline tools
FSC Unplot	DDLGen
FSIMlink	deltaV DCS Link
Generic IEC 1131 system handling	EB Parser
History Extraction Spreadsheet	EB Viewer
Honutils	Hygreen Instructor Station
idef/ odef	Hylinker
Imcomd	IS tester
IssueMonitoring	Performance Evaluation and Record Keeping
jpdef	Proconex SX003 Interface
mdef	Siemens Interface
O/I/Flink	Simulation Coordinator
Olgacomd	Simulation Server
PCON	SX003 driver
pdef	T3 Emulation Link
PMCL Translator	Trend
Potential Control Checkout Toolset	Yokogawa CS Link
Proconex SX003	Yokogawa CS offline tools
Proserve	Yokogawa CS3000 Interface
Recomd	ATUKOPCSERVER

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Remlink  
RTAP  
Softex HTL

MOORCOMD  
OPCCOMD  
serialpan



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**Appendix B – Confidential  
Bentley Purchase Agreement**

**[Redacted From Public Record Version, But Incorporated By  
Reference]**

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**Appendix C**

[Aspen Technology, Inc. letterhead]  
[date]

[Name of customer]

Attention: [name of contact person at customer]

[Address of contact person at customer]

[telephone number of contact person]

Dear [contact person]:

This letter is to inform you that, pursuant to an order of the Federal Trade Commission (“FTC”), Aspen Technology, Inc. (“AspenTech”) is required to notify certain customers that it has divested its operator training simulator business and rights to Hyprotech Ltd.’s (“Hyprotech”) process engineering software to [insert name of Commission-approved Acquirer].

The FTC order is part of a settlement between AspenTech and the FTC resolving the FTC’s action challenging AspenTech’s acquisition of Hyprotech. Under the settlement, AspenTech has the right to obtain a license back from [insert name of Commission-approved Acquirer] and to continue selling and developing all of its existing engineering software products, including those acquired in its acquisition of Hyprotech (with the exception of AXSYS and certain operator training products).

The order requires AspenTech, for a period of two years from [date of divestiture], to allow customers of Hyprotech process engineering simulation software to choose without penalty to maintain their current agreements for annual software maintenance and support with AspenTech or to pursue similar agreements with [insert name of Commission-approved Acquirer]. The order also provides for customers to be able to obtain additional copies of Hyprotech process engineering software from [insert name of Commission-approved Acquirer] without affecting current license agreements with AspenTech. AspenTech is further required to maintain certain published and open

## Decision and Order

interface standards with respect to HYSYS, Aspen Plus and certain CAPE-OPEN standards.

A link to [copy of] the Federal Trade Commission's complaint and final order in this matter may be found at [www.aspentech.com](http://www.aspentech.com) [is attached].

Sincerely,

David L. McQuillin  
President and Chief Executive Officer  
Aspen Technology, Inc.

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**Appendix D**

[Aspen Technology, Inc. letterhead]  
[date]

[Name of customer]

Attention: [name of contact person at customer]

[Address of contact person at customer]

[telephone number of contact person]

Dear [contact person]:

This letter is to inform you that, pursuant to an order of the Federal Trade Commission, Aspen Technology, Inc. (“AspenTech”), is required to notify all AspenTech customers with license rights to use AXSYS or Zyqad that it has divested its assets relating to AspenTech’s AXSYS business to Bentley Systems, Incorporated, and that, as of [insert date], Bentley will provide all license, development and services relating to AXSYS, unless otherwise subcontracted.

A link to [copy of] the Federal Trade Commission’s complaint and final order in this matter may be found at [www.aspentech.com](http://www.aspentech.com) [is attached].

Sincerely,

David L. McQuillin  
President and Chief Executive Officer  
Aspen Technology, Inc.

## Analysis

**Analysis of Proposed Agreement Containing Consent Order  
to Aid Public Comment**

The Federal Trade Commission, subject to its final approval, has accepted for public comment an Agreement Containing Consent Order (“Proposed Order”) with Aspen Technology, Inc. (“AspenTech”) to resolve the anticompetitive effects alleged in the Complaint issued by the Commission on August 6, 2003.

On or about May 31, 2002, AspenTech acquired Hyprotech, Ltd. from AEA Technology plc for approximately \$106.1 million in a transaction that was not reportable under the Hart-Scott-Rodino Act. At the time of the acquisition, AspenTech and Hyprotech were the primary global suppliers of process engineering simulation software and had only one other significant competitor, Simulation Sciences (“SimSci”). The Agreement requires that AspenTech divest its integrated engineering software business to Bentley Systems, Inc. (“Bentley”), and its batch and continuous process engineering software business to a Commission-approved buyer.

The Proposed Order has been placed on the public record for 30 days for interested persons to comment. Comments received during this 30 day period will become part of the public record. After 30 days, the Commission will again review the Proposed Order and the comments received and will decide whether it should withdraw the Proposed Order or make the Proposed Order final.

**I. The Parties**

AspenTech, headquartered in Cambridge, Massachusetts, is a developer and worldwide supplier of manufacturing, engineering, and supply chain simulation computer software. AspenTech’s products include non-linear process engineering simulation software used by the refining, oil and gas, petrochemical, chemical, pharmaceutical, and other process manufacturing industries and by engineering and construction companies that

Analysis

support those industries. AspenTech had total revenues of approximately \$323 million for fiscal year 2003, and it employs approximately 1,750 people worldwide.

Hyprotech was a wholly-owned operating division of AEA Technology plc, a corporation organized, existing, and doing business under the laws of the United Kingdom. Hyprotech was also a developer and worldwide supplier of engineering and simulation computer software used by the refining, oil and gas, petrochemical, chemical, pharmaceutical, and other process manufacturing industries and by engineering and construction companies that support those industries. Headquartered in Calgary, Alberta, Canada, Hyprotech had offices throughout the world, including the United States, and had revenues of approximately \$68.5 million in fiscal year 2002.

Prior to the acquisition, AspenTech and Hyprotech were the largest providers of process engineering simulation software. Process engineering simulation software enables plant designers, engineers, production planners, and others, to design, simulate, and analyze production processes used in various industrial operations. The software allows users to mathematically model, or simulate, a process to predict what happens when different variables (such as heat, pressure, or raw material composition) are changed, thereby allowing more efficient and lower cost operations. AspenTech and Hyprotech were also the two primary providers of integrated engineering software, which facilitates the sharing and implementation of process design data.

## **II. The Commission's Complaint**

On August 6, 2003, the Commission issued a Complaint charging that AspenTech unlawfully acquired the assets of Hyprotech in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45.

## Analysis

The Complaint alleges the following seven global markets within which to analyze the effects of the acquisition: (1) software used to simulate continuous process engineering applications; (2) four narrower markets contained within the overall continuous process engineering software market, each such market defined by end-use application (specifically oil and gas, refining, chemicals, and air separation process simulation); (3) software used to simulate batch process engineering applications, such as fine chemicals or pharmaceuticals; and (4) software used for integrated engineering applications (multi-user software that enables engineers to share process design data).

The Complaint alleges that, prior to the acquisition, AspenTech and Hyprotech were the closest competitors within each relevant market. The Complaint further alleges that, prior to the acquisition, AspenTech and Hyprotech vigorously competed to develop, license, and support continuous and batch process engineering simulation software and integrated engineering software. This competition provided customers with lower prices, better service, and increased product innovation. The Complaint maintains that entry into the relevant product markets is not likely and if entry did occur, it would be neither timely nor sufficient to prevent or mitigate the anticompetitive effects of the acquisition.

The Complaint charges that the combination of the two companies substantially lessened competition in the relevant markets. Specifically, the acquisition eliminated the competition between AspenTech and Hyprotech to reduce prices, enhance innovation, and offer better services with respect to their software offerings in the relevant markets. Thus the acquisition enhanced AspenTech's ability to raise customers' prices above competitive levels in the relevant markets. The acquisition also increased AspenTech's capability to undermine open standard setting organizations, diminishing the pro-consumer effectiveness of such organizations to promote third-party software design and sale.

Analysis

### **III. Terms Of The Proposed Order**

The Proposed Order effectively remedies the acquisition's alleged anticompetitive effects by requiring AspenTech to divest the overlapping Hyprotech assets. The continuous process and batch process assets, along with AspenTech's operator training software and service business, are to be divested to a Commission-approved buyer and in a manner approved by the Commission, and the integrated engineering software business is to be divested to Bentley, also subject to the Commission's final approval.

#### **A. Divestiture of the Hyprotech Process Engineering Software and AspenTech Operator Training Software Business**

The Proposed Order directs AspenTech to sell Hyprotech's continuous process and batch process assets, as well as AspenTech's operator training business, to a buyer acceptable to the Commission within the required time period. Section II. If AspenTech is unable to divest this set of assets to a Commission-approved buyer within 60 or 90 days of the Commission making the Proposed Order final, this time period dependant on when AspenTech provides an application for divestiture, the Commission may appoint a trustee to divest the assets to a Commission-approved buyer.

The Proposed Order assures the viability of the divestiture of the continuous and batch process engineering software assets by (1) requiring AspenTech to divest its operator training software and services business and (2) allowing customers with current software maintenance and support agreements to choose between maintaining those contracts with AspenTech or switching to the Commission-approved buyer. Section II. Customers will also be able to obtain additional copies of Hyprotech software from the Commission-approved buyer without affecting current license agreements with AspenTech. Paragraph II.F.



## Analysis

The Proposed Order allows AspenTech to license the Hyprotech continuous and batch process engineering software from the Commission-approved buyer to preserve software development efforts since the acquisition. The Proposed Order requires AspenTech to provide the Commission-approved buyer with (1) all releases and upgrades to the Hyprotech process engineering simulation software for two years and (2) within fourteen days after the two-year post-divestiture period, all Hyprotech process engineering software under development at that time. Paragraph II.D. The Proposed Order additionally requires AspenTech to provide support services on the process engineering software assets to the Commission-approved buyer for two years from the date of divestiture. Paragraph II.E. These provisions ensure that the Commission-approved buyer will be able to create and maintain integrated engineering products that interface with AspenTech engineering products.

The Proposed Order requires AspenTech to indemnify the Commission-approved buyer in the event that the divested process engineering software infringes specific intellectual property rights. AspenTech will be bound to either procure for the Commission-approved buyer the right to continue to use the software or modify or replace the software so that it does not infringe the third party's intellectual property rights. Paragraphs II.H. and II.I.

The Commission's purpose in divesting the process engineering simulation software assets is to allow the buyer to engage in the development and licensing of the Hyprotech software and to remedy the lessening of competition alleged in the Commission's Complaint in the markets for (1) continuous process engineering simulation flowsheet software for process industries and smaller markets contained therein, and (2) batch process engineering simulation flowsheet software for process industries.

Analysis

## **B. Divestiture to Bentley**

Pursuant to the Proposed Order and subject to the Commission's final approval, AspenTech will divest Hyprotech's AXSYS integrated engineering software business to Bentley. Section III. Bentley is a technology firm that provides architecture, engineering, construction, and operations software for a variety of applications, including buildings, industrial plants, and civil operations. Bentley reported 2003 revenues of approximately \$260 million.

Under the terms of the Proposed Order, Bentley will acquire Hyprotech's integrated engineering software products and, among other things, all rights to any existing software contracts no earlier than one day, and no later than ten days after the Proposed Order is placed on the public record. The Proposed Order contains additional provisions that require AspenTech to provide Bentley with updates, upgrades, and new releases of AspenTech's engineering and other products on at least as favorable terms as offered to any other person, for a period of five years. Paragraph III.E. AspenTech must also provide Bentley with no-cost support services relating to the AXSYS assets for a period of two years. Paragraph III.F. These provisions ensure that Bentley will be able to create and maintain integrated engineering products that interface with AspenTech engineering products.

The Commission believes that Bentley is a satisfactory buyer for these assets. The AXSYS software effectively complements the other software and services that Bentley currently offers. Bentley has the engineering, software, and marketing resources to support the AXSYS software, and the expertise to provide updated and innovative versions of AXSYS. As a result, the Commission believes that divestiture of this product line to Bentley will remedy the acquisition's alleged anticompetitive effects in the integrated engineering software market.

The purpose of the divestiture is to ensure the continued use and development of the AXSYS software in the same business in

## Analysis

which Hyprotech used the software prior to Hyprotech's acquisition by AspenTech and to remedy the lessening of competition alleged in the Commission's Complaint in the market for integrated engineering software for process industries.

**C. Other Provisions**

To maintain the viability of both packages and to provide a level playing field for third-party software developers that must interface with the Hyprotech and AspenTech process engineering simulation software products, the Proposed Order requires AspenTech to maintain a level playing field. For a period of five years after the divestiture, the Proposed Order requires AspenTech to develop its engineering simulation software in a manner that maintains its compatibility with HYSYS and to maintain published interfaces to AspenTech engineering simulation software. Paragraphs IV.A. and IV.B. AspenTech also must publish and provide support for all HYSYS and AspenPlus interfaces. Paragraphs IV.B. and IV.C. Finally, the proposed order prohibits AspenTech from entering into or enforcing any agreement with any competitors that has the purpose of impeding or obstructing the conduct or organizational structure of any standard-setting organization, which agreement has not been explicitly disclosed to the members of that standard-setting organization and that is inconsistent with the purpose of the Proposed Order as stated in Paragraphs II.K. and III.H. Paragraph IV.D.

To ensure that both the Commission-approved buyer of the process engineering software and operator training software and Bentley can hire employees familiar with the divested software, the Proposed Order directs AspenTech to provide the acquirers with access to relevant AspenTech employees. Paragraph V.A. This provision requires AspenTech to provide the acquirers with lists of relevant employees, remove any impediments deterring current AspenTech employees from switching to Commission-approved buyers, and for a period of two years following the divestitures, prevents AspenTech from soliciting any former

Analysis

AspenTech employees who choose to work for either of the Commission-approved buyers. Paragraphs V.B. through V.D.

Section VI of the Proposed Order includes the standard divestiture trustee provision pursuant to which the Commission may appoint a trustee to effectuate a required divestiture if AspenTech is unable to comply with its divestiture obligations in either Section II. or Section III., or both. Section VI. If, however, the Commission rejects Bentley as a buyer, AspenTech is granted an additional six months to divest the asset package to an acquirer that receives the prior approval of the Commission. Paragraph III.B. If AspenTech is unable to divest within that six month period, then the Commission may appoint a trustee to divest the AXSYS Assets.

#### **IV. Opportunity For Public Comment**

By accepting the Proposed 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 Order, including the proposed divestitures, to aid the Commission in its determination of whether it should make final the Proposed Order contained in the agreement. This analysis is not intended to constitute an official interpretation of the Proposed Order or modify the terms of the Proposed Order in any way.

Commission Opinion

## IN THE MATTER OF

**CHICAGO BRIDGE & IRON COMPANY, ET AL.**OPINION OF THE COMMISSION AND FINAL ORDER IN REGARD TO  
ALLEGED VIOLATIONS OF SEC. 7 OF THE CLAYTON ACT AND  
SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT*Docket 9300; File No. 0110015**Complaint, October 25, 2001--Opinion and Final Order, December 22, 2004*

In a unanimous Opinion, the Commission addressed the acquisition by Respondent Chicago Bridge & Iron Company ("CB&I") of the Engineered Construction and Water Divisions of Respondent Pitt-Des Moines, Inc. The Commission determined that the acquisition affected four relevant product markets involving the design and construction of liquefied natural gas (LNG) storage tanks; liquefied petroleum gas (LPG) storage tanks; liquid atmospheric gas (LIN/LOX) storage tanks; and thermal vacuum chambers (TVCs) in the United States. The Commission concluded that the acquisition substantially lessened competition in each of these markets, and therefore violated Section 7 of the Clayton Act and Section 5 of the Federal Trade Commission Act. The Final Order, among other things, requires Respondent CB&I to create two separate, stand-alone operating divisions or subsidiaries – each fully, equally, and independently engaged in all aspects of the relevant business, and capable of competing in the relevant markets – and to divest one of those divisions within six months to an acquirer approved by the Commission.

*Participants*

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For the Respondent: *Duane M. Kelley, Jeffrey A. Leon, Greg J. Miarecki, Christopher B. Essig, Michael P. Mayer, Andrew D. Shapiro, Danielle A.R. Coffman, David E. Dahlquist, James F. Herbison, and Lance W. Lange, Winston & Strawn L.L.P.*

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By SWINDLE, Commissioner, For A Unanimous Commission:

### I. Introduction and Statement of Issues

This case involves the acquisition of a company by its closest competitor in four relevant markets.<sup>1</sup> On February 7, 2001, in the midst of the Commission's investigation of the acquisition,<sup>2</sup> Respondent Chicago Bridge & Iron (CB&I) acquired certain assets of the Engineered Construction and Water Divisions of Respondent Pitt-Des Moines (PDM). At the time of the acquisition, both parties designed, engineered, and constructed storage tanks for liquefied natural gas (LNG), liquefied petroleum gas (LPG), and liquid atmospheric gases such as nitrogen, oxygen, and argon (LIN/LOX), as well as thermal vacuum chambers

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<sup>1</sup> This Opinion uses the following abbreviations for citations:

Tr. – Transcript of testimony before the Administrative Law Judge

ID – Initial Decision (page number)

IDF – Initial Decision Finding of Fact (the number of the factual finding)

CCFF – Complaint Counsel's Finding of Fact (the number of the factual finding)

RAB – Respondents' Appeal Brief

CCACAB – Answering and Cross-Appeal Brief of Counsel Supporting the Complaint

RRCARB – Respondents' Reply and Cross-Appeal Response Brief

OA – Transcript of the Oral Argument on Appeal

CX – Complaint Counsel's Exhibit

RX – Respondents' Exhibit

JX - Joint Exhibit

<sup>2</sup> Tr. at 4079-81.

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(TVCs), which are used to test satellites for the aerospace industry. The Commission's Complaint, issued October 25, 2001, charged that the acquisition may substantially lessen competition or tend to create a monopoly in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, and that, through the acquisition, the parties engaged in unfair methods of competition in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45.<sup>3</sup>

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<sup>3</sup> This Opinion uses the following abbreviations for third-party companies referenced herein: ABB Lummus Global (ABB Lummus), Air Liquide Process and Construction (Air Liquide), Air Products and Chemicals (Air Products), American Tank & Vessel, Inc. (AT&V), Atlanta Gas Light Co. (Atlanta Gas), BOC Gases (BOC), Boeing Satellite Systems (Boeing), British Petroleum (BP), Chart Process Systems (Chart), Chattanooga Boiler & Tank (Chattanooga), CMS Energy (CMS), Dynege, Inc. (Dynege), El Paso Corp. (El Paso), Enron Corp. (Enron), Fluor, Inc. (Fluor), Graver Tank (Graver), Freeport LNG Development LP (Freeport LNG), Howard Fabrication (Howard), Intercontinental Terminals Co. (ITC), Ishikawa Heavy Industries (IHI), Linde BOC Process Plant LLC (Linde), Matrix Service Co. (Matrix), Memphis Light, Gas & Water (MLGW), Morse Construction Group (Morse), Process Systems International (PSI), S.N. Technigaz (Technigaz), Skanska AB (Skanska), Toyo Kanetsu K.K. (TKK), TRW Space & Electronics (TRW), Whessoe International (Whessoe), Williams Energy (Williams), XL Technology Systems (XL), Yankee Gas Services Co. (Yankee Gas), Zachry Construction Corporation (Zachry). All other references to companies use the particular company's full name or the only name referred to in the record.

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A. The Initial Decision<sup>4</sup>

The Initial Decision held that CB&I's acquisition of PDM violated Section 7 of the Clayton Act and Section 5 of the FTC Act in four relevant lines of commerce in the United States: (1) field-erected LNG storage tanks, (2) field-erected LPG storage tanks, (3) field-erected LIN/LOX storage tanks, and (4) field-

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<sup>4</sup> The Initial Decision states that when the Commission amended its Rules of Practice for Adjudicative Proceedings, 16 C.F.R. § 3.51, in 2001 it removed the requirement under Rule 3.51(c)(3) that an Initial Decision be supported by substantial evidence. *Id.* at 85. Accordingly, it states that its findings of fact are based on "reliable and probative evidence." *Id.* To clarify, we note that when the Commission removed the word "substantial" from Rule 3.51(c)(3), it did not change the evidentiary standard upon which its decisions must be based.

The Federal Register Notice made clear that, prior to the amendment, the "substantial evidence" language in Rule 3.51(c)(3) referred to the standard for agency decisions under Section 556(d) of the Administrative Procedure Act, 5 U.S.C. § 556(d), which specifies the quantum of evidence (in most cases a preponderance) needed to support findings of fact. FTC Rules of Practice, 66 Fed. Reg. 17,622, 17,626 (Apr. 3, 2001). The Notice also made clear that the amendment removed the "substantial evidence" language merely to eliminate any confusion between Section 556(d) and the more deferential substantial evidence standard for judicial review of agency action. *Id.* Thus, we take it as settled law that regardless of the standard under which a reviewing court must accept the Commission's findings of fact, the Commission (and its ALJ) normally must base findings upon a "preponderance of the evidence." *See Carter Prods., Inc. v. FTC*, 268 F.2d 461, 487 (9<sup>th</sup> Cir. 1959). Of course, the Commission's factual and legal review of this matter is *de novo*.



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erected TVCs.<sup>5</sup> Although the Initial Decision rejected Complaint Counsel's proffered Herfindahl-Hirschman Indices (HHIs) as unreliable forecasters of the acquisition's competitive effects,<sup>6</sup> it nonetheless found that Complaint Counsel had established a prima facie case in each of the relevant markets.<sup>7</sup> Specifically, the Initial Decision found that Complaint Counsel demonstrated that "CB&I and PDM were the number one and two competitors . . . and that no other company provides effective competition."<sup>8</sup>

The Initial Decision also held that Respondents' evidence of actual or potential entry did not rebut Complaint Counsel's prima facie case.<sup>9</sup> It found that "potential and actual entry is slow and ineffective and cannot keep [the relevant] markets competitive."<sup>10</sup> For the LNG tank market, the Initial Decision concluded that many of the steps taken by recent or potential entrants are too preliminary to provide a basis for determining whether they can challenge CB&I's market power and that several other projects suggest that the new entrants do not constrain CB&I.<sup>11</sup> Similarly, for the LPG and LIN/LOX tank markets, the Initial Decision concluded that the actual and potential entry identified by Respondents is not sufficient to constrain CB&I's market power.<sup>12</sup>

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<sup>5</sup> IDF 18-19; ID at 126.

<sup>6</sup> ID at 89-93.

<sup>7</sup> ID at 89.

<sup>8</sup> ID at 125.

<sup>9</sup> ID at 100-103.

<sup>10</sup> ID at 102.

<sup>11</sup> ID at 103-105.

<sup>12</sup> ID at 105-106.

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It also found no evidence of actual or potential entry in the TVC market.<sup>13</sup>

In addition, the Initial Decision rejected Respondents' argument that customers in these markets are sophisticated and can thus constrain CB&I's pricing.<sup>14</sup> It found that past pricing is not well known in three of the four relevant markets,<sup>15</sup> and that most customers therefore do not have significant bargaining power.<sup>16</sup> It concluded that Respondents' evidence of customer sophistication did not rebut Complaint Counsel's prima facie case.<sup>17</sup>

Because it found that Respondents did not rebut Complaint Counsel's prima facie case, the Initial Decision concluded that Complaint Counsel carried their burden of persuasion that the merger was likely to substantially lessen competition in violation of Section 7 of the Clayton Act and Section 5 of the FTC Act.<sup>18</sup>

Although not required to do so, the Initial Decision also considered Complaint Counsel's evidence of post-acquisition

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<sup>13</sup> ID at 106.

<sup>14</sup> ID at 109.

<sup>15</sup> *Id.* The Initial Decision does not delineate in which relevant markets customers lack pricing information. In addition, because it references only those findings of fact related to the LNG tank market and its findings with respect to customer sophistication in other markets do not clearly establish a lack of price information (*see* IDF 204-07), we cannot determine which three markets the Initial Decision means to include in its analysis.

<sup>16</sup> ID at 109.

<sup>17</sup> *Id.*

<sup>18</sup> ID at 114-15.

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price increases in the LNG tank, LIN/LOX tank, and TVC markets and concluded that the evidence did not show such price increases.<sup>19</sup>

Finally, the Initial Decision dismissed Respondents' argument that the merger did not harm competition because PDM planned to exit the relevant markets even absent the merger.<sup>20</sup> The Initial Decision found that Respondents did not establish that PDM had made a decision to close the business or that PDM had conducted an exhaustive effort to sell the package of assets sold to CB&I.<sup>21</sup> It thus concluded that even if an exiting assets defense is legally recognizable, Respondents did not establish such a defense in this case.<sup>22</sup>

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<sup>19</sup> ID at 110-114.

<sup>20</sup> ID at 115-118. Respondents argued that (1) PDM would have liquidated its EC Division absent the merger; (2) CB&I was the only potential purchaser; and (3) the merger thus did not result in a substantial lessening of competition. ID at 115.

<sup>21</sup> ID at 116-118.

<sup>22</sup> *Id.*

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B. Legal Standards<sup>23</sup>

Section 7 of the Clayton Act provides, in relevant part, that “no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person . . . where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.”<sup>24</sup> “As its language suggests, [S]ection 7 is ‘designed to arrest in its incipiency . . . the substantial lessening of competition from the acquisition by one corporation of the whole or any part of the stock’ or assets of a competing corporation.”<sup>25</sup> Merger law “rests upon the theory that, where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive

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<sup>23</sup> In the present case, the alleged violation of the Federal Trade Commission Act’s Section 5 prohibition against unfair methods of competition follows from the alleged violation of Section 7 of the Clayton Act. *See FTC v. Cement Inst.*, 333 U.S. 683, 694 (1948) (conduct that violates other antitrust laws may violate Section 5 as well). Similarly, a seller’s participation in an unlawful transaction may violate Section 5 of the FTC Act. *See Yamaha Motor Co. v. FTC*, 657 F.2d 971, 985 (8<sup>th</sup> Cir. 1981) (upholding, solely on Section 5 grounds, a Commission finding that a sale of stock was unlawful). Accordingly, we determine that the alleged Section 5 violation does not require an independent analysis in this matter.

<sup>24</sup> Clayton Act §7, 15 U.S.C. § 18 (2004).

<sup>25</sup> *FTC v. University Health, Inc.*, 938 F.2d 1206, 1218 (11<sup>th</sup> Cir. 1991) (quoting *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 589 (1957)).

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levels.”<sup>26</sup> Thus, it is settled law that “[s]ignificant market concentration makes it ‘easier for firms in the market to collude, expressly or tacitly, and thereby force price above or farther above the competitive level.’”<sup>27</sup> The threat is that “firms in a concentrated market might in effect share monopoly power, setting their prices at a profit-maximizing, supracompetitive level by recognizing their shared economic interests and their interdependence with respect to price and output decisions.”<sup>28</sup>

The unifying theme of Section 7 decisional law and economic teaching is that “mergers should not be permitted to create or enhance market power or to facilitate its exercise.”<sup>29</sup> A merger or acquisition is illegal under Section 7 if the remaining firm or firms will be more likely to engage in conduct that enables it or them profitably to maintain prices above competitive levels for a significant period of time, even if that conduct would be lawful in itself.<sup>30</sup> In general, unlawful accretions of market power may

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<sup>26</sup> *FTC v. PPG Indus.*, 798 F.2d 1500, 1503 (D.C. Cir. 1986); see *FTC v. Elders Grain Inc.*, 868 F.2d 901, 905 (7<sup>th</sup> Cir. 1989).

<sup>27</sup> *University Health*, 938 F.2d at 1218 n.24 (quoting *United States v. Rockford Mem’l Corp.*, 898 F.2d 1278, 1282-83 (7<sup>th</sup> Cir. 1990)).

<sup>28</sup> *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993).

<sup>29</sup> U.S. Dep’t of Justice & Federal Trade Comm’n, *Horizontal Merger Guidelines* § 0.1 (1992, as amended 1997), reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,104 (hereinafter *Merger Guidelines*).

<sup>30</sup> Section 7 “is concerned with far more than ‘collusion’ in the sense of an illegal conspiracy; it is very much concerned with ‘collusion’ in the sense of tacit coordination not amounting to conspiracy.” 4 Phillip E. Areeda, Herbert Hovenkamp & John Solow, Antitrust Law: An Analysis of Antitrust Principles and

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come about in several ways. First, a merger may result in a single firm that so dominates a market that it is able to maintain prices above the level that would prevail if the market were competitive. While antitrust case law has long recognized that a competitor may achieve and maintain market dominance or monopoly status through its own prowess, or even through “historic accident,”<sup>31</sup> Section 7 expressly forbids acquisitions and mergers that “tend to create a monopoly.”<sup>32</sup> Second, a merger may result in only a few firms accounting for most of the sales of a product and thereby enable those firms to exercise market power by explicitly or tacitly coordinating their actions.<sup>33</sup> Third, in some circumstances, a merger may result in a single firm that is not a monopolist but nonetheless is able to exercise market power without the concurrence of – or coordinated responses by – other firms in the market.<sup>34</sup> In each of these circumstances, the exercise of market

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Their Application, ¶ 916, at 85 (rev. ed. 1998); *see Merger Guidelines* § 2.1.

<sup>31</sup> *United States v. Grinnell Corp.*, 384 U.S. 563, 571 (1966).

<sup>32</sup> 15 U.S.C. § 18.

<sup>33</sup> Areeda, Hovenkamp & Solow, *supra* note 30, ¶ 901b2, at 9; *see, e.g., University Health*, 938 F.2d at 1219 (four firms “easily could collude to [raise prices or reduce output] without committing detectable violations of . . . the Sherman Act”).

<sup>34</sup> Such unilateral effects are most likely to result in either of two circumstances. First, a firm might be able to increase prices in markets where competitors are distinguished primarily by differentiated products and the merging firms produce products that a substantial number of customers regard as their first and second choices (or, more precisely, where a substantial volume of sales are to customers who regard the products of the merging firms as their first and second choices). *See FTC v. Swedish Match*, 131 F. Supp. 2d 151, 168 (D.D.C. 2000); *New York v. Kraft Gen. Foods, Inc.*, 926 F. Supp. 321, 333-35 (S.D.N.Y.

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power results in lower output and higher prices and a corresponding transfer of wealth from buyers to sellers or a misallocation of resources. As we discuss in this opinion, CB&I's acquisition of PBM raises the very competitive problem that is the focus of Section 7 – an accretion of market power and a tightening of oligopoly market conditions.

We are guided in our assessment of this merger by the case law and the *Merger Guidelines*, both of which set out the general framework for our analysis and provide instruction for the issues raised on appeal. Under this framework, Complaint Counsel must first establish a prima facie case that the acquisition is unlawful. Typically, this has been accomplished by showing that the transaction will significantly increase market concentration,<sup>35</sup> which in turn establishes a “presumption” that the transaction is likely to substantially lessen competition.<sup>36</sup> Of course, “market share and concentration data provide only the starting point for analyzing the competitive impact of a merger.”<sup>37</sup> “That the

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1995); *see generally United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1113-21 (N.D. Cal. 2004). Second, although no case seems to have dealt directly with such facts, economic learning holds that a firm might be able to increase prices above competitive levels in some markets where capacity is constrained and competitors may not be able to increase output in response to an output restriction by the merged firm. *See, e.g., Merger Guidelines* § 2.22.

<sup>35</sup> As the D.C. Circuit has observed, “[t]he Supreme Court has adopted a totality-of-the-circumstances approach to [Section 7], weighing a variety of factors to determine the effects of particular transactions on competition.” *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 984 (D.C. Cir. 1990).

<sup>36</sup> *Merger Guidelines* §1.51; *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 715 (D.C. Cir. 2001); *Baker Hughes*, 908 F.2d at 982.

<sup>37</sup> *Merger Guidelines* § 2.0.

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government can establish a prima facie case through evidence on only one factor, market concentration, does not negate the breadth of this analysis. Evidence of market concentration simply provides a convenient starting point for a broader inquiry into future competitiveness.”<sup>38</sup> The strength of the initial presumption also varies according to how high the concentration numbers are. As we will discuss, Complaint Counsel may establish a prima facie case with concentration data and introduce other types of evidence relating to market and entry conditions to bolster their concentration data.

Respondents may rebut the prima facie case by producing evidence that

“show[s] that the market-share statistics [give] an inaccurate account of the acquisition[’s] probable effect[] on competition” in the relevant market. In so doing, the defendant may rely on “nonstatistical evidence which casts doubt on the persuasive quality of the statistics to predict future anticompetitive consequences,” such as: “ease of entry into the market, the trend of the market either toward or away from concentration, and the continuation of active price competition.”

Additionally, the defendant may demonstrate unique economic circumstances that undermine the predictive value of the government’s statistics.<sup>39</sup>

If Respondents are successful in their rebuttal efforts, the evidentiary burden shifts back to Complaint Counsel and merges with the ultimate burden of persuasion, which remains with Complaint Counsel at all times.<sup>40</sup>

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<sup>38</sup> *Baker Hughes*, 908 F.2d at 984.

<sup>39</sup> *University Health*, 938 F.2d at 1218 (citations omitted).

<sup>40</sup> *Id.* at 1218-19.



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### C. Issues and Summary of Decision

The relevant product and geographic markets are uncontested in the present case. As the Initial Decision found, they are field-erected LNG storage tanks, field-erected LPG storage tanks, field-erected LIN/LOX storage tanks, and field-erected TVCs (all four built in the United States).<sup>41</sup> Respondents also do not contest that CB&I and PDM were the dominant suppliers of the products in these four relevant markets prior to the acquisition. Rather, at the heart of this case are Respondents' arguments that post-acquisition entry has occurred in the LNG tank market and that smaller incumbents have expanded their presence in both the LPG and the LIN/LOX tank markets.<sup>42</sup> Respondents contend that this entry and expansion make the parties' former dominance irrelevant, that the Commission should focus solely on this post-acquisition period, and that the Commission should find that the acquisition does not violate the antitrust laws.

Established antitrust principles hold that entry must be not only likely to occur in a timely manner but also sufficient to constrain post-merger price increases to pre-merger levels.<sup>43</sup> In our assessment of whether the entry in these markets meets this

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<sup>41</sup> The Complaint initially pled the relevant lines of commerce as TVCs, LNG tanks, LNG peak-shaving plants, LNG import terminals, LPG tanks, and LIN/LOX/LAR tanks (which are also known as LIN/LOX tanks). However, the Initial Decision found the four relevant markets we identify, and the parties have not contested these markets. IDF 18-19.

<sup>42</sup> Although Respondents characterize both the LIN/LOX and the LPG tank markets as attracting new entry post-merger, we find that a more accurate characterization of the phenomenon to which Respondents point is an attempted expansion by smaller incumbents.

<sup>43</sup> *Merger Guidelines* §§ 3.2-3.4.

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standard, we have considered both the post-acquisition bidding evidence in the relevant markets<sup>44</sup> and the bidding history of those markets. The history of these markets reveals that they have not been characterized by easy entry and expansion and have been dominated by Respondents for decades.<sup>45</sup> Despite the fact that suppliers have come and gone in these markets over the years and have, on occasion, been awarded a bid and constructed a tank, the evidence demonstrates that the real competition in these markets has been between CB&I and PDM. The evidence strongly suggests that this dynamic would have continued absent the merger, and Respondents' own strategic planning documents

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<sup>44</sup> Some post-acquisition evidence may not necessarily receive as much weight as other types of evidence. *See United States v. General Dynamics Corp.*, 415 U.S. 486, 504-05 (1974) (“If a demonstration that no anticompetitive effects had occurred at the time of trial . . . constituted a permissible defense to a §7 divestiture suit, violators could stave off such actions merely by refraining from aggressive or anticompetitive behavior.”); *Hospital Corp. of America v. FTC*, 807 F.2d 1381, 1384 (7th Cir. 1986) (“Post-acquisition evidence that is subject to manipulation by the party seeking to use it is entitled to little or no weight.”); *B.F. Goodrich Co.*, 110 F.T.C. 207, 341 (1988) (same). *See also FTC v. Consolidated Foods Corp.*, 380 U.S. 592, 598 (1965) (finding that the court of appeals gave too much weight to post-acquisition evidence that, among other things, showed a declining share).

<sup>45</sup> Areeda, Hovenkamp & Solow have commented that “[t]he only truly reliable evidence of low barriers is repeated past entry in circumstances similar to current conditions.” 2A Phillip E. Areeda, Herbert Hovenkamp & John Solow, Antitrust Law: An Analysis of Antitrust Principles and Their Application, ¶420b, at 60 (2d ed. 2002). *See also FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 56 (D.D.C. 1998) (“[T]he history of entry into the relevant market is a central factor in assessing the likelihood of entry in the future.”).

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predicted that the merged firm would “dominate” the relevant markets.<sup>46</sup> Thus, to determine whether the entry Respondents suggest is likely to restore the competition lost from the merger, we must determine whether a sea-change has occurred in these markets so as to render inapplicable the competitive conditions that have held for so long. Based on the evidence, we conclude that such is not the case and that the entry and expansion alleged by Respondents are not sufficient to constrain CB&I’s conduct in the foreseeable future (and thus offset the harm to competition resulting from the acquisition).

In Part II of this Opinion, we discuss the product markets and review the conditions that characterize sales in those markets. Specifically, Part II explains how LNG tanks, LPG tanks, LIN/LOX tanks, and TVCs are constructed and how bidding takes place in each of these markets.

Part III of the Opinion examines the sufficiency of Complaint Counsel’s *prima facie* case, deals with the Initial Decision’s exclusion of the HHI evidence, and explains the role of such evidence in our assessment of Complaint Counsel’s case. We also examine the bidding history in each of the relevant markets and conclude, contrary to the Initial Decision, that this history not only bolsters the HHI evidence but also provides an independent reason

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<sup>46</sup> See CX 74 at PDM - C 1005941 (PDM document evaluating a possible acquisition of CB&I and stating that it would result in “[m]arket dominance in [the] Western Hemisphere”); CX 648 at PDM-HOU 000267 (recommendation to PDM’s Board that states that acquiring CB&I will result in “[m]arket dominance”); Tr. at 5169 (testimony from Luke Scorsone [now the head of CB&I’s Industrial Division] that he believed that an acquisition of CB&I by PDM could result in worldwide market dominance for LNG and LPG tanks). See also CX 1686 at CBI/PDM-H 4005550 (“When the integration process is over,” CBI “will truly be the world leader instorage [sic] tanks”).

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for finding that Complaint Counsel met their burden. Finally, we examine evidence related to entry conditions in each of the relevant markets and conclude that entry in each market is extremely difficult.

In Part IV, we examine Respondents' rebuttal case. We first reject Respondents' argument that the small size of the relevant markets precludes finding liability under Section 7 of the Clayton Act. We also examine Respondents' evidence of entry in the LNG, LPG, and LIN/LOX tank markets and conclude that the entry and expansion identified by Respondents are inadequate to restore these markets to their premerger state. Because we find that entry into the relevant markets is difficult and that effective entry and expansion are not likely to occur in the foreseeable future, we also reject Respondents' potential competition argument. Finally, we examine evidence related to whether customers can constrain a price increase by CB&I and determine that they cannot. We conclude that Respondents have not rebutted Complaint Counsel's *prima facie* case.

Part V of the Opinion discusses the likely competitive effects of the acquisition and concludes that the acquisition is likely to lessen competition substantially in the relevant markets.

In Part VI, we explain why, given our conclusions in Parts III, IV, and V, we do not need to consider the issues raised by Complaint Counsel's cross-appeal to the extent it argues that the ALJ erred in not finding that the acquisition resulted in actual anticompetitive effects.

In Part VII, we consider and reject Respondents' argument that competition in the relevant markets was not harmed because PDM would have exited the four relevant markets absent the acquisition.

Part VIII sets out the remedy that we are ordering in this matter and addresses the issues raised by Respondents' and Complaint Counsel's respective objections to the ALJ's order.

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In sum, we adopt the Initial Decision's holding that the acquisition violated Section 7 of the Clayton Act and Section 5 of the Federal Trade Commission Act in all four relevant markets, and we adopt the findings set out in the Initial Decision to the extent they are not inconsistent with our Opinion. We also make a number of new factual findings based upon our de novo review of the record.<sup>47</sup> We order Respondents to divest such assets and take such actions as are necessary and appropriate to establish a viable competitor to the market that will restore the competition lost from this acquisition.

## II. Industry Background

### A. LNG Tanks

LNG tanks are field-erected tanks that can store between 2.5 million and 42 million gallons of natural gas (primarily comprising methane)<sup>48</sup> at cryogenic temperatures (-260° F). These tanks are very large, potentially having a diameter of 200 feet or more<sup>49</sup> and a height of 100 to 150 feet, and can cost approximately \$35 million to \$50 million.<sup>50</sup> Because they store the gas cryogenically, LNG tanks must have inner walls made of 9 percent nickel steel.<sup>51</sup> The metallurgical properties of this 9 percent nickel steel require special welding techniques to ensure

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<sup>47</sup> Throughout this Opinion, our legal conclusions and findings of fact are intermixed according to subject matter.

<sup>48</sup> Tr. at 537, 1560, 4452, 4964. The transcript describes LNG tank capacity in terms of both gallons and barrels. For consistency, we have converted all capacity figures to gallons. There are 42 gallons in a barrel. Tr. at 320, 5007.

<sup>49</sup> IDF 24.

<sup>50</sup> Tr. at 4566, 6260.

<sup>51</sup> Tr. at 530.

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against cracking and other problems. If LNG leaks through the tank due to faulty welding, the consequences can be disastrous,<sup>52</sup> and although this result is unlikely given the quality checks now in place, faulty welding can result in significant construction delays and substantial economic and financial losses.<sup>53</sup>

There are three types of LNG tanks currently produced: (1) single-containment tanks, (2) double-containment tanks, and (3) full-containment tanks. A single-containment tank is a double-walled steel tank that comprises one 9 percent nickel steel tank surrounded by insulation and a carbon steel tank (to hold the insulation in place).<sup>54</sup> Both of these tanks are enclosed by a concrete or earthen dike.<sup>55</sup> A double-containment tank also consists of an outside container that encloses the inner 9 percent nickel steel and carbon tanks. However, unlike the structure surrounding the nickel-steel tank in a single-containment tank, the outer container in a double containment tank is also capable of holding the LNG so that if the inner tank fails, the liquid will be contained.<sup>56</sup> A full-containment tank has the 9 percent nickel steel tank used in a single-containment tank encased in a layer of concrete, so that both liquid and vapor are contained in the event of a spill.<sup>57</sup> Customers choose between tank types based on the nature of the area (urban versus rural), the land area for the site,

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<sup>52</sup> Tr. at 564-65, 1789, 6234-35.

<sup>53</sup> *See, e.g.*, Tr. at 6285-87 (liquidated damages account for the fact that the revenue stream does not begin until the facility is finished and that delay can result in the loss of “a lot of revenue”) (*in camera*).

<sup>54</sup> Tr. at 530, 4110.

<sup>55</sup> Tr. at 531, 6170.

<sup>56</sup> Tr. at 531, 6171.

<sup>57</sup> Tr. at 532, 6170.

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the size of the tank, and the Federal Energy Regulatory Commission's (FERC) vapor dispersion and thermal radiation requirements.<sup>58</sup>

The inner 9 percent nickel steel tank for any LNG tank is difficult to make. The sheets constituting these tanks must be curved and beveled correctly, and the design, welding, and erection of the tanks must take account of specific characteristics such as the fact that the thickness of the plate varies from top to bottom.<sup>59</sup> Among other things, the foundation of the tank also must be designed and constructed to protect the ground from the tank's cold temperatures, and piping connections and pumps must be designed and constructed to properly move the fluid in and out of the tank.<sup>60</sup> An LNG tank supplier must also identify, contract with, and supervise traveling field crews and local labor crews and maneuver the project through various federal and local regulatory processes. This entire process must occur in a timely manner, because delays in the project result in unrealized cash flow and economic losses to the customer, which may result in liquidated damages for the tank supplier.<sup>61</sup>

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<sup>58</sup> FERC regulations require that the radiation intensity of a potential fire and the vapor dispersion from a potential spill not exceed certain limits at the boundary of the site. Tr. at 533, 6969. A computer model calculates the distance needed from the center of the tank to the site boundary based on the size of the tank. Tr. at 6970. Because full-containment tanks result in lower vapor dispersion and thermal radiation values, they can be placed on smaller parcels of land than can accommodate single-containment or double-containment tanks. Tr. at 533-34. Similarly, double-containment tanks can be placed on smaller pieces of land than comparably sized single-containment tanks. Tr. at 6971.

<sup>59</sup> Tr. at 5898.

<sup>60</sup> Tr. at 5920-5922.

<sup>61</sup> Tr. at 6184, 6265-66, 6481-82.

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LNG storage tanks generally serve two types of facilities: LNG import terminals and peak-shaving plants. LNG import terminals receive LNG from tankers and offload the LNG to storage tanks. As the LNG is distributed, the import terminal pumps the liquid out of the LNG storage tanks, vaporizes and pressurizes the gas, and sends it to the pipeline.<sup>62</sup> In an import terminal, this process usually happens at roughly the same time that the liquid is unloaded from the tanker. A peak-shaving plant, on the other hand, is used by local utilities to store LNG to provide reserves in case of a shortage.<sup>63</sup> Thus, as natural gas is delivered, it is liquefied and stored in the tanks. When the gas is needed, the liquid is vaporized and then sent back through the natural gas pipeline. The two major components of a peak-shaving plant are the liquefaction unit (which brings the gas in, treats the gas so it can be liquefied, and then performs the liquefaction) and the LNG storage tanks.<sup>64</sup> Field-erected LNG tanks at peak-shaving plants tend to have smaller capacity than those used in LNG import terminals.<sup>65</sup>

B. LPG Tanks

LPG tanks are field-erected, refrigerated tanks for liquefied gases including propane, butane, propylene, and butadiene.<sup>66</sup> These tanks store liquefied gases at low temperatures, around

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<sup>62</sup> Tr. at 6170; IDF 25.

<sup>63</sup> IDF 26.

<sup>64</sup> *Id.*

<sup>65</sup> IDF 27.

<sup>66</sup> IDF 30; CX 993 at PDM-HOU021479.



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-50° F.<sup>67</sup> LPG tanks are also very large, store hundreds of thousands of barrels of LPG, and cost approximately \$5 million.<sup>68</sup>

As with LNG tanks, the steel for LPG tanks is fabricated in pieces, shipped to the site, assembled, and welded.<sup>69</sup> The tanks also require proper insulation and a foundation that protects against the very cold temperatures of the stored liquid moving from the tank into the earth.<sup>70</sup> If this temperature migration were to occur, the resulting frost would damage the structure of the tank.<sup>71</sup> Similar to LNG tanks, LPG tanks are a critical component of LPG import/export terminals in that they receive LPG from ships (to be moved through pipelines) and from pipelines (to be placed on ships and exported).<sup>72</sup> An LPG terminal with adequate storage capacity can both import and export LPG.<sup>73</sup>

### C. LIN/LOX Tanks

LIN (liquid nitrogen), LOX (liquid oxygen), and LAR (liquid argon) (collectively, LIN/LOX) tanks are field-erected cryogenic tanks that store various liquid gas products at cryogenic temperatures at approximately -300° F or lower.<sup>74</sup> Their design is similar to that of LNG tanks, and they usually include inner and

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<sup>67</sup> Tr. at 2722-23.

<sup>68</sup> Tr. at 6575, 6719-20, 7281.

<sup>69</sup> Tr. at 6567, 6574.

<sup>70</sup> Tr. at 6579-81.

<sup>71</sup> Tr. at 6581.

<sup>72</sup> Tr. at 6709.

<sup>73</sup> *Id.*

<sup>74</sup> Tr. at 825, 833-34; CX 650 at CBI/PDM H4019758.

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outer shells.<sup>75</sup> However, they are smaller than LNG tanks,<sup>76</sup> holding 300,000 to 1,000,000 gallons of liquid.<sup>77</sup> A typical LIN/LOX tank costs \$500,000 to \$1.5 million.<sup>78</sup>

LIN/LOX tanks are an essential part of integrated air separation facilities used by major industrial gas firms such as Air Liquide, Air Products, Praxair, BOC, and MG Industries. Air separation facilities separate air into its constituent components of nitrogen, oxygen, and argon.<sup>79</sup> Air separation facility customers use the gases for various industrial applications that require large amounts of storage capacity.<sup>80</sup>

At ambient temperatures, LIN is used to create inert (non-reactive) environments in applications such as chemical blanketing or purging. In its liquid form, LIN has cooling or freezing applications in the food and manufacturing industries. In manufacturing, LIN can also shrink materials that otherwise would not fit in the fabrication process. LOX, which unlike LIN is a very reactive gas and combines directly with virtually all elements, is used in the medical industry for oxygen treatment and in the steel and glass industries for combustion and melting. LAR is even more inert than LIN and has applications where an extremely inert environment is required, such as high-quality welding (where it is used as a shielding gas) and primary metal furnaces (where it acts to protect the furnace from high temperatures).

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<sup>75</sup> Tr. at 833.

<sup>76</sup> Tr. at 1346, 4072; CX 170 at CBI-PL009650.

<sup>77</sup> Tr. at 1346.

<sup>78</sup> Tr. at 1507-08.

<sup>79</sup> Tr. at 338, 824-26, 1386.

<sup>80</sup> JX 37 at 33.

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D. TVCs

A field-erected TVC is the outer shell of a large vessel that is used to simulate outer space in order to test satellites before they are launched.<sup>81</sup> TVCs also contain a thermal vacuum system composed of an inner shroud, vacuum insulated pipe, a thermal conditioning unit, and cryogenic pumps or other pumping equipment.<sup>82</sup> Together, this highly sophisticated system of temperature and vacuum controls allows the chamber to attain temperature ranges from  $-292^{\circ}$  to  $-238^{\circ}$  F and a range of extreme vacuum levels.<sup>83</sup> Field-erected TVCs can be as large as 45 by 45 by 60 feet<sup>84</sup> and can cost \$12 million to \$17 million.<sup>85</sup>

Typically, one company builds the shroud and another company builds the surrounding tank.<sup>86</sup> The dominant shroud constructors have been PSI (aka Chart) and XL, which, prior to the merger, formed alliances with the dominant tank constructors – PDM and CB&I, respectively.

E. Bidding

As we further discuss in Part III.B, *infra*, all four relevant markets are characterized by a purchasing process that uses some

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<sup>81</sup> Tr. at 1262.

<sup>82</sup> Tr. at 1263.

<sup>83</sup> Tr. at 1262. The testimony characterized the temperature range as  $-180^{\circ}$  to  $-150^{\circ}$  C. For consistency, we have converted these figures to Fahrenheit.

<sup>84</sup> Tr. at 1264.

<sup>85</sup> Tr. at 1891 (*in camera*), 1923 (*in camera*), 2074.

<sup>86</sup> Tr. at 1264.

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form of competitive bidding. In the LNG, LPG, and LIN/LOX tank markets, for example, buyers try to create a competitive environment by sending bid packages to multiple bidders.<sup>87</sup> Both LNG and LIN/LOX customers testified that they prefer to have at least three bidders.<sup>88</sup> In addition, although it appears most prevalent in the LPG and LIN/LOX tank markets, customers in all three tank markets use a second round of bidding to negotiate price so that they can “leverage the competitive environment prior to contract award.”<sup>89</sup> Customers in all three tank markets also sometimes inform bidders of the existence of competition in order to reduce the prices bid.<sup>90</sup> Similarly, in the TVC market, customers solicit proposals from multiple bidders and then either select one bidder with whom to negotiate a best and final offer (BAFO)<sup>91</sup> or negotiate BAFOs with multiple bidders.<sup>92</sup>

Bidding for LNG tanks, however, is particularly complicated, because the construction of peak-shaving plants and LNG import terminals can be organized in a number of ways.<sup>93</sup> For example, a facility owner may choose to manage the project and solicit competitive bids for various stages of the project, such as the front-end engineering and design (FEED) work for the facility or

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<sup>87</sup> Tr. at 2302, 2307, 7083.

<sup>88</sup> Tr. at 347-38, 4618-19, 6495.

<sup>89</sup> Tr. at 2299; *see also* Tr. at 349-50, 1992-93.

<sup>90</sup> Tr. at 2304-05, 4954, 5040, 6603, 6626-27.

<sup>91</sup> Tr. at 1440.

<sup>92</sup> Tr. at 211.

<sup>93</sup> Tr. at 704 (*in camera*). In addition to engaging in multiple iterations of bidding, LNG tank customers also employ blind bids, where a bidder has one shot to submit its bid and does not know who its competition is.

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the LNG tank. On the other hand, a facility owner may hire an Engineering, Procurement, and Construction (EPC) firm to manage the full breadth of the project. As the name suggests, an EPC contractor engineers the project, procures equipment and material, and constructs (or manages the construction of) the facility. Depending on its abilities and the customer's preference, an EPC contractor can perform the entirety of the work itself, subcontract portions of the work (such as LNG tanks) to other providers, or simply manage the various subcontractors for the owner.<sup>94</sup> In addition, although many LNG tank customers use competitive bids to select an EPC firm, some customers choose to negotiate sole-source contracts with certain suppliers.<sup>95</sup> This practice appears less prevalent in the LPG and LIN/LOX tank markets.<sup>96</sup>

### III. Complaint Counsel's Prima Facie Case

#### A. Herfindahl-Hirschman Index Calculations

At trial, Complaint Counsel presented sales evidence from 1990 to 2001 and asserted that CB&I and PDM accounted for over 70 percent of all sales made in each of the relevant markets

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<sup>94</sup> Where the EPC contractor takes on responsibility for the subcontractor's work or performs the work itself, the contract amounts to a turnkey contract. A turnkey contractor for an LNG import terminal or peak-shaving facility is responsible for building the entire plant from the engineering through the start-up of the plant. Tr. at 1323. Suppliers prefer to provide the customer with the entire facility, because such projects have higher margins than stand-alone LNG tanks. Tr. at 2812-13; CX 660 at PDM-HOU005013.

<sup>95</sup> Tr. at 6180-82, 6267.

<sup>96</sup> See Tr. at 6712-13.

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(and 100 percent of all sales in both the LNG and TVC markets).<sup>97</sup> Complaint Counsel argue that these sales data translate into HHIs that entitle them to a presumption that the acquisition will lessen competition.<sup>98</sup> Complaint Counsel alleged – and the Initial Decision found – that the acquisition would result in post-acquisition HHIs of 5,845 for the LIN/LOX tank market, 8,380 for the LPG tank market, and 10,000 for the LNG tank and TVC markets.<sup>99</sup> Based on Complaint Counsel’s evidence and the Initial Decision’s findings, the acquisition resulted in HHI increases of 2,635 for the LIN/LOX tank market, 3,911 for LPG tank market, 4,956 for the LNG tank market, and 4,999 for the TVC tank market.<sup>100</sup>

HHIs measure market concentrations and can indicate market power (or the lack thereof). They have been consistently employed by courts assessing the likely impact of a merger or acquisition.<sup>101</sup> The Initial Decision, however, refused to rely on the HHI data that Complaint Counsel put into evidence. The ALJ reasoned that in markets with sporadic sales, finders of fact must treat concentration data with a fair bit of skepticism, because the numbers may not accurately represent the competitive landscape. The Initial Decision also pointed out that the changes in concentration in this case are sensitive to the time period chosen and therefore concluded that the HHIs are arbitrary and

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<sup>97</sup> CCACAB at 21.

<sup>98</sup> *Id.* at 20.

<sup>99</sup> Tr. at 3443, IDF 273 (LIN/LOX); Tr. at 3403-04, IDF 218 (LPG); Tr. at 3055, IDF 68 (LNG); Tr. at 3494, IDF 371 (TVC).

<sup>100</sup> *Id.*

<sup>101</sup> *See, e.g., Heinz*, 246 F.3d at 716; *PPG Indus.*, 798 F.2d at 1503; *Cardinal Health*, 12 F. Supp. 2d. at 53-54.

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unreliable.<sup>102</sup> Specifically, the ALJ noted that because CB&I did not build an LNG or LPG tank or a TVC between 1996 and the acquisition, the change in concentration for that time period would be zero.<sup>103</sup>

We understand the ALJ's point and agree that in markets with sporadic sales, finders of fact must treat concentration statistics with care. However, total disregard of the concentration statistics is an entirely different matter and is a step we are unwilling to take in this case. Were one to look at a snapshot of a particular time, the HHIs taken alone might give the impression that CB&I was not a competitive force at that time. But such a notion is contradicted by other evidence in this case.<sup>104</sup> The ALJ's observation – which reflects a recognition that the sales in these markets are indeed sporadic – simply shows why it is appropriate to consider an extended period of time in analyzing these markets. Therefore, we reverse the ALJ's conclusion and will take account of the HHIs in this case.

We have considered the probative value of the concentration data in this case in light of all other evidence and have concluded that the evidence here corroborates – rather than refutes – the inferences that can be drawn from the HHIs. For example, in all four relevant markets, CB&I and PDM made by far the greatest number of sales, not only for the time period focused on by Complaint Counsel, but also for at least two decades. Indeed, as

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<sup>102</sup> ID at 91-92.

<sup>103</sup> ID at 91.

<sup>104</sup> Respondents' own economic expert, Dr. Barry Harris, acknowledged that it would be incorrect to conclude that the merger does not hurt competition simply because one Respondent accounted for all the sales in a relevant market over some period of years and the other Respondent accounted for none. Tr. at 7228.

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we noted earlier,<sup>105</sup> Respondents do not contest that they were the dominant suppliers in all four markets prior to the acquisition. In addition, none of the relevant markets is characterized by easy entry, and other firms making tanks in the various markets have not expanded their presence by any appreciable measure. We thus believe the nature of sales in these markets distinguishes the instant case from cases in which courts have given HHIs little weight due to market conditions. In *Baker Hughes*, for example, the government did not present evidence beyond the concentration levels themselves, and the court found those data unreliable given the volatile nature of the market and low entry barriers.<sup>106</sup> Similarly, in *General Dynamics*, the Supreme Court found that the market share data overstated the competitiveness of the acquired firm going forward, because they did not take into account that firm's depleted reserves and commitment contracts.<sup>107</sup>

In a case such as this, where there are very few sales in any given year, the aggregation of sales data over a period of years can present a compromise. On the one hand, aggregating sales over a longer period increases the risk that competitive conditions will have changed significantly over the period. On the other hand, extending the time period in order to enlarge the sample of sales reduces the risk that chance outcomes will obscure the competitive significance of the different firms. In other words, aggregating sales data over a longer period can either increase or decrease the degree to which the corresponding HHIs accurately reflect competitive conditions.

Here, the evidence shows that competitive conditions have not changed sufficiently over an extended period to undercut the

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<sup>105</sup> See Part I.C, *supra*.

<sup>106</sup> 908 F.2d at 986 (citing *United States v. Baker Hughes*, 731 F. Supp. 3, 11 (D.D.C. 1990)).

<sup>107</sup> 415 U.S. at 493.



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HHIs' central implication – that CB&I's acquisition of PDM combined the two principal competitors in these markets and is therefore likely to have harmed competition. Unlike the market described in *Baker Hughes*, the markets in this case are not volatile and shifting. Rather, these two companies are the only competitors that have made significant sales in each of the four markets for at least the past two decades. This fact is unquestionably reflected in the concentration levels presented by Complaint Counsel. Therefore, we believe that an extended time frame is an appropriate period in which to analyze the parties' sales data. Although the 11-year period chosen by Complaint Counsel is not the only option that was available, we are satisfied that the data present a representative picture of the various markets, given Respondents' long history of dominance in these markets preceding the acquisition. We also believe that the 1996-2001 period on which the ALJ focused provides a less reliable barometer than a more extended period.

The HHIs presented by Complaint Counsel for the four relevant markets range from 5,000 to 10,000 post-acquisition, with concentration increases that range from 2,600 to 5,000. They are thus well above the level needed to establish a prima facie case and entitle Complaint Counsel to a presumption that the merger is “likely to create or enhance market power or facilitate its exercise.”<sup>108</sup> As we will discuss, however, Complaint Counsel also presented evidence of pre-acquisition bids, contemporaneous documents from the parties, and customer testimony that all suggest that the acquisition will have an anticompetitive effect in each relevant market. We find that this additional evidence not only bolsters the validity of Complaint Counsel's HHIs but also provides ample reason for finding that they established a prima facie case.

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<sup>108</sup> *Merger Guidelines* § 1.51.

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B. Pre-Acquisition Competition in the Relevant Markets

In all four relevant markets the evidence establishes that CB&I and PDM were each other's closest competitor prior to the acquisition, and that together they largely dominated the sales of LNG, LPG, and LIN/LOX tanks and TVC tanks. These two companies also closely monitored each other's activities, and customers were frequently able to play one firm off against the other in order to obtain lower prices. The acquisition eliminated this substantial direct competition between them and left CB&I with an "undue" percentage share of each market. In this section, we further examine Complaint Counsel's market share case to consider the conditions that prevailed in each of the four markets. Based on this examination, we conclude that the qualitative evidence leaves no doubt that the acquisition has left CB&I as the dominant player – indeed, the only major player – in all of the markets and, as just noted, provides an independent reason for finding a strong prima facie case of presumptive liability. Accordingly, the evidence "creates, by a wide margin, a presumption that the merger will lessen competition" in each of the four markets.<sup>109</sup>

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<sup>109</sup> *Heinz*, 246 F.3d at 716. However, *Baker Hughes* noted that "evidence of market concentration simply provides a convenient starting point for a broader inquiry into future competitiveness." *Baker Hughes*, 908 F. 2d at 984. See also *General Dynamics*, 415 U.S. at 498 (1974) ("[S]tatistics concerning market share and concentration, while of great significance, [are] not conclusive indicators of anticompetitive effects[.]"); *Merger Guidelines* § 2.0 ("[M]arket share and concentration data provide only the starting point for analyzing the competitive impact of a merger."). Nonetheless, where concentration levels are extraordinarily high – as they are in this case – Respondents bear the burden of demonstrating that the HHIs are unreliable in predicting a transaction's competitive consequences. See *Heinz*, 246 F.3d at 715.

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1. Pre-Acquisition Competition in the LNG Tank Market

The evidence establishes that prior to the acquisition CB&I and PDM had a virtual duopoly in the manufacture and construction of LNG tanks. From 1990 to the acquisition in 2001, these two firms were the only winners of bids to build LNG tanks in the United States. While one could argue (as Respondents do) over whether 1990 to 2001 is the appropriate period to examine, the choice of another period would not dramatically change the results: CB&I and PDM were the only companies with non-trivial sales of LNG tanks for over three decades.<sup>110</sup>

In the 11 years prior to the acquisition, CB&I and PDM were also the only bidders for the vast majority of projects.<sup>111</sup> The evidence reveals that firms other than CB&I and PDM bid in only two projects of nine.<sup>112</sup> Moreover, both of those projects demonstrate that CB&I and PDM did not face significant

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<sup>110</sup> From 1975 to the time of the acquisition, PDM and CB&I were the only companies that constructed LNG tanks for import terminals. Similarly, out of the 95 LNG tanks awarded for United States peak-shaving facilities in the 35 years prior to the acquisition, only seven tanks went to companies other than CB&I and PDM, and none went to other companies in the preceding 11 years. CX 125, CX 1645. CX 1645 discusses two additional peak-shaving projects not identified in the 93 projects listed in CX 125 – the 1995 MLGW project and the 1995 Pine Needle LNG project. The Citizen’s Gas & Coke and South Carolina Pipeline Corp. projects discussed in CX 1645 are peak-shaving plants but CX 125 accounts for them. The Granite State Gas and Atlanta Gas projects were cancelled. CX 1645 at 2. The Enron, Cove Point, and Liquid Carbonic projects were not peak-shaving plants. CX 173 at CBI-PL010403, CX 853 at PDM-HOU011488.

<sup>111</sup> IDF 72-73.

<sup>112</sup> IDF 65, 72.

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competition from other suppliers. Although Lotepro teamed with Whessoe and Black & Veatch teamed with TKK, and both groups submitted bids for MLGW's peak-shaving plant in Capleville, Tennessee,<sup>113</sup> their bids were well above that of CB&I.<sup>114</sup> Similarly, evidence suggests that CB&I and PDM were each other's closest competitor in bidding for the Atlanta Gas peak-shaving plant. Although the project was ultimately cancelled, Atlanta Gas evaluated another bidder (Marlborough Enterprises) and deemed its bid inferior to those of CB&I and PDM.<sup>115</sup>

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<sup>113</sup> The bid for this project was awarded in 1995. CX 1645.

<sup>114</sup> Tr. at 560, 3196-98. Although PDM was disqualified from bidding on this project because it did not meet the specifications in the request for proposals, MLGW's project manager testified that once the bids were adjusted for quality, PDM's bid was very close to CB&I's. Tr. at 1876.

Respondents argued at trial that the tank bids themselves were competitive and that the difference in the MLGW bids is mostly attributable to the liquefaction portion of the bid. The evidence indicates, however, that CB&I's tank bid was well below those of Black & Veatch/TKK and Lotepro/Whessoe. CB&I bid \$36 million for the facility – \$22 million for the liquefaction facility and \$14 million allocated to the tank. Tr. at 648, 1809. In contrast, Lotepro/Whessoe's bid was \$40 million. Tr. at 1809. Although there is no evidence on the precise breakdown of Lotepro's bid, the project manager for MLGW testified that the tank portion of Lotepro's bid was "quite a bit higher" than CB&I's. Tr. at 1810. Similarly, Black & Veatch/TKK's bid was \$47.7 million, of which \$31 million was allocated to the liquefaction process and \$16.7 million was allocated to the tank. Tr. at 648.

<sup>115</sup> CX 161.

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Testimony from customers and industry participants establishes that PDM and CB&I were the only viable LNG tank suppliers prior to the acquisition and that the acquisition substantially harmed competition.<sup>116</sup> MLGW testified that it was concerned about the competition for its upcoming project in 2006, because post-acquisition it does not “see anyone out there with experience that could come into the market and compete with CB&I/PDM.”<sup>117</sup> A representative of another customer, People’s Light, Gas & Coke, testified that the acquisition eliminated a choice and would have a “negative impact.”<sup>118</sup> He elaborated that “[w]hat makes a vendor bid a lower price is not altruism but a fear that if you do not bid that lower price, you won’t get the job.”<sup>119</sup> An industry consultant echoed this concern and stated, “[T]here’s plenty of people out there that will bid, but I think it will be difficult for anybody to come in and beat a bid from CB&I at this point.”<sup>120</sup>

The parties’ internal documents also confirm that CB&I and PDM did not consider other firms to be significant competitive threats. In the years prior to the acquisition, CB&I and PDM focused almost exclusively on each other in their assessment of the competitive landscape and paid little or no attention to what other companies were doing. For example, PDM’s 1998 President’s Report to the Board of Directors devoted two of seven pages to CB&I, with virtually no mention of any other

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<sup>116</sup> The testimony discussed in this paragraph of text comes from witnesses who observed first-hand the competition between CB&I and PDM.

<sup>117</sup> Tr. at 1830.

<sup>118</sup> Tr. at 324.

<sup>119</sup> *Id.*

<sup>120</sup> Tr. at 703 (*in camera*).

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competitor.<sup>121</sup> PDM's 2000 Business Plan also analyzed the "Domestic LNG" market and concluded that "CB&I is PDM EC's domestic competition for LNG tanks."<sup>122</sup> In fact, Luke Scorsone, who now heads CB&I's Industrial Division,<sup>123</sup> candidly admitted that prior to the acquisition he viewed PDM as CB&I's lone competition in the LNG tank market.<sup>124</sup>

2. Pre-Acquisition Competition in the LPG Tank Market

Although the LPG tank market appears not to have been a duopoly prior to the acquisition,<sup>125</sup> only two of the 11 projects bid from 1990 until the acquisition were won by firms other than CB&I and PDM.<sup>126</sup> Furthermore, we find that fully crediting these two projects overstates their competitive impact. First, although Morse won a bid in 1994, it was later acquired by CB&I and is no longer in the market.<sup>127</sup> Second, although AT&V won a small project near its Gulf Coast fabrication facilities in 2000, the record suggests that this award was an anomaly given the small size and

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<sup>121</sup> CX 68.

<sup>122</sup> CX 94 at PDM-HOU017580.

<sup>123</sup> Prior to the acquisition, Mr. Scorsone was head of PDM's Erected Construction Division, which was the division responsible for sales of the various storage tanks and the TVCs at issue in this case.

<sup>124</sup> Tr. at 4851.

<sup>125</sup> In addition to CB&I and PDM, the record identifies AT&V, Matrix, Wyatt, Morse, and Pasadena Tank as bidders. Tr. at 3750, 5040, 6550, 6561, 7286. *See also* JX 23a at 119-123 (*in camera*), CX 397.

<sup>126</sup> IDF 210.

<sup>127</sup> Tr. at 6546.

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the proximity of the tank to its facilities.<sup>128</sup> Even if we credit these wins fully, CB&I and PDM still stand as the dominant players and closest competitors, with only an occasional job going to other firms.

We have taken note that CB&I had not won any LPG tank jobs from 1994 until after the acquisition.<sup>129</sup> While this fact, at first blush, seems to undermine the pre-acquisition competitive significance of CB&I and suggests that the acquisition may not have actually lessened competition between CB&I and PDM in LPG tanks, the record shows that CB&I's string of losses after 1993 is not competitively significant. One of the LPG jobs that PDM won during this period (the Sea-3 project) is anomalous because PDM's bid left out a \$400,000 piece of equipment that should have been included in the price.<sup>130</sup> It is not clear that PDM would have won the bid absent this error. In addition, during this period, CB&I continued to bid on each of the available LPG jobs, and the evidence suggests that its presence constrained PDM's pricing.<sup>131</sup>

Demand for LPG tanks has been declining,<sup>132</sup> and therefore customer testimony on the potential effect of the acquisition is

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<sup>128</sup> Tr. at 7129-31, 7133-34; CX 107 at PDM-HOU005015.

<sup>129</sup> Complaint Counsel's expert calculated the probability of CB&I's losing five straight bids if it were one of two equal bidders as 3.13 percent. Tr. at 3686-87. If it were one of three equal bidders, the probability would be 32/243 (or 13 percent). Tr. at 3688.

<sup>130</sup> Tr. at 4826.

<sup>131</sup> Tr. at 2300, 2306, 3375; CX-63, 68, 94 at PDM-HOU017582, 116, 660.

<sup>132</sup> *See* Tr. at 2309 (Fluor not aware of any field-erected LPG tanks being planned by anyone).

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scant. Nevertheless, Fluor testified that the competitive alternatives to Fluor for its Sea-3 project were PDM and CB&I.<sup>133</sup> In addition, as is the case with the LNG market, the parties' own documents reflect that they viewed each other as the primary competition for LPG tanks. PDM strategic planning documents identified CB&I as "PDM EC's only competitor on domestic . . . LPG . . . projects."<sup>134</sup> CB&I's documents echo this sentiment. A presentation for CB&I's Board of Directors examined business conditions for 2000 and remarked that "[t]he combination of CB&I/PDM would be very strong in aggregating technology expertise, field crews and customer relationships."<sup>135</sup> Mr. Scorsone also testified that PDM was a formidable competitor to CB&I in LPG tanks in the Western Hemisphere.<sup>136</sup>

As with the LNG market, Respondents projected that the acquisition would give them market power in LPG tanks. In August 1999, PDM's CEO suggested to the PDM Board that PDM acquire CB&I, with an eye to achieving "[m]arket dominance in [the] Western Hemisphere, . . . LPG worldwide

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<sup>133</sup> Tr. at 2307-08. Matrix, a would-be entrant, also stated that CB&I and PDM were the only competitors for LPG tanks. Tr. at 1614.

<sup>134</sup> CX 107 at PDM-HOU005016 (PDM's "Strategic Plan 2000"); CX 68, 94, 648, 660.

<sup>135</sup> CX 216 at CBI-PLO33892.

<sup>136</sup> Tr. at 4263-64; *see also* CX 163 (CB&I document mentioning PDM as main competitor in the low temperature and cryogenic market, which includes LPG); CX 216 (CB&I Board of Directors' September 2000 Strategy Meeting document) at CBI-PL033886 (PDM a "formidable competitor" to CB&I in LPG in Western Hemisphere).



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market dominance.”<sup>137</sup> Although Scorsone testified that he made these statements merely to elicit enthusiasm from the Board and that it would have been very hard to dominate the domestic market,<sup>138</sup> we find that these statements were more than mere puffery. CX 648 is replete with references to CB&I and makes no reference to the competitive impact of other firms. At his investigational hearing, Scorsone also testified that CB&I was the largest in the world and an “icon for us [PDM] to focus on.”<sup>139</sup> He admitted that he had believed that “market dominance” could be an outcome of an acquisition when he made the presentation to PDM’s Board in 1999.<sup>140</sup> In addition, testimony from two major LPG customers reflects the view that the only competitive alternatives in the LPG tank market were PDM and CB&I.<sup>141</sup>

### 3. Pre-Acquisition Competition in the LIN/LOX Tank Market

The LIN/LOX tank market includes (and has historically included) several small fringe firms. Thus, like the LPG tank market prior to the acquisition, the LIN/LOX market was not an outright PDM/CB&I duopoly. In addition, Graver manufactured LIN/LOX tanks from 1990 until its exit in 2001.<sup>142</sup> Two additional firms, AT&V and Matrix, entered the market not long

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<sup>137</sup> Tr. at 4788-87; CX 648 at PDM-HOU000267 (August 1999 presentation to PDM Board of Directors).

<sup>138</sup> Tr. at 4786-88.

<sup>139</sup> Tr. at 5168.

<sup>140</sup> Tr. at 5168-69. *See also* CX 68 at 8 (August 1998 PDM Board presentation) (“CBI is PDM EC’s major competitor in almost all of the significant markets PDM EC serves.”).

<sup>141</sup> Tr. at 2308, 3367.

<sup>142</sup> IDF 269-70.

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before the acquisition.<sup>143</sup> Chattanooga was an active bidder both before and after the acquisition but has yet to win a bid.<sup>144</sup> One additional firm, BSL, bid for a time and then exited the market.<sup>145</sup>

Despite the appearance, and disappearance, of multiple competitors in the LIN/LOX market, our examination of recent market history, customer testimony, and company documents leads us to find that the real competition in LIN/LOX tanks prior to the acquisition consisted of only CB&I, PDM, and Graver – and then of only CB&I and PDM after Graver exited in 2001. From 1990 to the acquisition, 109 LIN/LOX tanks were constructed.<sup>146</sup> Of these tanks, CB&I won 25, PDM won 44, Graver won 34, Matrix won 4, and AT&V won 2.<sup>147</sup> Graver was a well-known competitor in LIN/LOX tanks.<sup>148</sup> Its exit in 2001 was a significant event that further concentrated an already concentrated market.<sup>149</sup> Matrix had just entered the market a few years prior to the acquisition.<sup>150</sup> Shortly before the acquisition, AT&V also was finally able to win a LIN/LOX bid and has since

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<sup>143</sup> IDF 313, 320; Tr. at 4599.

<sup>144</sup> IDF 325-27.

<sup>145</sup> Tr. at 954-55, 1351-52, 1378-80, 1577-78, 2001.

<sup>146</sup> IDF 269; ID at 95.

<sup>147</sup> *Id.*

<sup>148</sup> *See* Tr. at 479, 1350-51, 1378, 1988-89, 6424-25.

<sup>149</sup> *See* Tr. at 1988-89. Before it exited the market in 2001, Graver's performance had been deteriorating following its acquisition by Iteq (several years before CB&I acquired PDM). Tr. at 2425.

<sup>150</sup> IDF 320.

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completed the project and won two additional bids.<sup>151</sup> The section on entry below (Part IV.C.3) discusses in detail why none of these third-party firms has been a sufficient entrant – that is, one that has replaced the competition lost from the acquisition.

Customer testimony supports the conclusion that CB&I and PDM were the two principal competitors in the U.S. LIN/LOX tank market after Graver's exit in 2001 and that the acquisition substantially reduced competition. Air Liquide testified that it was concerned about the acquisition because competition had already been reduced by Graver's exit and because prices would tend to rise with only one viable LIN/LOX tank supplier left.<sup>152</sup> Linde testified that the acquisition drastically reduced its choice to one vendor.<sup>153</sup> Air Products testified that the acquisition eliminated a low-cost, preferred bidder and that it expects prices in LIN/LOX to go up as a result.<sup>154</sup> MG Industries testified that the acquisition took away an aggressive competitive bidder and that it is worse off after the acquisition, without PDM in the market.<sup>155</sup> PDM was the lowest bidder for the last three or four project inquiries for MG Industries, which frequently pitted PDM against CB&I to get better prices.<sup>156</sup>

Documentary evidence related to bids also confirms that PDM was an aggressive competitor in the LIN/LOX tank market and

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<sup>151</sup> Tr. at 2321-22, 2504-05, 4599.

<sup>152</sup> Tr. at 1988-91.

<sup>153</sup> Tr. at 878.

<sup>154</sup> Tr. at 1352-53.

<sup>155</sup> Tr. at 475.

<sup>156</sup> Tr. at 462.

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frequently underbid CB&I.<sup>157</sup> Sometimes this dynamic caused both firms to submit bids with negative profit margins.<sup>158</sup> Respondents' documents also confirm that CB&I and PDM viewed each other as their primary competition. For example, CB&I and PDM monitored each other's past LIN/LOX bids but did not follow the bids of AT&V or Matrix.<sup>159</sup> In addition, both parties' documents often mention each other, with relatively little attention to other competitors.<sup>160</sup> Taken as a whole, this evidence supports the conclusion that the market was dominated by CB&I and PDM and that they were each other's closest competitor at the time of the acquisition.

4. Pre-Acquisition Competition in the TVC Market

Only CB&I, PDM, and Howard have submitted bids for TVC tank projects since 1990. The record demonstrates, however, that despite Howard's bidding presence, it has not been a significant factor in the TVC market. Howard has never won a project and is not regarded by customers as a credible bidder.<sup>161</sup> In fact, although Howard submitted a lower bid for Raytheon's Long Beach project, Raytheon chose the CB&I/XL pairing<sup>162</sup> because

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<sup>157</sup> CX 183; CX 193 at CBI-PL20339; IDF 279-82.

<sup>158</sup> CX 183; CX 193 at CBI-PL020339.

<sup>159</sup> IDF 277-79.

<sup>160</sup> *Id.*

<sup>161</sup> Tr. at 192-93, 384-87, 1443. In addition, Howard's founder testified that he did not believe that Howard had any real chance of winning a large TVC project. Tr. at 192-93.

<sup>162</sup> Typically, one company builds the shroud and another company builds the tank that encloses it. Tr. at 1264. The dominant shroud constructors have been PSI (aka Chart) and XL, which have formed alliances with the dominant tank constructors,

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Raytheon believed that CB&I/XL had a superior technical approach.<sup>163</sup> In addition, Howard's total yearly revenues are small, ranging from \$2.5 million-\$3.0 million, and its bonding capability is correspondingly small.<sup>164</sup>

Customers agree that the main competition for TVCs was between CB&I and PDM and that the acquisition would eliminate this competition to their detriment. For example, TRW testified that when it learned that CB&I had acquired PDM, it estimated that the cost for its planned chamber would increase 50 percent.<sup>165</sup> Another customer, Spectrum Astro, testified that it considers competition between at least two suppliers important to foster innovation and to keep prices down.<sup>166</sup>

As with the other product markets, Respondents' documents show us that the real competition for TVCs rested in CB&I and PDM. A draft business plan for CB&I and XL's strategic alliance to bid for TVC projects described the "only competition for the thermal vacuum systems market" as the PSI/PDM "strategic alliance."<sup>167</sup> Witnesses representing the two makers of shrouds for TVCs testified that the only companies able to construct tanks for field-erected TVCs were PDM and CB&I,<sup>168</sup> one stating that "there were basically two dominant companies that supplied the

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PDM and CB&I. Thus, in the bidding on field-erected TVC projects, PSI/PDM has typically been pitted against XL/CB&I.

<sup>163</sup> Tr. at 383-87.

<sup>164</sup> Tr. at 181, 200.

<sup>165</sup> Tr. at 1456-57.

<sup>166</sup> Tr. at 2050-51.

<sup>167</sup> CX 212 at CBI-PL031721; Tr. at 1159.

<sup>168</sup> Tr. at 1110, 1115, 1118, 1267.

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field-erected chambers and two dominant companies that supplied [thermal vacuum control] systems.”<sup>169</sup>

5. Conclusions on Pre-acquisition Competition

The qualitative record evidence thus bolsters the conclusions that can be drawn from the HHIs, which show extremely high levels of concentration in all four markets. The acquisition has resulted in a merger to monopoly or near-monopoly in each relevant market, giving rise to a very strong presumption that the merger is anticompetitive. We next turn to a discussion of entry conditions to determine if there is any evidence to suggest that the acquisition is less anticompetitive than the concentration levels show.

C. Entry Conditions

In addition to their prima facie case based on concentration numbers and a more detailed examination of competitive conditions in each market, Complaint Counsel presented evidence that the LNG, LPG, and LIN/LOX tank markets are difficult to enter.<sup>170</sup> Although Respondents present a very different entry argument as a major part of their defense, we analyze entry conditions in the context of Complaint Counsel’s prima facie case. We do this because evidence of high entry barriers necessarily strengthens the conclusions to be drawn from

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<sup>169</sup> Tr. at 1118.

<sup>170</sup> The difficulty of entry into the TVC market is not in dispute. Rather than suggesting that new entrants or expanding smaller incumbents will restore competition, Respondents argue that CB&I was not a competitive presence in the TVC market. RAB at 48.

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Complaint Counsel's showing of high concentration levels.<sup>171</sup> If entry is difficult, then CB&I would be sheltered from the threat of new entry and any market power it has would be more secure.<sup>172</sup> In contrast, if entry is easy, any market power gained from a merger can be quickly eroded in the event that incumbent firms, acting alone or in unison, increase prices to a supracompetitive level.<sup>173</sup>

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<sup>171</sup> In addition, while we acknowledge the conceptual framework of shifting burdens of production, we note that as a practical matter it would be difficult to consider this evidence elsewhere in our analysis, because Complaint Counsel introduced this evidence as part of their prima facie case. At least one court has noted this same difficulty. *See University Health*, 938 F.2d at 1219 n.25 (noting that the government introduced all of its evidence at one time and that defendant responded in kind, and concluding that it would analyze whether the FTC had demonstrated that it had "satisf[ied] its ultimate burden of persuasion," *id.* at 1219, rather than focusing on shifting burdens).

<sup>172</sup> *See Heinz*, 246 F.3d at 717 (high entry barriers eliminate the possibility that the competition lost from the merger will be mitigated by new entry); *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 342 (S.D.N.Y. 2001) ("The higher the barriers to entry, and the longer the lags before new entry, the less likely it is that potential entrants would be able to enter the market in a timely, likely, and sufficient scale to deter or counteract any anticompetitive restraints."), *aff'd*, 344 F.3d 229 (2d Cir. 2003).

<sup>173</sup> *Baker Hughes*, 908 F.2d at 987 ("In the absence of significant barriers a company probably cannot maintain supracompetitive pricing for any length of time."); *United States v. Syufy Enters.*, 903 F.2d 659, 671 n.21 (9<sup>th</sup> Cir. 1990) (noting that low barriers to entry precluded Syufy from maintaining market share and controlling prices).

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In the absence of actual new entry or expansion by smaller incumbents, predictions about entry require speculation firmly rooted in market realities. Indeed, Areeda & Hovenkamp have commented that “[t]he only truly reliable evidence of low barriers is repeated past entry in circumstances similar to current conditions.”<sup>174</sup> Over the years, however, courts and commentators<sup>175</sup> have identified a host of variables that might prohibit or deter a new entrant, including government regulation,<sup>176</sup> high initial investments,<sup>177</sup> incumbent control of an essential or superior resource,<sup>178</sup> access to customers,<sup>179</sup>

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<sup>174</sup> 2A Areeda, Hovenkamp & Solow, *supra* note 45, ¶420b, at 60 (2d ed. 2002). *See also* *Cardinal Health*, 12 F. Supp. 2d at 56 (“[T]he history of entry into the relevant market is a central factor in assessing the likelihood of entry in the future.”).

<sup>175</sup> Areeda, Hovenkamp & Solow identify and discuss economies of scale, high initial investment, capital market imperfections, risk, scarce inputs or customers, product reputation and promotion, and governmental constraints as potential barriers to entry. 2A *id.* ¶ 421, at 65-74.

<sup>176</sup> *See, e.g., Syufy*, 903 F.2d at 673 (“some of the most insuperable barriers in the great race of competition are the result of government regulation”); *United States v. Franklin Elec. Co.*, 130 F. Supp. 2d 1025, 1031 (W.D. Wisc. 2000) (identifying a patent as an entry barrier).

<sup>177</sup> *See, e.g., Visa*, 163 F. Supp. 2d at 341 (finding, among other barriers to entry, an up-front investment of over \$1 billion).

<sup>178</sup> *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1439 (9<sup>th</sup> Cir. 1995) (identifying, among other things, control by the incumbent of essential or superior resources as a barrier to entry).

<sup>179</sup> *Cardinal Health*, 12 F. Supp. 2d at 58; *see also Visa*, 163 F. Supp. 2d at 342 (identifying the inability of Visa to obtain customers and therefore vendors as a barrier to entry).



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reputation,<sup>180</sup> and economies of scale.<sup>181</sup> In addition, some courts have embraced the economic concept that for an entry barrier to exist, it must impose long-run costs on the new entrant that the incumbent did not shoulder.<sup>182</sup>

We first turn to Respondents' argument that entry barriers are low in the LNG, LPG, and LIN/LOX tank markets based on the alleged entry in those markets.<sup>183</sup> Respondents point to the facts that three new suppliers in the LNG tank market have contacted customers and that one of these suppliers will be awarded the job to build an LNG tank for Dynegy's Hackberry, Louisiana import terminal.<sup>184</sup> Similarly, Respondents attest that new entrants have bid in both the LPG and LIN/LOX tank markets and that one supplier has won awards to build three LIN/LOX tanks post-merger.<sup>185</sup> They thus conclude that although "[t]he ALJ identified several requirements that new entrants must meet in order to enter the relevant markets[,] . . . these requirements are not the same as

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<sup>180</sup> See, e.g., *Swedish Match*, 131 F. Supp. 2d at 170-71; *Avery Dennison Corp. v. Acco Brands*, 2000-1 Trade Cas. (CCH) ¶ 72,882, 87557 (also available at 2000 U.S. Dist. LEXIS 3938 (C.D. Cal. Feb. 22, 2000)). See also *Franklin Electric*, 130 F. Supp. 2d at 1031-32 (finding customers' insistence on firms with a track record a barrier to entry); *United States v. United Tote Inc.*, 768 F. Supp. 1064, 1079 (D. Del. 1991) (same).

<sup>181</sup> *Cardinal Health*, 12 F. Supp. 2d at 57.

<sup>182</sup> See *Western Parcel Express v. UPS of America*, 190 F.3d 974, 975 (9<sup>th</sup> Cir. 1999); *Rebel Oil*, 51 F.3d at 1439 ("capital market evaluations imposing higher capital costs on new entrants").

<sup>183</sup> RAB at 20, 25-26.

<sup>184</sup> RAB at 14-17.

<sup>185</sup> RAB at 17-19.

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entry barriers.”<sup>186</sup> If Respondents are correct and if entry barriers are low, the merger is not likely to create or enhance market power and thus is not anticompetitive.

We conclude, however, that Respondents’ argument misses a crucial point: in order to deter or counteract the competitive effects of a merger, entry must restore the competition lost from the merger. As the *Merger Guidelines* instruct, entry must be not only likely to occur in a timely manner but also sufficient to constrain post-merger price increases to pre-merger levels.<sup>187</sup> This mode of analysis has enjoyed widespread acceptance in courts, in the economic literature, and among antitrust scholars.<sup>188</sup> Indeed, cases prior to the 1992 revision of the *Merger Guidelines* also examined the sufficiency of entry in their analyses. These cases frequently focused on the ability of the new entrant to take market share from or reduce the prices of the incumbent firms. For example, in finding low entry barriers, *Baker Hughes* relied on, *inter alia*, the fact that a firm had entered the market and expanded from insignificance to become the market leader.<sup>189</sup>

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<sup>186</sup> RAB at 20.

<sup>187</sup> *Merger Guidelines* §§ 3.2-3.4.

<sup>188</sup> See *Visa*, 163 F. Supp. 2d at 342 (entry must be “timely, likely, and [of a] sufficient scale to deter or counteract any anticompetitive restraints”); *Cardinal Health*, 12 F. Supp. 2d at 55-58 (same); Robert D. Willig, *Merger Analysis, Industrial Organization Theory, and Merger Guidelines*, Brookings Papers on Economic Activity: Microeconomics, 281, 307 (1991) (“[T]he likelihood, timeliness, and sufficiency of the induced entry are the critical elements of the analysis.”); 2A Phillip E. Areeda, Herbert Hovenkamp & John Solow, *supra* note 45, ¶422, at 74-78. See also *FTC v. Staples Inc.*, 970 F. Supp. 1066, 1088 (D.D.C. 1997) (finding that expansion by Wal-Mart would not constrain the merging parties’ prices).

<sup>189</sup> 908 F.2d at 988-89.

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The court thus concluded that the market was “volatile and shifting”<sup>190</sup> and predicted that “competitors not only [could], but probably [would], enter or expand if [the] acquisition [led] to higher prices.”<sup>191</sup> The court’s description of that market made clear its understanding that new entrants or smaller incumbents could effectively constrain the merging entity. Similarly, the *Syufy* court found it dispositive that a post-merger entrant took a significant share of the first-run film market away from the incumbent firm, rendering benign what on its surface had been a merger to monopoly.<sup>192</sup>

The focus on sufficient entry has also led some courts to reject the type of argument that Respondents make in this case – that because new players have entered in some nominal sense, entry barriers are low or non-existent. For example, the court in *Rebel Oil* rejected the argument that the existence of two new entrants constituted evidence of low entry barriers and stated that “[t]he fact that entry has occurred does not necessarily preclude the existence of significant entry barriers.”<sup>193</sup> The court noted that because the new entrants would be unable “to take significant business away from the predator, they are unlikely to represent a challenge to the predator’s market power.”<sup>194</sup> The court in *Oahu Gas Service* also refused to find an absence of entry barriers because the new entrants had remained relatively small.<sup>195</sup> Similarly, the trial court in *Tote* found entry insufficient to rebut

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<sup>190</sup> *Id.* at 986.

<sup>191</sup> *Id.* at 989.

<sup>192</sup> 903 F.2d at 665.

<sup>193</sup> 51 F.3d at 1440 (quotation marks omitted).

<sup>194</sup> *Id.*

<sup>195</sup> *Oahu Gas Serv. Inc. v. Pacific Res. Inc.*, 838 F.2d 360, 366-67 (9<sup>th</sup> Cir. 1988).

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the government's prima facie case, because new entrants could not constrain anticompetitive price increases by the incumbents.<sup>196</sup> This focus on the competitive impact of the new entry echoes precisely the question posed by the sufficiency prong of the *Merger Guidelines* and relevant case law, and frames the ultimate question we must answer in this case.

In the LNG, LPG, and LIN/LOX tank markets, the mere fact that new entrants and fringe firms have an intent to compete does not necessarily mean that those firms are significant competitors capable of replacing lost competition. The evidence establishes that the firms that Respondents have identified in these markets are pursuing work and that customers have testified that they will consider bids from suppliers other than CB&I.<sup>197</sup> However, these facts at most show that these firms have the capacity to submit a bid.<sup>198</sup> Although the ability to submit a bid is obviously a necessary first step, we find it insufficient to answer the ultimate question – whether the new entry or smaller incumbent expansion can constrain CB&I at the level it was constrained pre-acquisition. As we discuss below, the evidence shows that to compete effectively with CB&I – and thus sufficiently constrain it – bids from these new entrants must also be taken seriously by the

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<sup>196</sup> 768 F. Supp. at 1082.

<sup>197</sup> AT&V has also won three awards to build LIN/LOX tanks. However, as we discuss in Part IV.B.3.a.(1), *infra*, AT&V's performance on these jobs calls into question its ability to compete in the future.

<sup>198</sup> In the LNG tank market, Skanska/Whessoe, TKK/AT&V, and Technigaz/Zachry have submitted bids for Dynegy's Hackberry, Louisiana project. In addition, AT&V and Matrix have submitted bids for LPG tank projects, and AT&V, Matrix, and Chattanooga have submitted bids for LIN/LOX tank projects. RAB at 14-19.

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customers in these markets and present the customers with credible alternatives.<sup>199</sup>

1. Entry Conditions of the LNG Tank Market

LNG tank customers require potential suppliers to have a good reputation, knowledge of the local labor force, knowledge of federal and local regulatory requirements, and employees who are skilled at designing and constructing tanks. In other words, suppliers must have experience to compete. The evidence suggests that customers view experience in the LNG tank market as evolving over time, with each successfully completed project improving a supplier's ability to provide a quality product and to obtain future work. For example, customers evaluate a potential supplier's strength in each of the aforementioned categories. Moreover, it appears that as an LNG tank supplier builds more tanks, it becomes more efficient both in terms of costs and its ability to build a quality product.<sup>200</sup> This dynamic is particularly important in the United States, where CB&I has decades of experience and has solidified a reputation for quality and reliability. To enter the U.S. market effectively, an LNG tank supplier must not only meet customers' basic requirements but also must be able to match CB&I's long-honed abilities.

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<sup>199</sup> We find the Initial Decision's discussion of entry barriers relevant in that it correctly identified a number of credentials any new entrant must have as well as market characteristics that a new entrant must overcome to successfully compete with CB&I. *See generally* IDF 46-54, 166-76, 237-53, 328-33, 415-18; ID at 99-108.

<sup>200</sup> *See, e.g.*, Tr. at 1639-40 (a former Zachry employee notes that the more LNG projects it completes, "the more [it] can optimize [its] methods and be more competitive" in terms of costs) (*in camera*).

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The evidence clearly establishes that an LNG tank supplier's reputation plays a key role in its ability to compete. Several customers testified that they prefer to deal with companies with experience in both designing and building tanks and that an LNG tank supplier needs to have constructed more than one tank to be viewed favorably. Yankee Gas, for example, testified that a supplier that has constructed only one tank will not meet the "broad level of experience that [it] will require in [its] evaluation."<sup>201</sup> Similarly, Dynegy testified that it prefers someone with LNG tank construction experience,<sup>202</sup> and Black & Veatch testified that it would be hesitant to use an inexperienced supplier.<sup>203</sup>

We find support for this testimony in the behavior of various customers when they select bidders. The first step many companies take in putting together a slate of bidders is to determine which companies have successfully built LNG tanks in the past.<sup>204</sup> Moreover, past performance is an essential aspect of a customer's evaluation of a potential LNG tank supplier. For example, in choosing an LNG tank supplier for its Capleville project, MLGW specifically assessed and rated the various bidders' experience.<sup>205</sup> Although that project occurred several years prior to the acquisition, the evidence suggests that customers continue to take a potential supplier's track record and reputation into account. El Paso testified, for example, that in qualifying bidders it evaluates, among other things, a company's history with

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<sup>201</sup> Tr. at 6702.

<sup>202</sup> Tr. at 4581-82.

<sup>203</sup> Tr. at 564-77.

<sup>204</sup> Tr. at 4544-45.

<sup>205</sup> Tr. at 1788-91.

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previous projects.<sup>206</sup> Similarly, Yankee Gas testified that experience will carry a lot of weight in its evaluation of bids for an upcoming project.<sup>207</sup> CB&I itself recognizes the importance of reputation and markets itself to customers based on the success of its past projects and cites this experience as a reason for choosing it instead of other suppliers.<sup>208</sup>

Antitrust law has long recognized that reputation can be a barrier to entry and expansion.<sup>209</sup> This principle applies especially to markets in which a product failure may result in dire consequences – as the failure of an LNG tank surely would. The court in *Franklin Electric* found that a consumer’s reluctance to switch away from firms with long track records in manufacturing submersible turbine pumps would likely prohibit meaningful entry.<sup>210</sup> Similarly, in *Tote*, the fact that a new entrant would need to demonstrate that its system could operate flawlessly for one to two years as a prerequisite to market acceptance was a factor that

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<sup>206</sup> Tr. at 6166-67.

<sup>207</sup> Tr. at 6702-03.

<sup>208</sup> CX 140, CX 162, CX 173. *Cf.* CX 1719 (investor fact sheet emphasizing “112 years of industry experience”).

<sup>209</sup> In *Cardinal Health*, for example, the court found that, among other things, the “strength of [the defendants’] reputation” served as a “barrier[] to competitors as they attempt to grow significantly.” 12 F. Supp. 2d at 57. Similarly, courts in other cases have found that brand loyalty can make meaningful entry unlikely. *See, e.g., Swedish Match*, 131 F. Supp. 2d at 170-71; *Avery Dennison*, 2000-1 Trade Cas. (CCH) ¶ 72,882 at 87,557 (also available at 2000 U.S. Dist. LEXIS 3938 at \*42-44).

<sup>210</sup> 130 F. Supp. 2d at 1031.

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would impede new entrants from gaining market share and constraining price increases.<sup>211</sup>

This precedent notwithstanding, Respondents cite *Baker Hughes* for the proposition that the mere fact that customers place great importance on product quality and reliable future service does not constitute a “high entry barrier.”<sup>212</sup> This argument not only misreads *Baker Hughes* but is wholly inapplicable to this case. In the passage cited by Respondents, the court of appeals specifically acknowledged that a customer’s focus on product quality and reliable future service “may handicap new entrants.”<sup>213</sup> It merely refused to overturn the district court’s conclusion that other factors – such as actual entry and expansion – outweighed the evidence regarding customers’ concerns.<sup>214</sup> In the instant case, the record presents quite a different picture. The evidence demonstrates that far from being “general statements” – as Respondents suggest<sup>215</sup> – the customers’ preference for experience repeatedly manifests itself in the way customers view potential suppliers and award bids in real-world contests. Moreover, unlike in *Baker Hughes*, there is no evidence in this case that new

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<sup>211</sup> 768 F. Supp. at 1079-1081.

<sup>212</sup> RAB at 21.

<sup>213</sup> 908 F.2d at 989 n.10.

<sup>214</sup> 908 F.2d at 989. We also note that the Ninth Circuit has concluded that reputation by itself does not necessarily reflect barriers to entry. *Omega Environmental Inc. v. Gilbarco*, 127 F.3d 1157, 1164 (9<sup>th</sup> Cir. 1997); *Syufy*, 903 F.2d at 669. As in *Baker Hughes*, entry in both of these cases occurred and expanded in the relevant markets. *Omega Environmental*, 127 F.3d at 1164; *Syufy*, 903 F.2d at 665. We thus find these cases inapplicable to the case before us, in which the markets have not seen competitively significant new entry or expansion post-acquisition.

<sup>215</sup> RAB at 21.



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entrants or smaller incumbents can expand their presence in the LNG tank market. Quite to the contrary, the LNG tank market is characterized by long-standing dominance by the two merged firms and a reluctance on the part of customers to take a chance on firms with no experience.

The customers' focus on experience is understandable, because building an LNG tank is not easy.<sup>216</sup> In addition, while some of the skills necessary to build an LNG tank may be of a general nature, others are not. Black & Veatch testified, for example, that the welding, foundation work, and pipeline connections for these cryogenic tanks require specialized skills to be done properly.<sup>217</sup> Similarly, Yankee Gas testified that it will not credit experience in building petroleum tanks as the type of experience necessary to build LNG tanks, because the cryogenic properties of LNG tanks require a special construction skill set.<sup>218</sup> To deal with these technical challenges, both CB&I and PDM developed specialized construction procedures, trained supervisors to manage various parts of the tank construction, and developed working relationships with traveling field crews and local labor. For a new entrant to be taken seriously, it would need to demonstrate that it has access to a group with similar knowledge and expertise. We thus find that it is critical for a tank supplier to have experienced and knowledgeable supervisors as well as access to specialized field crews.

One customer testified that it is necessary for an LNG tank supplier to have supervisors on staff, because they are otherwise difficult to find.<sup>219</sup> This statement is supported in the merging

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<sup>216</sup> See discussion *supra* at Part II.A.

<sup>217</sup> Tr. at 565.

<sup>218</sup> Tr. at 6701-02.

<sup>219</sup> Tr. at 6231-32.

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parties' own business practices. Prior to the acquisition, both PDM and CB&I had on salary a staff of supervisors for the construction of the tanks, and CB&I has retained such employees following the acquisition.<sup>220</sup> These supervisors must also be trained to ensure that they are familiar with LNG projects.<sup>221</sup>

Similarly, tank suppliers must employ and train field crews to perform some of the more specialized work on these tanks.<sup>222</sup> The training not only focuses on such obvious skills as the requisite specialized welding techniques, but also teaches the crew familiarity with the firm's procedures and the use of its equipment.<sup>223</sup> These crews, which can range from 40 to 60 people, travel from job to job and are distinct from the local labor pool.<sup>224</sup>

Respondents suggest that because field crews are hourly (rather than salaried) employees and because they can work for multiple companies, knowledge of and connections with these crews do not represent a competitive advantage for the merged firm.<sup>225</sup> We disagree. While it is true in theory that a prospective new entrant could hire members of these field crews, the crew would not be familiar with either the new entrant's procedures or its equipment and would thus need to be trained – a process that would result in additional time and costs to the new entrant.<sup>226</sup> As one CB&I

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<sup>220</sup> Tr. at 2626-27.

<sup>221</sup> Tr. at 2625-26.

<sup>222</sup> Tr. at 2633-34.

<sup>223</sup> Tr. at 2625-26.

<sup>224</sup> Tr. at 1598-99.

<sup>225</sup> RAB at 23.

<sup>226</sup> Tr. at 1641 (*in camera*), 2626.

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employee stated, “[T]here’s obviously a learning curve as that person learns a particular company’s procedures and equipment.”<sup>227</sup> He elaborated that a person working on an initial project “would probably be not as efficient as someone who had worked with the company’s procedures and equipment for years.”<sup>228</sup> This familiarity reduces CB&I’s costs and is likely to factor favorably into a customer’s assessment of a bid from CB&I.<sup>229</sup> CB&I can assure a customer not only that it has access to the needed field crews but also that its crews’ familiarity with CB&I will save the customer time and money over other options.<sup>230</sup> A new entrant would thus need to cultivate such relationships and be able to demonstrate to customers that it could match CB&I’s proficiency in attracting and working with field crews.

Respondents have also argued that access to welders is not a hurdle to entry in this market, because “[w]elding processes for LNG tanks are non-specific.”<sup>231</sup> The weight of the evidence suggests otherwise. Regardless of whether the welding is done by field crews, local labor, or the employees of a tank construction

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<sup>227</sup> Tr. at 2633-34.

<sup>228</sup> Tr. at 2634.

<sup>229</sup> Tr. at 2633-34.

<sup>230</sup> A Technigaz employee testified that CB&I has experienced field crews that can erect a tank in a shorter time than newly trained field crews. Tr. at 4713 (*in camera*). Similarly, a former Zachry employee stated that there is a learning curve associated with construction of LNG tanks, Tr. at 1637 (*in camera*), and that a company’s costs decrease as it builds more tanks. Tr. at 1639-40 (*in camera*). We find this testimony borne out in the Dynege bid, where Technigaz/Zachry (which has never built an LNG tank) was excluded for price reasons. Tr. at 4760 (*in camera*).

<sup>231</sup> RAB at 22.

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company, a tank supplier must first have welding procedures in place. CB&I has developed specialized, proprietary welding procedures that it does not share with the industry, and prior to the acquisition PDM did the same.<sup>232</sup> In fact, in a 2002 discussion with its investors, CB&I's CEO emphasized that building an LNG tank involves very specialized work and that facility owners recognize this fact and do not want to take a chance on "shoddy welding."<sup>233</sup> Similarly, AT&V's Vice President testified that "the [welding] equipment is quite expensive to develop. You can go buy it, but the stuff you buy has to be modified and tailored, and then you have to build procedures around it."<sup>234</sup> He elaborated that because LNG tanks are constructed of sophisticated materials, "you don't just weld them up any old way."<sup>235</sup> Matrix, which supplies LIN/LOX tanks, also testified that if it were to try to supply LNG tanks, it would need to develop specialized welding procedures.<sup>236</sup> As a result, we find that a new entrant would need to develop welding procedures, train its welders in those procedures and the use of its equipment, and demonstrate to customers that it would be able to safely weld and deliver an operable tank in a timely manner.

We also find that knowledge of and connections with local labor are a necessary prerequisite to an LNG tank supplier's ability to compete effectively. Several customers testified that LNG tank suppliers must have knowledge of these markets.<sup>237</sup>

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<sup>232</sup> Tr. at 6028-29; CX 109 at PDM-HOU006700; CCFF 331-32.

<sup>233</sup> CX 1731 at 44.

<sup>234</sup> Tr. at 2379.

<sup>235</sup> *Id.*; see also CCFF 327.

<sup>236</sup> Tr. at 1601.

<sup>237</sup> See, e.g., Tr. at 310, 4521, 7017-18.

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One customer even testified that it would not consider a foreign LNG tank designer for a U.S. project unless that designer teamed with an American construction firm.<sup>238</sup> In addition to having general knowledge of local labor markets in the United States, a new entrant would also need to learn how to employ those labor resources most effectively in the construction of LNG tanks and would need to develop relationships with local vendors and suppliers. In its SEC filings, CB&I has repeatedly pointed to the fact that it has cultivated such relationships and has stated that these relationships confer a competitive advantage.<sup>239</sup> In addition, CB&I's CEO testified that a company's local presence can translate into a competitive advantage through knowledge of the local vendors and suppliers and of the local labor markets.<sup>240</sup>

Respondents argue that much of the construction labor is contracted locally and that the construction skills necessary – including welding – can be easily learned. As proof of this position, they point out that Whessoe completed LNG tanks in Dabhol, India, with the use of local labor. We find, however, that Respondents' argument misses an essential point and that the experience in Dabhol actually exemplifies why entry and expansion in the U.S. market are difficult. The ability to hire local

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<sup>238</sup> Tr. at 7017-18.

<sup>239</sup> *See, e.g.*, CX 1061 at 10-11 (reporting in an SEC 10-K that CB&I “believes that it is viewed as a local contractor in a number of the regions it services by virtue of its long-term presence and participation in those markets” and that “[t]his perception may translate into a competitive advantage through knowledge of local vendors and suppliers, as well as of local labor markets”); CX 1575 at 7 (same). To avoid any possible confusion, we emphasize that the possession or acquisition of a “competitive advantage” is not illegal, but it can be a relevant factor when a merger is defended on the ground that entry is easy.

<sup>240</sup> Tr. at 4230.

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welders untrained in welding LNG tanks presupposes that a tank supplier is ready and able to train and supervise those workers. Although it contracted with a local construction company in India that employed skilled workers, Whessoe needed to bring a large number of supervisors to the work site. We would expect the same to hold true in the United States, given that any foreign firms that enter the U.S. market likely would have U.S. construction partners without experience in building LNG tanks. In fact, the evidence suggests that the international tank design firms recognize this fact and have plans to train U.S. construction employees in the management of these projects – an endeavor that will take a long time and be costly.<sup>241</sup> In addition, even after the U.S. construction employees are trained, it would likely take them a few years to become as efficient as those of CB&I – a fact that AT&V's Vice President acknowledged regarding his firm's employees.<sup>242</sup> Thus, whether the international design firms provide supervisors for a particular job or train employees in the United States, the new entrants face a long and costly learning process before they can become effective competitors to CB&I.

Finally, customers testified that an LNG tank supplier must be able to steer a proposed project through the FERC application process in a timely manner.<sup>243</sup> While it takes expertise to complete the tank drawings and various resource reports required

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<sup>241</sup> *See, e.g.*, Tr. at 2324-26 (TKK plans to train AT&V employees project managers and has thus far trained one), 2626-27(CB&I employee explaining that project managers must be trained).

<sup>242</sup> Tr. at 2379-80; IDF 147.

<sup>243</sup> Because the FERC regulations apply only to interstate commerce, they are usually not applicable to peak-shaving facilities, which serve only local markets. However, in some instances, an owner may specify that its peak-shaving facility be built to comply with the FERC regulations. Tr. at 4930.

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by FERC, many customers testified that it is also of paramount importance to secure approval in a timely manner.<sup>244</sup> Because construction on the LNG tank cannot begin until the FERC application is approved, delay in the approval process translates into delay in the construction and erection of the tank, which in turn delays completion of the entire facility. This delay, of course, can represent real costs for the customer.<sup>245</sup> Thus, customers take FERC experience into account when they evaluate potential bidders.<sup>246</sup> In fact, BP commented that the foreign companies

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<sup>244</sup> Tr. at 310 (stating a reluctance to use an inexperienced LNG tank supplier, because, among other things, the supplier would not be “familiar with all the [regulatory] parties that have requirements and how to satisfy all those parties in a reasonable time”). *Cf.* Tr. at 566 (meeting the schedule is important, and if the tank is delayed, that time is added to the project); Tr. at 627 (“delays in completing the tanks or problems with utilizing the tanks will impact the schedule and the success of the project”); Tr. at 6287 (CMS believed the number one risk on the project was schedule) (*in camera*).

<sup>245</sup> *See, e.g.*, Tr. at 3192 (missing deadlines causes “potential damage to the [LNG tank] client”); Tr. at 6286-87 (the revenue stream does not start until the LNG facility is ready for service) (*in camera*). These costs are usually mitigated by liquidated damages or other penalties. Tr. at 3191-92, 6286-87 (*in camera*).

<sup>246</sup> Prior to the acquisition, Atlanta Gas evaluated bids based partially on the bidders’ FERC experience. CX 161. Similarly, CB&I’s FERC experience appears to have played a crucial role in CB&I’s post-acquisition negotiations with both BP and CMS. As will be discussed more fully in Parts IV.B.1.(a)-(b) of this Opinion, the evidence suggests that CB&I successfully leveraged its completion of the FERC applications into sole-source contracts with BP despite BP’s initial reluctance to grant such contracts. When BP hired CB&I, it believed that CB&I’s FERC experience gave CB&I a significant advantage. Tr. at 6093 (*in camera*).

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would need to demonstrate the capability to steer a project through the FERC process before it would award them a bid.<sup>247</sup> The evidence also demonstrates that CB&I itself recognizes the importance of experience with the FERC approval process, because it touts its own FERC experience in dealing with prospective customers.<sup>248</sup>

The evidence thus establishes that, at a minimum, a new entrant would need to go through a time-consuming process to develop procedures to meet the unique challenges of building LNG tanks; recruit and hire supervisors with highly specialized experience; gain access to local labor forces; and acquire expertise in dealing with complex regulatory requirements.<sup>249</sup> Without such

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CMS also chose CB&I based in part on CB&I's FERC experience. Tr. at 6283 (*in camera*). Although some customers hire consultants and EPC contractors to help with the FERC approval process, Tr. at 4991, the evidence suggests that for some customers – especially those in sole-source negotiations – a bidder's FERC experience is crucial.

<sup>247</sup> Tr. at 6092 (*in camera*).

<sup>248</sup> In recent correspondence with a potential customer, the merged firm noted that “CB&I brings unmatched experience in preparing the documents . . . that are necessary for permitting and/or filing for FERC authorization permits.” CX 140. In the same correspondence, CB&I further described itself as a firm “whom the permitting agencies, most especially FERC, know and respect.” *Id.*

<sup>249</sup> We reject Complaint Counsel's suggestion that access to raw materials and ownership of fabrication facilities are necessary for a new entrant to be competitive. Although the 9 percent nickel steel for LNG tanks used to be sourced in the U.S., it appears that it is now sourced from Japan and Europe. Tr. at 4891 (CB&I purchases its 9 percent nickel steel from Japan and Europe). In addition, while owning a fabrication plant may be helpful in other



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attributes, an entrant's bid is not likely to be taken seriously, and it will be unable to constrain CB&I effectively. In fact, the new entrants recognize these requirements. AT&V's Vice President, for example, testified that TKK planned to train AT&V's employees in project management skills such as estimating, scheduling, and coordinating as well as in construction techniques, welding, and the operation of welding equipment.<sup>250</sup> While we find such testimony highly probative of AT&V's intent to stay in the market and its plans to become a competitive force, we find that, as of the time of trial – nearly three years after the acquisition – AT&V still has not become a factor in the market. It cannot yet constrain CB&I, and it certainly has not replaced the competition that was lost from the acquisition. Furthermore, we cannot predict when – or even whether – it might do so.

As we will discuss more fully in Part IV.B.1, *infra*, we also find that CB&I's long-standing presence in the U.S. confers on it a virtually insurmountable advantage in many of the attributes we just discussed, at least for the foreseeable future. It has many years of experience in building LNG tanks in the United States. This experience not only gives CB&I an advantage in terms of cost and efficiency but also provides it a reputation for quality and reliability.<sup>251</sup> We believe this dynamic explains why Asian tank

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relevant markets, there is no evidence to suggest that owning such a plant makes a difference for building LNG tanks. There is some general testimony that owning a fabrication plant might reduce one's costs on LNG projects, Tr. at 1636 (*in camera*), but we find more persuasive the fact that CB&I had its steel for some recent projects fabricated at the foreign steel mill and delivered directly to the site. Tr. at 4893-94.

<sup>250</sup> Tr. at 2325.

<sup>251</sup> Tr. at 1637-38 (a supplier that builds an LNG tank incurs expenses "that [it] can improve when [it] perform[s] the same work the second or the third time or subsequent times") (*in*

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manufacturers historically have built the majority of LNG tanks in Asia, European-based tank manufacturers have built the bulk of tanks in Europe, and PDM and CB&I have built the only tanks in the United States.<sup>252</sup> In essence, a new entrant faces a conundrum: its lack of experience and inability to build a reputation place it at a competitive disadvantage in terms of winning a bid, which is the very thing it needs to gain experience and build a reputation.

2. Entry Conditions of the LPG Tank Market

The evidence shows that conditions of entry and expansion in the LPG tank market are similar to those in the LNG tank market. It is very difficult to get work without an established record for building high-quality, field-erected LPG tanks.<sup>253</sup> Bidders are selected for inclusion in the bidding process based on past performance, technical capabilities, safety record, quality programs, the size and scope of structures built previously, the

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*camera*); Tr. at 2633-34 (“For any type of tank project, there’s obviously a learning curve as that person learns a particular company’s procedures and equipment, and during the initial project that person was used on he would probably be not as efficient as someone who had worked with the company’s procedures and equipment for years.”); Tr. at 4713 (CB&I has a cost advantage over Technigaz/Zachry because it has “experienced field crews that can erect an LNG tank in a shorter period of time than a newly trained field crew that has no past experience.”) (*in camera*). See also CX 392 at 4 (affidavit seeking *in camera* treatment for documents related to improving CB&I’s “processes and methods” that “improve [CB&I’s] efficiency and lower [its] costs”).

<sup>252</sup> See Tr. at 699 (*in camera*), 717-18 (*in camera*); CX 1649 (world map plotted with global tank sales).

<sup>253</sup> See Tr. at 1609 (LPG tank market characterized as having “learning curves and expenses” similar to the LNG tank market).

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volume of work performed, number of employees, qualifications of welders, and financial information.<sup>254</sup> Both Fluor and ITC, for example, pre-qualify bidders using these criteria.<sup>255</sup> It is also important to customers that a contractor show that it has managed a project of similar size,<sup>256</sup> that it is not stretched too thin at the time the project is to be built,<sup>257</sup> and that it has the ability to manage cash flow.<sup>258</sup> Moreover, as with the LNG tank market, an LPG tank supplier's depth of experience matters. AT&V testified, for example, that it would need not only automated equipment and extensive welding training but also years of experience to catch up to CB&I.<sup>259</sup>

Safety is a critical concern for LPG customers. The hazards of a leak are severe, as exemplified by the catastrophic failure of a Whessoe-built LPG tank in Qatar.<sup>260</sup> A builder's reputation and safety record are therefore among the most important considerations for customers,<sup>261</sup> and buyers are not inclined to

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<sup>254</sup> Tr. at 2290-97, 7083-84; JX 27 at 115-16. Sometimes buyers send bid packages to firms that would not meet qualification standards. Tr. at 7134. The buyer does not expect that such bidders will be accepted but allows them to bid as a matter of courtesy. Tr. at 7134; JX 27 at 57.

<sup>255</sup> Tr. at 2289-91, 7084.

<sup>256</sup> Tr. at 2291-92, 2295.

<sup>257</sup> Tr. at 2295.

<sup>258</sup> Tr. at 2297.

<sup>259</sup> Tr. at 2379-80.

<sup>260</sup> Tr. at 3323; *see also* Tr. at 7141-42.

<sup>261</sup> JX 27 at 70.

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contract with builders that have not already built similar tanks.<sup>262</sup> ITC testified that it sends packages to firms that it thinks are reputable and have the capability to build the tank.<sup>263</sup> ITC prefers an experienced builder for any tank that will contain liquid below -3° F, and even a 10 percent price cut would not make it worthwhile to use an inexperienced supplier.<sup>264</sup> ITC testified that at times it allows suppliers to bid even though it does not think they will be competitive, simply to foster its “relationships with them.”<sup>265</sup> After the first round of bids comes in, however, it evaluates whether the low bidder is “capable of doing the job that [it] want[s] done.”<sup>266</sup> There is no evidence in the record that an inexperienced bidder has made it past this first bidding round.

Technical barriers to entry are not as high in the LPG tank market as in LNG tank market, but they are high nonetheless.<sup>267</sup> LPG tanks are bigger than LIN/LOX tanks but smaller than LNG tanks, and they hold their contents at temperatures that are low (about -50° F) but above those of LNG tanks.<sup>268</sup> An LPG entrant would not need as many field personnel as an LNG entrant, and

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<sup>262</sup> Tr. at 7141 (“[P]eople want to see you have built one.”); JX 23a at 195 (*in camera*).

<sup>263</sup> Tr. at 7084.

<sup>264</sup> JX 27 at 115-16.

<sup>265</sup> Tr. at 7134; JX 27 at 57.

<sup>266</sup> Tr. at 7083.

<sup>267</sup> Morse testified that it did not have to extensively train its fabrication personnel to work on an LPG project. Tr. at 6570-71. Although Morse’s testimony may be viewed as self-serving because CB&I now owns it, we nonetheless find that owning a fabrication facility is not an entry barrier in the LPG tank market.

<sup>268</sup> Tr. at 1609-10, 4073.

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(unlike an LNG tank entrant) it would have no FERC requirements to master.<sup>269</sup> Generally, LPG tanks use the same kind of construction as LNG tanks but are able to use enhanced carbon steel or a special type of conventional steel (unlike LNG tanks, which require 9 percent nickel steel and more specialized welding techniques).<sup>270</sup> Nonetheless, LPG tank suppliers must develop specialized welding procedures and train welders to build these tanks.<sup>271</sup> Although many companies can make pressure spheres or various flat-bottomed tanks, the record does not indicate that any of these firms have either the requisite special equipment or welding crews that are both experienced with the materials required for LPG tanks and able to travel to the site to work on an extended LPG project.<sup>272</sup>

Arguably, one might expect supply-side substitution to occur if CB&I were to attempt to exert market power in the LPG tank market, because the LPG tank market lies somewhere between the LNG and LIN/LOX markets in the difficulty of its technical requirements and the size of the projects it involves. That is, an LNG tank manufacturer might easily bid on an LPG project, as the latter would be less technically demanding and smaller in scope than an LNG project. If a very large LPG project were available, it might (in theory) attract bids from LNG tank suppliers. There is no record evidence, however, that any LNG tank supplier has shown such interest. In addition, it might appear that a LIN/LOX tank supplier could attempt to make the leap into the LPG market – particularly if a smaller, relatively uncomplicated project were opened for bid. As we discuss in detail in Part IV.B.3 below, however, the existing LIN/LOX tank suppliers (other than CB&I) seem to have difficulty meeting the technical requirements for

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<sup>269</sup> Tr. at 1609-10.

<sup>270</sup> Tr. at 4890.

<sup>271</sup> Tr. at 6570-71.

<sup>272</sup> Tr. at 7106-07; JX 27 at 43, 59.

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smaller LIN/LOX tanks, so we find it unlikely that they will be able to compete effectively in the LPG market. Thus, for the foreseeable future, it does not appear that a foreign LNG tank firm will step into the U.S. LPG tank market, or that any LIN/LOX tank supplier identified in the record would be a credible entrant in the LPG market.

3. Entry Conditions of the LIN/LOX Tank Market

We find that entry barriers in the LIN/LOX tank market are also high. A great deal of specialized know-how and critical skills are required in the engineering, fabrication, and construction of LIN/LOX tanks.<sup>273</sup> Design of the tanks requires sophisticated engineering and adherence to stringent regulatory codes.<sup>274</sup> Experienced workers are also critical.<sup>275</sup>

As with the LNG market, ample evidence demonstrates that reputation and experience play a crucial role in a customer's acceptance of LIN/LOX tank manufacturers, making it difficult for new entrants to gain acceptance. LIN/LOX tanks can be very dangerous if they are improperly constructed. Tank failure can cause leaks of the cryogenic liquids and create a potentially catastrophic situation. For example, liquid nitrogen can cause severe (and potentially fatal) burns as well as asphyxiation.<sup>276</sup> Similarly, liquid oxygen is highly volatile, and its release can support intense fire that will consume everything in its path.<sup>277</sup> Customers are thus hesitant to contract with an inexperienced manufacturer. Air Liquide testified that safety is the most

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<sup>273</sup> Tr. at 842, 1343-1346, 2198-99.

<sup>274</sup> Tr. at 1566-67.

<sup>275</sup> Tr. at 2190.

<sup>276</sup> Tr. at 848, 1996-97.

<sup>277</sup> *Id.*

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important factor when it selects a LIN/LOX tank vendor.<sup>278</sup> In addition, LIN/LOX tank customers are liable to their customers for any tank failure.<sup>279</sup> Linde and Air Liquide testified that because of this potential for liability, they have to be very careful in selecting a LIN/LOX vendor.<sup>280</sup>

LIN/LOX tanks are an integral part of the construction and operation of large air separation facilities. Thus, even if a LIN/LOX tank does not fail outright, any problems in the completion or operation of a LIN/LOX tank can have a cascading effect on the much larger air separation plant that the customer is building and on the chemical or manufacturing facility that the plant will serve.<sup>281</sup> Therefore, meeting schedule deadlines is critical to LIN/LOX customers.<sup>282</sup> If a supplier falls behind schedule in the completion of a LIN/LOX tank, it is costly for the tank customer.<sup>283</sup> LIN/LOX customers are liable for liquidated damages to their air separation plant customers if they do not have the plant completed on time.<sup>284</sup> Consequently, LIN/LOX tank manufacturers need to be able to demonstrate a successful track record of completing LIN/LOX tanks on schedule.<sup>285</sup>

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<sup>278</sup> Tr. at 1996-97.

<sup>279</sup> Tr. at 849.

<sup>280</sup> Tr. at 849, 1996-99.

<sup>281</sup> Tr. at 4658-59.

<sup>282</sup> Tr. at 849, 2400-01.

<sup>283</sup> *Id.*; Tr. at 1997.

<sup>284</sup> Tr. at 849.

<sup>285</sup> Tr. at 849, 1996-97, 2399-2401.

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Customers are also reluctant to contract with an inexperienced LIN/LOX tank supplier because LIN/LOX tanks sometimes do not fail until several years after they are built. Thus, customers like to see that a vendor's tanks have held up over time,<sup>286</sup> and some customers refuse outright to hire a supplier that has never constructed a LIN/LOX tank.<sup>287</sup> In addition, suppliers that have built multiple tanks over time have an advantage that increases as they build more tanks.<sup>288</sup> Air Products testified, for example, that it would be risky to contract with a supplier that had never built a LIN/LOX tank.<sup>289</sup> Air Liquide testified that it would not buy a LIN/LOX tank from a manufacturer that had never built one before and that it prefers a supplier that has built many LIN/LOX tanks.<sup>290</sup> MG Industries testified that it is very important for a LIN/LOX tank supplier to have prior experience<sup>291</sup> and that it would not contract with Matrix until Matrix gained experience.<sup>292</sup>

This emphasis on experience is reflected in customers' bidding procedures. For example, as part of Air Products' pre-qualification process, it requires the provision of an experience list and calls past customers for references.<sup>293</sup> Air Products requires

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<sup>286</sup> Tr. at 998-99, 2399.

<sup>287</sup> Tr. at 467, 1995-99, 2017. *Cf.* Tr. at 1388 (discussing the stringent requirements that a LIN/LOX supplier with no experience would need to meet).

<sup>288</sup> Tr. at 467, 1995-99, 2017; *see also* Tr. at 2399.

<sup>289</sup> Tr. at 1391.

<sup>290</sup> Tr. at 1995-99, 2017.

<sup>291</sup> Tr. at 467.

<sup>292</sup> Tr. at 489.

<sup>293</sup> Tr. at 1357-60.



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that the engineers, field crew, and supervisors all have prior LIN/LOX experience.<sup>294</sup> Moreover, customers have a very strict pre-qualification process that a LIN/LOX tank manufacturer must go through before the customer will entertain a bid from the vendor. Much as in the LNG tank market, LIN/LOX tank customers examine the manufacturer's safety record, experience, technical capability, reputation, track record, and financial stability.<sup>295</sup> Given these pre-qualification requirements, it is very difficult for a manufacturer that has never built a LIN/LOX tank to win a bid.<sup>296</sup>

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<sup>294</sup> Tr. at 1388-91.

<sup>295</sup> Tr. at 1357-60 (Air Products uses safety criteria, technical capability, financial viability, and price to select a LIN/LOX tank supplier); Tr. at 1994 (a supplier's technical abilities, safety record, and financial strength are factors that Air Liquide focuses on in selecting a LIN/LOX supplier); Tr. at 849 (Linde is very careful when selecting a LIN/LOX vendor).

<sup>296</sup> Tr. at 2398-99. LNG and LPG tank suppliers have expertise similar to that needed to build LIN/LOX tanks, and, as a result, there is the theoretical possibility that a supplier in one or both of the two former markets might also be a credible LIN/LOX tank supplier. However, as of the time of the trial in this matter, none of the new entrants in the LNG tank market had submitted a bid to build a LIN/LOX tank, and no evidence suggests any plans to do so in the future. While there is some overlap among firms in the LPG tank and the LIN/LOX tank markets – Matrix, Chattanooga, and AT&V each participate in both markets – those LPG tank suppliers that have historically focused solely on building LPG tanks have not bid on any post-merger LIN/LOX projects, and there is no evidence that they plan to do so. As we discuss in Parts IV.B.2-3, *infra*, for the most part the firms participating in both markets have not been successful in either. Moreover, we find that experience in building LPG tanks does not necessarily mean that a supplier would be proficient and efficient at building

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Based on the evidence, we conclude that it is very difficult, if not almost impossible, for new LIN/LOX entrants to overcome these obstacles. Therefore the LIN/LOX tank market displays the same conundrum that characterizes the LNG market – an entrant must have a proven track record and a solid reputation to win a bid, but it can only obtain these qualities after it has already successfully completed prior LIN/LOX projects.

4. Entry Conditions of the TVC Market

As noted earlier (n.170, *supra*), Respondents do not dispute that technical barriers to entry into the TVC market are very high. A significant technological challenge in the building of a successful TVC vessel is the highly specialized welding technique needed to maintain a near-perfect vacuum: “if the welds are improper and there’s [sic] overlaps that trap gas . . . there will be a continuous leak.”<sup>297</sup> Any such leak will jeopardize the accuracy of testing done in the TVC because the required vacuum levels are so high. One customer testified that “the vacuum levels that we deal with are almost – you can almost count the number of molecules of gas that remain[] in the chamber.”<sup>298</sup> If the chamber has a larger defect, it may lose vacuum rapidly during a satellite test, creating “a serious issue with saving the satellite.”<sup>299</sup>

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LIN/LOX tanks without some experience in the LIN/LOX market. For example, LIN/LOX and LPG tanks are made of different types of steel. Like LNG tanks, LIN/LOX tanks must be made of 9 percent nickel steel to contain the cryogenic liquid they hold. LPG tanks, which do not require liquid to be contained at such cold temperatures, use enhanced carbon steel.

<sup>297</sup> Tr. at 1142.

<sup>298</sup> Tr. at 1141.

<sup>299</sup> Tr. at 1144; *see also* Tr. at 1454.

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A field-erected TVC tank maker needs to have “a crew that virtually lives in the field for elongated periods of time. . . . You need construction management people, safety people.”<sup>300</sup> In the TVC market, buyers place a premium on having the entire project – from engineering to turnkey operability – handled by a tightly integrated team.<sup>301</sup>

Customers also place great importance on the TVC tank maker’s ability to stay on schedule.<sup>302</sup> While a satellite is being tested in a TVC, the satellite engineers working on the project are put on hold and are not reassigned to other work.<sup>303</sup> TVC tests take between 2 weeks and 40 days, and each day of testing delays completion of the satellite program by at least a day.<sup>304</sup> Moreover, satellite makers may incur penalties for delaying a spacecraft launch.<sup>305</sup>

We thus find that the absence of any entry into the TVC market, together with the immensely difficult technical challenges any new entrant into that market would face, “largely eliminates the possibility that the reduced competition caused by the merger will be ameliorated by new competition from outsiders and further strengthens” Complaint Counsel’s prima facie case.<sup>306</sup>

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<sup>300</sup> Tr. at 1103.

<sup>301</sup> Tr. at 385-87, 1920 (*in camera*).

<sup>302</sup> Tr. at 206.

<sup>303</sup> Tr. at 1734.

<sup>304</sup> Tr. at 1734-37.

<sup>305</sup> Tr. at 1737.

<sup>306</sup> *Heinz*, 246 F.3d at 717 (citing *University Health*, 938 F.2d at 1219 & n.26).

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## 5. Conclusions on Entry Conditions

We conclude that entry and expansion in each of the four relevant markets are difficult and time-consuming. At a minimum, the entry conditions we have outlined are likely to foreclose new entrants and smaller incumbents from winning bids for some time to come, because they would need to accumulate experience in order to compete with CB&I. Moreover, the new entrants' and smaller incumbents' attempts to gain this experience run up against CB&I's long-standing presence in each of the markets, which gives it a decided advantage over inexperienced suppliers. We do not conclude that these new suppliers will never become a competitive presence in the market. However, they lack experience and are unable in a reasonable time frame to build a reputation for quality and reliability – in markets that, for obvious reasons, highly value such a reputation. We therefore find that entry and expansion in these markets are not likely to replace the competition lost through the acquisition or to sufficiently constrain CB&I in a timely manner.

### D. Conclusions on Complaint Counsel's Prima Facie Case

As set forth in more detail above, Complaint Counsel have established extraordinarily high levels of concentration through HHIs, provided additional evidence of pre-merger bids that independently demonstrates the markets to be highly concentrated and enhances the HHIs, and strengthened that showing with evidence of difficult entry conditions. Accordingly, we find that Complaint Counsel have established a strong prima facie case and now turn to Respondents' rebuttal case.

### IV. Respondents' Rebuttal Case

Once Complaint Counsel has established a prima facie case, the burden shifts to the respondent to establish that the case inaccurately predicts the probable effects of the merger. As we noted earlier, “[t]he Supreme Court has adopted a totality-of-the-circumstances approach to [Section 7], weighing a variety of

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factors to determine the effects of particular transactions on competition.”<sup>307</sup> Accordingly, a respondent in a Section 7 case may introduce evidence on a wide variety of qualitative or quantitative factors to show that Complaint Counsel’s prima facie case gives an inaccurate account of the acquisition’s probable effects on competition in the relevant markets.<sup>308</sup>

In the present case, Respondents do not challenge the relevant product and geographic markets identified in the Initial Decision. They also do not dispute that each of the markets was highly concentrated before the acquisition or that the acquisition increased concentration levels substantially.<sup>309</sup> Rather, Respondents proffer a number of other claims (listed in the order in which we treat them): that the acquisition did not violate Section 7 because the relevant markets are minuscule and do not affect a “substantial” line of commerce; that any possible anticompetitive effects of the acquisition have been cured by post-acquisition entry into the LNG tank market and the expansion of other competitors in the LPG and LIN/LOX tank markets;<sup>310</sup> that

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<sup>307</sup> *Baker Hughes*, 908 F.2d at 984.

<sup>308</sup> *See University Health*, 938 F.2d at 1218, and cases discussed therein.

<sup>309</sup> Respondents do argue that CB&I was not a competitive force in the TVC market at the time of the acquisition and that it is “questionable whether CB&I would have the necessary expertise to construct TVCs absent the [a]cquisition.” RAB at 48. However, the evidence shows that CB&I continued to exert competitive pressure on PDM in the TVC market up to the time of the acquisition. *See* Part. III.B.4, *supra*.

<sup>310</sup> Respondents argue that the ALJ erred by not considering post-acquisition evidence in his evaluation of Complaint Counsel’s prima facie case. However, the post-acquisition evidence proffered by Respondents goes to whether new firms have entered the LNG market or fringe firms have expanded in the

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potential entry already constrains CB&I or can be expected to occur in the event of an anticompetitive price increase; that economic evidence demonstrates that CB&I cannot profitably raise prices; that customers in each of the markets are sophisticated and can thus restrain CB&I from imposing post-acquisition price increases; and that PDM would have exited the market even absent the acquisition.

We begin our analysis of these defenses by noting that Respondents' burden on rebuttal is linked to the strength of Complaint Counsel's case.<sup>311</sup> Where, as here, Complaint Counsel have established a strong *prima facie* case, Respondents' burden is high.

A. Small Size of the Relevant Markets

At the outset, we address Respondents' argument that the ALJ erred because "he failed to consider that, in light of the small size of the relevant markets, substantial effects on competition are unlikely."<sup>312</sup> Respondents read Section 7 of the Clayton Act to require substantial effects in a relevant market in terms of some threshold of unit or dollar sales. As support for their position,

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LPG and LIN/LOX markets. The proper place to analyze this evidence is in Respondents' rebuttal case, and accordingly we will do so.

<sup>311</sup> *Heinz*, 246 F.3d at 725 ("The more compelling the *prima facie* case, the more evidence the defendant must present to rebut it successfully.") (citing *Baker Hughes*, 908 F.2d at 991); *FTC v. Arch Coal, Inc.*, No. 04-0534 (D.D.C. Aug. 16, 2004) (slip op. at 30); see also 2A Areeda, Hovenkamp & Solow, *supra* note 45, ¶422, at 74 ("The more concentrated the market and the greater the threat posed by the challenged practice, the more convincing must be the evidence of likely, timely, and effective entry.").

<sup>312</sup> RAB at 10.

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they cite language in the *Baker Hughes* district court decision to the effect that “[t]he minuscule size of the market creates problems for the government’s case, because one element of a Section 7 violation is that ‘the market must be substantial.’”<sup>313</sup>

Respondents’ reading of both Section 7 and the trial court’s language in *Baker Hughes* is erroneous. Complaint Counsel correctly point out that the 1950 Celler-Kefauver Amendments to Section 7 of the Clayton Act<sup>314</sup> added the phrase “in any line of commerce” and that courts have consistently held that the volume or size of commerce affected by an acquisition is not a factor in determining the legality of a horizontal merger.<sup>315</sup> We note in addition that Congress extended Section 7 in 1980 to reach firms engaged “in any activity affecting commerce” and to apply to acquisitions by or from “persons,” including natural persons and partnerships as well as corporations.<sup>316</sup> In short, we find nothing in the history of Section 7 or the case law even suggesting that some threshold must be reached before Section 7’s prohibitions are triggered. As made clear by the statute itself, the relevant inquiry under Section 7 is whether “the effect” of a given transaction “may be substantially to lessen competition, or to tend

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<sup>313</sup> 731 F. Supp. at 9 (citing *du Pont*, 353 U.S. at 595).

<sup>314</sup> Monopolies in Restraint of Trade – Supplementing Existing Laws, Pub. L. No. 81-899, 64 Stat. 1125, 1184 (1950).

<sup>315</sup> See, e.g., *FTC v. Food Town Stores*, 539 F.2d 1339, 1345 (4th Cir. 1976) (“The fact that the markets in which the firms compete may be small is irrelevant under the Clayton Act, and does not affect the legality of the merger.”); cf. *United States v. Bethlehem Steel Corp.*, 168 F. Supp. 576, 595 (S.D.N.Y. 1958) (“a merger violates section 7 if the proscribed effect occurs in any line of commerce ‘whether or not that line of commerce is a large part of the business of any of the corporations involved’”).

<sup>316</sup> Antitrust Procedural Improvements Act of 1980, Pub. L. No. 96-349, § 6(a), 94 Stat. 1157.

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to create a monopoly” “in any line of commerce or in any activity affecting commerce in any section of the country.”<sup>317</sup>

We also find that, when placed in context, the *Baker Hughes* language quoted by Respondents is more correctly read as questioning whether the government had accurately defined a relevant market in the first instance. The language quoted by Respondents immediately follows a discussion of whether the government had defined both the relevant product and geographic markets too narrowly.<sup>318</sup> The court then added that the narrow line of commerce advocated by the government resulted in insignificant figures in terms of numbers of sales and that the government’s statistics were thus vulnerable, given the sporadic nature of sales in the market.<sup>319</sup> Only then did the court conclude, as noted above, that “[t]he minuscule size of the market creates problems for the government’s case, because one element of a Section 7 violation is that ‘the market must be substantial.’”<sup>320</sup> Moreover, the *Baker Hughes* opinion’s quotation from *du Pont* deals with the question of whether the relevant market was properly defined.<sup>321</sup> Thus, although the meaning of the *Baker Hughes* language that Respondents quote may not be perfectly clear, nothing in that opinion mandates our acceptance of the standard that Respondents advocate, particularly in light of the case law cited by Complaint Counsel, the history and scope of Section 7, and the failure of the appellate court in *Baker Hughes* to embrace the lower court’s language.

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<sup>317</sup> 15 U.S.C. § 18 (2004).

<sup>318</sup> 731 F. Supp. at 6-8.

<sup>319</sup> *Id.* at 9.

<sup>320</sup> *Id.* (citation omitted).

<sup>321</sup> 353 U.S. at 595.



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**B. Actual Entry****1. Actual Entry in the LNG Tank Market****a. Entrants into the LNG Tank Market**

Respondents argue that increasing demand in the LNG tank market has triggered entry by international LNG tank designers that have formed alliances with U.S. construction companies. Respondents also posit that these new entrants have all of the assets necessary to make them competitive with CB&I, such as international reputations for design, connections with local labor forces, and knowledge of various regulatory requirements. They thus claim that three new entrants – Skanska/Whessoe, Technigaz’s joint venture with Zachry, and TKK’s joint venture with AT&V – now impose competitive constraints on CB&I.<sup>322</sup> At first blush, Respondents’ story has some appeal. As we discuss below, however, a closer examination leads us to conclude that these new entrants do not confront CB&I with competition sufficient to constrain it from raising prices.

**(1) The New Entrants’ Lack of Reputation and Experience**

We begin by noting that, as of the time of trial, none of the alleged new entrants had ever built an LNG tank in the United States. By themselves, they each lack a crucial attribute of any successful LNG tank supplier – a reputation with U.S. customers for quality and reliability.<sup>323</sup> Respondents, however, argue that the

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<sup>322</sup> RAB 14-17.

<sup>323</sup> We also question whether Skanska/Whessoe’s reputation is wholly favorable. Whessoe was precluded from bidding on an expansion of Atlantic LNG’s plant in Trinidad based on its previous performance. Tr. at 596. In addition, although it appears that Enron was ultimately satisfied with Whessoe’s work on its

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new entrants have an international reputation that will be recognized and credited by LNG customers in the United States. Indeed, they point to testimony by some customers who stated that they are less hesitant to consider the three foreign tank designers, given their alliances with U.S. construction firms.

Although we think such statements indicate a positive long-term potential for additional competition to develop in the United States, we do not think the statements take Respondents where they want to go. We are even willing to assume that U.S. customers are likely to credit the new entrants' reputations in tank design, but we are unable to make the same assumption about their construction capabilities in the United States. The evidence suggests that customers evaluate not only the experience of a design firm but also the experience of its domestic construction partner. One customer even testified that the ability of the new entrants to compete depends on the capabilities of the U.S. construction companies.<sup>324</sup> We thus find it significant that the U.S. construction companies with which the design firms are partnered have no experience in constructing and erecting LNG

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Dabhol, India, project, problems at the outset of the project required Enron to spend extra money to assist Whessoe. Tr. at 4458-59. Internal PDM documents suggest that Whessoe's poor performance on the Trinidad and Dabhol projects is known by customers and would hinder Whessoe's chances of winning a bid. See CX 115, 135 (*in camera*). See also CX 693 at BP 01 028 (BP internal document noting that "Whessoe did not perform at all well in Trinidad, and Bechtel had to provide substantial project management support.").

In addition, Technigaz has not itself constructed an LNG tank, so it is questionable whether it has the skills to transmit such knowledge to Zachry. Tr. at 4718 (*in camera*).

<sup>324</sup> Tr. at 4521.

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tanks, even though they would be expected to lead such efforts.<sup>325</sup> Given CB&I's long history of both designing and building LNG tanks in the U.S., and based on the record as it relates to post-acquisition bids (Part IV.B.1.b, *infra*), we simply cannot conclude that United States customers would rate the new entrants – each a combination of an experienced tank designer and an inexperienced tank constructor – as having a reputation on par with that of CB&I.

Thus, Respondents' reliance on testimony from a number of U.S. customers that plan to consider bids from various combinations of the three new entrants<sup>326</sup> falls far short of proving Respondents' point that entry has been sufficient to replace the competition lost from the acquisition. Unless they were willing to consider these new bidders, LNG tank customers in the United States would have no choice other than CB&I. We thus take their testimony as little more than a refusal to throw themselves on CB&I's mercy. Moreover, these general statements say nothing about the ability of the new entrants to compete effectively with CB&I. We also note that some customers with upcoming projects were unaware of the existence of one or more of the new entrants,<sup>327</sup> which suggests that these new firms' international reputations may not necessarily place them in parity with CB&I.

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<sup>325</sup> Zachry has never built a field-erected tank of any sort, much less a cryogenic LNG tank. Tr. at 1645 (*in camera*). Likewise, Skanska has never built an LNG tank in the United States. IDF 153. Although AT&V has constructed a number of LIN/LOX tanks, these projects have not been wholly successful, and it has never constructed an LNG tank. See Part IV.B.3.a.(1), *infra*.

<sup>326</sup> Tr. at 1326-27, 4487-89, 6993, 6999, 7005.

<sup>327</sup> Tr. at 1326, 1846-48, 1852-53. Cf. Tr. at 6424-25; IDF 142-43 (Calpine had contacted only CB&I to discuss its upcoming LNG import terminal).

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(2) The New Entrants' Lack of Trained Supervisors and Unfamiliarity with Field Crews and Local Labor Markets

CB&I's supervisors are located in the United States and are experienced at managing the construction of LNG tanks. Because the new entrants' U.S. construction partners do not have any such experience, the tank designers either would need to train the construction company employees to supervise the project or would need to send their own supervisors to the U.S. work sites.<sup>328</sup> In either case, they would bear costs that CB&I does not, and these costs likely would make the new entrants less competitive, at least over the next several years.<sup>329</sup>

In addition, we find that CB&I enjoys a competitive advantage due to its relationships with the field crews that construct these tanks. The evidence is mixed regarding whether the U.S. construction partners of the new entrants would have adequate access to field crews at all. At least in theory, it would seem that field crews, who are (or work for) independent contractors, should be willing to sign on with any tank supplier to work on a project. The real world, however, does not seem to work that way. A former Zachry employee testified that Zachry would have needed to hire plate welders, plate erectors, and insulation installers to be competitive with CB&I on the Dynege project, but he had no information on Zachry's chances of doing so.<sup>330</sup> AT&V also testified that TKK planned to train some of AT&V's employees to be a field crew, which suggests that TKK is not relying on access

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<sup>328</sup> See discussion Part III.C.1, *supra*, at p. 39; Tr. at 2626-27.

<sup>329</sup> Tr. at 2379-80; IDF 147 (AT&V's Vice President believes that AT&V's employees will need a few years of experience in the construction of LNG tanks before they work as efficiently as CB&I's employees).

<sup>330</sup> Tr. at 1641-42 (*in camera*).

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to the field crews that have traditionally worked with CB&I (or PDM).<sup>331</sup> Moreover, as noted earlier, a tank supplier needs to provide substantial training to its field crews in proprietary techniques, company procedures, and the use of company-specific equipment. Thus, even if a new entrant had the needed access to these field crews, it would be at a competitive disadvantage because of the field crews' unfamiliarity with the entrant's procedures and equipment.<sup>332</sup>

We also find that the U.S. construction companies' inexperience in working with the local U.S. labor market in the construction of LNG tanks, combined with their subcontracting various parts of the tanks, has adverse competitive implications. Although the new entrants' U.S.-based construction companies have general familiarity with local labor regulations and knowledge of the local labor markets, CB&I (as the merged firm) has built virtually every LNG tank constructed in the United States. It thus knows in great detail how those labor markets can most effectively be accessed for the construction of LNG tanks. More important, CB&I has long-standing connections with various suppliers in these local markets. The evidence suggests that CB&I believes its knowledge of and connections with the local labor markets give it a competitive advantage. In a post-acquisition 10-K filing, CB&I stated that "it is viewed as a local contractor in a number of regions it services by virtue of its long-term presence and participation in those markets."<sup>333</sup> It further

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<sup>331</sup> Tr. at 2325-26.

<sup>332</sup> A CB&I employee testified that CB&I's "field crews are trained in our [CB&I's] procedures and with our equipment, and hiring people off the street would involve training costs. . . . [Y]ou have to train them and ensure that they were experienced in your particular line of work." Tr. at 2626-27.

<sup>333</sup> Tr. at 4231; CX 1061 at 10-11.

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noted that “[t]his perception may translate into a competitive advantage through knowledge of local vendors and suppliers, as well as of local labor markets and supervisory personnel.”<sup>334</sup> Thus, we cannot assume – as Respondents suggest – that these new entrants, who have never staffed or managed an LNG tank project, would have a knowledge and experience base comparable to that of CB&I.<sup>335</sup>

(3) The New Entrants’ Lack of Regulatory Experience

In addition, it appears that the new entrants have little to no experience with the FERC process, which makes some customers hesitant to use them. For instance, BP testified that Skanska/Whessoe, TKK/AT&V, and Technigaz/Zachry all lacked the level of FERC experience that it would require for its upcoming project and that CB&I’s FERC experience gave it a significant advantage over other tank builders.<sup>336</sup> BP elaborated that although other LNG manufacturers were doing some work, none had demonstrated that it can actually get through the FERC application process in a reasonable amount of time.<sup>337</sup> This general view is supported by BP’s own business practices.

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<sup>334</sup> CX 1061.

<sup>335</sup> We also question whether the new entrants actually have adequate access to the local labor markets and note that Technigaz/Zachry did not bid for El Paso’s Baja, California, LNG import terminal, in part because it did not believe it had access to the local labor it would need. Tr. at 1651-54 (*in camera*).

<sup>336</sup> Tr. at 6092-93 (*in camera*). BP testified that MHI, IHI, and Hyundai have virtually no regulatory experience; Daewoo, Technigaz, and Tractebel have a little more experience; and Whessoe might have even a bit more experience. Tr. at 6094-95 (*in camera*).

<sup>337</sup> Tr. at 6103 (*in camera*).

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Although Skanska/Whessoe heavily marketed itself to BP, BP entered into sole-source contracts with CB&I for each of its North American projects.<sup>338</sup> Similarly, when CMS needed to hire a company to help it meet a FERC filing deadline in a short time, it turned to CB&I alone.

Respondents argue that the new entrants have the requisite regulatory experience because “U.S. standards are de facto international standards.”<sup>339</sup> We reject this argument, which contradicts both the testimony and the real-world behavior of customers demonstrating that FERC experience is crucial. The only firm to gain any FERC experience as of the record’s close is Skanska/Whessoe, which successfully steered Dynegy’s LNG project through the FERC application process.<sup>340</sup> Based on the evidence, we do not find that this single experience puts Skanska/Whessoe on par with CB&I. We note, for example, that BP’s testimony about the advantage conferred on CB&I because of the latter’s FERC experience occurred after the announcement that Dynegy’s facility obtained FERC approval. We thus find that, on balance, the evidence establishes that the new entrants do not have the level of FERC experience necessary to compete effectively in this market.

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<sup>338</sup> Tr. at 4180, 6069, 6087-88 (*in camera*). One reason for this decision appears to be grounded in CB&I’s FERC experience. After CB&I refused to prepare the FERC application unless it was able also to build the entire facility, BP structured a deal to meet CB&I’s demands – despite its initial reluctance to do so. Tr. at 4180, 6069-71.

<sup>339</sup> RAB at 22.

<sup>340</sup> Tr. at 4932-33; RX 926.

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(4) Conclusions on Entry in the LNG Tank Market

We do not suggest that the new entrants would be totally incapable of building an LNG tank in the U.S. It is true that the new entrants have taken a necessary step toward competing in the United States by partnering with U.S. construction firms, which have experience in a wide variety of construction projects and may have some knowledge about various local labor markets that the new entrants can use.<sup>341</sup>

The evidence establishes, however, that being successful at building LNG tanks in the United States requires years of experience in managing the overall project, attracting qualified field crews and local labor, having working relationships with subcontractors, and making regulatory filings.<sup>342</sup> The fact that CB&I has cultivated these skills through decades of experience means that it has some advantages compared to a supplier that has not yet built a tank in the U.S.<sup>343</sup> In addition, CB&I has extensive

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<sup>341</sup> Tr. at 656-57 (Zachry has civil engineers and access to labor in the United States); Tr. at 657-59 (Skanska has a presence in the U.S.); Tr. at 4487 (Zachry is a big construction firm in the U.S. that is generally familiar with U.S. construction practices, labor forces, and pricing).

<sup>342</sup> It is curious that Respondents' description of the process for constructing an LNG tank comes from a project manager for an LNG tank to be built in Bonny Island, Nigeria, rather than from any of the numerous projects CB&I has built or is under contract to build in the United States. *See* Tr. at 5868. Unlike in the United States, CB&I has no particular advantage in the Bonny Island market, so this witness's testimony is not probative of the state of competition in the U.S. market.

<sup>343</sup> *See, e.g.*, Tr. at 6224 (El Paso testimony about cost savings resulting from knowledge of and existing relationships with suppliers).



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knowledge of and relationships with various U.S. labor forces and a knowledge of the U.S. regulatory environment, which are attributes customers value. All of these factors work together to help form CB&I's reputation for quality and reliability. While no single competitive advantage we have identified necessarily makes entry difficult, in the aggregate they preclude new entrants from sufficiently constraining CB&I in any reasonable time frame. Thus, we find that even entrants with the technical wherewithal to build LNG tanks have not restored the competition lost from the acquisition and likely cannot do so in the foreseeable future.<sup>344</sup>

Prior to the acquisition, CB&I and PDM were on relatively equal footing. Both firms had experienced tank designers and builders, long experience with the regulatory processes necessary to build LNG facilities, connections to local labor forces, and solid reputations. In other words, each firm had the attributes necessary to satisfy any LNG tank customer. While the new suppliers appear to have gained or are seeking to gain a toehold in the market, they are not on equal footing with CB&I, and their modest progress cannot restore the vibrant competition that once existed.

b. Post-Acquisition Bids in the LNG Tank Market

As of the time of trial, no LNG tank bids in the United States had been awarded to any supplier other than CB&I. Nevertheless, Respondents contend that sufficient entry has occurred because Dynege accepted bids from the three new entrants while precluding CB&I from bidding on its proposed import terminal. The evidence makes clear, however, that far from shunning CB&I, Dynege negotiated with CB&I on multiple occasions and rejected

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<sup>344</sup> In apparent recognition of the importance of its advantage, internal CB&I correspondence conveyed a concern that should CB&I win the Dynege project, it would work side-by-side with Skanska and thus expose its "crews, suppliers, and construction methods" to a competitor. CX 1528.

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its offer to bid on the LNG tanks only because CB&I's bid came too late in the process to be considered. The Dynegy project, where CB&I completely ignored its prospective customer's wishes and ultimately removed itself from the competition, comes up short as proof of vibrant competition.

At the outset, we address Respondents' suggestion that Dynegy's award of an EPC contract<sup>345</sup> to Skanska amounts to competition in the relevant market of LNG tanks.<sup>346</sup> This argument fails to distinguish between an EPC contract award and an award for LNG tanks. As we stated earlier, EPC contractors are essentially general managers for an LNG import terminal or a peak-shaving facility. Dynegy made clear to its potential suppliers that it intended to hire an EPC contractor but wanted to bid the LNG tanks separately from the engineering work to save costs.<sup>347</sup> In keeping with this strategy, Dynegy's award of the EPC contract to Skanska did not include an award on the LNG tank.<sup>348</sup> As a result, we discount Respondents' suggestion that this EPC award to Skanska amounts to competition in the relevant market (LNG tanks). We note, however, that even if we were to accept this premise, it appears that CB&I may have taken itself out of the running for the EPC award, which therefore is not evidence of the new entrants' ability to constrain CB&I.<sup>349</sup>

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<sup>345</sup> See discussion, *supra* Part II.E.

<sup>346</sup> See RAB at 15 (arguing that post-merger "Skanska has *already won* the job of EPC contractor for this project, beating out CB&I and several major international engineering and construction firms") (emphasis in original).

<sup>347</sup> Tr. at 4568-71.

<sup>348</sup> Tr. at 4568.

<sup>349</sup> Some evidence suggests that even if CB&I did not formally withdraw its name from consideration, it did so in effect by continuing to push a turnkey solution despite its customer's desire

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After the EPC contract was awarded to Skanska, CB&I refused to submit a bid for the LNG tanks alone, citing concerns about submitting bid information to a competitor's contractor.<sup>350</sup> As a result of these concerns, Dynegy created a firewall around those employees evaluating the LNG tank bids,<sup>351</sup> and these safeguards satisfied both TKK/AT&V and Technigaz/Zachry.<sup>352</sup> Nonetheless, for months CB&I continued to refuse to bid on the LNG tanks and also continued to insist that it be allowed to bid for the facility on a turnkey basis.<sup>353</sup> Only at the close of the bidding did CB&I approach Dynegy with an offer to bid on the LNG tanks themselves. At that point, Dynegy declined CB&I's offer, because it had come too late in the bidding process.<sup>354</sup>

Although it appears that CB&I may have overplayed its hand in negotiating with Dynegy, we cannot conclude on these facts that Skanska/Whessoe, TKK/AT&V, and Technigaz/Zachry effectively constrain CB&I. At most, Respondents have established that LNG customers may award a bid to one of the new entrants when CB&I effectively refuses to bid. This observation, of course, says nothing about the state of competition between the new entrants and CB&I. No evidence suggests that, had CB&I chosen to bid, the new entrants would have overcome the competitive disadvantages we identified earlier. In fact,

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for an alternative. Tr. at 4571-72; CX 138, 139, 140.

<sup>350</sup> Tr. at 4576-77.

<sup>351</sup> Tr. at 4576; RX 144.

<sup>352</sup> Tr. at 4577.

<sup>353</sup> CX 139, 140, 1528.

<sup>354</sup> Although the record does not definitively establish whether Dynegy's bidding period had actually closed, Dynegy's project manager testified that considering CB&I's bid at such a late stage would have been unfair to the other bidders. Tr. at 4572.

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CB&I's reluctance to give Dynegey what it wanted and Dynegey's repeated attempts to bring CB&I into the fold may suggest that Dynegey was concerned about the new entrants' disadvantages. Black & Veatch, which was hired to help evaluate bids for the project, testified that it "had concerns that if [it did] not have a domestic tank price for that project that the prices that the client would receive for those tanks would be higher."<sup>355</sup>

Even if we assume that CB&I lost the Dynegey bid on the merits, we would have to weigh that loss against CB&I's other post-acquisition wins. CB&I is in or has completed sole-source negotiations for six LNG tanks post-acquisition.<sup>356</sup> In addition to the significance of this fact standing alone, we find that the circumstances surrounding most of these projects suggest that the new entrants do not constrain CB&I in any meaningful way. For both the CMS and El Paso projects, the new entrants were not even considered as possible suppliers. CMS testified that it was under time constraints and contacted CB&I because it was already familiar with CMS's facility and knew the FERC process.<sup>357</sup> As for BP's award of three tanks to CB&I, this appears to be an example of CB&I's ability to foreclose competition. Although BP wanted to offer the LNG tanks for its three facilities through competitive bidding, CB&I refused to undertake any FERC work without a commitment that would allow it to build the entire facility.<sup>358</sup> Rather than turn to another supplier, BP acceded to CB&I's demands and awarded it turnkey contracts for all three

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<sup>355</sup> Tr. at 622.

<sup>356</sup> In addition to the awards of CMS, El Paso, and three BP projects, CB&I has entered into sole-source negotiations with Poten & Partners for an LNG tank. Tr. at 4399. The record, however, does not elaborate on the circumstances surrounding the Poten & Partners bid.

<sup>357</sup> Tr. at 6282-83 (*in camera*).

<sup>358</sup> Tr. at 6069.

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facilities.<sup>359</sup> It is notable that BP’s internal analysis on these projects questioned Skanska/Whessoe’s ability to perform the work, noted that Technigaz was “not active” in the U.S. market, and failed to mention TKK/AT&V at all.<sup>360</sup> Based on the evidence as a whole, we conclude that CB&I’s increased market power following the acquisition is not constrained by the new entrants.

It is somewhat surprising that Respondents cite both the CMS and the El Paso (Southern LNG) sole-source negotiations as evidence of vibrant competition post-acquisition. Boiled down, their argument is that the customer can always seek out another supplier even in the course of a sole-source negotiation, and that accordingly CB&I does not have the ability to dictate price.<sup>361</sup> As evidence of this point, Respondents elicited testimony from both CMS and El Paso that they were prepared to solicit other suppliers if they were not satisfied in their negotiations with CB&I.<sup>362</sup> Respondents argue that this pressure from customers caused CB&I to reduce its price on these two projects.

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<sup>359</sup> Tr. at 6069-71.

<sup>360</sup> CX 693 at BP 01 028.

<sup>361</sup> See RAB at 35-37. For the CMS project, Respondents also argue that CMS received a cost-competitive estimate that was lower than the budget price submitted by Skanska/Whessoe. RAB at 35-36. However, CB&I was unaware that CMS sought a bid from Skanska/Whessoe to check CB&I’s competitiveness. Tr. at 6295 (*in camera*). Under these circumstances, the fact that Skanska’s bid came in higher than CB&I’s does not establish “the pro-competitive force of new entry” claimed by Respondents. RAB at 35. An alternative hypothesis – which is fully consistent with evidence – is that Skanska/Whessoe is unable to sufficiently constrain CB&I.

<sup>362</sup> See RAB at 35-37.

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We find these arguments unpersuasive. First, we note that the evidence about the supposed price reductions comes solely from CB&I and that the record does not provide adequate information to determine whether these price reductions occurred in an absolute sense. Both of these contract negotiations had multiple provisions, and any price decrease could easily have been traded for a concession on another point.<sup>363</sup> CB&I's Mr. Scorsone even conceded that CB&I "negotiated some things in exchange for [the] price reduction" on the El Paso project.<sup>364</sup> In addition, Respondents' argument fails to recognize that the customers' ability to exert pressure by threatening to use another supplier is limited by the strength of the alternative suppliers. We find that the evidence amply demonstrates that the new entrants are not a strong alternative to CB&I and thus do not confer much power on the customer. We therefore view the customers' general statements about switching merely as evidence that the customers are not willing to contract with CB&I at any cost. These statements, however, in no way prove that CB&I is constrained to the same degree that it was before the acquisition. Moreover, the price reductions cited by Respondents occurred well after the Complaint in this case issued and are the type of evidence that is wholly manipulable.<sup>365</sup> We find far more compelling the fact that these customers chose CB&I as their supplier in the first instance.

As evidence of entry, Respondents also point to the fact that the new entrants have contacted a number of customers with projects in the very early stages of development.<sup>366</sup> While this fact

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<sup>363</sup> See Tr. at 6285 (CMS identified escalation clauses, change orders, and financial security issues as topics of negotiations) (*in camera*).

<sup>364</sup> Tr. at 5080 (*in camera*).

<sup>365</sup> See *supra* note 44.

<sup>366</sup> RAB 15-16.

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may be credible evidence that the new entrants have a desire to compete, it does not establish that meaningful entry has occurred. Simply put, evidence that new entrants are soliciting business (or are even providing some services to the market) is not itself evidence that they are now, or will be in the near future, firms that can sufficiently constrain CB&I. At the time of trial, these projects were at too early a stage to be probative of the state of competition in the LNG tank market. For example, Freeport LNG had applied for FERC approval and had hired S&B/Daewoo to do its FERC work; however, it had plans to bid its EPC contract competitively.<sup>367</sup> In addition, it had not yet awarded – or indeed even identified – potential bidders for the construction of the tank.<sup>368</sup> CB&I's CEO even testified that he believes CB&I to be in the running for this project.<sup>369</sup> Similarly, although Yankee Gas had sought budget pricing and had met with CB&I and Skanska/Whessoe, it had not yet pre-qualified any manufacturers and had not sent out requests for proposals for its tank.<sup>370</sup> Finally, MLGW and Calpine testified that they were considering LNG projects, but they had done nothing more than request preliminary budget pricing.<sup>371</sup> Given the early stages of these projects – and, more important, the customers' consequential lack of information necessary to evaluate the new entrants' proposals – these projects provide inconclusive evidence of whether the new entrants pose a sufficient competitive threat to CB&I.

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<sup>367</sup> Tr. at 6974-76, 6978, 7049.

<sup>368</sup> See Tr. at 7043 (Freeport LNG will send out requests for proposals once the FERC application is approved).

<sup>369</sup> Tr. at 4142-45.

<sup>370</sup> Tr. at 6447-49, 6451.

<sup>371</sup> Tr. at 1825-28, 6493-94. In addition, Dominion's Cove Point II expansion project is at an early stage. As of the time of trial, CB&I had submitted only a budget price. Tr. at 4148, 4988.

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We also address Respondents' argument that the ALJ erred by disregarding evidence relating to Enron's project in the Bahamas and Atlantic LNG's expansion in Trinidad. Citing their expert's testimony, Respondents assert that "the ability of new entrants to compete effectively in places near the U.S. . . . sheds light on their ability to compete effectively in the U.S."<sup>372</sup> However, there is a crucial difference between competition in the United States market and competition in these other two markets. There are no incumbent firms in either the Bahamas or Trinidad. No one tank supplier enjoys the advantages that come from being the incumbent firm, and all firms can compete on a roughly equal playing field. In contrast, in the United States, the incumbent CB&I has a long-standing presence in the market and consequently enjoys a significant competitive advantage over new entrants.

Respondents argue that CB&I was the "incumbent" in Trinidad, because it had built the last tank there.<sup>373</sup> We cannot say whether building one tank in Trinidad makes an LNG tank supplier an "incumbent" in the sense that we have used that term throughout this Opinion, but it matters little. The record amply demonstrates the power of – and the advantages accruing to – CB&I's true incumbency in the United States and that these advantages are extremely difficult to overcome. We thus conclude that Atlantic LNG's project in Trinidad sheds no significant light on the competitive landscape in the United States. In our view, neither does it demonstrate that LNG tank suppliers can easily enter and effectively compete with CB&I in the United States. Therefore, we find that the ALJ properly excluded evidence related to the Trinidad and Bahamas projects.

Nonetheless, we have examined the evidence surrounding these two projects and conclude that they do not substantiate

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<sup>372</sup> RAB at 38.

<sup>373</sup> *Id.*



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Respondents' assertion that the projects demonstrate that entry is easy in the U.S. LNG tank market. The testimony on Enron's Bahamas project is scant at best. Only slightly more than four of the nearly 8,400 pages of trial transcript are devoted to this project.<sup>374</sup> Further, the sole testimony about the bids came from Mr. Carling, who was at Enron at the time but never actually saw the bids. In addition, his testimony is uncorroborated by other evidence. While Carling remembered the relative positions of the bidders and that they were within 7 to 10 percent of one another, there is no evidence regarding the details of the pricing (*e.g.*, budget or firm prices) or whether the bids were quality-adjusted.<sup>375</sup>

Respondents' Trinidad example is similarly flawed. CB&I's Mr. Scorsone testified that Bechtel informed him that CB&I's initial bid was 5 percent higher than another bidder's and that, despite CB&I's subsequent price reduction, TKK/AT&V was awarded the bid.<sup>376</sup> Respondents argue that this award is an "example of the ability of foreign entrants to discipline CB&I in North America."<sup>377</sup> However, the evidence concerning TKK/AT&V's winning bid comes exclusively from Mr. Scorsone, whose testimony was not corroborated by any other evidence and, indeed, was offered solely to show his state of mind.<sup>378</sup> In addition, the record does not contain any details about the submitted bids and does not reveal why the job was awarded to

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<sup>374</sup> See Tr. at 4477-4482.

<sup>375</sup> Tr. at 4481.

<sup>376</sup> Tr. at 4492.

<sup>377</sup> RAB at 39.

<sup>378</sup> Tr. at 4951. Mr. Rapp, the project manager for the most recent expansion in Trinidad, was deposed prior to the tank award to TKK/AT&V. When Rapp was deposed, CB&I, TKK, and MHI (among others whose names he could not remember) had not gone past being pre-qualified. Tr. at 1318.

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TKK/AT&V. Accordingly, even if we were inclined to consider evidence from these two projects, it would be impossible to draw conclusions about them from the record before us.

c. Evidence of CB&I's and Customers' Views on the LNG Tank Market

Respondents argue that CB&I views the new entrants as significant competitors and that its assessment of these firms factors into its bidding.<sup>379</sup> The chief evidence on this point again comes from CB&I's own employee, Mr. Scorsone, who testified that upon hearing TKK/AT&V's, Technigaz/Zachry's, and S&B/Daewoo's joint venture announcements, he believed that these joint ventures were serious about winning contracts and that the pairings would make strong competitors.<sup>380</sup> However, because Respondents put forward no contemporaneous evidence to corroborate Scorsone's views, we view his testimony with considerable skepticism. Moreover, in the post-acquisition period, CB&I has not acted as if it took the new entrants into account in its negotiations with potential customers. For several post-acquisition projects, CB&I has insisted that it do the work on a turnkey basis – even after customers have expressed a strong preference to bid parts of the project competitively. In negotiating with BP, Freeport LNG, and Dynegey, CB&I refused to do any design or FERC work without a commitment from the customer that it would award the entire project to CB&I. Although BP initially was reluctant, it eventually acceded to CB&I's wishes and agreed to allow CB&I to build its three proposed facilities (on the condition that it was satisfied with CB&I's work on the FERC application). CB&I's strategy was less successful with Freeport LNG and Dynegey, both of which selected other companies to do the desired work. However, the fact that CB&I thought it was in a position to make such demands and, in the case of Dynegey, to

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<sup>379</sup> RAB at 35; *see generally* Tr. at 4860-72.

<sup>380</sup> Tr. at 4853-54, 4856, 4858, 4860-72.

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ignore its customer's wishes on multiple occasions speaks volumes about CB&I's view of the competitive landscape. If CB&I truly believed the new entrants provided meaningful competition, it is unlikely that it would have behaved in such a fashion.

Further, the customer testimony cited by Respondents does not support their arguments about the competition provided by the new entrants.<sup>381</sup> Freeport LNG testified at trial that it would seek bids from the new entrants and that it was comfortable with the options it currently has available to build an LNG tank.<sup>382</sup> However, in our view, the Freeport LNG representative could not credibly have made assumptions about these new entrants and their competitive ability based on past experience. Although he had been involved in various LNG projects worldwide, he had not been involved in selecting the tank constructor but rather had focused on the preliminary design aspects.<sup>383</sup> He also had no prior experience with the construction of an LNG tank in the United States.<sup>384</sup> Moreover, the Freeport LNG project was at an early stage, and the company had not yet requested proposals on the tank.<sup>385</sup> Although Freeport may yet consider CB&I, Technigaz, TKK, Daewoo, and IHI as potential bidders in the future, at present Freeport LNG has not evaluated either the new entrants or their ability to constrain CB&I.<sup>386</sup> Similarly, BP's statement that it had sufficient competition to ensure reasonable prices is unpersuasive because the testimony is inconsistent with BP's

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<sup>381</sup> RAB at 39-41.

<sup>382</sup> Tr. at 7018-19.

<sup>383</sup> Tr. at 7025-30.

<sup>384</sup> Tr. at 7025.

<sup>385</sup> Tr. at 7043.

<sup>386</sup> Tr. at 7023, 7043.

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internal documents (discussed at p. 60, *supra*) and its actual conduct. Rather than seeking another supplier, BP agreed to give CB&I a turnkey contract for three of its facilities despite what appears to have been an initial reluctance to do so.<sup>387</sup> This evidence suggests that BP did not consider other suppliers as equivalent to CB&I, nor did BP have any experience with evaluating the new entrants' capabilities or pricing.

Finally, we are troubled by Respondents' characterization of some of the customer testimony. Respondents suggest that Bechtel stated that it could get a reasonable price by pitting Technigaz/Zachry against CB&I.<sup>388</sup> However, Bechtel actually testified that it would "assume" it could.<sup>389</sup> While this distinction may seem slight, the record is clear that the Bechtel witness knew very little about Technigaz/Zachry, had not yet pre-qualified it as a supplier, and assumed that the alliance between the two companies was organized to offer a suite of services competitive with those of CB&I.<sup>390</sup> We therefore view the testimony cited by Respondents as merely Bechtel's statement that if Technigaz/Zachry stacked up favorably against CB&I, Bechtel intended to engage them in competitive bidding. Similarly, Respondents cite testimony from Calpine to suggest that Calpine is satisfied with the state of competition post-acquisition.<sup>391</sup> Our review of the testimony (including that cited in Respondents' brief) reveals no such conclusion. Rather, Calpine merely testified that it would consider Technigaz/Zachry, Skanska/Whessoe, TKK/AT&V, and CB&I as potential bidders

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<sup>387</sup> Tr. at 6069-71.

<sup>388</sup> RAB at 40.

<sup>389</sup> Tr. at 1334.

<sup>390</sup> Tr. at 1333-36.

<sup>391</sup> RAB at 39-40.

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for its LNG tank when the time comes.<sup>392</sup> We note that at the time of trial, Calpine's project was at a preliminary stage. Requests for proposals had not been issued, and Calpine had done no evaluation of the new bidders. Therefore, we find that this testimony does not corroborate Respondents' assertion.

In sum, we do not view the customer testimony cited by Respondents as supportive of their argument that the new entrants have restored competition lost from the acquisition.<sup>393</sup> While we do not ignore the fact that these customers have not complained about the acquisition, all of these customers (except BP) are at early planning stages and have not issued requests for bids or received pricing from the new entrants. In addition, although BP has awarded three bids to CB&I, it did so only after it was confronted by CB&I's demand that it do the entire project alone, and it gave little consideration to the new entrants. Therefore, it is unlikely that the customers relied upon by Respondents were in a position to have evaluated the state of competition post-acquisition. Accordingly, we view the testimony of these customers as little other than speculation that new entrants might constrain CB&I at some level – which, of course, does not demonstrate that they are an adequate replacement for the competition that has been lost.

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<sup>392</sup> Tr. at 6495-96.

<sup>393</sup> Nor does Respondents' reference to both El Paso's and MLGW's testimony support their position. *See* RAB at 40. Although El Paso testified that the acquisition has not harmed competition in the global market, Tr. at 6140-46, it is the United States market that we must consider. Similarly, MLGW testified that it would have no way of knowing whether a price increase had occurred, and that it would not know until it evaluated bids whether more competition exists now than in 1994. Tr. at 1858-61. This testimony does not establish that "the [a]cquisition has not substantially harmed competition." RAB at 40.

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2. Actual Entry in the LPG Tank Market

a. Entrants into the LPG Tank Market

The LPG tank market has been characterized more by exit than by entry as numerous firms that competed in the 1970s today are out of business.<sup>394</sup> The actual or potential entrants in this market also appear vastly overmatched by CB&I.

(1) AT&V

AT&V successfully won and completed a very small LPG tank project in 2000.<sup>395</sup> Its success with this project, however, says little about AT&V's ability to compete on larger LPG projects so as to act as a constraint against CB&I. The evidence suggests that this project not only was small but also was within the region of the country where AT&V is located.<sup>396</sup> It is therefore questionable whether this win indicates an ability to compete nationwide with CB&I. AT&V's Vice President testified, for example, that his firm's ability to compete with CB&I is limited by AT&V's lack of equipment, lack of trained welding personnel, and CB&I's years of experience.<sup>397</sup> He also stated that CB&I automatically gets bidding opportunities that AT&V does not.<sup>398</sup> In addition, he testified that AT&V has limited capacity to obtain bonding due to its small size and uncertain financial position.<sup>399</sup> To overcome

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<sup>394</sup> Tr. at 2391.

<sup>395</sup> Tr. at 7088-89, 7129-31, 7133-34.

<sup>396</sup> CX 107 at PDM-HOU005015 (AT&V characterized as a "Gulf-Coast Regional Competitor").

<sup>397</sup> Tr. 2379-80.

<sup>398</sup> Tr. at 2421-22.

<sup>399</sup> Tr. at 2365-66.

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some of its shortcomings, AT&V has partnered with TKK, which supplies the refrigeration expertise that AT&V lacks<sup>400</sup> and allows AT&V to obtain bonding for larger projects than it could secure on its own.<sup>401</sup> This arrangement, however, is only intermittent and has been ineffective at times. For example, the record indicates that AT&V lost an LPG project in Trinidad to CB&I because TKK was not interested in the project and did not bid aggressively.<sup>402</sup> We also note that AT&V has had quality problems in the LIN/LOX tank market<sup>403</sup> post-acquisition, which raises doubts as to whether it could effectively constrain CB&I going forward in the LPG market.

(2) Matrix, Wyatt, Pasadena Tank, and Chattanooga

Respondents also identify as competitors four would-be LPG tank suppliers, none of which had won any bids as of the time of trial: Matrix, Wyatt, Pasadena Tank, and Chattanooga. The evidence related to Matrix, Wyatt, and Pasadena Tank is limited, but it establishes that all three of these suppliers are marginal at best and do not constrain CB&I effectively. For instance, although Matrix testified that it would pursue bidding on an LPG tank if it were given the opportunity, it also testified that it has never bid on an LPG tank.<sup>404</sup> Similarly, although Wyatt pursued LPG business “many years ago,” it faces entry barriers because it has never constructed an LPG tank.<sup>405</sup> Wyatt bid on the ABB Lummus post-acquisition project; however, it lost to CB&I in part because ABB

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<sup>400</sup> JX 23 at 49-50, 57 (*in camera*).

<sup>401</sup> Tr. at 2557.

<sup>402</sup> Tr. at 2430-32.

<sup>403</sup> See discussion *infra* at Part IV.B.3.(a).

<sup>404</sup> Tr. at 1609.

<sup>405</sup> JX 27 at 71-72.

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Lummus found Wyatt unresponsive to technical questions about the project.<sup>406</sup> In addition, it is not clear that Wyatt has the capability to compete in the LPG market. Pasadena Tank also appears to be no more than a marginal competitor. One customer is not willing to use Pasadena Tank because it was very late on an earlier project and had problems that it was unable to solve.<sup>407</sup> In addition, a PDM strategic planning document characterized Pasadena as having “one shop and one office” and as specializing in non-refrigerated tanks.<sup>408</sup>

The Chief Operating Officer and part owner of Chattanooga also testified that it believes it has the ability and the necessary equipment to design and build a field-erected LPG tank,<sup>409</sup> that it has employees who are experienced in building such tanks,<sup>410</sup> and that it plans to pursue LPG jobs in the future.<sup>411</sup> These assertions are questionable, however, because the same witness mistakenly characterized methane tanks as LPG tanks,<sup>412</sup> thought gasoline was LPG,<sup>413</sup> and did not know whether propane, butane, propylene, and butadiene would be in a gaseous or liquid state at ambient temperature.<sup>414</sup> In addition, the Chattanooga witness did

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<sup>406</sup> Tr. at 3750-51.

<sup>407</sup> JX 27 at 132-34.

<sup>408</sup> CX 660 at HOU5015.

<sup>409</sup> Tr. at 6355, 6393.

<sup>410</sup> Tr. at 6356.

<sup>411</sup> Tr. at 6365.

<sup>412</sup> Tr. at 6357-58

<sup>413</sup> Tr. at 6388.

<sup>414</sup> Tr. at 6402.



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not recall whether any of Chattanooga's tanks were built for -50° Fahrenheit, though he was confident that Chattanooga would have no trouble building one.<sup>415</sup> In short, Chattanooga's ability to compete in the LPG market is questionable at best.

(3) Morse

Respondents also use Morse as an example of easy "hit-and-run" entry. Morse had never built an LPG tank before it bid on and won a 1994 Texaco job near its home base in the Pacific Northwest. It was able to complete the project quickly and profitably.<sup>416</sup> According to Respondents, Morse was thus poised in 1994 to move from being a regional operation into the nationwide market for LPG tanks. However, after the job for Texaco, Morse did not bid on any other LPG contract in the United States, and internal CB&I and PDM documents do not discuss Morse as a nationwide competitor.<sup>417</sup> Significantly, CB&I acquired Morse in November 2001 – about a month after the Complaint was issued in this case.<sup>418</sup> Moreover, CB&I acquired Morse for only \$3 million, which indicates that it was a very small operation compared to CB&I or PDM.<sup>419</sup> In addition, there is testimony that CB&I's acquisition of PDM did not lead Morse to

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<sup>415</sup> Tr. at 6388-89.

<sup>416</sup> Tr. at 7297.

<sup>417</sup> Morse did participate in at least the first round of bidding on an LPG tank in Canada. Tr. at 6589. However, Morse was not asked to bid on an important LPG project, Sea-3/Tampa – reinforcing the characterization of Morse as a regional, not national, competitor. *Id.*; see also CX 107 at PDM-HOU005015 (PDM strategic planning document for 2000 describing Morse as "mostly a Northwest tank company").

<sup>418</sup> Tr. at 6545.

<sup>419</sup> *Id.*

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believe it would be able to take PDM's place in the LPG market.<sup>420</sup>

(4) Foreign Suppliers

Foreign suppliers do not present a credible entry scenario sufficient to support Respondents' argument. TKK has partnered in the past with AT&V to bid on LPG projects, but has not shown consistent interest in this market.<sup>421</sup> Technigaz has built only one LPG tank of the type used in the United States.<sup>422</sup> In short, while Respondents point to firms that theoretically might enter the LPG market, no such firm presents more than a speculative possibility of effective entry in the foreseeable future.

(5) Conclusions on Entry in the LPG Tank Market

Of the two firms that have actually won bids in the LPG market, one (Morse) has now been acquired by CB&I, while the other (AT&V) was involved only in one very small, local project that would have little effect on future success in the LPG market. On the basis of the record before us, the other firms identified by Respondents – Matrix, Wyatt, Pasadena Tank, and Chattanooga – are not convincing potential entrants. We therefore conclude that these firms cannot sufficiently constrain CB&I or restore the competition lost from the acquisition.

b. Post-Acquisition Bids in the LPG Tank Market

Respondents cite the single post-acquisition LPG tank project as evidence that the merged firm does not have market power and that the market has become significantly more competitive since

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<sup>420</sup> Tr. at 6662-63.

<sup>421</sup> Tr. at 2431.

<sup>422</sup> Tr. at 4708 (*in camera*).

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the acquisition. AT&V and Wyatt participated in the bidding on this project but lost to CB&I – apparently not only because CB&I lowered its profit margins in the second round of bidding but also because AT&V and Wyatt were not responsive to the customer’s technical questions.<sup>423</sup>

The post-acquisition project in question involved an LPG tank to be constructed for BASF/ABB Lummus in Port Arthur, Texas. After the first round of bidding, ABB Lummus told CB&I it was in third place out of three bidders.<sup>424</sup> CB&I then found ways to cut costs by redesigning other parts of the project, lowered its margins from over 4 percent to approximately 2½ percent, and won the job in the second round of bidding.<sup>425</sup> This project would seem to suggest that AT&V and Wyatt were acting as constraints on CB&I’s exercise of market power, at least in one instance. However, we have found that the other bidders for this job are not convincing entrants. Moreover, the most probative evidence related to this transaction – CB&I’s reduction in price – is the type of post-acquisition evidence on which courts and the Commission have been reluctant to rely, because that evidence was controlled by CB&I itself.<sup>426</sup> CB&I’s price reduction may well have been influenced by CB&I’s knowledge that its acquisition of the PDM assets had been challenged and its desire to preserve the transaction.<sup>427</sup> As a result, this evidence, standing alone, does not

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<sup>423</sup> Tr. at 3750-51.

<sup>424</sup> Tr. at 5040.

<sup>425</sup> Tr. at 5041-42.

<sup>426</sup> *Hospital Corp.*, 807 F.2d at 1384 (“[p]ost-acquisition evidence that is subject to manipulation by the party seeking to use it is entitled to little or no weight”); *B.F. Goodrich Co.*, 110 F.T.C. at 341 (same).

<sup>427</sup> Respondents correctly point out that they did not have the ability to control whether would-be competitors (AT&V and

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overcome the other evidence related to the difficulty of fully replacing the competition lost by the merger.

In short, the post-acquisition evidence in the LPG tank market demonstrates no more than that two minor competitors submitted bids after the acquisition. We are not, however, persuaded that CB&I's cost-cutting and margin-shaving represent a "sea-change" in the market sufficient to overcome the contrary evidence.

3. Actual Entry in the LIN/LOX Tank Market

a. Entrants into the LIN/LOX Tank Market

Our assessment of entry into the LIN/LOX tank market is aided by the experiences of a few firms that have entered or attempted to enter the market. Respondents argue that the entry of AT&V, Matrix, and Chattanooga rebuts Complaint Counsel's prima facie case in the LIN/LOX market.<sup>428</sup> However, we find that the experiences of these firms in entering the market, as well as the failed entry effort by a fourth firm not mentioned by Respondents, illustrate instead the high entry barriers in the LIN/LOX market. Furthermore, Respondents' examples do not adequately explain how entry into the LIN/LOX market will overcome the obstacles discussed below and constrain CB&I to the same degree that it

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Wyatt) submitted bids for this post-acquisition job. However, CB&I's response to those bids provides more relevant information about the post-merger competitive landscape.

<sup>428</sup> Respondents argue that AT&V, Matrix, and Chattanooga are examples of "new" entry that has taken place "in just three years." RAB at 19. This characterization is inaccurate. All three firms have been engaged in long-term efforts to obtain LIN/LOX business that predate the acquisition. Only AT&V and Matrix have been able to gain a foothold in the market by winning a few bids; Chattanooga was an unsuccessful bidder before the acquisition and continues to be unsuccessful.

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was constrained before the acquisition. We thus agree with the Initial Decision's conclusion that Respondents have not demonstrated that entry is sufficient to constrain the exercise of market power by CB&I in the LIN/LOX tank market.

(1) AT&V

AT&V won its first bid to supply two LIN/LOX tanks to BOC in late 2000,<sup>429</sup> and it has since completed that project.<sup>430</sup> By the time of trial, AT&V had won two additional bids – one more for BOC and one for Air Liquide (which was under construction at the time of trial).<sup>431</sup> Far from establishing that entry into this market is easy, however, AT&V's experience demonstrates how difficult it is to gain a presence in supplying LIN/LOX tanks. AT&V testified that entry into the LIN/LOX market took years of effort.<sup>432</sup> For example, although AT&V started visiting customers and marketing itself as a LIN/LOX tank supplier in the early 1990s, it did not win a contract until 2000.<sup>433</sup>

AT&V testified that it took so long to win a contract because customers preferred the reputation and experience of CB&I and PDM.<sup>434</sup> It also testified that prior to the acquisition, customers generally wanted to deal only with CB&I or PDM and that those

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<sup>429</sup> Tr. at 4599.

<sup>430</sup> Tr. at 4600.

<sup>431</sup> Tr. at 2235 (*in camera*), 2241 (*in camera*), 2504-05, 5291-92.

<sup>432</sup> Tr. at 2503-05.

<sup>433</sup> Tr. at 2397, 4599.

<sup>434</sup> Tr. at 2397-98, 2506-07.

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two companies dominated the marketplace.<sup>435</sup> Moreover, AT&V stated that Air Liquide told it that AT&V would have to build one operational LIN/LOX tank that performed well in order for it to win a contract from – or even by considered by – Air Liquide.<sup>436</sup> Thus, AT&V had a difficult time bidding on contracts between 1996 and 2000 because, despite its efforts, it had not yet garnered customer confidence.<sup>437</sup>

AT&V testified that *some* customers are giving it a more serious look because PDM is no longer in the market.<sup>438</sup> However, the evidence surrounding the projects AT&V has won suggests that it will not meaningfully constrain CB&I in the future.

AT&V was required to spend \$50,000 on marketing before it won its first contract with BOC in 2000.<sup>439</sup> In addition, BOC testified that because of AT&V's inexperience, BOC planned to spend \$50,000 in oversight to ensure that the tank would be delivered on time, on schedule, and on budget. BOC accounted for this expense by adding the \$50,000 to AT&V's bid when BOC evaluated the bids, and AT&V's bid was still the lowest.<sup>440</sup> AT&V was thus finally able to convince BOC to take a chance on

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<sup>435</sup> Tr. at 2389-90.

<sup>436</sup> Tr. at 2466-68.

<sup>437</sup> Tr. at 2506-08.

<sup>438</sup> Tr. at 2572.

<sup>439</sup> Tr. at 2383, 2507-08.

<sup>440</sup> Tr. at 4620-21, 4655-56. However, a Linde witness testified that he was told by BOC that there were many cost overruns and that in the end AT&V's price was higher than those of the other bidders. Tr. at 931-32.

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it, despite its lack of experience.<sup>441</sup> Although BOC was eventually willing to take a chance, the evidence suggests that some customers are more averse to risk. For instance, MG Industries testified that it was surprised that BOC was willing to contract with AT&V.<sup>442</sup>

In 2002, Air Liquide also awarded a LIN/LOX tank to AT&V for its Freeport, Texas, project.<sup>443</sup> AT&V was selected because it had a significant price advantage over the other bidders (approximately \$200,000 less) and also because Air Liquide saw its project as an opportunity to develop another supplier as an alternative to CB&I.<sup>444</sup> The location of the project also affected Air Liquide's choice of AT&V. Because Freeport is very close to Air Liquide's office, Air Liquide felt that it could easily keep track of AT&V.<sup>445</sup> Air Liquide also testified that had PDM been in existence at the time and submitted a credible and competitive bid, Air Liquide would have been far less likely to have taken the risk of developing a new supplier.<sup>446</sup> Air Liquide elaborated that development of a new LIN/LOX tank supplier entails technical, commercial, and financial risks and requires due diligence.<sup>447</sup>

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<sup>441</sup> Tr. at 2506-08.

<sup>442</sup> Tr. at 460-70.

<sup>443</sup> Tr. at 2235 (*in camera*).

<sup>444</sup> Tr. at 2235-37 (*in camera*).

<sup>445</sup> *Id.*

<sup>446</sup> Tr. at 2236 (*in camera*).

<sup>447</sup> Tr. at 2236-37 (*in camera*). Before awarding the bid to AT&V, Air Liquide contacted BOC and obtained a detailed assessment of AT&V's performance from BOC. Tr. at 2239 (*in camera*).

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As of the time of trial, [ redacted redacted ]<sup>448</sup> AT&V did not execute several of the specifications on the tank that Air Liquide required [ redacted redacted ]<sup>449</sup> AT&V also was behind schedule by three months and had informed Air Liquide of another month-long delay just before the Air Liquide witness gave his testimony. Air Liquide testified that this delay will have negative repercussions for both Air Liquide and its customer, Dow Chemical. In the worst-case scenario, Dow could have [ redacted ] as a result of the delay.<sup>450</sup> This result [ redacted redacted ] exemplifies the importance of quality [redacted] and reputation to customers.

[ redacted redacted ]<sup>451</sup>  
Air Liquide further stated that the only manufacturer [ redacted ] is CB&I because CB&I has the technical capability, a good reputation in the industry, and a good performance record and relationship with Air Liquide.<sup>452</sup> Although Air Liquide contacted CB&I about replacing AT&V on the project, CB&I declined.<sup>453</sup> Air Liquide testified that it would not be willing to contract with Matrix [ redacted ] because Matrix is [ redacted ] not pre-qualified by Air Liquide's standards.<sup>454</sup> Air Liquide elaborated that to contract with Matrix,

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<sup>448</sup> Tr. at 2241 (*in camera*).

<sup>449</sup> Tr. at 2241-43 (*in camera*).

<sup>450</sup> Tr. at 2246-47 (*in camera*).

<sup>451</sup> Tr. at 2252 (*in camera*).

<sup>452</sup> *Id.*

<sup>453</sup> Tr. at 5036.

<sup>454</sup> Tr. at 2253 (*in camera*).



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it would have to go through the whole process of qualifying Matrix as a bidder (including due diligence) and that it can no longer afford to take a chance with an inexperienced supplier.<sup>455</sup>

In addition, AT&V's performance on this job has eliminated any savings that Air Liquide may have enjoyed at the outset. Air Liquide anticipated spending between \$100,000 to \$150,000 to develop AT&V as a supplier – less than the \$200,000 price advantage in AT&V's bid. But Air Liquide testified that it has already spent the full \$200,000 difference in pricing and, with the further delays, expects to incur another \$100,000 to \$150,000 in costs by the end of the project.<sup>456</sup> [

redacted  
redacted ]<sup>457</sup>

(2) Matrix

Matrix was active in the LIN/LOX tank market in the late 1990s, having successfully completed four tank projects between 1997-2000.<sup>458</sup> As was the case with AT&V, the Matrix witness testified that it took Matrix a long time and hundreds of thousands of dollars to enter.<sup>459</sup> It took between one and one-half and two years from Matrix's initial decision to enter before it won its first contract, and then another year to successfully complete the

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<sup>455</sup> *Id.*

<sup>456</sup> Tr. at 2254-55 (*in camera*).

<sup>457</sup> Tr. at 2255-56 (*in camera*).

<sup>458</sup> IDF 320.

<sup>459</sup> Tr. at 1567, 1584-85.

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tank.<sup>460</sup> Matrix's entry was also in part customer-driven.<sup>461</sup> Matrix subsequently completed three tank projects for Praxair and one for Air Products.<sup>462</sup>

However, Matrix sold its Brown Steel fabrication facility in August 2000.<sup>463</sup> Matrix testified that since that sale, it has been at a competitive disadvantage and has elevated costs.<sup>464</sup> Whereas the tanks that Matrix built previously were made when it still owned Brown Steel, today Matrix must subcontract some of the work, which increases its costs.<sup>465</sup> Specifically, the plates for the outer tanks would have to be sent out for blasting and priming.<sup>466</sup> The testimony related to post-acquisition bids reflects that these increased costs have made Matrix non-competitive. For example, Matrix testified that some customers have informed it that its bids were high and questioned its qualifications.<sup>467</sup> Several customers corroborated this view and testified that Matrix has indeed been bidding high.<sup>468</sup> Moreover, Air Liquide was reluctant to contract

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<sup>460</sup> Tr. at 1585.

<sup>461</sup> Praxair needed a union builder and, as between CB&I and PDM, only CB&I did union work. Tr. at 1617. Matrix had built a cluster tank in Ohio for Praxair, so Praxair was familiar with Matrix and awarded Matrix the job. Tr. at 2174-75.

<sup>462</sup> IDF 320.

<sup>463</sup> Tr. at 1589-90.

<sup>464</sup> Tr. at 1590.

<sup>465</sup> Tr. at 2159-61.

<sup>466</sup> *Id.*

<sup>467</sup> Tr. at 2155.

<sup>468</sup> Tr. at 489, 1019, 2000-01.

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with Matrix because of its lack of experience<sup>469</sup> and would not consider [ redacted ] Matrix [ redacted ].<sup>470</sup>

Matrix testified that it is not planning to exit the LIN/LOX market and that it intends to continue to bid for jobs, though its offering will not be as competitive.<sup>471</sup> Although the acquisition has presented Matrix with some limited opportunities,<sup>472</sup> the evidence suggests that Matrix's viability as a competitor has diminished. Matrix has not won a LIN/LOX job since CB&I acquired the PDM assets. In addition, other LIN/LOX tank suppliers do not view Matrix as a serious competitor. AT&V testified that its only competitors are CB&I and, on a much smaller scale, Matrix.<sup>473</sup> Air Products also testified that Matrix has not replaced PDM.<sup>474</sup> We thus find that the preponderance of the evidence supports the Initial Decision's conclusion that Matrix's competitive viability has diminished since the sale of its Brown Steel facility and that it no longer is a competitive constraint on CB&I.

(3) Chattanooga

Although Respondents assert that "Chattanooga has recently entered this market,"<sup>475</sup> it is more accurate to say that Chattanooga

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<sup>469</sup> Tr. 1588, 2021-22.

<sup>470</sup> Tr. at 2253 (*in camera*).

<sup>471</sup> Tr. at 1595.

<sup>472</sup> Tr. at 2182.

<sup>473</sup> Tr. at 2332-33.

<sup>474</sup> Tr. at 1354.

<sup>475</sup> RAB at 19.

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has continued its attempts to gain LIN/LOX business that it began prior to the acquisition. Despite the fact that it has bid on projects since prior to the acquisition, Chattanooga still has not won a bid, and it has yet to construct a LIN/LOX tank.<sup>476</sup> Although Chattanooga hired some former Graver employees and bought some equipment from Graver when the latter exited the market,<sup>477</sup> the Chattanooga witness testified that it has never created any strategic plans or pricing strategy for designing, engineering, fabricating, or erecting LIN/LOX tanks, and that it has not been participating in the LIN/LOX market.<sup>478</sup>

In certain instances, potential entrants like Chattanooga can have a competitive influence on incumbents by bidding, even though they have not yet won a bid. However, in the LIN/LOX tank market such influence does not come from submitting a bid alone. Rather, customers must take the bid seriously, and the bid must be competitive if the bid is to have any constraining effect. As discussed above, customers also have extensive qualifications that a manufacturer must satisfy.

LIN/LOX tank customers may acknowledge a bid from a firm, but they will not take it seriously if it is too high, as has been the case with Chattanooga. For example, MG Industries testified that it ignored Chattanooga's March 2002 bid on MG's new Johnsonville, Tennessee, project, which was 30 percent higher than CB&I's bid.<sup>479</sup> The MG Industries witness also questioned

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<sup>476</sup> IDF 325.

<sup>477</sup> Tr. at 6318.

<sup>478</sup> Tr. at 6421-22, 6426. The Chattanooga witness testified that LIN/LOX is a market it will be interested in pursuing when there is sufficient demand. Tr. at 6422.

<sup>479</sup> Tr. at 451, 461-62.

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whether Chattanooga is a viable LIN/LOX tank supplier in light of its high costs.<sup>480</sup>

A firm like Chattanooga is at a further disadvantage because it lacks the experience and reputational assets of a firm such as CB&I. For example, Air Liquide was not even aware that Chattanooga competed for LIN/LOX tanks.<sup>481</sup> Consequently, Chattanooga has not been able to establish a foothold in this market. Based on the balance of the evidence, we agree with the Initial Decision's conclusion that Chattanooga "does not effectively compete in the LIN/LOX market."<sup>482</sup>

(4) BSL

BSL is a French company that has built LIN/LOX tanks in Europe and Asia.<sup>483</sup> BSL attempted to enter the U.S. LIN/LOX tank market through the use of subcontractors. It formed an alliance with a U.S. firm, Bay Construction, but customers did not consider BSL to be sufficiently qualified due to its lack of experience and proposed use of subcontractors.<sup>484</sup> As with Chattanooga, BSL's bids were too high,<sup>485</sup> and it never won a bid. BSL has since gone out of business.<sup>486</sup>

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<sup>480</sup> Tr. at 466.

<sup>481</sup> Tr. at 2027.

<sup>482</sup> IDF 325; *see also Merger Guidelines* § 3.4.

<sup>483</sup> Tr. at 1342-43.

<sup>484</sup> Tr. at 954, 2002-03; *see also* Tr. at 1577-78.

<sup>485</sup> Tr. at 955, 1378-80; CX 608 at CBI-PL023631.

<sup>486</sup> Tr. at 955, 1351, 1380, 2001.

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(5) Conclusions on Entry in the LIN/LOX Tank Market

The competitive capabilities of the firms identified by Respondents as entrants in the LIN/LOX tank market are insufficient to replace the competition that was lost from the acquisition in a meaningful time frame. The LIN/LOX tank market is not “volatile and shifting,” as the court found in *Baker Hughes*.<sup>487</sup> Indeed, the structure of the market today is not significantly different from what it was prior to the acquisition, except that PDM is now absent. We see no evidence that AT&V, Matrix, and Chattanooga have, in the aggregate, expanded their competitive presence post-acquisition or that they now constrain CB&I in the manner it was constrained prior to its acquisition of PDM.<sup>488</sup> While AT&V may have made some limited progress as

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<sup>487</sup> 908 F.2d at 986 (citing 731 F. Supp. at 11).

<sup>488</sup> MG Industries’ experience with a LIN/LOX tank project bid after the acquisition is a good example of the dearth of competition provided by some of these firms. In April 2002, MG Industries received bids on a LIN/LOX tank project in New Johnsonville, Tennessee, from CB&I, Chattanooga, and Matrix. Tr. at 456-57. Matrix’s and Chattanooga’s bids were, respectively, 20 percent and 30 percent higher than CB&I’s bid. MG Industries did not negotiate with either Matrix or Chattanooga, because those bidders would have had to drop their prices by 20 percent and 30 percent, and MG testified that it would have been concerned that such a price drop would be detrimental to the project. Tr. at 461. MG Industries attempted to bluff CB&I into giving it a lower price, but CB&I held firm on its price and was awarded the project. Tr. at 460-61; *see* IDF 306-10. MG Industries testified that the pre-acquisition PDM had bid lowest in its last three or four LIN/LOX projects and that it was able to use PDM in negotiations to get better prices from other suppliers. However, MG Industries testified that its negotiations concerning the New Johnsonville project were limited to making

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a competitor in the few years before and after the acquisition – although even this progress may be questionable in light of AT&V’s negative performance with Air Liquide – Matrix has lost ground. Prior to the acquisition, Matrix was gaining a foothold with a few completed tanks. Since the acquisition, however, Matrix has not won any bids and, by its own admission, is not as competitive as it used to be because of the sale of its Brown Steel fabrication facility. Chattanooga was an insufficient entrant prior to the acquisition and continues to be insufficient. Consequently, Respondents have not presented any evidence of “dramatic changes in the market”<sup>489</sup> that would lead us to believe that future attempts at new entry or expansion will be any different from the past experiences recounted above. Respondents also have not demonstrated that entry into the LIN/LOX market would be sufficient to replicate the competition lost from the acquisition, nor is there evidence that firms other than AT&V, Matrix, or Chattanooga plan to enter.

We should note that it is not surprising that customers have attempted to develop suppliers to replace PDM in the LIN/LOX tank market; customers testified that they prefer to have multiple suppliers.<sup>490</sup> Even before the acquisition, the exit of Graver – the only firm that approached CB&I’s and PDM’s level of experience and reputation – led to a highly concentrated market. The acquisition further concentrated it.

However, the mere fact that a customer may try to develop an additional supplier in an attempt to enhance competition does not mean that the competition lost from an acquisition has been

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the best deal it could get from CB&I. Tr. at 462. AT&V was not invited to bid on this project because MG Industries was not aware of AT&V. Tr. at 482.

<sup>489</sup> OA at 4.

<sup>490</sup> Tr. at 347-49, 1531-32, 2030, 4618-19, 4673-75.

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replaced. Section 7 of the Clayton Act would be meaningless if a weak showing of entry sufficed to rebut a prima facie case.

Consider Air Liquide's experience with AT&V. Air Liquide testified that it contracted with AT&V because it believed that it needed to develop a new supplier in the wake of PDM's removal from the market.<sup>491</sup> Air Liquide also testified that it would have been far less likely to take the risk of contracting with AT&V had PDM still been in the market and submitted a competitive bid.<sup>492</sup> [

redacted redacted ]

Air Liquide expects that it will have cost Air Liquide \$100,000 to \$150,000 above and beyond the \$200,000 price advantage in AT&V's bid.<sup>493</sup> [

redacted

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reasons, this project is hardly an example of *sufficient* entry or of a restoration of the competition lost from the acquisition.

We also note that the decline in demand for LIN/LOX tanks may make entry/expansion of existing or bidding firms even less likely. Chattanooga testified that the demand for LIN/LOX tanks has decreased, making it less desirable for Chattanooga to enter the LIN/LOX market.<sup>495</sup> While both Matrix and Chattanooga testified that the acquisition has created an opportunity for them because customers will be looking to replace PDM,<sup>496</sup> the fact remains that neither has been able to win a bid post-acquisition.

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<sup>491</sup> Tr. at 2235-36 (*in camera*).

<sup>492</sup> Tr. at 2236 (*in camera*).

<sup>493</sup> Tr. at 2254-55 (*in camera*).

<sup>494</sup> See Tr. at 2252 (*in camera*), 5036.

<sup>495</sup> Tr. at 6380-82.

<sup>496</sup> Tr. at 2182-83, 6367-68.



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b. Post-Acquisition Bids in the LIN/LOX Tank Market

Respondents point out that AT&V has won three of four competitively bid LIN/LOX tank projects in support of their argument that entry into this market rebuts a prima facie case.<sup>497</sup> It is true that AT&V has gained a foothold in the LIN/LOX tank market by continuing the efforts to compete that it began prior to the acquisition. However, AT&V does not have nearly the reputation or capacity of CB&I.<sup>498</sup> AT&V testified that it can construct only four tanks at a time<sup>499</sup> and has turned down the opportunity to bid for LIN/LOX tanks due to capacity constraints.<sup>500</sup> In addition, as we discussed in the previous section, AT&V's competitive viability is now marred by its recent negative performance on Air Liquide's Freeport project. AT&V will not receive a favorable reference from Air Liquide, and this will have some impact on its ability to get future work.<sup>501</sup> Thus, we find that AT&V's post-merger wins do not establish that it can restore the competition lost from CB&I's acquisition of the PDM assets.

4. Actual Entry in the TVC Market

The record evidence shows no attempted entry into the TVC market by any suppliers. There is record testimony that new entry is unlikely because the market is small and because field-

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<sup>497</sup> RAB at 18.

<sup>498</sup> IDF 315-19.

<sup>499</sup> Tr. at 2376.

<sup>500</sup> Tr. at 2375.

<sup>501</sup> See Tr. at 2400. Customers are very careful to check a firm's references before awarding a LIN/LOX tank. Before Air Liquide hired AT&V, it visited BOC and inspected the tank that AT&V built for BOC. Tr. at 2239 (*in camera*).

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erected TVC tank fabrication has more exacting “design engineering,” “leak testing and cleanliness” requirements than tank fabricators encounter in other markets.<sup>502</sup> In addition, entry by a foreign supplier is unlikely, since many of these projects require security clearances and may have “Buy America” requirements as well.<sup>503</sup>

5. Conclusions on Actual Entry

Given the evidentiary record, we believe Respondents’ reliance on *Baker Hughes* is misplaced. It is certainly true that the district court in *Baker Hughes* relied on the fact that two companies had each won a contract for hydraulic rig orders in the U.S. to support its conclusion that the acquisition was unlikely to harm competition over the long term.<sup>504</sup> However, those findings were corollaries of the court’s determination that barriers to entry and expansion were low – as evidenced by one firm’s entry and expansion to become the market leader. Indeed, the court of appeals in that case highlighted this growth as the rationale for its conclusion that competitors not only could, but probably would, enter the market in response to supracompetitive pricing.<sup>505</sup>

In contrast, and as explained at length above, the relevant markets in the instant case are not prone to such activity. The LNG tank market, for instance, has been dominated by CB&I and PDM for nearly three decades. These two companies not only won the vast majority of projects but in many instances were the only bidders. Moreover, while it appears that some new suppliers have decided to compete in the LNG tank market following the

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<sup>502</sup> Tr. at 1272.

<sup>503</sup> Tr. at 1147-49.

<sup>504</sup> 731 F. Supp. at 10.

<sup>505</sup> 908 F.2d at 989.

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acquisition, we find them unable to constrain CB&I sufficiently. Similarly, in both the LIN/LOX and LPG tank markets, the firms to which Respondents point were present prior to the acquisition, and there is no evidence to suggest that these firms have increased their aggregate market presence. Thus, while other firms may enter and exit each of these markets, the evidence shows that their presence has not diminished the market dominance of the merged firm, nor have they undermined the conclusion that CB&I and PDM would have remained the only two major players in these markets absent the acquisition.

We therefore concur with the ALJ and find the markets in this case analogous to that at issue in *Tote*, where the court found, among other things, that the technical requirements associated with creating a totalisator system coupled with the customers' need for reliability would "hinder both new entrants and incumbents in their efforts to gain market share or affect prices."<sup>506</sup> In reaching this conclusion, the court rejected defendants' argument that a new entrant's submission of a number of bids and contacts with customers constituted evidence of entry.<sup>507</sup> The court did not agree that the mere submission of a bid made the new entrant a genuine competitor. Rather, the court examined the likely strength of those bids and their ability to constrain anticompetitive price increases by the incumbents.<sup>508</sup> We have employed that same approach in this case and conclude that the entry pointed to by Respondents is insufficient to constrain CB&I post-acquisition.

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<sup>506</sup> 768 F. Supp. at 1081.

<sup>507</sup> *Id.* at 1080-81.

<sup>508</sup> *Id.* at 1081-82.

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C. Potential Entry

Respondents assert that evidence of potential entry in both the LNG tank and LPG tank markets rebuts Complaint Counsel's prima facie case. They contend that the actual entrants they have pointed to "empirically demonstrat[e] that entry barriers are low."<sup>509</sup> In light of these assertedly low entry barriers, Respondents then argue that potential entrants either already constrain CB&I or can be expected to enter the market in the event of anticompetitive price increases by CB&I.<sup>510</sup> Of course, for a potential entrant or the threat of a potential entrant to act as a competitive constraint on incumbent firms, entry – at least for that firm – must be easy.<sup>511</sup> As discussed above, entry into both the LNG tank and LPG tank markets is extremely difficult and time-consuming.<sup>512</sup> We thus reject Respondents' arguments.

D. Critical Loss Analysis

Respondents also argue that the ALJ erred in disregarding their expert's conclusion (based on his critical loss analysis) that CB&I could not raise prices, and they assert that this evidence shows that the acquisition has not harmed competition.<sup>513</sup> Critical loss analysis provides a quantitative framework for testing whether a

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<sup>509</sup> RAB at 20.

<sup>510</sup> *Id.* at 19.

<sup>511</sup> *United States v. Marine Bancorporation Inc.*, 418 U.S. 602, 628 (1974) (“[E]ase of entry . . . is a central premise of the potential-competition doctrine.”); *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 581 (1967) (Procter exerted influence on the market because, *inter alia*, “barriers to entry by a firm of Procter’s size and with its advantages were not significant”).

<sup>512</sup> See discussion, *supra* at Parts III.C.1-2.

<sup>513</sup> RAB at 47-48.

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hypothesized price increase of a certain magnitude will be profitable. The first step in a critical loss analysis is to calculate the critical loss threshold, *i.e.*, the fraction of current sales that would need to be lost to render a hypothesized percentage price increase unprofitable.<sup>514</sup> To accomplish this, one must weigh the profits forgone on the sales that would be lost as a result of the price increase against the increased profits on the retained sales. The critical loss is the fraction of sales that would need to be lost to balance exactly those countervailing effects. The second step is to estimate the likely loss in sales that would result from the hypothetical price increase. If the hypothetical price increase results in a loss of sales that exceeds the critical loss, then the price increase would not be profitable and would be unlikely to occur.

Critical loss analysis is a still-evolving analytical approach that some courts have applied for delineation of markets<sup>515</sup> and for competitive effects analysis.<sup>516</sup> Although we do not doubt the soundness of the logic underlying critical loss analysis (*i.e.*, that businesses are unlikely to impose price increases that will, on balance, be unprofitable), we are mindful that recent economic literature has cautioned that the analysis has certain vulnerabilities. The literature informs us that, if misapplied, critical loss analysis (like any other tool of economic analysis) can suggest results that are contrary to real-world experiences and inconsistent with established economic principles.<sup>517</sup> To take a

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<sup>514</sup> Tr. at 7259.

<sup>515</sup> *FTC v. Tenet Health Care Corp.*, 186 F.3d 1045 (8<sup>th</sup> Cir. 1999); *FTC v. Occidental Petroleum Corp.*, 1986-1 Trade Cas. (CCH) ¶ 67,071 (D.D.C. Apr. 29, 1986).

<sup>516</sup> *FTC v. Swedish Match*, 131 F. Supp. 2d at 169.

<sup>517</sup> See generally Michael L. Katz & Carl Shapiro, *Critical Loss: Let's Tell the Whole Story*, 17 Antitrust 49 (Spring 2003); Daniel P. O'Brien & Abraham L. Wickelgren, *A Critical Analysis*

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simple example, critical loss principles hold that a firm may not have the power to increase prices profitably for products with high profit margins. This is so because price increases typically cause a loss of some sales and the profits earned from them. When the profit per unit is high, even a small loss of sales will produce a large loss in profits – so much so, that the higher profits on retained sales may not make up for the lost profits from the lost sales. In that situation, a critical loss analysis might conclude that a merged firm does not have the market power to profitably increase prices, because it will lose too many sales to its competitors (or due to consumers foregoing purchase of the product altogether). However, basic economic principles also tell us that high profit margins may be a sign of products with relatively inelastic demand (*i.e.*, products for which the quantity demanded is relatively insensitive to price, as could be the case if, for example, there are few or no substitutes). A merger between two firms that enjoy high profit margins and relatively inelastic demand may very well result in a price increase, because the merged firm may not anticipate losing any sales if it increases its price. Information on pre-merger and post-merger elasticities of demand is thus important to determine whether this condition is present. Accordingly, both critics of and adherents to critical loss analysis agree that critical loss analysis is only as good as the factual premises and the data that underlie it.<sup>518</sup> In particular, a solid evidentiary basis must support any assumptions used in the analysis and the actual loss of sales posited for a given price increase.

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*of Critical Loss Analysis*, 71 Antitrust L.J. 161 (2003). *But see* David T. Scheffman & Joseph J. Simons, *The State of Critical Loss Analysis: Let's Make Sure We Understand the Whole Story*, The Antitrust Source (Nov. 2003).

<sup>518</sup> See Katz & Shapiro, *supra*, note 517 at 52; Scheffman & Simons, *supra* note 517, at 4 n.11.

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Here, Respondents proffered a critical loss analysis by their expert, Dr. Barry Harris. Dr. Harris testified that CB&I cannot profitably impose a price increase as a result of its acquisition of PDM, because post-acquisition CB&I has already lost actual sales far in excess of the level that would have been consistent with a profitable price increase.<sup>519</sup> He further stated that new entrants and fringe suppliers have simply been able to defeat CB&I post-acquisition.<sup>520</sup> We have carefully considered Dr. Harris's analysis, but in the end, we are not convinced that he has reached the correct conclusion for this case – especially because that conclusion is at odds with the competitive effects that established economic principles conclude likely follow from the extraordinarily high concentration levels that we discussed in Part III.A, *supra*, the state of pre-acquisition competition that we discussed in Part III.B, *supra*, and the nearly insurmountable entry barriers that we found to predominate in Part III.C, *supra*.

Besides finding that his analysis is outweighed by the contrary evidence in this case, we conclude for several other reasons that we must reject Dr. Harris's analysis. First, it appears from the record that Dr. Harris did not perform a critical loss analysis for each distinct relevant market.<sup>521</sup> Instead, he combined the post-merger sales for all four relevant markets and concluded generally CB&I has lost “in excess of half” of the bids<sup>522</sup> and roughly 82 to 83 percent of the dollars available from the post-merger

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<sup>519</sup> Tr. at 7263, 7265-66.

<sup>520</sup> Tr. at 7345-46 (Dr. Harris noting that, in contrast to Dr. Simpson, he believes that the entrants have been successful competitors).

<sup>521</sup> In addition to this general analysis, Dr. Harris performed a separate critical loss analysis for the LNG tank market, which we discuss below.

<sup>522</sup> Tr. at 7356.

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projects.<sup>523</sup> Even if one assumes, *arguendo*, the validity of Dr. Harris's underlying factual assumptions – several of which we discuss below – this approach is not informative of CB&I's ability to raise prices in any particular relevant market and thus does not convince us that CB&I cannot raise prices in the relevant markets. Although the four relevant markets share some characteristics, each is distinct. For example, none of the markets has the same mix of new entrants or fringe competitors, and the strength of these new entrants or expanded fringe firms in *each* of the relevant markets is a crucial consideration in the assessment of CB&I's ability to raise price. In addition, grouping the sales of multiple relevant product markets together can skew results. For example, AT&V's three post-merger wins in the LIN/LOX tank market in large part form the basis for Dr. Harris's conclusion that CB&I has lost in excess of half the bids in all four relevant markets.<sup>524</sup> Dr. Harris did not explain why it was appropriate to group all four relevant product markets together in his critical loss analysis, and his testimony did not shed light on how (or whether) he might have accounted for market differences. Nor can we, on our own, discern any compelling reason to treat the four separate markets as a single market. Accordingly, we do not find his critical loss analysis helpful in assessing CB&I's ability to sustain price increases in any relevant market.

We have other concerns about Dr. Harris's analysis. For example, he included CB&I's sole-source contract with CMS, but excluded CB&I's sole-source contract with El Paso and CB&I's

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<sup>523</sup> Tr. at 7357. Dr. Harris did not have the aid of a calculator in testifying and thus qualified these figures as being approximate.

<sup>524</sup> RX 951. (RX 951 was admitted into evidence for demonstrative purposes only. However, we reviewed it because it forms the basis for Dr. Harris's general discussion about CB&I's post-acquisition losses.)



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three sole-source contracts with BP.<sup>525</sup> The omission of the El Paso and BP contracts significantly changes CB&I's post-merger win-to-loss ratio,<sup>526</sup> and, as discussed below, Dr. Harris included three projects that we believe should not have been counted. We also question Dr. Harris's assumption that both the Dynegy and Trinidad projects represented instances of CB&I's losing a bid to new entrants in the LNG tank market. These concerns lead us to reject his analysis in this case.

Indeed, we find that the record does not support Dr. Harris's inclusion of at least three of the projects included in his analysis, because they either did not involve a relevant product or occurred before the acquisition. For example, Dr. Harris included a TVC award to XL/Votaw. Although he noted that this project was small – approximately the size of a shop-built tank – he testified that he included it because it was field-erected.<sup>527</sup> However, no evidence suggests – and indeed, Respondents do not even assert – that Votaw is a competitor in the large, field-erected TVC market. We thus conclude that this award should not have been included in Dr. Harris's calculations. Similarly, without sufficient explanation for doing so, Dr. Harris included BOC's Midland, North Carolina, project, which was solicited in late 2000<sup>528</sup> and awarded prior to the acquisition.<sup>529</sup> Given the timing of this

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<sup>525</sup> *Id.*

<sup>526</sup> Dr. Harris concluded that CB&I won 4 out of 10 projects post-merger. Even if we assume that Dr. Harris is correct and that CB&I has won only 40 percent of the post-merger bids, inclusion of these other 4 bids would have increased CB&I's win-to-loss ratio to 8 out of 14, or roughly 60 percent.

<sup>527</sup> Tr. at 7355-56.

<sup>528</sup> Tr. at 4599.

<sup>529</sup> See RX 951 (project awarded Feb. 1, 2001); *see also* RX 208.

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project, we think it was inappropriate to consider it without some explanation of its relevance. Finally, we question Dr. Harris's decision to include CB&I's Praxair win. Scorsone, the President of CB&I's Industrial Division, testified that this project was not bid competitively, because CB&I – as a result of its acquisition of the PDM assets – “inherited the responsibilities” from PDM to construct Praxair's LIN/LOX/LAR tanks at a 4 percent margin.<sup>530</sup>

We now turn to Dr. Harris's examination of the LNG tank market. As with his more general analysis, he found that CB&I lost more sales post-acquisition than would have been profitable from a price increase.<sup>531</sup> This conclusion is premised on an assumption that CB&I's not winning the Dynegy and Trinidad bids shows that it cannot profitably impose a 5 percent price increase in the LNG tank market. We find this assumption unsupported by the evidence.

We conclude that the Dynegy project is not illustrative of the alleged new entrants' ability to constrain CB&I effectively. As we discussed earlier, time and again, CB&I refused to bid for the tanks on this project and repeatedly insisted that Dynegy contract with it on a turnkey basis. Only after the bidding process was nearly complete did CB&I approach Dynegy to submit a bid. We find that Dynegy's refusal to accept CB&I's bid at such a late stage does not represent the result of a competition on the merits, and this outcome therefore tells us little about whether an

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<sup>530</sup> Tr. at 5019-20. Although the history of the CB&I/Praxair agreement is not corroborated by other evidence, we mention it out of an abundance of caution – the exclusion of this project would benefit Dr. Harris's calculation, because it would reduce the number of CB&I's post-merger wins.

<sup>531</sup> Tr. at 7263.

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attempted exercise of market power by CB&I would lead to a loss of sales that exceeded a critical loss threshold.<sup>532</sup>

Dr. Harris similarly included the Trinidad project in his analysis because he found “a lot of similarities between Trinidad and the United States.”<sup>533</sup> In addition to Trinidad’s close geographic proximity to the United States, Dr. Harris emphasized that LNG tanks in Trinidad are built to standards similar to those in effect in the U.S. and that CB&I, which had built the previous tank at the site, had “some local advantages.”<sup>534</sup> However, as we have already stated, the Trinidad project provides little or no relevant information with which to assess LNG sales in the United States. Trinidad has no domestic incumbent LNG tank providers, and therefore all LNG tank suppliers stand on more equal footing. Despite Dr. Harris’s assertion that CB&I has local advantages, the evidence shows that CB&I is not an incumbent firm in the same sense that it is in United States market, where it has participated for decades. Thus, we are not convinced by his rationale for including this project, and we conclude that this outcome does not

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<sup>532</sup> Moreover, even if we accepted Dr. Harris’s assumption that CB&I lost the Dynegy project, we could not conclude (based on the evidence) that CB&I could not raise prices post-merger. Like any other supplier, CB&I’s pricing is constrained at some level. However, the mere fact that buyers switch awards to new entrants at some point tells us nothing about the effectiveness of the new entrants’ ability to constrain CB&I’s prices to pre-acquisition levels. This concept, commonly referred to as the “Cellophane Fallacy,” derives from criticism of the approach taken by the Supreme Court in *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956). See, e.g., Steven C. Salop, *The First Principles Approach to Antitrust, Kodak, and Antitrust at the Millennium*, 68 *Antitrust L.J.* 187, 197 (2000).

<sup>533</sup> Tr. at 7268.

<sup>534</sup> *Id.*

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shed light on whether a price increase in the United States market would lead to a loss of sales that exceeds a critical loss threshold.

Because Respondents sponsored Dr. Harris's testimony, it was, of course, up to Respondents and Dr. Harris to show that his conclusions were sound and well supported.<sup>535</sup> Based on the problems that we have identified, we find that Respondents have not carried this burden and that the ALJ correctly disregarded the analysis.

E. Customer Sophistication

There is some support for Respondents' point that sophisticated customers with bargaining power can ameliorate the anticompetitive effects of a merger.<sup>536</sup> However, many of the cases in which courts have accepted buyer power or customer sophistication arguments have also found easy entry and expansion and have relied on both facts to determine that the prima facie case has been rebutted.<sup>537</sup> At a basic level, customers must have alternative suppliers in order to have any real bargaining power. Despite the instant case's similarities to *Baker Hughes* – e.g., customers in all four relevant markets have

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<sup>535</sup> Rules of Practice for Adjudicative Hearings, 16 C.F.R. § 3.43(a).

<sup>536</sup> See RAB at 30 (“[T]he sophistication and bargaining power of buyers play a significant role in assessing the effects of [an acquisition].”) (brackets in original) (citations omitted). See *Baker Hughes*, 908 F.2d at 986-87.

<sup>537</sup> See, e.g., *Advo Inc. v. Philadelphia Newspapers*, 854 F. Supp. 367, 375 (E.D. Pa. 1999) (noting the ability of customers to bring in other suppliers); *R.R. Donnelley & Sons Co.*, 120 F.T.C. 36, 191-92 (1995) (finding that buyers in the relevant market “use procurement designed to ensure negotiating leverage” and have the ability to “solicit and obtain *multiple* bids”) (emphasis added).

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elaborate bidding procedures and engage in competitive bidding – there is one determinative difference: the buyers in this case have no real alternatives to the monopolist. As we have discussed at length, the alternatives to CB&I are weak at best in the LNG, LPG, and LIN/LOX tank markets and non-existent in the TVC market. For example, the new entrants in the LNG tank market do not have a long-term presence or experience in the market and thus cannot effectively compete with CB&I – a fact that CB&I itself recognizes in its dealings with customers. The new entrants’ inexperience also appears to have played a central role in CB&I’s success in securing some of its post-acquisition sole-source contracts. Similarly, although there are more alternative suppliers in the LPG and LIN/LOX tank markets, they still face a variety of obstacles, including capacity constraints, lack of experience, and poor performance records.<sup>538</sup> Indeed, many of the alternative suppliers in these two markets competed at least to some degree with CB&I prior to the acquisition, and there is no indication that they have collectively increased their presence after the acquisition. We conclude from this evidence that the competition to which Respondents refer does not provide a viable alternative to CB&I in the relevant markets and does not provide customers with any real ability to thwart price increases post-merger.

In addition, some evidence suggests that customers in the LNG, LPG, and LIN/LOX tank markets may suffer from inadequate information on pricing and thus may be unable to constrain CB&I from increasing prices post-acquisition.<sup>539</sup> Any particular

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<sup>538</sup> See, e.g., Tr. at 1588, 1609, 2021-22, 2155, 2252 (*in camera*), 2365-66, 2379-80; JX 27 at 72-73. Respondents point to AT&V, Matrix, Wyatt, Chattanooga, and Pasadena Tank as alternatives to CB&I for the construction of LPG tanks. As we discussed above, however, these suppliers face a variety of difficulties.

<sup>539</sup> The Supreme Court has recognized that a lack of information can impede a buyer’s ability to exert its bargaining

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customer in each of these markets purchases a tank infrequently<sup>540</sup> and therefore is unlikely to have the necessary information on hand to know whether it has been subjected to a price increase. For example, CMS testified that in order to evaluate CB&I's price for its Lake Charles expansion, it looked at the FERC filing for Cove Point's expansion, because that was the only place CMS could find costs.<sup>541</sup> CMS further testified that because the projects are not identical, the comparison was difficult to make.<sup>542</sup> Similarly, El Paso testified that it is "operating a little bit in the dark in terms of knowing . . . the costs . . . for LNG tank suppliers."<sup>543</sup> There is also no evidence that customers in these various markets share information about the cost of their purchases with other potential customers.

On the other hand, other evidence indicates that at least some tank customers may have access to information they would need to adequately assess whether CB&I has raised prices. For example, in the LNG tank market CMS employed a consultant to help it evaluate CB&I's price, and the consultant provided a rough

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power by switching (or threatening to switch) to an alternative supplier. *See, e.g., Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992). In *Kodak*, the Court found that a lack of information regarding the cost of service and parts of Kodak's equipment explained why an increase in those costs did not affect Kodak's market share in the original sale of equipment. *Id.* at 473. While the facts of this case, of course, are not analogous to those of *Kodak*, we believe the broader point – that lack of the necessary information may impede a buyer's ability or incentive to switch to alternative suppliers – is relevant to our inquiry.

<sup>540</sup> IDF 204, 210-11, 233-34, 269, 292-93.

<sup>541</sup> Tr. at 6290 (*in camera*).

<sup>542</sup> *Id.*

<sup>543</sup> Tr. at 6238; IDF 207.

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benchmark for what level of pricing to expect.<sup>544</sup> In addition, there may be better price information in the LIN/LOX and LPG tank markets because customers have traditionally purchased these types of tanks more frequently. ITC, an LPG tank customer, testified that it regularly evaluates confidential bids from multiple tank suppliers.<sup>545</sup> Similarly, MG Industries, a LIN/LOX tank customer, testified that it purchased 14 tanks in the 1990s<sup>546</sup> and decreased its costs prior to the merger by informing vendors that their prices were too high.<sup>547</sup>

However, even if customers had access to the pricing information for multiple projects, such information would not necessarily assist them in detecting a price increase. In seeking to rebut Complaint Counsel's proof of anticompetitive effects, Respondents elicited a large volume of testimony to demonstrate that it is difficult, if not impossible, to compare prices of various tanks because the specifications vary so widely from project to project. This conclusion appears sound, yet it leads to the related conclusion – not helpful to Respondents' argument – that it would be difficult, if not impossible, for customers to look at these projects and determine whether the prices they pay after the acquisition exceed what they would have paid but for the acquisition.

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<sup>544</sup> Tr. at 6290-91 (*in camera*); *see also* Tr. at 6239 (consultants “can provide a rough benchmark” and inform customers, “based on their experience, [that] a tank should cost [a certain amount] per cubic meter of storage”).

<sup>545</sup> Tr. at 7082-83.

<sup>546</sup> Tr. at 478.

<sup>547</sup> Tr. at 350; IDF 354.

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Therefore, we conclude that Respondents have not carried their burden to produce evidence of customer sophistication sufficient to rebut Complaint Counsel's prima facie case.

V. Competitive Effects of the Acquisition and Conclusions

Based on the totality of the evidence, we find that Complaint Counsel established that CB&I's acquisition of PDM is likely to lessen competition substantially throughout the United States in each of the four relevant product markets. Complaint Counsel presented a strong prima facie case through both extraordinarily high levels of concentration and other evidence of Respondents' dominance in sales over the last decade. The evidence shows that CB&I purchased its closest competitor in the LNG tank, LPG tank, LIN/LOX tank, and TVC markets. Complaint Counsel's case was enhanced by proof that entry in each of the relevant markets is difficult and that new entry or expansion by existing firms cannot replicate the competition lost as a result of the acquisition.

Respondents' evidence of entry into the LNG tank market and expansion of smaller incumbents in the LPG and LIN/LOX tank markets establishes neither that entry or expansion into these markets is easy nor that it has actually occurred at a level that will meaningfully constrain CB&I post-acquisition. Although some companies have shown interest in these markets, we find that this mere interest and intention to compete does not make them competitors sufficient to replace the competition lost from CB&I's acquisition of PDM. In addition, we are not persuaded by Respondents' critical loss argument or by their argument that sophisticated customers will be able to thwart a price increase by CB&I. This is especially true here because there are no alternative suppliers to which customers can turn in the face of supracompetitive pricing by CB&I. In accord with Complaint Counsel's economic expert, we find that customers in these markets will likely be harmed post-acquisition, because CB&I can significantly increase price or reduce quality before other suppliers



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can begin to constrain it.<sup>548</sup> For these reasons, we conclude that Respondents have not rebutted Complaint Counsel's prima facie case.

#### VI. Anticompetitive Price Increases

Based on our analysis in Parts III-V, *supra*, we have concluded that the acquisition violates Section 7 of the Clayton Act and Section 5 of the Federal Trade Commission Act.<sup>549</sup> We need not consider Complaint Counsel's cross-appeal to the extent that they argue that the ALJ erred in declining to find that the acquisition resulted in actual anticompetitive effects. Because Respondents have not rebutted Complaint Counsel's prima facie case, Complaint Counsel are not required to come forward with additional evidence to show actual anticompetitive effects. As several courts have observed, "Congress used the words 'may be substantially to lessen competition' . . . to indicate that its concern

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<sup>548</sup> See Tr. at 3072-73. For example, Matrix testified that it is at a competitive disadvantage in the LIN/LOX market due to the sale of its Brown Steel subsidiary and that its costs are now higher. Tr. at 1590. The same Matrix witness testified later that the acquisition created some potential opportunities for the company in some limited circumstances. Tr. at 2182. One way to interpret this later statement is that it is consistent with an anticompetitive effect: if a higher-cost firm begins to see more market opportunities, the acquisition may have raised price levels in the market.

<sup>549</sup> See *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158, 171 (1964) (a Section 7 violation is established when a reasonable likelihood of a substantial lessening of competition is shown); *United States v. SunGard Data Sys.*, 172 F. Supp. 2d 172, 180 (D.D.C. 2001) (same).

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was with probabilities, not certainties.”<sup>550</sup> Nonetheless, Complaint Counsel argue that CB&I has engaged in several instances of actual anticompetitive conduct since the acquisition and that these instances provide the Commission another reason for finding liability under the antitrust laws.<sup>551</sup> In light of our holdings above, we decline to address these arguments.

VII. Exiting Assets

Respondents’ final argument is that absent the acquisition, PDM’s Erected Construction Division would have ceased operating in the relevant markets and that CB&I’s acquisition of these assets therefore had no impact on competition.<sup>552</sup> First, we want to be clear that Respondents are not arguing that PDM’s EC Division met the requirements of the failing firm defense recognized under the *Merger Guidelines*.<sup>553</sup> Rather, they rely on the so-called “exiting assets” defense outlined in a 1986 law review article, which suggests that where a company has made exhaustive efforts to sell assets that would actually have exited the relevant market absent the acquisition, such facts might justify an otherwise anticompetitive acquisition.<sup>554</sup> The Commission, however, has not yet sustained this defense in any of the cases that

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<sup>550</sup> *SunGard*, 172 F. Supp. 2d at 180 (citations omitted); see also *Heinz*, 246 F.3d at 708 (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962)).

<sup>551</sup> See CCACAB at 51-60 (alleging actual post-merger price increases for several LNG, LIN/LOX and TVC projects).

<sup>552</sup> RAB at 58-61.

<sup>553</sup> OA at 30.

<sup>554</sup> John E. Kwoka, Jr. & Frederick R. Warren-Boulton, *Efficiencies, Failing Firms, and Alternatives to Merger: A Policy Synthesis*, 31 Antitrust Bull. 431 (1986).

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have raised this issue,<sup>555</sup> and this case is no different. We agree with the ALJ that Respondents did not present persuasive evidence that PDM had made the decision to close the business in the near future,<sup>556</sup> nor did Respondents show that PDM conducted an exhaustive search for alternative buyers.<sup>557</sup> Instead, PDM chose to sell its assets to its closest competitor, thereby creating a firm with unmatched market dominance. Even were we to accept the exiting assets defense in theory, we agree with the ALJ that Respondents have not established the defense on these facts.

VIII. Remedy

After concluding that Complaint Counsel had presented sufficient evidence to prove that the acquisition violated Section 5 of the FTC Act and Section 7 of the Clayton Act, the ALJ fashioned a remedy to address the law violation he found. In relevant part, his Order directed CB&I to divest: (1) all the assets (including PDM's Water Division) that it acquired from PDM along with any additional assets that it has acquired to replace or maintain the acquired PDM assets; (2) all intellectual property and rights to such property, including the PDM name, that it acquired from PDM; (3) all contracts that it acquired from PDM, to the extent they have not been fully performed; and (4) "if possible," a sufficient revenue base to assure the divested assets can actively compete in the LNG market.

In their appeal, Respondents object that the ALJ's Order may actually harm competition by reducing the number of competitors

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<sup>555</sup> See *Olin Corp.*, 113 F.T.C. at 618 (finding that management of the acquired company had not conducted an exhaustive search).

<sup>556</sup> ID at 116-17; IDF 504-14.

<sup>557</sup> Tr. at 2931; ID at 116-18; IDF 517-20, 524.

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who are able to bid on large projects.<sup>558</sup> They also argue that the divestiture will result in two “higher cost companies” instead of one low cost company and accordingly that Complaint Counsel failed to show the efficacy of divestiture as a remedy in this case.<sup>559</sup> Respondents also object to the divestiture of PDM’s Water Division assets, arguing that there is no evidence to show that another firm could not “compete in the relevant markets without the Water Division assets.”<sup>560</sup>

Complaint Counsel in a cross-appeal argue that aspects of the ALJ’s Order are vague and ambiguous and that it does not go far enough. Specifically, Complaint Counsel assert that, in addition to divesting all the assets identified by the ALJ, Respondents must also assign to the prospective buyer a percentage share of all work in progress so that the firm can be assured of becoming a viable competitor in the relevant markets. In addition, Complaint Counsel argue that Respondents must be compelled to take affirmative steps to ensure that a sufficient number of experienced employees are transferred to the buyer and to provide the buyer with necessary technical and administrative assistance for a period of time. Finally, Complaint Counsel argue in favor of the appointment of a monitor trustee who will oversee the divestiture process. In response, Respondents assert that they have had insufficient notice of all the relief demanded by Complaint Counsel and that they have not had a fair opportunity to respond to the final order proposed by Complaint Counsel.

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<sup>558</sup> RAB at 52.

<sup>559</sup> RAB at 55-56.

<sup>560</sup> RAB at 57. Respondents’ appeal brief actually states: “Nor is there evidence that a party purchasing the EC Division could compete in the relevant product markets without Water Division assets.” We assume, however, that Respondents meant to say that there is no evidence that a purchaser could *not* compete without the Water Division assets.

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This Part of our opinion is divided into two sections. In the first section, we discuss the remedy that we have fashioned to address the law violation and ensure that meaningful and effective competition is restored to the market. In the process of expounding on our Order provisions and our rationale for adopting them, we address all the arguments raised by Complaint Counsel and most of the arguments raised by Respondents. In the second section, we examine any remaining arguments, to the extent they are not addressed in the first section.

A. Standard and Explanation of Remedy

CB&I's acquisition of PDM's Erected Construction and Water Divisions resulted in a monopoly or a near-monopoly in all four relevant markets, and violated both Section 7 of the Clayton Act and Section 5 of the FTC Act. We thus must determine how most effectively to "pry open to competition [the] market[s] that [have] been closed by defendants' illegal restraints."<sup>561</sup> Based on our review of the record, we agree with the Initial Decision's determination that divestiture is the most appropriate remedy to effectuate this outcome. The Clayton Act itself contemplates that, upon our finding that Section 7 of the Act has been violated, we order Respondents to divest themselves of "the stock, or other share capital, or assets held" in violation of that section.<sup>562</sup> Much of the case law has echoed this sentiment and found divestiture the most appropriate means for restoring competition lost as a consequence of a merger or acquisition. In the *du Pont* case, the Supreme Court stated that "[t]he very words of §7 suggest that an undoing of the acquisition is a natural remedy"<sup>563</sup> and that divestiture "should always be in the forefront of a court's mind

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<sup>561</sup> *Du Pont*, 366 U.S. at 323.

<sup>562</sup> 15 U.S.C. § 12(b).

<sup>563</sup> *Du Pont*, 366 U.S. at 329.

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when a violation of § 7 has been found.”<sup>564</sup> Similarly, the Court stated in *Ford Motor* that “[c]omplete divestiture is particularly appropriate where asset or stock acquisitions violate the antitrust laws.”<sup>565</sup> In this case, the evidence shows that in four separate markets, CB&I acquired its closest competitor and thus obtained monopoly or near-monopoly power, entry is extremely difficult, and no new entry or fringe expansion has been able to challenge CB&I effectively. Given these facts, we find it highly unlikely that the relevant markets will return to their pre-acquisition state absent divestiture. In addition, as we will discuss in this portion of our Opinion, we find that a number of ancillary provisions are crucial to establishing a viable entrant to replace the competition lost from CB&I’s acquisition of PDM.<sup>566</sup>

We order CB&I to reorganize its Industrial Division (and, to the extent necessary, its water tank unit) into two separate, stand-alone divisions (New PDM and New CB&I) and to divest New PDM within six months after our Order becomes final. We have taken this approach to give CB&I, which is best positioned to know how to create two viable entities from its current business, the opportunity to do so. We also believe this approach will remedy the anticompetitive effects of the merger more quickly than would immediately appointing a divestiture trustee, who would have to learn the business before recommending a divestiture package. While we recognize that this approach places the burden of unscrambling the merger on CB&I’s shoulders, we find this burden justified. CB&I proceeded with its acquisition of PDM with the knowledge that the Commission was still

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<sup>564</sup> *Id.* at 331.

<sup>565</sup> *Ford Motor Co. v. United States*, 405 U.S. 562, 573 (1972).

<sup>566</sup> Section 11(b) of the Clayton Act and pertinent case law afford the Commission broad remedial powers. 15 U.S.C. § 21(b) (granting the Commission the power to order divestiture “in the manner and within the time fixed by said order”).

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investigating the transaction. Because Respondents have created – at least to an extent – any problems associated with unwinding the transaction (and restoring competition), equity necessitates that they help solve them.

In addition, because common sense tells us that Respondents' self-interests will be best served by creating less rather than more competition from the divested assets, we have also included two provisions to ensure that CB&I creates a viable business and divests it to an appropriate buyer within a reasonable time frame. First, if CB&I has not divested New PDM under the requirements of our Order within 180 days of the Order's becoming final, we reserve the right to appoint a divestiture trustee<sup>567</sup> to divest either New PDM or New CB&I. This provision should ensure that CB&I has an incentive to assemble a package of assets that will be sufficient to create a viable competitor and readily attract an acceptable buyer. It also provides CB&I with the incentive to maintain the strength and viability of the to-be-divested assets. Second, we have appointed a monitor trustee. Experience has shown not only that a seller has the incentive to create a weak competitor with its divestiture package, but also that buyers may lack the necessary information to assess properly the asset package. A monitor trustee will ensure that a good mix of assets is made available to the acquirer and that the acquirer receives what it needs to maintain a viable business. A monitor trustee also will make certain that the divestiture proceeds smoothly by providing a conduit between the acquirer and Respondents and promptly notifying the Commission of any problems.

In addition to the general requirement that CB&I create two viable, stand-alone businesses, the Order contains a number of

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<sup>567</sup> Our Final Order specifies that the monitor trustee, who will oversee the divestiture requirements of our that Order, may be the same person as the divestiture trustee (whom we may appoint if Respondents fail to divest the required assets in accordance with the Order). Final Order ¶ V.C.

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specific provisions that warrant discussion. We begin this discussion by noting that the Supreme Court has recognized that “[t]he relief which can be afforded” from an illegal acquisition “is not limited to the restoration of the status quo ante.”<sup>568</sup> “There is no power to turn back the clock. Rather, the relief must be directed to that which is ‘necessary and appropriate in the public interest to *eliminate the effects* of the acquisition offensive to the statute.’”<sup>569</sup> With this standard in mind, we explain the ancillary relief we have ordered in this matter.

We have included in the assets to be divested not only those assets necessary to build the four relevant products but also those necessary to build water tank products, similar to those tanks historically built by PDM’s Water Division. Respondents argue that such additional relief is inappropriate, because it does nothing to restore the competition in the relevant markets.<sup>570</sup> They also argue that there is no evidence that a purchaser needs other tank assets to compete in the relevant markets.<sup>571</sup> Complaint Counsel, on the other hand, point to the irregular timing of sales in the relevant markets and the facts that PDM’s EC and Water Divisions were inter-related before the acquisition and were sold together as a going concern. They assert that given these facts, PDM’s Water Division assets are necessary to ensure the viability of a newly-created entrant.<sup>572</sup>

We think that Complaint Counsel have the stronger argument but acknowledge that it is impossible to know whether a new entrant must have the assets similar to those of PDM’s Water

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<sup>568</sup> *Ford Motor Co.*, 405 U.S. at 573 n.8.

<sup>569</sup> *Id.* (emphasis in original) (citations omitted).

<sup>570</sup> RAB at 56-57.

<sup>571</sup> *Id.* See *supra* note 560.

<sup>572</sup> CCACAB at 78.



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Division in order to compete in the relevant markets. However, there is no evidence to suggest that a smaller set of assets than those illegally acquired by CB&I will suffice to restore competition, and what we know with certainty is that this combination of assets has made a saleable package in the past. Thus, we follow the Supreme Court's guidance in *du Pont* and resolve this dispute in favor of including broader rather than narrower relief. The Court in *du Pont* stated that "it is well settled that once the Government has successfully borne the considerable burden of establishing a violation of law, all doubts as to the remedy are to be resolved in its favor."<sup>573</sup> We find this rule especially compelling where – as here – Complaint Counsel have established such a strong prima facie showing, including the fact that entry is extremely difficult in each of the relevant markets. Moreover, to ensure that narrower relief is available if it is warranted by market conditions, we have included a provision that allows the exclusion of the water tank assets if the acquirer and monitor trustee both find them unnecessary and agree to exclude them.

The Order also requires CB&I to divide its customer contracts between its newly-created subsidiaries (New CB&I and New PDM) as successors to CB&I. While this may seem a drastic step at first blush, we find it a necessary one under the circumstances of this case. As we discussed in Part III.C, *supra*, a supplier must gain experience and a good reputation from past jobs to compete effectively in each of the relevant markets. This task is difficult not only because of technical requirements, customer preferences, and the need to match the long-honed experience and reputation of the incumbent firm, CB&I, but also because the irregular timing of the sales in these markets. Without a division of customer contracts, a purchaser would have virtually no on-going business on which to build a reputation and would have no way of knowing when – or if – it might make a sale.

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<sup>573</sup> *Du Pont*, 366 U.S. at 330.

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The Supreme Court has recognized the importance of a customer base. In response to a vertical merger by which Ford Motor Company acquired a spark-plug manufacturer with a 15 percent market share, the Court upheld ancillary relief designed to provide the divested entity “an assured customer while it struggles to be re-established as an effective, independent competitor.”<sup>574</sup> We find that approach equally valid where CB&I, through its illegal acquisition of PDM, has gained monopoly or near-monopoly power in markets characterized by extremely difficult and time-consuming entry. We thus conclude that a division of contracts is necessary to ensure that the purchaser will be able to gain the requisite experience in these markets and restore the vibrant competition lost from the acquisition. Moreover, to the extent that CB&I is unable to transfer or assign customer contracts, the Order requires CB&I – the party best-situated to deal with these issues – to “enter into such agreements, contracts, or licenses as are necessary to realize the same effect as such assignment or transfer.”<sup>575</sup>

We have also required CB&I to facilitate the transfer of employees so that New PDM and New CB&I each have the technical expertise to complete the customer contracts assigned to them and to bid on and complete new customer contracts. The evidence overwhelmingly demonstrates that experience is the lynchpin to success in any of the relevant markets, which logically means that the transfer of employees is crucial to this divestiture’s success. To effectuate this transfer and to ensure the employees are fairly allocated, our Order further requires CB&I to: (1) provide the acquirer with information about its employees, (2) remove contractual impediments that could prevent employees

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<sup>574</sup> *Ford Motor Co.*, 405 U.S. at 576-577.

<sup>575</sup> Final Order ¶ III.B.

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from accepting employment with the acquirer,<sup>576</sup> (3) provide certain financial incentives to employees who accept offers of employment from the acquirer, and (4) refrain from inducing employees hired by the acquirer to terminate their employment with the acquirer.

Finally, we turn to issues concerning the provision of technical assistance and administrative services. Complaint Counsel object to the ALJ's failure to order technical assistance and administrative services. Like the ALJ, we recognize that such requirements raise the possibility of coordination in markets with few major participants. As we have noted throughout this Opinion, the relevant products all require a great deal of technical competence and knowledge to produce – some of which is proprietary information known only to CB&I. We anticipate, however, that the transfer of employees will likely provide the

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<sup>576</sup> Such impediments can include, but are not limited to, “any non-compete or confidentiality provisions of employment or other contracts with CB&I that would affect the ability of the Relevant Business Employee to be employed by the Acquirer.” Final Order ¶ IV.D.2.(ii). Respondents argue that this provision “encourages the exchange of confidential business information between competitors and denies CB&I confidentiality regarding issues unrelated to the relevant products.” RRCARB at 56. Respondents’ first argument in fact supports the need for a monitor trustee, who can ensure that any problems related to an information exchange are resolved without violating the law. With regard to Respondents’ second point, we note that the purpose of the provision is to ensure that current CB&I employees are not prevented from working for the acquirer by a breach of contract suit (or the threat of it). The provision is thus qualified as requiring a waiver only as to contractual provisions that “would affect the ability” of the transferred employee “to be employed by the [a]cquirer.” Final Order ¶ IV.D.2.(ii). This qualifier should protect CB&I’s interest with respect to those products not involved in the divestiture.

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technical competence and knowledge needed for the acquirer to produce the relevant products without the technical assistance of CB&I. Because technical knowledge typically resides with the people who implement it, we believe that the acquiring firm's need for technical assistance and administrative services may be inversely proportional to the quantity and quality of experienced personnel who transfer from CB&I to the acquiring firm.

Of course, apart from directing CB&I to provide incentives and remove obstacles to facilitate employee transfers, we cannot control the degree to which the transfers occur. We are also unable to predict at this point in the divestiture process whether a critical mass of employees will make the transfer to adequately provide the necessary knowledge and technical competence to the acquirer (and obviate any need for the acquiring entity to seek either assistance or services from CB&I).<sup>577</sup> Given these uncertainties, we conclude, as we did with respect to the divestiture of PDM's Water Division assets, that the monitor trustee must determine whether, and if so to what extent, these services may be necessary to restore the competition lost through the acquisition. We believe this issue needs to be finally resolved in the context of our review of a specific divestiture package for prior approval.

Accordingly, we direct the monitor trustee to include in the final report to the Commission concerning the sale of the divested assets, a recommendation regarding the need for such services

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<sup>577</sup> We also note that even with transfer of experienced personnel, there remains the possibility that technical assistance may be required. As we have stated, constructing the relevant products is extremely difficult and draws on the knowledge and experience of a variety of CB&I employees. Therefore, it is possible that transferred employees, while experienced and able to construct these products in a general sense, may have gaps in their knowledge that would necessitate assistance (at least in the short term).

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and, if he or she believes there is such a need, a recommendation with respect to the provision, manner, and duration of these services.<sup>578</sup> We will consider this recommendation along with the acquiring firm's need for such assistance when we exercise our right of prior approval of the final divestiture package. If we determine that the provision of such services is a necessary part of the divestiture package, we will allow CB&I to recover its costs from any assistance it provides, which should ensure that the acquirer seeks CB&I's help only to the extent necessary. While we prefer a complete disentanglement between CB&I and the acquiring firm, we recognize that some level of assistance may be necessary to enable the acquiring firm to compete successfully.

Even though we did not accept Complaint Counsel's Proposed Order in its entirety, a number of our Order's provisions raise issues similar to those that Respondents raised in opposition to Complaint Counsel's proposals. Specifically, Respondents objected to the requirements that: (1) CB&I transfer employees to the divested entity,<sup>579</sup> (2) CB&I assign customer contracts other than those formerly held by PDM,<sup>580</sup> (3) CB&I waive contractual impediments to its employees' working for the acquirer,<sup>581</sup> and (4) CB&I provide transitional assistance.<sup>582</sup> Respondents argue that

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<sup>578</sup> We require the monitor trustee's assessment because we recognize that an information imbalance may exist between CB&I and the acquiring firm, which may not be in the best position to assess fully all of its needs before acquiring the divested assets. Given the monitor trustee's neutral role in the process, we anticipate that he or she will have access to information that the acquiring firm may not be able to get.

<sup>579</sup> RRCARB at 50-52.

<sup>580</sup> *Id.* at 52-56.

<sup>581</sup> *Id.* at 56.

<sup>582</sup> *Id.* at 57.

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the evidence does not establish that any of these requirements are necessary for an effective divestiture and that these requirements may, in fact, harm competition.<sup>583</sup> However, as we have just discussed, we find that the evidence provides clear support for these requirements.

In sum, we find that the additional water tank assets, allocation of customer contracts, and transfer of employees are necessary to ensure that the divested entity can compete effectively in the relevant markets. Depending on the details of the divestiture package, we also find it possible that the provision of technical assistance and administrative services may be needed for the divestiture to be effective. The record is replete with evidence that these markets are very difficult to enter and that a new entrant must have experience and a solid reputation. With these provisions, both New PDM and New CB&I will have on-going projects upon which to build a reputation as well as knowledgeable and skilled employees to do the work. Therefore, the Order should thus insert a competitive acquirer into the market and help replicate the competition lost from the acquisition.

B. Respondents' Other Arguments

Respondents make three additional arguments in opposition to divestiture and ancillary relief. First, they assert that a divestiture would harm competition by reducing “the number of competitors that can bid on large LNG projects.”<sup>584</sup> Second, Respondents argue that they did not receive proper notice of the provisions of Complaint Counsel’s Proposed Order and that Complaint Counsel’s attempt to “raise new arguments” in the form of their cross-appeal to supplement the ALJ’s order should be “rejected on

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<sup>583</sup> See generally RRCARB at 49-58.

<sup>584</sup> RAB at 52.

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fundamental grounds of fairness.”<sup>585</sup> Third, Respondents argue that before we consider implementing any of Complaint Counsel’s Proposed Order, we should remand this case for additional evidence on remedy issues. We find that Respondents’ arguments are not supported in the record or the law.

With respect to Respondents’ first argument, we note at the outset that prior to its acquisition of PDM, CB&I had no trouble convincing LNG customers to consider its bids, and Respondents presented no evidence to show why returning CB&I to its pre-acquisition state will preclude it from being a viable supplier. Instead, they point to testimony from three customers in support of their argument. We find that this testimony – when read in context – does not support Respondents’ position.

Calpine and CMS both testified that the financial and bonding capability of the two new companies would be of concern to them. However, we view their general testimony *in its totality* as stating the obvious – that LNG tank customers consider financial stability and bonding capacity in selecting a tank supplier. For example, in addition to testifying that he would be concerned about the new companies’ ability to guarantee a job,<sup>586</sup> the Calpine representative testified that he “would have to take a fresh view of whether they would be put on the bid list.”<sup>587</sup> Similarly, CMS did not testify “that a break-up would create two companies that CMS would not

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<sup>585</sup> RRCARB at 48.

<sup>586</sup> Tr. at 6510-11.

<sup>587</sup> Tr. at 6511. Respondents also cite testimony by a witness from Calpine that he did not believe that PDM would make Calpine’s bid list and that CB&I’s inclusion on the list would depend on what was left of the company. RAB at 53. However, he also testified that he had no knowledge of how either company would look post-divestiture and that he was merely speculating about the post-divestiture world. Tr. at 6538.

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want to deal with” as Respondents suggest,<sup>588</sup> but rather testified that it “would have to look at” the impact a break-up would have on either company’s ability to guarantee a job.<sup>589</sup>

We also find Respondents’ reliance on testimony from El Paso misplaced. El Paso testified that the acquisition gave it some comfort in CB&I’s ability to guarantee a job (because El Paso can now seek more assets in the event CB&I fails to construct the tank). However, this testimony says nothing about El Paso’s comfort level with CB&I pre-merger or the impact of a Commission-required divestiture on El Paso’s assessment of either CB&I or a new company going forward. It is thus not probative of the impact a divestiture will have in the LNG tank market. In fact, in its speculation about a post-divestiture world, El Paso did not testify that a break-up might cause it not to consider buying from either CB&I or a new company, but rather that “it would be less inclined to do any more than maybe one or two jobs with them total.”<sup>590</sup> For obvious reasons, this testimony does not suggest that either New CB&I or New PDM will be unable to compete post-divestiture.

We have also considered Respondents’ argument that they did not receive proper notice of Complaint Counsel’s Proposed Order.

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<sup>588</sup> RAB at 54.

<sup>589</sup> Tr. at 6265. Furthermore, the quote from a CMS employee that CMS “wouldn’t have wanted anyone smaller than CB&I,” which Respondents cite as evidence of the potential harm that will flow from a divestiture, is taken out of context. *See* RAB at 54. Rather than discussing the potential impact of a divestiture, this testimony discusses the ability of the new entrants to guarantee their work. Tr. at 6288-89 (*in camera*). Given the context, it is inappropriate to interpret this customer’s testimony as a commentary on divestiture.

<sup>590</sup> Tr. at 6155-56.



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We reject this assertion as lacking factual support. Far from providing the “barest” sketch, the Notice of Contemplated Relief that accompanied the Complaint in this matter stated that if CB&I’s acquisition of PDM was found to violate either Section 5 of the FTC Act or Section 7 of the Clayton Act, the Commission could order, among other things, “[r]eestablishment by CB&I of two distinct and separate, viable, and competing businesses, one of which shall be divested by CB&I.” Later in the same paragraph, the Notice elaborated that a divestiture could include “such other businesses as necessary to ensure each [new business’s] viability and competitiveness” in the relevant markets, and “all intellectual property, knowhow, trademarks, trade names, research and development, customer contracts, and personnel, including but not limited to management, sales, design, engineering, estimation, fabrication, and construction personnel . . .” We thus reject Respondents’ claim that they were not on notice that the relief in this case might include the assignment of contracts, the transfer of employees, and the divestiture of water tank assets similar to those acquired by CB&I from PDM’s Water Division.<sup>591</sup>

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<sup>591</sup> We note that the technical assistance and administrative services requirements are not specifically enumerated in the Notice but rather are covered under the language “and such other arrangements as necessary or useful in restoring viable competition in the lines of commerce alleged in the complaint.” Plainly, “such other arrangements” encompass terms that were not specifically enumerated but are related to the enumerated relief and geared to make such relief effective. As discussed above, that is precisely the nature of the additional terms at issue. Moreover, Respondents have not proffered any new evidence – in their appeal or cross-appeal response, or at oral argument – to counter the evidence that suggests such a provision will be necessary to ensure effective competition. In any event, as we have discussed, the requirement to provide such assistance or services may be rendered unnecessary, depending on the contours of the final agreement negotiated by CB&I and the Acquirer and approved by

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Furthermore, it should hardly come as a surprise that the type of general language contained in the Notice of Contemplated Relief often triggers the types of specific provisions set forth in our Order. For example, a number of consent orders that the Commission has entered into over the last several years included provisions that required the respondents to effectuate employee transfers by both removing contractual impediments<sup>592</sup> and

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the Commission. In addition, we note that the provisions allow Respondents to recover their costs for providing these services, so the provisions should result in no economic harm to CB&I. Thus, having weighed these factors, we conclude that the inclusion of these provisions is equitable.

<sup>592</sup> See *Baxter Int'l Inc. and Wyeth*, Dkt. No. C-4068 (Feb. 3, 2003) (Decision and Order), available at [http://www.ftc.gov/opa/2003/02/baxter\\_wyethdo.pdf](http://www.ftc.gov/opa/2003/02/baxter_wyethdo.pdf) (requiring respondent to “remove any impediments within the control of Respondents that may deter these employees from accepting employment with the . . . [a]cquirer, including, but not limited to, any non-compete provisions of employment or other contracts with Respondents that would affect the ability or incentive of those individuals to be employed by the . . . [a]cquirer” (¶ II.H)); *MSC Software Corp.*, Dkt No. 9299 (Oct. 29, 2002) (Decision and Order), available at <http://www.ftc.gov/os/2002/11/mscdo.pdf> (requiring that respondent shall “eliminate any non-compete restrictions that would otherwise prevent employment of such employees by the Acquirer; and shall eliminate any confidentiality restrictions that would prevent employees who accept employment with the Acquirer from using or transferring to the Acquirer any information or Intellectual Property that is in the employee’s memory or that is part of the Licensed Rights” (¶ V.C.3.)); *Amgen, Inc. and Immunex Corp.*, Dkt. No. C-4056 (Sept. 3, 2002) (Decision and Order), available at <http://www.ftc.gov/os/2002/09/amgendo.pdf> (requiring respondents to “remove any impediments within the control of Respondents that may deter these employees from accepting

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providing financial incentives.<sup>593</sup> In addition, while the issue of contract allocation does not occur as frequently as the other provisions Respondents have challenged, it should be noted that in cases involving such issues, the Commission's orders have set forth a requirement that the respondents realize the same effect of a transfer or assignment in the event that they are unable to transfer contractual rights.<sup>594</sup> We are mindful that a consent order is not binding authority in a legal sense. Nonetheless, the fact that these provisions appear time and again – and without substantial variation – demonstrates that those same provisions could logically be part of a remedy for an acquisition that has been adjudged illegal.

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employment with the Commission-approved Acquirer, including, but not limited to, any non-compete provisions of employment or other contracts with Respondents that would affect the ability or incentive of those individuals to be employed by the Commission-approved Acquirer” (§ II.I).

<sup>593</sup> See *Baxter/Wyeth*, *supra* note 592 (requiring respondents to provide employees with incentives to accept employment with the acquirer, including a bonus equal to 10 percent of the employee's current salary and commissions (including any annual bonuses\_ (§ II.H.4.)); *Amgen/Immunex*, *supra* note 592 (requiring respondents to provide employees “an incentive equal to three (3) months of [an] . . . employee's base annual salary” to accept employment with the Commission-approved acquirer (§ II.J)).

<sup>594</sup> See, e.g., *Conoco Inc. and Phillips Petroleum Co.*, Dkt. No. C-4058 (Feb. 7, 2003) (Decision and Order), available at <http://www.ftc.gov/os/2003/02/conocophillipsdo.htm> (requiring respondents to assign customer contracts (§ II.B.) and to “substitute equivalent assets or arrangements” in the event that they are unable to effectuate a transfer of contractual rights (§§ II.J, II.L., V.E)).

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Respondents' last argument is that Complaint Counsel were required to present some evidence that their remedy is likely to be efficacious and that their failure to do so "deprived [Respondents] of proper judicial resolution on the issue of remedy."<sup>595</sup> They thus contend that before we implement any provisions of Complaint Counsel's Proposed Order, we must remand this case to take evidence on the remedy issue. Respondents are certainly correct that a "party has the right to judicial resolution of disputed facts not just as to the liability phase, but also as to appropriate relief."<sup>596</sup> It is also true that Complaint Counsel did not introduce evidence showing definitively that their proposed remedy will be efficacious and feasible once it is implemented. However, the standard Respondents propose is not grounded in the law, which asks only whether "the relief required effectively . . . eliminate[s] the tendency of the acquisition condemned by §7."<sup>597</sup> In this vein, Complaint Counsel presented evidence – discussed at length in this Opinion – that demonstrates that a new entrant would need experience, knowhow, and a solid reputation to compete effectively. This is, of course, the type of evidence that courts have consistently used to determine whether ancillary relief is warranted to reverse the anticompetitive effects of an illegal acquisition.<sup>598</sup> As we discussed in the previous section, this evidence led us to find that the relief ordered in the Initial Decision "leaves a substantial likelihood that the tendency

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<sup>595</sup> RRCARB at 49; *see generally Id.* at 49-57.

<sup>596</sup> RRCARB at 49 (citing *du Pont*, 353 U.S. at 607); *see also United States v. Microsoft Corp.*, 253 F.3d 34, 101 (D.C. Cir. 2001) ("A hearing on the merits – *i.e.*, a trial on liability – does not substitute for a relief-specific evidentiary hearing unless the matter of relief was part of the trial on liability, or unless there are no disputed factual issues regarding the matter of relief.").

<sup>597</sup> *Du Pont*, 366 U.S. at 325.

<sup>598</sup> *See, e.g., Ford Motor Co.*, 405 U.S. at 572-78 (finding the ancillary provisions necessary given certain market conditions).

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towards monopoly of the acquisition condemned by §7 has not been satisfactorily eliminated.”<sup>599</sup> We thus have decided to include additional water tank assets, to order Respondents to divide current contracts and to effectuate the transfer of employees to the new companies, and to require Respondents to provide the new company with technical assistance and administrative support.

We also decline to remand this case to receive evidence on remedy. Although Respondents assert that the appellate court’s decision in *Microsoft* requires a remand, we do not agree. As the ALJ concluded, *Microsoft* is inapposite, because it is not a merger case and that decision “does not impose on Complaint Counsel the burden of presenting evidence related to the effectiveness of Complaint Counsel’s proposed remedy for this violation of the Clayton Act.”<sup>600</sup> In addition, unlike in the *Microsoft* case, Respondents have not proffered any new evidence to dispute the remedy provisions they challenge.<sup>601</sup> Instead, they argue that Complaint Counsel did not present evidence to demonstrate the efficacy of their remedy and that the customer testimony *in the record* demonstrates that a divestiture may harm competition. Because we have already resolved these disputes in our analysis, we find no reason to delay these proceedings further, and accordingly we have issued a Final Order.

In addition, the other case law that Respondents cite – *du Pont*, *Ford Motor*, and *Ward Baking* – does not support their argument.<sup>602</sup> In *du Pont*, the Supreme Court ordered divestiture and remanded as to the specifics of any ancillary relief, because

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<sup>599</sup> *Du Pont*, 366 U.S. at 331-32.

<sup>600</sup> ID at 120.

<sup>601</sup> *United States v. Microsoft Corp.*, 253 F.3d at 98-103.

<sup>602</sup> See RAB 54-56; RRCARB at 49-50.

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the record bore “on the tax and market consequences for the owners of the du Pont and General Motors stock” rather than on “the competition-restoring effect of the several proposals.”<sup>603</sup> As we have discussed, the evidence in case before us forms the basis of the relief we have ordered. Therefore, *du Pont* does not apply to these facts. Respondents also point out that the Court in *Ford Motor* required the remedy at issue to be supported in the evidence. Yet in finding support for the ancillary relief in that case, the Court looked to the very types of evidence that exist in the record of the present case – the structure and competitive conditions of the market.<sup>604</sup> Finally, we find *Ward Baking* wholly inapplicable to this case. The issue before the Court in *Ward Baking* was whether the district court properly entered a consent judgment without the actual consent of the government (which had objected to the judgment and asked for stronger relief).<sup>605</sup> Indeed, the Court in *Ward Baking* held that the government could not be foreclosed from a right to go to trial and returned the case to the trial court so the government could prove the scope of the alleged law violation.<sup>606</sup>

Thus, having found that CB&I’s acquisition of PDM’s Erected Construction Division violates both Section 7 of the Clayton Act and Section 5 of the FTC Act, we order divestiture and ancillary relief as prescribed by our attached Order.

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<sup>603</sup> *Du Pont*, 366 U.S. at 320-21.

<sup>604</sup> *See generally Ford Motor Co.*, 405 U.S. at 572-77.

<sup>605</sup> *United States v. Ward Baking Co.*, 376 U.S. 327 (1964).

<sup>606</sup> *Id.* at 334-35.

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**FINAL ORDER**

This matter having been heard by the Commission upon the appeal of Respondents and the cross-appeal of Complaint Counsel, and upon briefs and oral argument in support thereof and opposition thereto, and the Commission for the reasons stated in the accompanying Opinion having determined to sustain the Initial Decision with certain modifications:

*It is ordered* that the Initial Decision of the administrative law judge be, and it hereby is, adopted as the Findings of Fact and Conclusions of Law of the Commission, to the extent not inconsistent with the findings of fact and conclusions contained in the accompanying Opinion.

Other findings of fact and conclusions of law of the Commission are contained in the accompanying Opinion.

*It is further ordered* that the following Order to cease and desist be, and it hereby is, entered:

**Order****I.**

*It is ordered* that, for the purposes of this Order, the following definitions shall apply:

- A. "Acquirer" means an entity approved by the Commission to acquire the Relevant Business and assets of New PDM or New CB&I pursuant to this Order.
- B. "Acquisition" means the transaction between CB&I and PDM, consummated on February 7, 2001, in which CB&I acquired the assets and business of PDM's Water Division and Engineered Construction Division.

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- C. “Administrative Services” means accounting, purchasing, warehousing, and other administrative services needed to operate the Relevant Business.
- D. “CB&I” means Respondent Chicago Bridge & Iron Company N.V. and Respondent Chicago Bridge & Iron Company, individually and collectively, as well as their respective directors, officers, employees, agents, representatives, predecessors, successors, and assigns; each subsidiary, division, group, and affiliate controlled by Chicago Bridge & Iron Company N.V. or Chicago Bridge and Iron Company, and the respective directors, officers, employees, agents, representatives, successors, and assigns of each such entity.
- E. “CB&I License” means (i) a worldwide, royalty-free, perpetual, irrevocable, transferable, sublicensable, non-exclusive license to all Intellectual Property owned by or licensed to CB&I for any use and (ii) such tangible embodiments of the licensed rights (including but not limited to physical and electronic copies) as may be necessary or appropriate to enable the Acquirer to utilize the licensed rights.
- F. “Commission” means the Federal Trade Commission.
- G. "Customer Contracts" means all agreements and rights under agreements (including sole-source arrangements, phased contracting, and phased bidding arrangements) between Respondents and any Person(s) pursuant to which Respondents supply services or products relating to the Relevant Business to such Person(s).
- H. “Direct Cost” means the cost of direct material and direct labor used to provide the relevant assistance or service.



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- I. “Divestiture Trustee” means a person appointed with the Commission’s approval to effect the divestiture requirements of this Order.
- J. “Intellectual Property” means, without limitation, (i) all trade names, registered and unregistered trademarks, service marks and applications, domain names, trade dress, copyrights, copyright registrations and applications, in both published works and unpublished works; (ii) all patents, patent applications, and inventions and discoveries that may be patentable; and (iii) all know-how, trade secrets, confidential information, customer lists, customer records and files, bidding and estimating documents, software, technical information, data, registrations, applications for governmental approvals, processes and inventions, practices, standards, formulae, recipes, methods, and product and packaging specifications.
- K. “Monitor Trustee” means a person appointed with the Commission’s approval to oversee the divestiture requirements of this Order.
- L. “New CB&I” means the Relevant Business and assets that must be organized pursuant to Paragraph III of this Order but need not be divested except in the manner and to the extent provided in Paragraph V of this Order.
- M. “New PDM” means the Relevant Business and assets that must be organized pursuant to Paragraph III of this Order and that the Commission requires to be divested pursuant to Paragraph IV of this Order.
- N. “PDM” means Pitt-Des Moines, Inc., its directors, officers, employees, agents, representatives, predecessors, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by Pitt-Des Moines, Inc., and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

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O. "Person" means any individual, partnership, firm, corporation, association, trust, unincorporated organization, governmental body, or other entity.

P. "Relevant Business" means all employees, managers, and supervisors and all assets of every description, including but not limited to:

1. All real property (including fee simple interests and real property leasehold interests), including but not limited to the fabrication facilities wherever located;

2. All personal property;

3. All inventories, stores, and supplies;

4. All rights under any contract, including but not limited to any lease, Customer Contract, supply agreement, sole-source arrangement, and procurement contract;

5. All Intellectual Property;

6. All governmental approvals, consents, licenses, permits, waivers, or other authorizations;

7. All rights under warranties and guarantees, express or implied;

8. All items of prepaid expense; and

9. All books, records, and files

engaged, directly or indirectly, in all aspects of engineering, designing, estimating, bidding, procuring, fabricating, erecting, rehabilitating, or selling any: water storage tank or system; industrial process system, including but not limited to any digester, absorber, reactor, and tower; flat bottom tank; pressure vessel or sphere; low temperature or cryogenic tank or

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system; vacuum chamber or system; steel plate fabrication; and specialty structure, including the Relevant Products.

- Q. “Relevant Business Employee” means any person currently or previously employed by CB&I in the Relevant Business, including but not limited to management, sales, and marketing personnel, engineers, draftsmen, estimators, purchasers, and field personnel.
- R. “Relevant Products” means those products identified and described in the accompanying Opinion as (1) thermal vacuum chambers, (2) liquified natural gas tanks, (3) liquid petroleum gas tanks, and (4) liquid nitrogen, liquid oxygen, and liquid argon tanks.
- S “Technical Assistance” means providing expert advice, assistance, and training with respect to the operation of the Relevant Business.

**II.**

*It is further ordered that:*

- A. Within thirty (30) days after this Order is final, Respondents shall retain a Monitor Trustee, acceptable to the Commission, to monitor Respondents’ compliance with their obligations under this Order, consult with Commission staff, and report to the Commission regarding Respondents’ compliance with their obligations under this Order.
- B. If Respondents fail to retain a Monitor Trustee as provided in Paragraph II.A of this Order, a Monitor Trustee, acceptable to the Commission, shall be identified and selected by the Commission’s staff within forty-five (45) days after this Order is final.
- C. Respondents shall consent to the following terms and conditions regarding the powers, duties, authorities, and

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responsibilities of the Monitor Trustee selected under Paragraph II.A or II.B of this Order:

1. The Monitor Trustee shall have the power and authority to monitor Respondents' compliance with the terms of this Order and shall exercise such power and authority and carry out the duties and responsibilities of the Monitor Trustee pursuant to the terms of this Order and in a manner consistent with the purposes of this Order, in consultation with Commission's staff.
2. Within ten (10) days after Commission's approval of the Monitor Trustee, Respondents shall execute an agreement that, subject to the approval of the Commission, confers on the Monitor Trustee all the rights and powers necessary to permit the Monitor Trustee to monitor Respondents' compliance with the terms of this Order in a manner consistent with the purposes of this Order. If requested by Respondents, the Monitor Trustee shall sign a confidentiality agreement prohibiting the use, or the disclosure to anyone other than the Commission (or any Person retained by the Monitor Trustee pursuant to Paragraph II.C.5 of this Order), of any competitively sensitive or proprietary information gained as a result of his or her role as Monitor Trustee, for any purpose other than performance of the Monitor Trustee's duties under this Order.
3. The Monitor Trustee's power and duties under this Paragraph II shall terminate three (3) business days after the Monitor Trustee has completed his or her final report pursuant to Paragraph II.C.8, or at such other time as directed by the Commission.
4. Respondents shall provide the Monitor Trustee with full and complete access to Respondents' books, records, documents, personnel, facilities and technical information relating to compliance with this Order, or to any other

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relevant information that the Monitor Trustee may reasonably request. Respondents shall cooperate with every reasonable request of the Monitor Trustee. Respondents shall take no action to interfere with or impede the Monitor Trustee's ability to monitor Respondents' compliance with this Order.

5. The Monitor Trustee shall serve, without bond or other security, at the expense of Respondents, on such reasonable and customary terms and conditions as the Commission may set. The Monitor Trustee shall have authority to employ, at the expense of Respondents, such consultants, accountants, attorneys and other representatives and assistants as are reasonably necessary to carry out the Monitor Trustee's duties and responsibilities. The Monitor Trustee shall account for all expenses incurred, including fees for his or her services, subject to the approval of the Commission.
6. Respondents shall indemnify the Monitor Trustee and hold him or her harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Monitor Trustee's duties, including all reasonable fees of counsel and other expenses incurred in connection with the preparation for or defense of any claim, whether or not resulting in any liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from the Monitor Trustee's gross negligence or willful misconduct. For purposes of this Paragraph II.C.6, the term "Monitor Trustee" shall include all Persons retained by the Monitor Trustee pursuant to Paragraph II.C.5 of this Order.
7. If at any time the Commission determines that the Monitor Trustee has ceased to act or failed to act diligently, or is unwilling or unable to continue to serve, the Commission may in its discretion appoint a substitute to serve as

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Monitor Trustee in the same manner as provided by Paragraph II.A or II.B of this Order.

8. The Monitor Trustee shall report in writing to the Commission (i) every sixty (60) days from the date the Monitor Trustee is appointed, (ii) at the time a divestiture package is presented to the Commission for its approval, such report to include appropriate recommendations regarding (a) the sale of the flat bottom tank, pressure vessel or sphere, and low temperature tanks or systems, (b) the need for, and, if appropriate, the terms applicable to the provision of technical assistance and administrative services, and (c) the qualifications of each proposed acquirer, and (iii) at any other time as requested by the staff of the Commission, concerning Respondents' compliance with this Order.

- D. On its own initiative or at the request of the Monitor Trustee, the Commission may issue such additional orders or directions as may be necessary or appropriate to assure compliance with the requirements of this Order.

### III.

*It is further ordered that:*

- A. Within ninety (90) days after the date on which this Order becomes final, CB&I shall reorganize its Relevant Business into two independent, stand-alone operating divisions or subsidiaries, respectively New PDM and New CB&I, each fully, equally, and independently engaged in all aspects of the Relevant Business. The purpose of this Paragraph III is to create two stand-alone business entities, each having approximately equal shares of the markets for the Relevant Products, each fully capable of being divested, and each fully (and, to the extent practicable, equally) engaged in all aspects of the Relevant Business.

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- B. In connection with the reorganization mandated by Paragraph III.A of this Order, and in consultation with the Monitor Trustee and the Commission's staff, CB&I shall accomplish all actions necessary to ensure that New PDM and New CB&I are each assigned Customer Contracts, equitably apportioned among the types of products relating to the Relevant Business, to the extent necessary to effect the purpose of Paragraph III.A; *provided, however*, that if for any reason CB&I is unable to accomplish such an assignment or transfer of Customer Contracts, it shall enter into such agreements, contracts, or licenses as are necessary to realize the same effect as such transfer or assignment.
- C. Respondents shall transfer to New PDM and to New CB&I all necessary Relevant Business Employees so that each such entity shall possess the technical experience and expertise: (i) to complete all Customer Contracts assigned or transferred to it, (ii) to bid on and obtain new Customer Contracts relating to the Relevant Business, and (iii) to complete any new Customer Contracts relating to the Relevant Business in substantially the same manner and quality employed or achieved by CB&I in the conduct of the Relevant Business prior to the date on which this Order becomes final.

**IV.**

*It is further ordered that:*

- A. No later than one hundred eighty (180) days from the date this Order becomes final, Respondents shall divest New PDM, absolutely and in good faith, at no minimum price, only to an Acquirer that receives the prior approval of the Commission and only in a manner that receives the prior approval of the Commission (including an executed divestiture agreement, which shall not vary from or contradict, or be construed to vary from or contradict, the terms of this Order); *provided, however*, that if the Acquirer, with the concurrence of the Monitor Trustee, determines that acquiring any or all of the following

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assets is not necessary to achieve the purposes of this Order, then Respondents need not divest assets that involve no Relevant Products and are related exclusively to engineering, designing, estimating, bidding, procuring, fabricating, erecting, rehabilitating, or selling any water storage tank or system; any industrial process system, including but not limited to any digester, absorber, reactor, and tower; any flat bottom tank; any pressure vessel or sphere; any low-temperature or cryogenic tank or system; any vacuum chamber or system; any steel plate fabrication; or any specialty structure.

- B. Respondents shall comply with all terms of the divestiture agreement approved by the Commission pursuant to this Order, which agreement shall be deemed incorporated by reference into this Order, and any failure by Respondents to comply with the terms of such divestiture agreement shall constitute a failure to comply with this Order.
- C. No later than the date New PDM is divested, CB&I shall grant to the Acquirer a CB&I Licence for use in the conduct of all business acquired under Paragraph IV.A of this Order.
- D. Respondent shall take all actions necessary to assure the employment by the Acquirer of any Relevant Business Employee whose transfer to the Acquirer is required by this Order, including but not limited to:
  - 1. No later than four (4) weeks before the execution of an agreement to divest New PDM, CB&I shall (i) provide to the Acquirer a list of all Relevant Business Employees; (ii) provide any available contact information, including last known address for any Person formerly employed by any Respondent in the Relevant Business, and whose employment ended after September 8, 2000; (iii) provide the Acquirer an opportunity to interview any Relevant Business Employee; and (iv) allow the Acquirer to inspect the personnel files and other documentation relating to such employees or to any Person formerly employed by any



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Respondent in the Relevant Business, to the extent permissible under applicable laws.

2. CB&I shall (i) not offer any incentive to any Relevant Business Employee to decline employment with the Acquirer; (ii) remove any contractual impediments that may deter any Relevant Business Employee from accepting employment with the Acquirer, including but not limited to any non-compete or confidentiality provisions of employment or other contracts with CB&I that would affect the ability of the Relevant Business Employee to be employed by the Acquirer; and (iii) not interfere with the employment by the Acquirer of any Relevant Business Employee.
3. CB&I shall provide such Relevant Business Employees with financial incentives to accept a position with the Acquirer at the time of divestiture, including but not limited to (i) vesting of all current and accrued pension benefits as of the date of transition of employment to the Acquirer; (ii) continuation of all employee benefits offered by CB&I until the date New PDM is divested; and (iii) no later than thirty (30) days from the date CB&I divests New PDM, payment of a bonus to any Relevant Business Employee who accepts an offer of employment from the Acquirer.
4. For a period of two (2) years following the date on which the divestiture of New PDM to the Acquirer is completed, CB&I shall not, directly or indirectly, solicit, induce, or attempt to solicit or induce any Relevant Business Employee who has accepted an offer of employment with the Acquirer to terminate his or her employment relationship with the Acquirer unless that individual has been terminated by the Acquirer; *provided, however*, a violation of this provision will not occur if: (i) Respondents advertise for employees in newspapers, trade publications, or other media not targeted specifically at Relevant Business Employees, or (ii) Respondents hire employees

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who apply for employment with Respondents, as long as such employees were not solicited by Respondents in violation of this Paragraph IV.D.4.

- E. Respondents shall submit the following reports to the Monitor Trustee: (i) no later than forty-five (45) days from the date this Order becomes final, a report that identifies all assets of the Relevant Business (including but not limited to those listed in Paragraph I.P of this Order) and all Customer Contracts existing at the time this Order becomes final; and (ii) no later than sixty (60) days from the date this Order becomes final, a report that identifies and lists all contracts, assets, and employees that relate to the operation of the Relevant Business.
- F. If in a divestiture agreement that receives the prior approval of the Commission, the Commission approves a Technical Assistance provision:
  - 1. CB&I shall provide Technical Assistance to the Acquirer sufficient to enable the Acquirer to conduct the Relevant Business in substantially the same manner as that employed by CB&I prior to the date this Order becomes final.
  - 2. In connection with such Technical Assistance, CB&I shall allow the Acquirer reasonable and timely access to CB&I's fabrication facilities for the purpose of inspecting fabrication operations relating to the operation of New PDM's Relevant Business.

*Provided, however,* that CB&I shall not (i) require the Acquirer to pay compensation for Technical Assistance that exceeds the Direct Cost of providing Technical Assistance; (ii) terminate its obligation to provide Technical Assistance because of a material breach by the Acquirer of any agreement concerning the provision of Technical Assistance, in the absence of a final order of a court of competent jurisdiction; or (iii) seek to limit the damages (such as indirect, special, and

## Final Order

consequential damages) that the Acquirer would be entitled to receive in the event of CB&I's breach of any agreement to provide Technical Assistance

- G. If in a divestiture agreement that receives the prior approval of the Commission, the Commission approves an Administrative Services provision, CB&I shall provide Administrative Services to the Acquirer at substantially the same level of quality and efforts as those provided by CB&I in connection with CB&I's Relevant Business prior to the date this Order becomes final; *provided, however*, that CB&I shall not (i) require the Acquirer to pay compensation for Administrative Services that exceeds the Direct Cost of providing such Administrative Services; (ii) terminate its obligation to provide Administrative Services because of a material breach by the Acquirer of any agreement concerning the provision of Administrative Services, in the absence of a final order of a court of competent jurisdiction; or (iii) seek to limit the damages (such as indirect, special, and consequential damages) that the Acquirer would be entitled to receive in the event of CB&I's breach of any agreement to provide Administrative Services.
- H. The purpose of the divestiture of New PDM is to remedy the lessening of competition alleged in the Commission's complaint in Docket No. 9300, to restore the competition lost as a result of the Acquisition, and to ensure the continued operation of the Relevant Business by New PDM and New CB&I in the same manner in which such business was operated at the time of the announcement of the Acquisition.

## V.

*It is further ordered that:*

- A. If Respondents have not divested, absolutely and in good faith, New PDM within the time and in the manner required by Paragraph IV.A of this Order, the Commission may at any time

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appoint a Divestiture Trustee, who upon his or her appointment shall undertake to divest, in his or her discretion with the approval of the Commission, either New PDM or New CB&I in a manner that satisfies the purposes and requirements of this Order. In the event the Divestiture Trustee divests New CB&I, the terms of Paragraph IV of this Order shall apply to the divestiture of New CB&I in the same way in which they apply to New PDM.

- B. In the event that the Commission or the Attorney General brings an action pursuant to Section 5(*l*) of the Federal Trade Commission Act, 15 U.S.C. § 45(*l*), or any other statute enforced by the Commission, Respondents shall consent to the appointment of a Divestiture Trustee in such action. Neither the appointment of a Divestiture Trustee nor a decision not to appoint a Divestiture Trustee under this Paragraph shall preclude the Commission or the Attorney General from seeking civil penalties or any other available relief, including appointment of a court-appointed Divestiture Trustee, pursuant to Section 5(*l*) of the Federal Trade Commission Act or any other statute enforced by the Commission, for any failure by the Respondents to comply with this Order.
- C. The Commission shall select any Divestiture Trustee appointed under this Order, subject to the consent of Respondents, which consent shall not be unreasonably withheld. The Divestiture Trustee shall be a Person with experience and expertise in acquisitions and divestitures and may be the same Person as the Monitor Trustee appointed under Paragraph II of this Order. After receiving notice by the Commission's staff of the identify of any proposed Divestiture Trustee, Respondents shall have ten (10) days in which to submit a written statement to the Commission stating their reasons, if any, for opposing the selection of the Divestiture Trustee. Absent the timely submission of written objections, Respondents shall be deemed to have consented to the selection of the proposed Divestiture Trustee.

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- D. If a Divestiture Trustee is appointed by the Commission or a court pursuant to this Paragraph V, Respondents shall consent to the following terms and conditions regarding the Divestiture Trustee's powers, duties, authority, and responsibilities:
1. Subject to the prior approval of the Commission, the Divestiture Trustee shall have the exclusive power and authority to effect the divestiture for which he or she has been appointed pursuant to the terms of this Order and in a manner consistent with the purposes of this Order.
  2. Within ten (10) days after appointment of the Divestiture Trustee, Respondents shall execute an agreement that, subject to the prior approval of the Commission and, in the case of a court-appointed Divestiture Trustee, of the court, transfers to the Divestiture Trustee all rights and powers necessary to permit the Divestiture Trustee to effect the divestiture for which he or she has been appointed.
  3. The Divestiture Trustee shall have twelve (12) months from the date the Commission approves the agreement described in Paragraph V.C.2 of this Order to accomplish the divestiture of either New PDM or New CB&I, which shall be subject to the prior approval of the Commission. If, however, at the end of the twelve-month period the Divestiture Trustee has submitted a plan of divestiture or believes that divestiture can be achieved within a reasonable time, the divestiture period may be extended by the Commission or, in the case of a court appointed Divestiture Trustee, by the court.
  4. Respondents shall provide the Divestiture Trustee with full and complete access to the personnel, books, records, and facilities related to the assets to be divested, or to any other relevant information, as the Divestiture Trustee may request. Respondents shall develop such financial or other information as the Divestiture Trustee may reasonably request and shall cooperate with the Divestiture Trustee.

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Respondents shall take no action to interfere with or impede the Divestiture Trustee's accomplishment of the divestiture. Any delays in divestiture caused by Respondents shall extend the time for divestiture under this Paragraph in an amount equal to the delay, as determined by the Commission or, for a court-appointed Divestiture Trustee, by the court.

5. The Divestiture Trustee shall use his or her best efforts to negotiate the most favorable price and terms available in each contract that is submitted to the Commission, but shall divest expeditiously at no minimum price. The divestiture shall be made only to an Acquirer that receives the prior approval of the Commission, and the divestiture shall be accomplished only in a manner that receives the prior approval of the Commission; *provided, however*, if the Divestiture Trustee receives bona fide offers from more than one acquiring entity, and if the Commission determines to approve more than one such acquiring entity, the Divestiture Trustee shall divest to the acquiring entity or entities selected by Respondents from among those approved by the Commission; *provided, further*, that Respondents shall select such entity within five (5) business days of receiving written notification of the Commission's approval.
6. The Divestiture Trustee shall serve, without bond or other security, at the cost and expense of Respondents, on such reasonable and customary terms and conditions as the Commission or a court may set. The Divestiture Trustee shall have the authority to employ, at the cost and expense of Respondents, such consultants, accountants, attorneys, investment bankers, business brokers, appraisers, and other representatives and assistants as are necessary to carry out the Divestiture Trustee's duties and responsibilities. The Divestiture Trustee shall account for all monies derived from the divestiture and all expenses incurred. After approval by the Commission and, in the case of a court-

## Final Order

appointed Divestiture Trustee, by the court of the account of the Divestiture Trustee, including fees for his or her services, all remaining monies shall be paid at the direction of the Respondents, and the Divestiture Trustee's power shall be terminated. The Divestiture Trustee's compensation shall be based at least in significant part on a commission arrangement contingent on the Divestiture Trustee's divesting the assets.

7. Respondents shall indemnify the Divestiture Trustee and hold the Divestiture Trustee harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Divestiture Trustee's duties, including all reasonable fees of counsel and other expenses incurred in connection with the preparation for or defense of any claim, whether or not resulting in any liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from gross negligence or willful misconduct by the Divestiture Trustee. For purposes of this Paragraph V.C.7, the term "Divestiture Trustee" shall include all Persons retained by the Divestiture Trustee pursuant to Paragraph V.C.6 of this Order.
8. If the Divestiture Trustee ceases to act or fails to act diligently, the Commission may appoint a substitute Divestiture Trustee in the same manner as provided in this Paragraph V for appointment of the initial Divestiture Trustee.
9. The Divestiture Trustee shall have no obligation or authority to operate or maintain the assets to be divested.
10. The Divestiture Trustee shall report in writing to the Commission every sixty (60) days concerning the Divestiture Trustee's efforts to accomplish the divestiture.

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- E. On its own initiative or at the request of the Divestiture Trustee, the Commission (or, in the case of a court-appointed Divestiture Trustee, the court) may issue such additional orders or directions as may be necessary or appropriate to accomplish the divestiture required by this Order.

**VI.**

*It is further ordered* that from the date this Order becomes final until the date New PDM or New CB&I is divested to an Acquirer pursuant to this Order:

- A. Respondents shall take such actions as are necessary to maintain the viability, marketability, and competitiveness of the Relevant Business of New PDM and New CB&I and all their assets, and shall prevent the destruction, removal, wasting, deterioration, sale, disposition, transfer, or impairment of the Relevant Business or the assets, except for ordinary wear and tear.
- B. Respondents shall maintain the operations of the Relevant Business by New PDM and New CB&I in the ordinary course of business and in accordance with past practice (including regular repair and maintenance of the assets of the Relevant Business), and shall use best efforts to preserve the existing relationships with customers, suppliers, vendors, employees, landlords, creditors, agents, and others having business relations with New PDM, New CB&I, and the Relevant Business. Among other things as may be necessary, Respondents shall:
1. Use best efforts to maintain and increase sales of the Relevant Business by New PDM and New CB&I, and proportionately to maintain all administrative, technical, and marketing support for the Relevant Business of New PDM and New CB&I at the year 2002 or budgeted levels for the year 2003 (whichever are higher);



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2. Use best efforts to maintain the current workforce and to retain the services of employees and agents relating to New PDM and New CB&I, including payment of bonuses as necessary;
  3. Assure that Respondents' employees with primary responsibility for managing and operating New PDM and New CB&I are not transferred or reassigned to other areas within Respondents' organization, except for transfer bids initiated by employees pursuant to Respondents' regular, established job posting policy;
  4. Provide sufficient working capital to maintain the Relevant Business of New PDM and New CB&I as economically viable and competitive ongoing businesses; and
  5. Except as part of a divestiture approved by the Commission pursuant to this Order, not remove, sell, lease, assign, transfer, license, pledge for collateral, or otherwise dispose of New PDM or New CB&I Relevant Business assets.
- C. Respondents shall cooperate with the Monitor Trustee appointed pursuant to Paragraph II of this Order and any Divestiture Trustee that may be appointed pursuant to Paragraph V of this Order in the performance of his or her obligations.

**VII.**

*It is further ordered that:*

- A. Except in the course of performing their obligations under this Order, Respondents shall not (i) provide, disclose, or otherwise make available any trade secrets or any sensitive or proprietary commercial or financial information relating to New PDM or New CB&I to any Person or (ii) use any such information for any reason or purpose.

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- B. Respondents shall disclose trade secrets or sensitive or proprietary commercial or financial information relating to New PDM or New CB&I (i) only in the manner and to the extent necessary to satisfy their obligations under this Order and (ii) only to Persons who agree in writing to maintain the confidentiality of such information.
- C. Respondents shall enforce the terms of this Paragraph VII as to any Person and take such action as is necessary, including training, to cause each such Person to comply with the terms of this Paragraph VII, including any actions that Respondents would take to protect their own trade secrets or sensitive or proprietary commercial or financial information.

**VIII.**

*It is further ordered* that, no later than ten (10) days from the date on which this Order becomes final, Respondents shall provide a copy of this Order to each of Respondents' officers, employees, or agents having managerial responsibility for any of Respondents' obligations under this Order.

**IX.**

*It is further ordered* that:

- A. Respondents shall file a verified written report with the Commission setting forth in detail the manner and form in which they intend to comply, are complying, and have complied with this Order (i) no later than thirty (30) days from the date this Order becomes final, (ii) every thirty (30) days thereafter (measured from the due date of the first report under this Order) until the divestiture of New PDM is accomplished, and (iii) thereafter, every sixty (60) days (measured from the date of divestiture) until the Commission's staff advises Respondents in writing that, based on information available to the staff at that time, Respondents have substantially complied

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with their obligations under Paragraphs II through VIII of this Order; *provided, however*, that Respondents shall also file the report required by this Paragraph IX at any other time as the Commission or its staff may require.

- B. Respondents shall include in their compliance reports, among other things required by the Commission, a description of all substantive contacts or negotiations relating to the divestiture required by this Order, the identity of all parties contacted, copies of all written communications to and from such parties, internal documents and communications, and all reports and recommendations concerning the divestiture, the date of divestiture, and a statement that the divestiture has been accomplished in the manner approved by the Commission.

**X.**

*It is further ordered* that Respondents shall notify the Commission at least thirty (30) days prior to any proposed change in Respondents such as dissolution, assignment, sale resulting in the emergence of a successor corporation, or the creation or dissolution of subsidiaries or any other change in any Respondent that may affect compliance obligations arising out of this Order.

**XI.**

*It is further ordered* that for the purpose of determining or securing compliance with this Order, and subject to any legally recognized privilege, and upon written request with reasonable notice, Respondents shall permit any duly authorized representative of the Commission:

- A. Access, during office hours and in the presence of counsel, to all facilities and access to inspect and copy all non-privileged books, ledgers, accounts, correspondence, memoranda, and other records and documents in the possession or under the

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control of Respondents relating to any matter contained in this Order; and

- B. Upon five (5) days' notice to Respondents and without restraint or interference from them, to interview their officers, directors, or employees, who may have counsel present, regarding any such matters.

Complaint

**INITIAL DECISION**

By D. Michael Chappell, Administrative Law Judge

**I. INTRODUCTION****A. Federal Trade Commission Complaint**

The Federal Trade Commission ("FTC") issued its Complaint in this matter on October 25, 2001. The Complaint charges that Chicago Bridge & Iron Company N.V., a foreign corporation, Chicago Bridge & Iron Company, a corporation (collectively, "CB&I") and Pitt-Des Moines, Inc. ("PDM"), a corporation, entered into an agreement in violation of Section 5 of the Federal Trade Commission Act ("FTC Act"), as amended. 15 U.S.C. § 45. The Complaint alleges that on or about February 7, 2001, CB&I acquired, pursuant to agreement with PDM, PDM's Water Division and Engineered Construction ("EC") Division for approximately \$ 84 million ("the Acquisition"). The Complaint alleges that the relevant geographic market is the United States as a whole and that the relevant product markets are large, field-erected: (1) liquefied natural gas ("LNG") storage tanks (individually, or as a component of an import terminal or a LNG peak shaving plant); (2) refrigerated liquid petroleum gas ("LPG") storage tanks; (3) liquid nitrogen, oxygen and argon ("LIN/LOX") storage tanks; and (4) thermal vacuum chambers ("TVCs").

The Complaint charges two violations. Count I alleges the effect of the Acquisition may be substantially to lessen competition or tend to create a monopoly in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the FTC Act. Count II alleges that CB&I and PDM ("Respondents"), through the Acquisition and the Acquisition agreement have engaged in unfair methods of competition in or affecting commerce in violation of Section 5 of the FTC Act.

**B. Respondents' Answers**

Following the issuance of the Complaint, the parties filed

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three joint motions seeking extensions of time for Respondents to file the Answer to the Complaint. In each motion, the parties represented an extension was needed in order for the parties to pursue settlement of this action. CB&I and PDM each filed an Answer on February 4, 2002. Respondents denied most of the allegations of the Complaint. CB&I admitted that on February 7, 2001, CB&I completed its acquisition of certain assets of PDM related to its Water Division and Engineered Construction Division. Respondents asserted that the Acquisition has caused a repositioning, which has given an incentive to previously dormant competitors to invest in this business to attempt to replace PDM as a bidder in the relevant markets.

**C. Procedural History**

On August 29, 2000, CB&I and PDM entered into a letter of intent for CB&I to acquire PDM's Engineered Construction and Water Divisions. Respondents made their filings under the Hart-Scott-Rodino Act ("HSR"), 15 U.S.C. § 18a, on September 12, 2000. The initial waiting period under HSR expired on October 12, 2000.

The FTC did not seek a preliminary injunction in a U.S. district court, pursuant to Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), to halt CB&I's impending acquisition. On February 7, 2001, CB&I completed its acquisition of certain assets of PDM's Water Division and Engineered Construction Division.

On October 25, 2001, the FTC issued its Complaint. After extensive pretrial discovery, the administrative trial in this case commenced on November 12, 2002. By Order signed on June 18, 2002 by the previous Administrative Law Judge in this litigation, Respondents' motion for a 60 day extension was granted, extending the deadline for filing the Initial Decision to December 25, 2002. By Order issued December 17, 2002, because the trial in this matter was then still proceeding, an additional 60 day extension was granted, extending the deadline for filing the Initial Decision to February 24, 2003.

## Complaint

The administrative trial concluded on January 16, 2003. On January 21, 2003, the parties filed a joint motion to extend the deadline for filing the Initial Decision. By Order dated January 28, 2003, extraordinary circumstances were found to exist sufficient to extend the deadline for filing the Initial Decision by an additional 60 days, to April 28, 2003. The January 28, 2003 Order also revised the post trial briefing schedule and closed the hearing record pursuant to Commission Rule 3.44(c). On April 24, 2003, in response to a request made pursuant to Commission Rule 3.51(a), the Commission issued an Order extending the time to file the Initial Decision until June 12, 2003.

**D. Evidence**

The Initial Decision is based on the transcript of the testimony, the exhibits properly admitted in evidence, and proposed findings of fact and conclusions of law and replies thereto filed by the parties. Citations to specific numbered Findings of Fact in this Initial Decision are designated by "F."

The parties submitted extensive post-trial briefs and reply briefs. The Initial Decision addresses only material issues of fact and law. Proposed findings of fact not included in the Initial Decision were rejected, either because they were not supported by the evidence or because they were not dispositive to the determination of the allegations of the Complaint. The Commission has held that Administrative Law Judges are not required to discuss the testimony of each witness or all exhibits that are presented during the administrative adjudication. In *re Amrep Corp.*, 102 F.T.C. 1362, 1670 (1983). Administrative adjudicators are "not required to make subordinate findings on every collateral contention advanced, but only upon those issues of fact, law, or discretion which are 'material.'" *Minneapolis & St. Louis Ry. Co. v. United States*, 361 U.S. 173, 193-94 (1959).

On March 7, 2003, Respondents filed a motion to strike, seeking an order striking certain exhibits that were never admitted into evidence and striking a number of Complaint Counsel's Proposed Findings of Fact ("CCPFF") from the record. Complaint

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Counsel filed its opposition to the motion to strike on March 13, 2003. By separate Order issued June 12, 2003, Respondents' motion was granted. For the reasons set forth in that Order, proposed findings of fact that fail to cite any evidence or that cite to documents, graphs, or charts not in evidence have been disregarded.

Many of the documents and parts of the oral testimony were received into the record in camera. Where an entire document or where certain trial testimony was given in camera treatment, but the portion of the document or the trial testimony utilized in this Initial Decision does not rise to the level necessary for in camera treatment, such information is disclosed in the public version of this Initial Decision, pursuant to Commission Rule 3.45(a) (the ALJ "may disclose such in camera material to the extent necessary for the proper disposition of the proceeding"). Material that has been given in camera treatment is indicated in bold font and brackets in the in camera version and is redacted from the public version of the Initial Decision, in accordance with 16 C.F.R. § 3.45(f).

### **E. Summary**

As fully set forth below, Complaint Counsel has established by reliable and probative evidence that the effect of the Acquisition of PDM's EC and Water Divisions by CB&I may be to substantially lessen competition in the relevant markets. CB&I's asserted exiting assets defense fails as a matter of fact and law. Complaint Counsel has met its burden of proof on Count I and Count II of the Complaint. The appropriate remedy is divestiture.

## **II. FINDINGS OF FACT**

### **A. Respondents**

#### **1. Chicago Bridge and Iron**

1. Respondent Chicago Bridge & Iron Company N.V. is a



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foreign corporation organized and existing under the laws of the Netherlands, with its principal place of business at Polarisavenue 31, 2132 JH Hoofddorp, The Netherlands. (Complaint P1; Answer P1).

2. Respondent Chicago Bridge & Iron Company ("CB&I"), a wholly owned subsidiary of Chicago Bridge & Iron Company N.V., is a corporation, as "corporation" is defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44, organized and existing under the laws of the State of Delaware, with its principal place of business at 1501 North Division Street, Plainfield, Illinois 60544. (Complaint P2; Answer P2).

3. Among other products and services, CB&I is engaged in the business of designing, engineering, manufacturing and constructing field-erected LNG, LPG and LIN/LOX storage tanks and TVCs in the United States and abroad. (CX 1033 at 6; CX 212 at CBI-PL 031711).

4. In 1999, prior to the merger, CB&I had revenues of \$ 674 million; in 2000, revenues were \$ 612 million; in 2001, after the merger with PDM, revenues were approximately \$ 1.081 billion. (CX 1033 at 22). CB&I's acquisition of Howe Baker, Inc. (a process contractor operating in gas refining and processing) in December 2000 accounts for an increase in CB&I's revenues. (Glenn, Tr. 4086, 4403-05).

5. CB&I's acts and practices, including the acts and practices alleged in the Complaint, are in or affect commerce as "commerce" is defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44. (Complaint P7; CB&I Answer at P7).

## **2. Pitt-Des Moines**

6. Pitt-Des Moines, Inc. ("PDM") was a corporation organized and existing under the laws of the Commonwealth of Pennsylvania, publicly traded on the American Stock Exchange, with its principal place of business at 1450 Lake Robbins Drive,

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Suite 400, the Woodlands, Texas, 77380. (CX 328 at CBI 001253-CHI; CX 21 at PDM-C 1000003; Byers, Tr. 6732). PDM's headquarters was located at 10200 Grogan's Mill Road, Suite 300, the Woodlands, Texas, 77380. (CX 661 at PDM-HOU017554).

7. In 1999, PDM had a total revenue of \$ 629 million and Earnings Before Interest and Taxes ("EBIT") of \$ 41 million. (CX 520 at TAN 1003289; Scheman, Tr. 2915-16). In 2000, PDM had a total revenue of \$ 659 million and EBIT of \$ 76 million. (CX 520 at TAN 1003289; Scheman, Tr. 2915-16). In 1999, PDM's EC and Water Divisions had total revenues of \$ 281 million and EBIT of \$ 16.1 million. (CX 525 at TAN 1000385). In 2000, PDM's EC and Water Divisions had total revenues of \$ 268 million and EBIT of \$ 0.7 million. (CX 525 at TAN 1000385).

8. Prior to the Acquisition, PDM was a diversified company with several divisions, two of which were PDM Engineered Construction (PDM EC) and PDM Water. Both divisions were acquired by CB&I. (CX 328 at CBI 001253-CHI).

9. Among other products and services, PDM was engaged in the business of designing, engineering, manufacturing and constructing field-erected LNG, LPG and LIN/LOX storage tanks and TVCs in the United States and abroad. (CX 522 at TAN 1003371; CX 850 at PDM-HOU 0129192-0129195, 0129199; CX 911 at CBI 028717-HOU -028726).

### **B. The Acquisition**

10. In August 2000, CB&I offered \$ 93.5 million to PDM. (CX 521 at TAN 1000328). On August 29, 2000, CB&I and PDM entered into a letter of intent for CB&I to acquire PDM's Engineered Construction and Water Divisions. (CX 21 at PDM-C 1000003).

11. CB&I's initial offer of \$ 93.5 million to PDM was negotiated downward to \$ 84 million in December of 2000 because of financial losses suffered by PDM EC in 2000. (Byers,

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Tr. 6789-90). CB&I's purchase price of \$ 84 million was eventually lowered to approximately \$ 76 to \$ 77 million because of losses in PDM's foreign subsidiary, PDM Venezuela, that did not become apparent until after the transaction was consummated. (Byers, Tr. 6793-94).

12. Respondents made their filings under the Hart-Scott-Rodino Act ("HSR") on September 12, 2000. (CX 56 at PDM-HOU 002331). The initial waiting period under HSR expired on October 12, 2000. (CX 56 at PDM-HOU 002331). The Federal Trade Commission did not seek an injunction to prevent CB&I from purchasing PDM EC and PDM Water. On February 7, 2001, CB&I acquired PDM EC and PDM Water ("the Acquisition"). (Byers, Tr. 6764-66).

13. The Complaint in this matter was filed on October 26, 2001. On November 12, 2002, the administrative trial began before D. Michael Chappell, Administrative Law Judge. (Tr. 4).

### **C. The Relevant Geographic Market**

14. The relevant geographic market is the United States. F. 15-17.

15. The parties agree that the relevant geographic market in which to analyze the merger is the United States. (Respondents' Position on Each Element of the Case, October 21, 2002, p.1). Complaint Counsel's expert, Dr. John Simpson, and Respondents' expert, Dr. Barry Harris, agree that the relevant geographic market in which to assess the impact of the Acquisition is the United States. (Simpson, Tr. 3035 (LNG); Harris, Tr. 7192 (LNG); Simpson, Tr. 3361-62 (LPG) (citing CX 116); Harris, Tr. 7280 (LPG); Simpson, Tr. 3421 (LIN/LOX); Harris, Tr. 7300-01 (LIN/LOX); Simpson, Tr. 3488 (TVC); Harris, Tr. 7324 (TVC)).

16. By definition, field-erected LNG, LPG and LIN/LOX storage tanks and TVCs must be built at customers' sites in the United States. "LNG tanks are purchased as part of a larger facility that is designed to supply natural gas to gas users in a

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particular area. As a consequence, the LNG tanks have to be located in a particular locality." (Simpson, Tr. 3034). "LIN/LOX/LAR tanks are purchased as part of a facility that makes liquefied gas, and those facilities are built close to a customer." (Simpson, Tr. 3420).

17. It is economically infeasible to import a field-erected storage tank from anywhere outside the United States. (Kistenmacher, Tr. 840, 881).

#### **D. The Relevant Product Markets**

18. The relevant product markets in which to analyze the Acquisition are large, field-erected: (1) liquefied natural gas ("LNG") storage tanks (individually, or as a component of an import terminal or an LNG peak shaving plant); (2) refrigerated liquid petroleum gas ("LPG") storage tanks; (3) liquid nitrogen, oxygen and argon ("LIN/LOX") storage tanks; and (4) large (over 20 feet in diameter) TVCs ("TVCs"). F. 19-45.

19. Respondents agree that the relevant product markets are field-erected LNG storage tanks, LPG storage tanks, and LIN/LOX storage tanks, and TVCs. (Respondents' Position on Each Element of the Case, October 21, 2002, p.1). Complaint Counsel's expert, Dr. John Simpson, and Respondents' expert, Dr. Barry Harris, agree on the relevant product markets, except that Dr. Harris believes that spheres should not be included in the LIN/LOX market. (Harris, Tr. 7301-02, 7192-95, 7280, 7324). (Simpson, Tr. 2989 (LNG); Harris, Tr. 7192 (LNG); Simpson, Tr. 3356-57 (LPG); Harris, Tr. 7280 (LPG); Simpson, Tr. 3416-17 (LIN/LOX); Harris, Tr. 7300 (LIN/LOX); Simpson, Tr. 3483 (TVC); Harris, Tr. 7324 (TVC)).

#### **1. LNG tanks and facilities**

20. Liquefied natural gas ("LNG") is natural gas that has been converted to a liquid by cooling and condensing the natural gas to about -162 [degrees] C (-260 [degrees] F). (Glenn, Tr. 4066; CX 1259 at CBI-HWH030454). LNG is composed primarily of

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methane (typically at least 90%), but may also contain ethane, propane and heavier hydrocarbons. (Kistenmacher, Tr. at 889; CX 1259 at CBI-HWH030464). Neither LNG, nor its vapor, can explode by common ignition sources in an unconfined environment. (CX 1259 at CBI-HWH030469). LNG weighs approximately 45% as much as the same volume of water. (See CX 1259 at CBI-HWH030465).

**a. LNG tanks**

21. LNG storage tanks are a type of cryogenic tank that stores natural gas at a temperature of -260 [degrees] F. (Kistenmacher, Tr. 879; CX 1074 at CBI-001243-PLA). Due to these very cold temperatures, LNG storage tanks are made of 9% nickel steel which has certain crack arresting properties when containing LNG at low temperatures, and is less brittle than carbon steel. (Kistenmacher, Tr. 881-82; CX 1074 at CBI-001245-PLA; Glenn, Tr. 4109-10).

22. The purpose of an LNG tank is to contain natural gas in liquid form. (Glenn, Tr. 4066; Price, Tr. 530). When stored at ambient temperatures (i.e. room temperature), natural gas takes a gaseous form. (CX 1259 at CBI-HWH030454). When liquefied, natural gas is far easier to store, as natural gas in gaseous form takes up 600 times the volume of its liquid equivalent. (CX 1259 at CBI-HWH030454).

23. LNG tanks typically are double-walled and often use perlite insulation between the two shells and may have some form of concrete containment for safety reasons. (Glenn, Tr. 4110; Kistenmacher, Tr. 881-82; CX 1074 at CBI-001243-PLA). The outer walls of single containment tanks are carbon steel and the inner walls are nine percent nickel steel. (CX 1074 at CBI-001243-PLA).

24. An LNG tank often has a diameter of 200 feet or more and can store millions of gallons of LNG. (Price, Tr. 524-525; Kistenmacher, Tr. 879; CX 176 at CBI-PL010926, in camera; CX 162 at CBI-PL006153; Puckett, Tr. 4566; J. Kelly, Tr. 6260).

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**b. LNG import terminals**

25. LNG import terminals are "facilities to receive an LNG tanker, offload LNG into LNG storage tanks, take the LNG from those storage tanks over time, vaporize it, pressurize the gas, and send it out into a pipeline." (Bryngelson, Tr. 6170). The terminals include storage tanks, ship loading/unloading facilities, send-out facilities and vapor handling systems. (CX 650 at CBI/PDM-H4019758). LNG is stored in the tanks, pumped out, vaporized and injected into pipelines for transmission to end users. (CX 853 at PDM-HOU011487).

**c. LNG peak shaving plants**

26. LNG peak shaving plants store LNG to provide an emergency reserve of LNG in the event that gas customers experience a severe shortage of natural gas. (CX 650 at CBI/PDM-H4019758). LNG peak shaving plants consist of a liquefaction unit, where the gas is turned into liquid, and LNG storage tanks. (Kistenmacher, Tr. 884-85). In LNG peak shaving facilities, natural gas from a pipeline is refrigerated in the liquefaction unit and stored in liquid form in an LNG tank during the warmer months when demand and prices are low. (CX 142 at CBI 000241-HOU). As gas demand increases in colder months, the stored LNG is heated, vaporized and put back into the supply stream to meet heating demand peaks, when prices are high. (CX 142 at CBI 000241-HOU; Hall, Tr. 1775-1776).

27. LNG tanks in peak-shaving facilities are similar to, but tend to be smaller than, LNG tanks used at import terminals. (Glenn, Tr. 4070; Bryngelson, Tr. 6141-42).

28. Luke Scorsone, President of CB&I Industrial and former President of PDM-EC, could not cite a single instance in which a potential customer of an LNG tank tried to get a lower price by threatening to switch to an alternative to an LNG tank. (Scorsone, Tr. 2845).

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29. The large tanks required for LNG storage are much too large to practically shop-fabricate and ship to the site. (Andrukiewicz, Tr. 6697-98). Shop-fabricated tanks cannot provide the storage levels required for LNG facilities. A shop-fabricated tank provides less than 1% of the storage that a field-erected LNG tank provides. (RX 6 at CBI-PL 031593). Shop-built tanks have size limitations and are "not a direct substitute for larger quantities of LNG." (Davis, Tr. 3184). LNG tanks designed to hold above a certain volume of LNG must be field-erected. (Blaumueller, Tr. 287). The largest shop-built tanks "would pale in comparison to field tanks." (Davis Tr. 3184-85). For example, 420 shop erected tanks would be required to replace one large LNG tank. (Price, Tr. 536-37).

**2. LPG tanks**

30. Liquid petroleum gas ("LPG") tanks are field-erected, refrigerated tanks that store liquefied gases such as propane, butane, propylene and butadiene at refrigerated temperatures of around -50 [degrees] F. (Warren, Tr. 2275, 2306; CX 258 at CBI-H001793; CX 650 at CBI/PDM-H 4019758; CX 993 at PDM-HOU021479).

31. The LPG market does not include pressure vessels or tanks which store gases that are liquified using pressure and stored at ambient temperatures. There are two types of high pressure storage tanks used to store liquid petroleum gasses -- bullets and field-erected pressure spheres. Bullets are ambient temperature, low pressure spheres or storage vessels that are usually built in a shop. Pressure spheres are ambient temperature pressure vessels supported by columns or plate skirts. (JX 37 at 19 (Newmeister, Dep.)). These two types of storage tanks are not in the LPG market because they are not economic substitutes for field-erected, refrigerated tanks (which comply with the API 620, Appendix R standard). (JX 27 at 39-39, 141-42 (N. Kelley, Dep.); Crider, Tr. 6720).

32. LPG customers are oil and petrochemical companies, such as Marathon, Enron, and Texaco; owners of LPG terminals, such

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as Sea-3, CMS Energy, and Intercontinental Terminals Co., that import/export LPG and transfer the LPG between ships and storage tanks via pipelines; and engineering, procurement, and construction ("EPC") contractors, such as Fluor, who subcontract tank suppliers to build LPG tanks for larger facilities. (CX 993 at PDM-HOU-021484).

### 3. LIN/LOX tanks

33. LIN is an industry expression for liquid nitrogen. A LIN tank is a special tank that stores liquid nitrogen at atmospheric pressure. LOX is the industry expression for liquid oxygen. A LOX tank stores liquid oxygen. (Kamrath Tr. 1982-83); V. Kelley Tr. 4596). LAR is the industry expression for liquid argon and a LAR tank stores liquefied argon. (Patterson, Tr. 340-41). Tanks to hold LIN, LOX or LAR are commonly referred to as LIN/LOX tanks. (Patterson, Tr. 340-41).

34. LIN/LOX tanks are field-erected cryogenic tanks that store various liquid gas products at cryogenic temperatures, typically at -300 [degrees] F or lower. (CX 650 at CBI/PDM-H4019758). LIN/LOX tanks typically hold 400,000 to 1,000,000 gallons and cost \$ 500,000 to \$ 1 million each. (CX 170 at CBI-PL009650).

35. The LIN/LOX market does not include spheres, which are constructed in a different manner, serve different functions, and are not a substitute for LIN/LOX tanks. (Harris, Tr. 7301-02).

36. LIN/LOX tanks typically include an inner and outer shell of steel material. (JX 37 at 13 (Newmeister, Dep.)). The inner tank is made of stainless steel to withstand cryogenic temperatures without becoming brittle and cracking. (Kistenmacher, Tr. 835). Between the two shells is perlite insulation. (Kistenmacher, Tr. 833-834). LIN/LOX tanks have dome roofs, safety relief valves and nozzles that connect to piping and other equipment. They are built to withstand wind and seismic conditions. (Kistenmacher, Tr. 864).



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#### 4. Thermal Vacuum Chambers

37. A thermal vacuum chamber ("TVC") is a large metal enclosure used to simulate the vacuum of space for the purpose of testing satellites and satellite components prior to launch. (Gill, Tr. 179-83; Neary, Tr. 1423-24). A TVC simulates the atmospheric and thermal conditions found in space. (Gill, Tr. 183; Proulx, Tr. 1722-23; Thompson, Tr. 2039-40; Higgins, Tr. 1264).

38. During a test, air is pumped out of the enclosure and, within the enclosure, liquid or gaseous nitrogen circulates through pipes to heat or cool the interior environment. Controls allow users to adjust the temperature and vacuum conditions inside the enclosure so that satellites can be tested in a space-like environment. (Thompson, Tr. 2039-40). Temperatures simulated within the chamber can range "from minus 180 degrees C to plus 150 degrees C" and the vacuum can range from  $1 \times 10^{-6}$  torr to  $1 \times 10^{-8}$  torr. (Higgins, Tr. 1262; Scully, Tr. 1143).

39. The customers of field-erected TVCs are aerospace companies such as Boeing Satellite Systems ("Boeing"), Raytheon Systems, Spectrum Astro and TRW Space & Electronics ("TRW"); and government agencies, such as NASA. TVCs are used to test satellites purchased by the Department of Defense, NASA and commercial buyers. (Neary, Tr. 1420; Glenn, Tr. 4074-75; see also CX 1196 at PDM-HOU011524-011525 (list of PDM customers)).

40. "Customers are typically testing satellites costing \$ 50MM to \$ 200MM in TVCs costing \$ 5MM - \$ 20MM." (CX 212 at

CBI-PL031718). The satellites sold by TRW range in value from \$ 750 million to \$ 1.5 billion, while those sold by Spectrum Astro, a smaller satellite manufacturer, range in value from \$ 10 million to \$ 55 million. (Neary, Tr. 1420-21; Thompson, Tr. 2038).

41. TVCs are the only satellite testing equipment capable of

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simulating the vacuum and thermal conditions of outer space. (Higgins, Tr. 1262-63). Other testing chambers are not substitutes for TVCs because they only simulate other conditions. (Scully, Tr. 1139; Proulx, Tr. 1729). Large satellite customers require that manufacturers test their satellites in TVCs. (Neary, Tr. 1424).

42. Scorsone could not recall an instance in which a potential customer of a TVC tried to get a lower price by threatening to switch to an alternative. (CX 646 at 76-77 (Scorsone, IHT)).

43. The construction of a shop-fabricated TVC is "markedly different" from the construction of a field-erected TVC. (Scully, Tr. 1101-02; Gill, Tr. 235). "In shop-built chambers, all of the equipment and capability, personnel capability, lies within the confines of the shop." (Scully, Tr. 1103). However, some shop-built TVCs still require field-erection, including for example, the small field-erected chambers being built by XL/Votaw for Raytheon Systems. (Hart, Tr. 406-07). In contrast, field-erected chambers require a crew that "virtually lives in the field for elongated periods of time. . . . It's a vastly different technology than what a shop-built chamber requires." (Scully, Tr. 1103).

44. Satellites above a certain size cannot be tested in shop-fabricated TVCs. (Scully, Tr. 1139; Neary, Tr. 1425). Consequently, shop-fabricated TVCs are not an alternative to large, field-erected TVCs for testing large satellites. (Scully, Tr. 1140).

45. Other products, such as "thermal cycling chambers" and "altitude chambers" are not functional equivalents because they cannot mimic the conditions a satellite will face in space. (Neary, Tr. 1463-64; see Scully, Tr. 1135-39).

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**E. Effects on Competition in the LNG Market****1. Overview of the LNG market**

46. Construction of an LNG tank is "highly specialized" work. (Hall, Tr. 1831; Kistenmacher, Tr. 881; see Andrukiewicz, Tr. 6702 ("just in my own knowledge of LNG we're talking about a cryogenic fluid that is stored at minus 260 degrees Fahrenheit, clearly has different handling characteristics than the oil tank that may be located in my basement for heating fuel. So clearly there is a degree of specialized -- in fact, the preliminary engineering report speaks to the specialty nature of the construction of these facilities."). When addressing his investors, Mr. Gerald Glenn, Chairman, President and CEO of CB&I, emphasized that "a lot of owners out there, if they go to build a sophisticated project, like an LNG project or an LNG tank, they don't want to take a chance on a low price and a potential second class job or shoddy welding or any of that kind of stuff. The kind of work that we do is very specialized, very sophisticated." (CX 1731 at 44).

47. There is special expertise required in constructing an LNG tank, because "you would have to use the right welding technique to weld that particular type steel," which is a "different type of welding technique from ordinary carbon steel." (Hall, Tr. 1792). LNG tanks require sophisticated engineering analysis to take into account expansion and contraction because of differences in temperatures. (Newmeister, Tr. 1566; Kistenmacher, Tr. 881).

48. The engineering of an LNG tank entails special challenges. The inner tank of an LNG tank holds cryogenic fluid at a very low temperature while the outer tank is at ambient temperature. (Kistenmacher, Tr. 842). The inner tank shrinks when it comes into contact with the cryogenic fluid and there are differential rates of shrinking between the inner and outer tank. (Kistenmacher, Tr. 842). Consequently, an LNG tank engineer must have very specialized knowledge relating to how tank materials behave during the shrinking process; how to design piping for the tank; and how to avoid cracking of the tank components. (Kistenmacher, Tr. 842).

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49. PDM EC used three fabrication facilities located in Warren, Pennsylvania, Clive, Iowa, and Provo, Utah. (Scorsone, Tr. 4892). CB&I Industrial utilizes fabrication shops in Houston, Texas and Provo, Utah. (Scorsone, Tr. 4893).

50. In assembling its labor force, CB&I uses a core team of 4-5 management employees, including a project manager and two or three key people to begin the project. (Rano, Tr. 5917-18, 5952-53). CB&I recruits local labor, workers who live less than 100 miles from the jobsite, to help construct the facility. (Rano, Tr. 5906-07).

51. To build a field-erected LNG tank requires constructing the foundation. (Rano, Tr. 5920). CB&I subcontracts the foundation work to a company with an expertise in concrete work. (Rano, Tr. 5920).

52. The field-erection process for an industrial tank involves erecting the structure in accordance with the plans and contract specifications and testing the work quality. (Scorsone, Tr. 4895-96). The construction of LNG tanks involves rigging, which is the practice of attaching cables, slings, and ropes to pieces and hoisting them into position. (Scorsone, Tr. 4897-98).

53. To weld a field-erected LNG tank, two different welding processes are used: (1) hand welding, in which the welder holds the welding cable in his hand; and (2) submerged arc welding, which involves the use of a welding machine. (Rano, Tr. 5930-31). These welding processes are not only used for LNG tanks, but also for LPG tanks, water tanks, and oil tanks. (Rano, Tr. 5931). Construction of LNG tanks requires welders trained in procedures unique to welding 9% nickel steel (a special alloy that is not widely used), that can weld together the tank's large steel pieces with a precision that eliminates leaks. (Cutts, Tr. 2379; Kistenmacher, Tr. 881-82; Fabel, Tr. 1628-29, in camera; Hall, Tr. 1792; JX 30 at 180-81 (Outtrim Dep.)). A CB&I due diligence report on PDM's construction practices states that "CB&I has some of the best welders in the industry . . . Over the years CB&I

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has felt that our welding expertise is one of our core strengths." (CX 1357 at CBI-H 4000270-271).

54. Mr. W. T. Cutts, Vice President with American Tank & Vessel, Inc. ("AT&V"), states that LNG tanks are ". . . built out of fairly sophisticated materials. You don't just weld them up any old way. And its actually automated equipment that you weld them up with. The equipment is quite expensive to develop. You can go buy it, but the stuff you buy has to be modified and tailored, and then you have to build procedures around it. So it's not like you can go buy an automobile. It's unique equipment and the procedures that go with that make it very unique. . . ." (Cutts, Tr. 2379). Peter Rano, a CB&I vice president, testified that CB&I considers its welding procedures for LNG projects to be proprietary work product which it does not want to fall into the hands of its competitors. (Rano, Tr. 6028-29).

## **2. Demand in the LNG market**

55. The LNG tank market is a "worldwide market" in which a few LNG contractors compete against each other all over the world. (Eyer mann, Tr. 6994; J. Kelly, Tr. 6262). Demand for LNG in the United States had been very small over the past 20 to 30 years. (Glenn, Tr. 4091; Carling, Tr. 4513; J. Kelly, Tr. 6263). However, demand for LNG facilities has increased since the 1990s, as a number of companies are developing LNG import terminals in the U.S., the Caribbean, and Mexico. (Scorsone, Tr. 4934; Jolly, Tr. 4701-02, in camera). See generally F. 88-143. CB&I believes demand is rising and will continue to rise over the next 10 to 20 years, due to rising gas prices. (Glenn, Tr. 4091). [redacted] (Outtrim, Tr. 699, in camera).

56. There are three basic types of LNG tanks: (1) single containment; (2) double containment; and (3) full containment. (Puckett, Tr. 4541; Bryngelson, Tr. 6170-71).

57. Single containment LNG tanks store LNG in a nine percent nickel steel inner tank that is surrounded by a low earthen dike which would contain LNG in case of a leak. (Puckett, Tr.

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4541; Bryngelson, Tr. 6170-71; CX 1074 at CBI 001243-PLA). Double containment tanks have the same nine percent nickel steel inner tank as a single containment tank, but offer a concrete outer tank to contain spillage from the inner tank. (Price, Tr. 530-32; CX 1074 at CBI 001243-PLA). Full containment tanks consist of a self-supporting inner tank and the outer tank used in a double-containment tank, but also include a concrete roof, so that the inner tank is completely encapsulated in a concrete shell. (CX 1074 at CBI 001243-PLA). Full containment tanks are designed to contain both the spillage of refrigerated liquid and the vapor resulting from leakage. (CX 1074 at CBI 001243-PLA- 1244).

58. With the exception of the tank built by PDM for Enron in Puerto Rico, all LNG tanks that have been built in the United States are single containment tanks. (CX 1645; Glenn, Tr. 4110-4111; Jolly, Tr. 4701-02, 4708-09, in camera).

59. Customers view full and double containment tanks as safer than single-containment tanks. (Glenn, Tr. 4112-13; Hall, Tr. 1843; Scorsone, Tr. 4922).

60. An owner can site a double and full containment LNG tank on a smaller piece of property than it could for a single containment tank in order to comply with federal laws relating to vapor dispersion and thermal radiation in the event of a spill. (Scorsone, Tr. 4922). Full-containment tanks are more likely to be used "if you are closer to population in more of an urban setting or close to an urban setting, full-containment typically is used just for the extra bit of safety it has." (Bryngelson, Tr. 6133).

61. Full-containment tanks are 30-100% more expensive than single-containment tanks. (RX 157 at BP 02 004; CX 124 at PDM-HOU2011156; CX 1075 at CBI-001240-PLA; CX 1161 at CBI/PDM-H4008131-133, in camera; JX 23a at 89 (Cutts, Dep.); Jolly, Tr. 4724-25, in camera).

62. Two expansion projects in Cove Point, Maryland ("Cove Point I," Williams Energy) and Lake Charles, Louisiana (CMS Energy) specify the use of additional single containment tanks.

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(Eyermann, Tr. 7053-54). Southern Natural Gas, an affiliate of El Paso, is planning on building a single containment LNG tank at Elba Island, Georgia. (Bryngelson, Tr. 6214). Memphis Light Gas & Water will likely build a single containment tank when it expands its current facility. (Hall, Tr. 1831, 1842). The tanks for Dynegy's Hackberry facility will be full containment tanks. (Puckett, Tr. 4541-42). Cheniere Energy's Freeport LNG tank will be double containment. (Eyermann, Tr. 6968). Williams Energy's Cove Point II tanks will be full containment. (Scorsone, Tr. 4987-88). Yankee Gas and Calpine have not determined what types of tanks will be built. (Andrukiewicz, Tr. 6464-65; Izzo, Tr. 6522).

### **3. Market shares and concentration in the LNG market prior to Acquisition**

#### **a. Tank projects awarded**

63. There are four LNG import terminals in the United States: Everett, Massachusetts; Cove Point, Maryland; Elba Island, Georgia; and Lake Charles, Louisiana. (Glenn, Tr. 4068-69). PDM constructed the storage tanks for the Cove Point, Maryland and Lake Charles, Louisiana terminals. (CX 853 at PDM-HOU011488). CB&I constructed an LNG tank in Everett, Massachusetts and built three LNG tanks in Elba Island, Georgia. (CX 154 at CBI-PL002958, 961).

64. There are seventy five LNG peak shaving plants in the United States. (CX 125, at CBI-HOU 2017163-167). CB&I and PDM have constructed all but six of these. (CX 125, at CBI-HOU 2017163-167). The last time a firm other than CB&I or PDM built an LNG tank in the United States was in 1975, by Graver, a company that is now out of business. (CX 125 at PDM-HOU2017165; CX 1546).

65. From 1990 to the Acquisition, there have been nine LNG tank projects awarded. Of the nine awarded projects, CB&I won five projects and PDM won four. A project for [redacted] and a project for Atlanta Gas Light Co. were subsequently canceled. (Simpson, Tr. 3046, 3052-54; CX 1210, in camera; CX 824; CX

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1212, in camera; CX 26 at CBI-PL069530, in camera; RX 757).

66. LNG tank awards to CB&I are: South Carolina Pipeline Corp. (1991); Liquid Carbonic (1992); Memphis Light Gas & Water ("MLGW") (1995); [redacted]; Pine Needle LNG Co. (1995). LNG tank awards to PDM are: Citizens Gas & Coke Utility (1991); Enron (1997); Atlanta Gas Light Co. (1998); Cove

Point I (2001). (Simpson, Tr. 3046, 3052-3055; CX 1210, in camera; CX 824; CX 1212, in camera; CX 26 at CBI-PL069530, in camera; RX 757).

67. No foreign company has ever built an LNG tank in the United States. (Jolly, Tr. 4683, in camera; CX 125).

**b. HHI calculations**

68. From 1990 to Acquisition, CB&I's market share, based on sales, is 45.3%. PDM's market share, based on sales is 54.7%. (See Simpson, Tr. 3055-58; CX 1646). The combined market share of the two companies is 100%. Assigning shares based on sales, Dr. Simpson testified that the premerger HHI was 5,044, the change in the HHI as a result of the Acquisition was 4,956, and the post-acquisition HHI is 10000. (Simpson, Tr. 3055 (referencing CX 1646)).

69. Dr. Simpson calculated LNG HHI based on data from 1990 to Acquisition. (Simpson, Tr. 3703). Dr. Simpson admitted that he chose 1990 as the beginning date for his HHI analysis because 1990 was the cut-off date for discovery and thus his information dated back to 1990. (Simpson, Tr. 3704-05).

70. If data dating back to 1996 instead is used to calculate HHI, CB&I had no sales over that time period and the change in the HHI based on sales in the LNG market would be zero. (Harris, Tr. 7228; Simpson, Tr. 3721-22, 3743-44).



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71. The LNG tank market is a thin market, with very few data points to look at. (Harris, Tr. 7218).

**c. Bidders on projects**

72. For all but two LNG tank projects from 1990 to Acquisition (MLGW and Atlanta Gas & Co.), no company other than CB&I and PDM submitted bids. (Simpson, Tr. 3670; CX 161 at CBI-PL006114).

73. On the 1994 MLGW LNG tank, in addition to CB&I, PDM, Lotepro/Whessoe International, and Black & Veatch/Toyo Kanetsu K.K provided bids. (Hall, Tr. 1804-05).

**4. Respondents were each others' closest competitors in the LNG market**

74. Dr. Harris acknowledges that prior to the merger, United States LNG tanks were built entirely by CB&I and PDM. (Harris Tr. 7196, 7521-22). According to Dr. Harris, "until roughly 2001 I guess, the competitors in the market, . . . were almost entirely limited to CB&I and PDM." (Harris, Tr. 7220).

**a. Respondents' views**

75. An LNG/Aerospace marketing presentation, dated November 2000, states that CB&I was "PDM's competition for LNG tanks alone." (CX 116 at PDM-HOU019176).

76. PDM's 2000 Business Plan states that "CB&I is PDM EC's domestic competition for LNG tanks." (CX 94 at PDM-HOU017580).

77. PDM characterized CB&I as "PDM EC's only competitor on domestic cryogenic, LNG, LPG, Ammonia and thermal vacuum projects." (CX 107 at PDM-HOU005016).

78. In a 1997 PDM Customer Briefing, PDM determined that

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with "only two capable LNG tank builders in the U.S. (PDM and CB&I) our teaming with Air Products has essentially put Lotepro and other liquefaction design companies out of the LNG business in the domestic U.S." (CX 113 at PDM-HOU014838).

**b. Industry views**

79. Industry participants recognize that prior to the merger, CB&I and PDM built nearly all of the field-erected LNG tanks in the United States. (Kistenmacher, Tr. 891; Outtrim, Tr. 714-15, in camera ("From 1965 through '97 or so, the only two companies pretty much across the board that built LNG plants in the United States were PDM and CB&I"); Cutts, Tr. 2390 (CB&I and PDM "dominated the marketplace significantly and the interpretation by most people would have been that any large cryogenic projects in the United States would have been built by CB&I or PDM.")).

80. Robert Davis, Director of HYCO Services for Air Products, testified that "virtually all, with just very few exceptions, of the LNG tanks in this country had been built by CB&I and PDM." (Davis, Tr. 3131-32).

81. John Newmeister, Vice President of Marketing and Business Development at Matrix Services, Inc., explained that historically the suppliers of LNG tanks in the U.S. were "CB&I, PDM and possibly Graver," but with Graver's exit and CB&I's acquisition of PDM, "the list of qualified LNG tank suppliers decreased to one." (Newmeister, Tr. 2166).

82. Brian Price, Vice President of LNG Technology for Black & Veatch, who competed against CB&I and PDM for the MLGW LNG project, saw first-hand that "the two competitors with the lowest prices were CB&I and PDM." (Price, Tr. 558).

**c. Competition between Respondents lead to lower prices**

83. In 1994, MLGW sought bids for the construction of a peak-shaving plant in Capleville, Tennessee. (Hall, Tr. 1778). Mr. James Clay Hall, project engineer and manager for MLGW,

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believed that "essentially we had two viable companies in the United States that could compete" for the project - CB&I and PDM. (Hall, Tr. 1799-1800). Nevertheless, MLGW encouraged Black & Veatch, an engineering firm, "to team up with a foreign tank builder to compete," and also encouraged Lotepro, a German engineering firm, to compete in the bidding process. (Hall, Tr. 1799).

84. PDM was the lowest bidder for the MLGW project, but PDM's bid was rejected as non-conforming to the specifications. (Price, Tr. 560; Hall, Tr. 1877-78). The prices quoted by CB&I and PDM were comparable. (Hall, Tr. 1876). CB&I provided the next lowest bid at \$ 10,500,000. (Price, Tr. 560; Kistenmacher, Tr. 899; CX 829 at 5). Lotepro/Whessoe International's bid for the LNG tank was \$ 15,000,000. (Kistenmacher, Tr. 899; CX 829 at 5). Black & Veatch/Toyo Kanetsu K.K.'s bid for the LNG tank was \$ 16,700,000. (Price, Tr. 648).

85. The tank was awarded to CB&I and included an [redacted]. (Harris, Tr. 7501; CX 906 at CVI 031076-HOU, in camera).

86. In 1998, Atlanta Gas Light Company ("Atlanta") sent requests for bids to CB&I, PDM/Air Products, and a third competitor, Marlborough Enterprises, for a proposed LNG peak shaving facility. According to CB&I, "[Atlanta] considered the Marlborough bid more of a courtesy proposal with the real competition between CB&I and PDM/AP." (CX 161 at CBI-PL006113). Atlanta awarded the business to PDM because it offered a lower price than CB&I [redacted] and a shorter construction schedule. (CX 161 at CBI-PL006114; CX 1321 at CBI-PL 069518, in camera). The Atlanta project was never built. (Simpson, Tr. 3054).

87. In 2000, CB&I and PDM competed against each other to win a 750,000 barrel LNG tank for Columbia LNG to be built at Cove Point. (CX 293 at CBI/PDM-H 4008141). Prior to the Acquisition, CB&I and PDM bidding against each other constrained pricing for the Cove Point project. F. 184-85.

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### **5. Competition in the LNG market from Acquisition to time of trial**

88. The parties presented evidence on numerous LNG projects announced recently. LNG projects that are outside the United States are outside the relevant geographic market. Findings relating to tank projects in the relevant market follow.

#### **a. Dynegy's Hackberry Facility**

89. Dynegy is currently scheduled to build a large LNG import facility that will be located on the Calcasieu River, south of Lake Charles, Louisiana, in the town of Hackberry. (Puckett, Tr. 4539). The facility will contain three LNG full containment tanks, two docks for receiving LNG ships, pump and vaporization capacity of 1.5 billion cubic feet per day, and roughly 30 miles of pipeline to move the gas from the terminal to other interstate pipelines for delivery. (Puckett, Tr. 4539-40). When completed, the Hackberry facility will be the largest LNG regasification facility in the United States. (Puckett, Tr. 4540).

90. Dynegy estimates that the approximate dollar value for the entire project is somewhere between \$ 550 to \$ 700 million. (Puckett, Tr. 4565). Dynegy estimates that each of the three LNG tanks will cost around \$ 40 or \$ 50 million. (Puckett Tr. 4566).

91. Dynegy asked four tank builders, Toyo Kanetsu K.K. ("TKK"), S.N. Technigaz ("Technigaz"), Skanska AB ("Skanska"/Whessoe International ("Whessoe")), and CB&I, to provide lump-sum turnkey bids for the construction of the Hackberry LNG tanks. (Puckett, Tr. 4552-53).

92. As part of the bid procedure, Dynegy required CB&I to submit its drawings, technical information and a firm price to Black & Veatch, Dynegy's consultant. (Glenn, Tr. 4130-31).

93. Black & Veatch had concerns that if a domestic tank manufacturer did not participate in the bid contest, Dynegy would

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receive higher prices for the tanks. (Price, Tr. 622).

94. CB&I met with Dynegy and indicated that it was uncomfortable providing a bid given that Black & Veatch, a major competitor, was acting as the EPC contractor, and was under contract with Skanska/Whessoe. Skanska/Whessoe was a bidder for the LNG tanks. (Glenn, Tr. 4411). CB&I did not want Skanska to obtain its bidding information or to gain access to its prices and designs. (Puckett, Tr. 4577-78). Further, given these circumstances, CB&I believed that its chances of being awarded the project were slim. (Glenn, Tr. 4411). Prior to the bid due date, CB&I indicated to Dynegy that it was not going to submit a bid, however, CB&I was prepared to submit a proposal to cover the construction of the entire project on a turnkey basis. (Puckett, Tr. 4559). CB&I told Dynegy that the "project as structured does not fit our corporate strategy." (CX 139 at CBI 019779-HOU).

95. Generally, "turnkey, design build projects typically return higher margins than standalone storage tank projects." (CX 660 at PDM-HOU 005013). Scorsone agreed that industry participants view a turnkey project to result in "higher margins." (Scorsone, Tr. 2812-13).

96. CB&I sent Dynegy a letter expressing its decision not to submit a tank-only bid. (Glenn, Tr. 4133-34; RX 143). In its letter, CB&I again offered to construct the Hackberry facility on a turnkey basis. (RX 143). Dynegy rejected CB&I's second attempt to propose a turnkey approach. (Puckett, Tr. 4559-60).

97. After learning of CB&I's decision not to bid, Dynegy further solicited a tank-only bid by offering to let CB&I submit its bid directly to Dynegy and promising not to share the information with Black & Veatch. (Puckett, Tr. 4578; Glenn, Tr. 4134-35; RX 144).

98. Dynegy received bids sometime after February 1, 2002 from TKK/AT&V, Skanska/Whessoe, and Technigaz/Zachry. (Puckett, Tr. 4556). All three of the bids Dynegy received met its

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technical expectations and were within Dynegy's expected price range. (Puckett, Tr. 4557).

99. CB&I decided that if Dynegy would accept and evaluate the bids itself, CB&I would submit a tank-only bid. (Glenn, Tr. 4136). CB&I communicated its decision to Dynegy within two to three weeks after it received Dynegy's offer. (Glenn, Tr. 4136). CB&I requested to submit a tank-only bid in March of 2002. (Glenn, Tr. 4412; Puckett, Tr. 4578).

100. Dynegy responded to CB&I's request by informing CB&I that Dynegy was satisfied with the three tank-only bids it had received and telling CB&I that it was too late in the process to accept its bid. (Puckett, Tr. 4559-60; Glenn, Tr. 4137).

101. [redacted] (Jolly, Tr. 4690-91, in camera). [redacted] (Jolly, Tr. 4760, in camera).

**b. CMS Energy, Lake Charles, Louisiana Expansion**

102. CMS Energy ("CMS") is planning to build one single containment tank expansion to its existing Lake Charles, Louisiana facility. (J. Kelly, Tr. 6260). The CMS expansion project will involve constructing an LNG tank on a site that already contains numerous single containment LNG tanks. (Eyermann, Tr. 7053-54).

103. [redacted] (J. Kelly, Tr. 6284, 6292, in camera). [redacted] (J. Kelly, Tr. 6293, in camera).

104. [redacted] (RX 595 at CBI 060850, in camera). [redacted] (Scorsone, Tr. 5075-76, in camera) [redacted] (RX 595 at CBI 060850, in camera).

105. CMS Energy has awarded the tank portion of the contract to CB&I over Skanska/Whessoe. (Glenn, Tr. 4399).

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**c. El Paso/Southern LNG: Elba Island**

106. [redacted] (Scorsone, Tr. 5077-78, in camera). [redacted] (Scorsone, Tr. 5078, in camera).

107. [redacted] (RX 640 at CBI 069126, in camera). [redacted] (Scorsone, Tr. 5079, in camera).

**d. Poten & Partners**

108. CB&I is negotiating a sole-source contract to construct an LNG import terminal for Poten & Partners in the Northeastern United States. (Glenn, Tr. 4399).

**e. British Petroleum**

109. British Petroleum ("BP") is a global petrochemical company based in Britain with operations all over the world. (JX 33 at 19-20 (Sawchuk, Dep.)). BP is evaluating the possibility of constructing three new LNG import terminal facilities in the United States. (JX 33 at 9-10 (Sawchuk, Dep.)).

110. BP has decided to work with CB&I on the front end development of these projects. (Glenn, Tr. 4180). If BP is satisfied with CB&I's pricing, schedule and terms and if the projects move forward, BP has indicated that CB&I will be awarded those jobs. (Glenn, Tr. 4180).

111. Generally, a sole-source supplier can earn higher margins than if competing against other firms in a competitive bidding situation. (See Kamrath, Tr. 2030 ("we found that always a competitive bid resulted in a better cost for us, lower cost [than 'sole sourcing']"); Outtrim, Tr. 720-21, in camera (cost of sole-sourced LNG tank from CB&I was [redacted] more than comparable facilities). However, using one contractor may provide an owner with greater flexibility, lower costs, and may save time when a project is under development. (Bryngelson, Tr. 6134; Scorsone, Tr. 4959).

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112. In an internal memorandum discussing the status of BP's LNG re-gas terminals and storage tanks and status of work with CB&I, BP noted, "there is less competition than we would like on a regional basis. Since their acquisition of PDM, CB&I now dominate the US market." (CX 693 at BP 01 027). Having assessed the firms that could supply the LNG tanks as a subcontractor or as a main contractor, BP asked what would be the best way of going forward. BP's "key choices in the US will be: - do we form a closer relationship with CB&I in order to guarantee access to the resources we need for our US regas projects? - or do we deepen the market in the US by encouraging competition?" (CX 693 at BP 01 028).

113. In an internal memorandum assessing competition in the LNG market in August 2001, BP stated: "since the acquisition of PDM, a couple of companies have come forward to state that they can build LNG tanks in the US. . . . [However], the reality for today is that in the US, [CB&I is] the leading company in the LNG Tank business and the other competitors will need to demonstrate their capabilities in this market." (CX 691 at BP 10 032).

**f. Cove Point II**

114. Williams Energy ("Williams") has plans to add between four and six new LNG tanks to its existing Cove Point facility in Cove Point, Maryland ("Cove Point II expansion").

(Scorsone, Tr. 4987-88). These additional tanks are required to be full-containment designs because of property limitations at Cove Point. (Scorsone, Tr. 4988).

115. CB&I has submitted budgetary pricing for the Cove Point II expansion. (Scorsone, Tr. 4962; Glenn, Tr. 4148).

116. TKK, in partnership with DYWIDAG and AT&V, submitted budgetary pricing to Halliburton KBR for the Cove Point II expansion. (RX 185 at TWC 000003). Under this arrangement, TKK would execute the engineering, procurement,



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and select vendors/subcontractors. (RX 185 at TWC 000036). AT&V will be responsible, under TKK's direct control, for site construction and fabrication of materials done in the U.S. (RX 185 at TWC 000036). DYWIDAG will be responsible for the civil engineering aspects of the facility. (RX 185 at TWC 000035).

**g. Yankee Gas**

117. In 2001, Yankee Gas, a natural gas distribution company, initiated plans to construct an LNG peak shaving facility in Waterbury, Connecticut. (JX 21 at 17-18 (Andrukiewicz, Dep.); Andrukiewicz, Tr. 6439-40).

118. During the first quarter of 2001, Yankee Gas retained the services of CHI Engineering ("CHI"), a consulting firm, to perform a preliminary engineering and budget study. (JX 21 at 23 (Andrukiewicz, Dep.); CX 1507 at CBI 059483).

119. On April 23, 2001, CHI issued a request for prices exclusively for the LNG tank portion of the project rather than "facility turnkey pricing." (CX 1507 at CBI 059483). CHI's request was sent to CB&I, Skanska/Whessoe and Technigaz. (JX 21 at 24 (Andrukiewicz, Dep.)).

120. On May 4, 2001, CB&I wrote Chris Beschler, VP of Operations at Yankee Gas, that CB&I wanted to do the work on a turnkey basis but also expressed that CB&I would be "an excellent choice to support any project Yankee Gas Services Company may have in the LNG industry." (CX 417 at CBI 026845-HOU). Eric Frey, CB&I's representative to Yankee Gas, intended to "make every effort to restructure how the project will be bid and executed." (CX 430 at CBI 026934-HOU).

121. CB&I submitted its budgetary pricing to CHI on June 12, 2001. (RX 4 at 4). CB&I submitted rough pricing because: (1) the owner requested "broad" numbers; and (2) CB&I viewed CHI as a potential competitor. (CX 1507 at CBI 059483).

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122. On October 26, 2001, Yankee Gas requested that CB&I submit a proposal for contracting for the facility directly to Yankee Gas. (CX 1507 at CBI 059484; see also CX 787 at CBI 065244, in camera) ([redacted]).

123. CB&I's budget estimate for the Yankee Gas project anticipates a margin of [redacted]. (RX 54 at CBI 026812-HOU, in camera; CX 421 at CBI 026843-HOU; Scorsone, Tr. 5317, in camera). CB&I cited the price paid for the Cove Point LNG tank in setting the price for Yankee Gas. (CX 421 at CBI 026843-HOU [redacted]).

124. [redacted] (CX 787 at CBI 065242, in camera).

125. CHI sent a second request of prices for the liquefaction process. (CX 1507, at CBI 059483). CHI received pricing information from Whessoe and Technigaz. (JX 21 at 24 (Andrukiewicz, Dep.); CX 1507 at CBI 059484).

126. Skanska/Whessoe sent CHI Engineering information regarding the Waterbury facility that included: preliminary design solutions; preliminary design data sheets complete with design drawings; and pricing information. (Andrukiewicz, Tr. 6445; RX 4 at 2). Skanska/Whessoe provided pricing information as part of its submission. (Andrukiewicz, Tr. 6446).

127. [redacted] (Jolly, Tr.4693, in camera). On June 12, 2001, in response to a request from Yankee Gas' consultant CHI Engineering, the alliance submitted a preliminary pricing proposal for an LNG storage tank. (RX 4 at 3). [redacted] (Jolly, Tr. 4693, in camera). [redacted] provided pricing information as part of its submission. (Andrukiewicz, Tr. 6446).

128. CHI no longer has a "contractual relationship" with Yankee Gas. (Andrukiewicz, Tr. 6460). CHI has been replaced by SEA Consultants. (Id. at 6445). Yankee Gas will "look to SEA to provide us with the potential builders of this facility." (Id. at 6452).

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129. Yankee Gas has not determined whether Skanska/Whessoe or Technigaz are qualified to bid; the "pre-qualification" process has not started. (Andrukiewicz, Tr. 6451). SEA Consultants, the consultant that replaced CHI, will be responsible for evaluating the potential builders. (Andrukiewicz, Tr. 6451-52). At this stage, Yankee Gas has not "built the criteria by which we will evaluate any particular contract constructor of any component of the plant." (Andrukiewicz, Tr. 6453).

130. In the preliminary engineering report CHI submitted to Yankee Gas, CHI specifically proposed a double containment tank, with a concrete roof, in which both the inner tank and outer tank would be made of concrete. (Andrukiewicz, Tr. 6464-65). Mr. Andrukiewicz of Yankee Gas testified that Yankee Gas has "made no commitment on tank design." (Andrukiewicz, Tr. 6464-65).

131. An April 12, 2002 CB&I internal memo prepared by Eric Frey, the sales representative to Yankee Gas, states Yankee Gas was beginning to realize that concrete inner tanks were not common and not the norm and that more conventional designs using steel as the product container were equally as safe (or safer) and probably less expensive. Yankee Gas agreed to do their best to get the concrete inner tank requirement removed. (CX 1507 at CBI 059484).

132. CB&I has stated it might not bid on the Yankee Gas project if the design calls for a double concrete wall full containment LNG tank. (Scorsone, Tr. 4989-90; Glenn, Tr. 4141).

**h. Freeport LNG**

133. The Freeport LNG project is in the early design stages and may never be built. (Eyermann, Tr. 7043-44). At the time of trial, Freeport LNG had not yet filed for FERC approval of the terminal. (Eyermann, Tr. 6977).

134. Freeport LNG and its predecessor Cheniere Energy have never built an LNG facility before. (Eyermann, Tr. 7033).

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Freeport LNG has not obtained any bids or selected a supplier for the LNG tanks planned for the Freeport, TX import terminal. (Eyermann, Tr. 7029). Mr. Volker Eyermann, LNG Technical Director of Cheniere Energy Company, has never been involved in evaluating or selecting an LNG tank supplier for a project, and has never reviewed the prices submitted by LNG tank bidders. (Eyermann, Tr. 7025-7028).

135. CB&I sent Freeport LNG a proposal to do the front end engineering and design to the level of detail that is required for FERC and as a first phase for the operation. (Eyermann, Tr. 7049-50). CB&I sought a sole-source arrangement; it wanted to be the complete engineer on the whole project from the start through the EPC contracting. (Eyermann, Tr. 7069).

136. Black & Veatch sent Freeport LNG a letter which indicated that it had formed an alliance with Whessoe to build LNG tanks in the Western Hemisphere. (Eyermann, Tr. 6992). Based on this document, Freeport LNG believes that Black & Veatch and Whessoe are "serious and trying to compete." (Eyermann, Tr. 6992).

137. Skanska/Whessoe met with Freeport LNG in August 2002 to discuss contracting strategies and general tank designs. (Eyermann, Tr. 6983). Skanska/Whessoe provided Freeport LNG with marketing materials. (Eyermann, Tr. 6983). Freeport LNG believes Skanska's worldwide LNG director expressed interest in competing for the Freeport LNG project. (Eyermann, Tr. 6981-82). Freeport LNG knows that Skanska/Whessoe has built LNG tanks in Dabhol, India, Trinidad, and Greece, and that Whessoe did a "very good" job on the Dabhol project. (Eyermann, Tr. 6980-81). Freeport LNG believes that Skanska/Whessoe is a potential supplier of LNG tanks and plans to solicit a bid from Skanska/Whessoe for the Freeport LNG project. (Eyermann, Tr. 6993).

138. TKK/AT&V approached Freeport LNG in 2001 for the proposed LNG project in Freeport, Texas. (Eyermann, Tr. 7000-01). TKK/AT&V prepared presentations on the companies'

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capabilities, and discussed contracting capabilities. (Eyermann, Tr. 7000-01). Freeport LNG perceives that AT&V has quality welders which will be sufficient to perform the proposed LNG project in Freeport, Texas. (Eyermann, Tr. 7001-02). Freeport LNG also believes that TKK is a qualified tank constructor with the ability to adapt to different working conditions in different countries. (Eyermann, Tr. 7000, 7004-05). Freeport LNG plans on soliciting bids from TKK/AT&V, even though the partnership has never constructed a field-erected LNG tank in the U.S. (Eyermann, Tr. 7005).

139. Technigaz/Zachry approached Freeport LNG to present its alliance. (Eyermann, Tr. 6994). The alliance sent Freeport LNG marketing materials describing its expertise in liquefied gas facilities and Technigaz's experience building LNG tanks. (Eyermann, Tr. 6996-98). Freeport LNG believes that Technigaz is "keenly interested" in working on the Freeport LNG project. (Eyermann, Tr. 6996-98).

140. S&B contacted Freeport LNG and indicated it had combined its efforts with Daewoo to compete in the American market for LNG tanks. (Eyermann, Tr. 6976-77). Representatives from S&B and Daewoo had a meeting with Freeport LNG to discuss its capabilities, experience with current projects, and contracting strategies. (Eyermann, Tr. 6976-77; 7008). S&B and Daewoo also presented various brochures to Freeport LNG. (Eyermann, Tr. 7008). Based on these discussions, Freeport LNG requested Daewoo's LNG tank drawings to be used in connection with Freeport LNG's FERC application for its proposed LNG facility in Freeport, Texas. (Eyermann, Tr. 6976-77).

**i. Calpine, Humboldt Bay**

141. Calpine's Humboldt, California facility is "in the early stages of possible development;" there is only a 50% chance that the facility will be built. (Izzo, Tr. 6521-22). Calpine expects that new LNG tanks in the United States will be "at least double containment if not full containment," but if FERC authorizes the construction of a single containment LNG tank at Humboldt Bay,

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Calpine will not build a double or full containment tank. (Izzo, Tr. 6492, 6522-23).

142. Calpine has not spoken to Skanska/Whessoe, Zachry/Technigaz or AT&V/TKK about the Calpine project. (Izzo, Tr. 6524-25). Mr. Lawrence Izzo, Calpine's Senior Vice President, testified that he would have to "guess" as to whether any of these three firms will provide a bid to Calpine, what the price will be, and how they would compare to CB&I's price. (Izzo, Tr. 6525). Izzo admits that he knows "nothing firsthand" about AT&V's capabilities, and that he has never "worked with any foreign firm on a U.S. LNG project." (Izzo, Tr. 6520, 6539). Whessoe is the only foreign firm with which Izzo has first-hand knowledge about its construction performance and prices, and this was based on Whessoe's work in India. (Izzo, Tr. 6519).

143. The only firms with which Izzo has worked with on a U.S. LNG construction project are CB&I and PDM. (Izzo, Tr. 6514-16). Further, the only firm with which Izzo has discussed the project is CB&I. (Izzo, Tr. 6524-25).

## **6. Recent entry in the LNG market**

### **a. TKK/AT&V**

144. Toyo Kanetsu K.K. ("TKK") is a Japanese company involved in the construction of low temperature and cryogenic tanks. (RX 872 at 2). TKK has completed 72 LNG storage tanks throughout the world. (RX 772 at 2-21; RX 818). TKK has built more double containment and full containment LNG tanks than any other constructor in the world. (Cutts, Tr. 2572-73). TKK's annual sales are approximately 34.9 billion Yen. (RX 872 at 24).

145. American Tank & Vessel, Inc. ("AT&V") is an engineering and construction firm that was incorporated in 1982. (RX 818). AT&V, based in Mobile, Alabama, offers complete turnkey services for, and has extensive experience in, the engineering, design, and fabrication of tanks, vessels and spheres. (RX 31 at 9; Carling, Tr. 4489). AT&V has engineering facilities

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in Birmingham, Alabama; Houston, Texas; George County, Mississippi; and Mobile, Alabama. (RX 31 at 1). AT&V has fabrication facilities in George County, Mississippi and Houston, Texas. (RX 31 at 1).

146. TKK has extensive LNG experience outside the U.S., but has never built an LNG tank in the United States. (Cutts, Tr. 2336). AT&V has never built an LNG tank of any kind. (Cutts, Tr. 2393-94).

147. TKK has teamed with AT&V to supply LNG tanks in the United States. (Cutts, Tr. 2437-38). Pursuant to this partnership, TKK will "carry the lead responsibility" for engineering and design of the LNG tank. (Cutts, Tr. 2327). AT&V will supply the field labor for the erection of the LNG tank and share some of the responsibility for estimating the costs of the project. (Cutts, Tr. 2327-28). TKK will train AT&V employees on how to construct LNG tanks, including the use of TKK's welding equipment. (Cutts, Tr. 2379). Cutts anticipates that the newly trained AT&V employees will need a few years of experience constructing LNG tanks before they work as efficiently as experienced CB&I employees. (Cutts Tr., 2379-80). TKK's sales force will supplement AT&V's sales force in the LNG area. (Cutts, Tr. 2570).

148. AT&V has undertaken steps to research, design, and develop procedures associated with scheduling, welding technology, and general construction sequencing for LNG tanks. (Cutts, Tr. 2440). AT&V has researched and developed techniques to weld nine percent nickel steel. (Cutts, Tr. 2464).

149. Prior to its alliance with TKK, one LNG customer, BP, expressed that it did not view AT&V as an LNG tank supplier. AT&V "will need to demonstrate [its] capabilities in this market" first. (CX 691 at BP 01 032).

150. TKK/AT&V provided a bid to Dynegy for its Hackberry facility which met Dynegy's technical expectations [redacted]. F. 100-01. TKK, in partnership with DYWIDAG and AT&V, has

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submitted budgetary pricing to Halliburton KBR for the Cove Point II expansion. F. 116. TKK/AT&V approached Freeport LNG to present their capabilities. F. 138.

**b. Skanska/Whessoe**

151. Skanska AB ("Skanska") is one of the world's largest construction groups, and is a well-established Swedish based civil contractor that has operated internationally for more than 50 years. (RX 839 at 4; RX 870 at 25). In 2002, Engineering News Record ("ENR"), a leading industry publication, ranked Skanska as the number one contractor in the world. (RX 736 at 1). Skanska earned an annual revenue of more than \$ 14 billion in 2001. (RX 736 at 1). In August of 2000, Skanska acquired Whessoe International ("Whessoe"). (RX 770 at 33).

152. Whessoe is a 200 year old engineering and construction firm with a well established reputation in the international LNG business. (RX 908 at 1). Whessoe has been involved in various aspects of LNG storage for facilities throughout the world including India, Spain, Greece and Algeria. (RX 839 at 5-8).

153. Skanska/Whessoe has never built an LNG tank in the United States. (Eyermann, Tr. 6993).

154. Skanska/Whessoe is poised as a specialist EPC company combining contracting and risk management with engineering and design skills to offer its clients a complete package in the design and construction of facilities for cryogenic gas storage and handling. (RX 870 at 5). Skanska/Whessoe combines the engineering and construction skills of Skanska Construction with the design, engineering and procurement skill of Whessoe International. (RX 870 at 6). From its UK base, Skanska/Whessoe operates worldwide to design and build LNG tanks and terminals. (RX 870 at 5).

155. PDM noted Whessoe's historically poor performance in communications with consultants. In August 1999, Luke Scorsone wrote that he expected a potential customer, Unocal, to look



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favorably upon PDM relative to Whessoe on a project, "given that Noell Whessoe has performed poorly at Trinidad and Dabhol." (CX 115 at PDM-HOU017554).

156. Skanska/Whessoe provided a bid to Dynegy for its Hackberry facility which met Dynegy's technical expectations [redacted]. F. 100-01. [redacted]. F. 103, 105. Skanska/Whessoe provided pricing information and preliminary design solution for the Yankee Gas project. F. 126. Skanska/Whessoe met with Freeport LNG to discuss contracting strategies and general tank designs. F. 137. Skanska/Whessoe spoke to [redacted] a number of times regarding its capabilities and desire to construct LNG tanks in the United States. (Sawchuck, Tr. 6087, in camera).

**c. Technigaz/Zachry**

157. French based SN Technigaz and its parent company earn an annual revenue of more than \$ 3 billion and employ about 20,000 people. (Jolly, Tr. 4438). Technigaz has considerable experience in the design and construction of LNG tanks worldwide. (RX 43 at ZCC000005). Technigaz is one of the world's leading suppliers of liquefied gas facilities. (RX 773 at 1-2). Technigaz offers a broad range of services including: feasibility studies and conceptual design, basic and detail engineering, project management, procurement, quality control, construction, coordination of subcontractors, supervision and technical assistance, commissioning and start-up, and operation. (RX 773 at 3).

158. Technigaz has never built an LNG tank in the U.S. (Jolly, Tr. 4719, in camera). Technigaz currently has eight full-containment LNG tanks under construction around the world: Spain, Egypt and India. (Jolly, Tr. 4440). Technigaz believes it is the "largest contractor today in full-containment tanks worldwide." (Jolly, Tr. 4689, in camera).

159. [redacted] (Jolly, Tr. 4757, RX 738 at FTC001537 (Jolly, Dec.), in camera). [redacted] (RX 738 at FTC 001535 (Jolly, Dec.), in camera).

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160. Texas-based Zachry Construction Corporation is a leading United States construction company, with sales of around \$ 1.7 billion and more than 14,000 employees in 2001. (RX 43 at ZC 000002). In 2001, Zachry was ranked eighteenth in the annual ranking of top construction contractors by ENR. (RX 871 at 71). Zachry placed fifteenth overall among construction firms that also sold their own design work. (RX 871 at 71).

161. Zachry is an experienced civil contractor in the United States with licensed engineers and access to local labor in the United States. (Price, Tr. 656-57). Zachry began as a civil constructor and therefore has a great deal of knowledge about concrete construction. (Fahel, Tr. 1682-83, in camera). Zachry has unlimited bonding capacity. (RX 45 at ZCC 000039).

162. Zachry has never constructed an LNG tank. (Fahel, Tr. 1402).

163. In June or July of 2001, Technigaz took a step toward entering the United States market for LNG tanks by entering into a Memorandum of Understanding ("Memorandum") with Zachry. (Jolly, Tr. 4685, in camera). A press release announcing the joint venture was issued in January of 2002. (RX 43 at ZCC000002). In the press release, the alliance held itself out as pooling Technigaz's recognized turnkey LNG project expertise and broad-based knowledge of the market with Zachry's construction capabilities and strong positions in the Americas. (RX 43 at ZCC000002).

164. Since signing the Memorandum, Technigaz/Zachry [redacted] (Jolly, Tr. 4692, in camera; Fahel, Tr. 1650-51, 1689, in camera). Technigaz/Zachry provided a bid for Dynegy's Hackberry facility which met Dynegy's technical expectations [redacted] F. 100-01. [redacted] F. 127. Technigaz/Zachry approached Freeport LNG to present its expertise in liquefied gas facilities and Technigaz's experience building LNG tanks. F. 139.

165. Mr. Jean-Pierre Jolly, Vice President of Marketing at SN Technigaz, stated that [redacted] (RX 738 at FTC001536 (Jolly,

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Dec.); see also Jolly, Tr. 4753-54, in camera).

### **7. Barriers to entry in the LNG market**

166. LNG tanks are "built out of fairly sophisticated materials. You don't just weld them up any old way . . . . The equipment is quite expensive to develop. You can go buy it, but the stuff you buy has to be modified and tailored, and then you have to build procedures around it. So it's not like you can go buy an automobile. It's unique equipment . . . ." (Cutts, Tr. 2379).

167. There are "tremendous safety considerations" regarding LNG tanks. (Price, Tr. 564-65). If LNG should leak from a tank, the vaporized LNG could lead to fires and death, and liability for losses. (Bryngelson, Tr. 6234-35; see also Blaumueller, Tr. 293-94).

168. To avoid catastrophes, customers seek experienced tank suppliers. "If you're going to be handling something like liquefied natural gas, you don't want some amateur putting it together. The results can be catastrophic." (Hall, Tr. 1789). Dr. Hans Kistenmacher, a vice president at Linde BOC Process Plants ("Linde"), testified that risks associated with leakage causes Lotepro to subcontract the design and construction of LNG tanks to companies that have a long track record of experience in constructing these facilities. (Kistenmacher, Tr. 903-05).

169. Companies, such as Black & Veatch and Air Products, that provide the liquefaction systems and other components, but not the LNG tanks, do not want to partner with an inexperienced LNG tank supplier. (CX 157 at CBI-PL003348 (Black & Veatch "are looking to partner on a project with a firm which has better experience"); Davis, Tr. 3190-01 (Air Products chose to partner with PDM "because we needed to have somebody who would be competent to work with and capable of project execution, and they had demonstrated those capabilities.")).

170. There is a learning curve in building LNG tanks, because "any time you perform work for the first time you would incur

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experience that you can improve when you perform the same work the second or third time or subsequent times." (Fahel, Tr. 1637-38, in camera).

171. Builders of LNG tanks benefit from learning by doing. Samuel Leventry, CB&I's Vice President of Technology Services, testified: "Again, if you have the same people doing the same work more continuously there's going to be some efficiencies in that." (CX 497 at 68 (Leventry, Dep.); CX 392 at 4).

172. CB&I has worked many "years" to "streamline its processes" and lower its costs. (CX 392 at 3). Experience can reduce a firm's costs. A Strengths, Weaknesses, Opportunities, and Threats ("SWOT") Analysis of CB&I acknowledges that its precontract costs for LNG projects has decreased as CB&I moves up the experience curve. (CX 629 at CBI-PL033069, in camera).

173. Newmeister of Matrix testified that if it were to enter the LNG tank market, it would be likely to operate at a higher cost level than an experienced supplier like CB&I for some time while it learned from its mistakes. (Newmeister, Tr. 1605-06).

174. A new entrant would be disadvantaged by not having a fabrication facility. [redacted] testified that the lack of a fabrication plant currently obstructs the [redacted] partnership's penetration of the LNG market. ([redacted], Tr. 1635-37, in camera). Companies that have fabrication capabilities have lower total installed cost because they would not have to incur the additional markup that's normally associated with a third party subcontractor. ([redacted], Tr. 1635-37 in camera). [redacted] considered that its pricing will be perhaps higher than others who have their own fabrication facilities. ([redacted], Tr. 1635-37 in camera).

175. A new entrant must have a sufficiently large revenue base to enhance the tank supplier's ability to offer the financial guarantees necessary to win contracts. (CX 891 at 43, 47 (Glenn, Dep.); Izzo, Tr. 6511-12). Customers require the tank supplier "to provide a bond to the contractor . . . that guarantees the project

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will get finished." (Stetzler, Tr. 6385). An entrant's ability to bond a project, or bonding capacity, "has to do with your financial strength, and also the size of your company." (Stetzler, Tr. 6385).

176. LNG facility contracts often impose large liquidated damage provisions on the constructor if the project is completed late. (CX 891 at 46 (Glenn, Dep.); Izzo, Tr. 6485-86; Bryngelson, Tr. 6154-55). Customers want suppliers with a large asset base, because there is a larger target to go after if the contractor is late in completing the project and the customer sues for liquidated damages. (Bryngelson, Tr. 6154-55; JX 27 at 69 (N. Kelley, Dep.); Izzo, Tr. 6485-86; CX 1121 at CBI-HWH 053087).

## **8. Alleged post-acquisition price increases**

### **a. MLGW**

177. In 2002, Memphis Light Gas & Water ("MLGW") sought budgetary prices for another LNG peak shaving tank. (Hall, Tr. 1824-1825). In January 2002, MLGW contacted CB&I's Eric Frey, a business development manager. MLGW called CB&I because MLGW has a "working relationship with CB&I", Hall has "contacts there," and MLGW believed CB&I is the ["only ones (sic)"] that can provide ["reliable"] tank pricing in the United States. (Hall, Tr. 1825-27). MLGW did not contact other LNG firms because MLGW cannot "trust" the pricing information from foreign firms. (Hall, Tr. 1827-28). Hall stated

that he would need a lot of additional information from Whessoe and TKK to determine if they were viable competitors in the U.S. (Hall, Tr. 1832-33, 1846-48, 1853-54).

178. On January 15, 2002, Marty Smith, CB&I's Vice President of Global LNG Sales, instructed Frey to quote MLGW [redacted] for a 300,000 barrel tank. (RX 732 at CBI 071501, in camera; CX 422 at CBI-E 009500, in camera; Scorsone, Tr. 5323, in camera). Smith explained that Frey's original estimate was [redacted]. (CX 422 at CBI-E 009500, in camera.) Smith also

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instructed Frey [redacted] (CX 422 at CBI-E 009500, in camera).

179. On January 15, 2002, Frey e-mailed Smith with the proposal to quote MLGW a price that [redacted] (RX 732 at CBI 071501, in camera).

180. Margins contained in budget prices are not representative of the actual profit margin that CB&I seeks in fixed, firm price bids. (Scorsone, Tr. 5003). Because CB&I's internal budget documentation does not contain a line item for these contingencies and uncertainties that exist when preparing budget pricing, CB&I accounts for these contingencies in the margin line calculation of the budget estimate. (Scorsone, Tr. 5002-03). Thus, although a margin line item on a budget price may be [redacted], this does not mean that CB&I will seek a [redacted] profit margin if, and when, a firm, fixed price bid is submitted. (Scorsone, Tr. 5003).

181. On January 16, 2002, Frey quoted MLGW a budget price of [redacted], almost [redacted] higher than what Frey had originally prepared. (RX 732 at CBI 071499-500, in camera; CX 422 at CBI-E 009500, in camera; Scorsone, Tr. 5323, in camera). [redacted] (RX 732 at CBI 071499, in camera). [redacted] (CX 422 at CBI-E 009500, in camera).

182. The budget price CB&I provided "was not a buying offer." (Scorsone, Tr. 5250). Rather, the estimate that CB&I provided to MLGW was a SWAG -- a "scientific wild assed guess." (Hall, Tr. 1865-66). Hall testified that MLGW did not provide CB&I nearly enough information to receive an accurate price, and agreed that "volumes more" information would be required for this purpose. (Hall, Tr. 1865-66). Because MLGW was asking CB&I to "extrapolate" into the future, and because it did not provide detailed information, Hall was not expecting a number of more than plus or minus 40% accuracy. (Hall, Tr. 1866-68).

183. On July 17, 2002, Clay Hall of MLGW e-mailed Frey to comment that "we all know that CB&I/PDM is, in fact, the only

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qualified US based firm capable of executing the work." (CX 786 at CBI 065153). Hall added that MLGW is "concerned about where we're going to get competition for our bids in the next few years . . . because we don't see anyone out there with experience that could come into the market and compete with CB&I/PDM." (Hall, Tr. 1830).

**b. Cove Point I**

184. In 2000, CB&I and PDM competed against each other for a 750,000 barrel LNG tank for Columbia LNG ("Columbia") to be built at Cove Point. (CX 293 at CBI/PDM-H 4008141).

185. In January 2000, PDM's Mike Miles announced to PDM staff working on the Cove Point bid, including Jeff Steimer, that (a) "PDM is bidding against CB&I on this one;" and (b) PDM needed a "very competitive price to be successful." (CX 293 at CBI/PDM-H 4008141).

186. On March 29, 2000, Gary Marine of CB&I relayed minutes of a meeting that he had with a representative from Columbia. (CX 226 at CBI-PL0 44978, in camera). Marine wrote: "I told him I bet that by getting two bids, they saved a lot of money over whatever budget they had previously (from PDM). I told him I guessed the price came down at least [redacted] million, and he said it was more like [redacted] million. So PDM had given them a budget of something like [redacted] million for this work." (CX 226 at CBI-PL044978, in camera).

187. Marine advised that CB&I should reduce its price to [redacted] (CX 226 at CBI-PL044979, in camera).

188. Columbia sold Cove Point to Williams Energy ("Williams") in June of 2000. (See CX 863 at CBI/PDM-H 4018410; Harris, Tr. 7724-25). In June of 2000, PDM's Miles reminded the team that Cove Point was a "very competitive situation," and, "in accordance with Luke's [Scorsone's] direction," emphasized the need to get to "the lowest price possible" and to "save every dollar we can." (CX 863 at

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CBI/PDM-H 4018410).

189. Williams considered an increase in the size of the Cove Point tank from 750,000 barrels to 850,000 barrels and initiated a second phase of bidding for the 850,000 barrel tank. (CX 863 at CBI/PDM-H 4018410; Scorsone, Tr. 4964-66).

190. On August 29, 2000, CB&I and PDM agreed to merge. (CX 21 at PDM-C 1000003).

191. Williams' modifications of the project's specifications and increasing the tank size from 750,000 barrels to 850,000 barrels required PDM to re-design and re-price the tank. (Scorsone, Tr. 4964). The re-design took approximately 200 hours, and the follow-up estimating for the project took between 100 and 200 hours. (Scorsone, Tr. 4964).

192. CB&I did not submit a price on the 850,000 barrel tank. (Scorsone, Tr. 4965).

193. On September 8, 2000, PDM quoted Williams a budget price of [redacted] for an 850,000 barrel tank and [redacted] for a 750,000 barrel tank. (CX 1388 at CBI/PDM-H 4015363, in camera).

194. After the September 8, 2000 budget price, PDM prepared a new estimate for the 850,000 barrel tank because the "tank geometry changed." (Scorsone, Tr. 4966).

195. PDM held a bid review meeting to discuss the re-estimated cost of the 850,000 barrel tank for the Cove Point facility. (Scorsone, Tr. 4967-68). The participants at the meeting included Luke Scorsone, acting as the chair of the meeting; Steve Owens, Vice President of Operations for PDM; Jeff Steimer, the sales representative for the project; Mike Wilson, a manager of PDM's estimating group; Kurt Schneider, a manager of the engineering group; and Ron Blum, who was the head of sales. (Scorsone, Tr. 4968). As reflected on a document created for evaluating an estimate in a formal bid review meeting, the



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materials estimate and engineering estimate were revised at the bid review meeting. (Scorsone, Tr. 4971-73; CX-1160 at CBI/PDM-H 4007485, in camera). PDM's management team increased the cost estimates for the Cove Point project because there was "a very uncertain start date for this project . . . ." (Scorsone, Tr. 4978).

196. [redacted]. (CX 1160 at CBI/PDM-H 4007486-7487, in camera). [redacted] (CX 1160 at CBI/PDM-H 4007486-7487, in camera).

197. Overall, Steimer viewed the November 2 [redacted] bid for Cove Point as [redacted]. (CX 1160 at CBI/PDM-H 4007486, in camera).

198. Neither Scorsone nor the bid review group agreed with Steimer's comments with respect to the revised estimates for fabrication, field-erection, subcontracting, and project management or regarding the final bid submitted to Williams. (Scorsone, Tr. 4981-82).

199. PDM entered into sole-source negotiations with, and was granted a letter of intent by, Williams to construct the expansion of the Cove Point facility. (Scorsone, Tr. 4963). The letter of intent was ultimately transferred into a negotiated contract after PDM was acquired by CB&I in February 2001. (Scorsone, Tr. 4963).

200. The price of the Cove Point project that CB&I is constructing for Williams is currently at [redacted]. (Scorsone, Tr. 5333, in camera). Since November 3, 2001, the price increased from [redacted] to [redacted] for the 850,000 barrel tank. (Scorsone, Tr. 5333-34, in camera). Scorsone testified that this increase occurred because: [redacted] (Scorsone, Tr. 5334, in camera).

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201. The current price of [redacted] million includes a gross profit margin of [redacted]. (Scorsone, Tr. 5334, in camera). The gross profit margin includes SG&A (sales and general administrative) costs plus profit. (Scorsone, Tr. 5335, in camera).

202. PDM's November 2, 2000 bid of [redacted] anticipates a profit of [redacted], or [redacted] on the sold price. (CX 1160 at CBI/PDM-H 4007485, in camera).

203. Scorsone testified that CB&I was able to increase its profit due to [redacted] (Scorsone, Tr. 5336, in camera). [redacted] (Scorsone, Tr. 5337, in camera). [redacted] (Scorsone, Tr. 5337-38, in camera).

### **9. Sophistication of customers**

204. LNG owners do not routinely purchase LNG tanks. (Bryngelson Tr. 6060-61, 6208) (the last time El Paso purchased an LNG tank was in the late 1970's or early 1980's); (Eyermann, Tr. 7033) (Freeport LNG and its predecessor Cheniere Energy have never built an LNG facility before); (J. Kelly, Tr. 6257) (the tanks at CMS's only U.S. LNG terminal were built in the late 1970's).

205. Most owners of LNG facilities are not very knowledgeable about procuring LNG tanks. (Outtrim, Tr. 705, in camera; see CX 1507 at CBI 059484 (Yankee Gas must hire someone to evaluate pricing because "they know very little about the LNG industry and they were banking heavily on the report from CHI); CX 138 at CBI 019913-HOU ("Dynergy is not willing to take bids directly themselves since they do not have the staff, experience, and knowledge to analyze the bids and make an informed selection."); (JX 26 at 53 (J. Kelly Dep.) [redacted]

206. Past pricing for LNG tanks is "not something that's well known." (Bryngelson, Tr. 6207). Because of confidentiality provisions, "experienced engineering firms such as Kellogg . . . can provide a rough benchmark, but that's about the best we can do." (Bryngelson, Tr. 6239).

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207. Even with open book sole-source contracts, customers do not know how a supplier's pricing compares to that of other suppliers. Bryngelson of El Paso, which has an open book contract with CB&I for its Bahamas LNG terminal, admits to being "in the dark in terms of knowing what the costs are for LNG tanks suppliers." (Bryngelson, Tr. 6238, see also 6177-78).

**F. Effects on Competition in the LPG Market****1. Overview of the LPG market**

208. Typically, LPG tanks are manufactured the same way as LNG tanks, but for storage at a lower temperature. (G. Glenn, Tr. 4073).

209. The time needed to fabricate and construct an LPG tank varies. For a small LPG tank, construction can take 8 to 10 weeks of fabrication in the shop -- from buying steel, fabricating, and preparing to send out the pieces. The tank construction process can take 16 weeks in the field. Finally, the remaining site work and piping systems occur after the tank is completed. (N. Kelley, Tr. 7109-10). In an example of a large LPG tank, 60 weeks to field-erect the tank was scheduled. (Maw, Tr. 6634).

**2. Market shares and concentration in the LPG market prior to Acquisition****a. Tank projects awarded**

210. From 1990 to the Acquisition, CB&I and PDM built the majority of LPG tanks constructed in the United States. Of the eleven LPG tank projects awarded in the United States between 1990 and 2001, CB&I won five and PDM won four. From 1994 to the Acquisition, of the five LPG tank projects built in the United States, CB&I won zero and PDM won three. Morse Tank and AT&V each won one in 1994 and 2000, respectively. (CX 486; CX 824; CX 1210, in camera; CX 1212 at 7, in camera; CX 397, in camera; (CX 396 at 2, in camera; RX 757; Simpson, Tr. 3368, 3372-3375).

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211. LPG tank awards to CB&I are: Texaco Chemical (1990); Intercontinental Terminals (1991); Mitsui & Co. (1991); Hess Oil (1992); and Koch Refining (1993). LPG tank awards to PDM are: Koch Hydrocarbons (1991); Enron (1995); Sea-3 (1996); Sea-3 (1998). (CX 486; CX 824; CX 1210, in camera; CX 1212 at 7, in camera; CX 397, in camera; (CX 396 at 2, in camera; RX 757; Simpson, Tr. 3368, 3372-3375).

212. Dr. Simpson's calculated each company's market share from 1990 through 2001. In his calculation, he included the 2001 LPG project for BASF in Port Arthur, Texas that CB&I won. (Simpson, Tr. 3375). The Port Arthur project was awarded post-acquisition. (Simpson, Tr. 3686, 3829).

213. Using data dating back to 1990 and including a post-acquisition win by CB&I, Dr. Simpson calculated the data to the advantage of Complaint Counsel to conclude that, based on sales, PDM had a 34.5 percent market share, CB&I had a 56.7 percent market share, Morse Tank had an 8.2 percent market share, and AT&V had a 0.6 percent market share. (Simpson, Tr. 3404). Using this time frame, the combined market share of the merged company is 91.2 percent. (Simpson, Tr. 3404-3405). If the post-acquisition win is excluded, the combined market share of the merged company is 90.9 percent. (See CX 486; CX 824; CX 1210, in camera; CX 1212 at 7, in camera; CX 397, in camera; CX 396 at 2, in camera; RX 757; Simpson, Tr. 3368, 3372-3375).

214. On November 30, 2001, CB&I acquired Morse Tank, the firm that had accounted for the next most substantial share of LPG sales prior to the Acquisition. (Maw, Tr. 6545). If Morse's market share is added to CB&I's market share, the combined market share of Morse, CB&I and PDM is nearly 100%. See F. 213.

215. Respondents' expert, Dr. Harris acknowledged that CB&I and its two acquisitions, PDM and Morse, account for all but one of the sales of LPG tanks in the United States from 1990 to the time of the Acquisition. (Harris, Tr. 7522).

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**b. HHI calculations**

216. Complaint Counsel's expert, Dr. John Simpson, calculated the HHI index for the LPG market from 1990 to early 2001. (Simpson, Tr. 3368).

217. Dr. Simpson's HHI calculation included the 2001 LPG project for BASF in Port Arthur, Texas that CB&I won. (Simpson, Tr. 3375). The Port Arthur project was awarded post-acquisition. (Simpson, Tr. 3686, 3829).

218. Dr. Simpson calculated that, using data from 1990 to 2001, CB&I's acquisition of PDM increased LPG market concentration, as measured by the HHI, by 3911 points to a level of 8380. (Simpson, Tr. 3404-3405).

219. If data dating back to 1994 is used and the 2001 post-acquisition win by CB&I is excluded, Dr. Simpson acknowledged that CB&I had no sales over that time period and that the change in the HHI based on sales in the LPG market would be zero. (Simpson, Tr. 3746-47).

220. Competition in the LPG market is extraordinarily thin, and the market is almost nonexistent. (Harris, Tr. 7281-82). HHI calculations are not accurate in determining the concentration in the LPG market due to the extraordinarily thin market and almost nonexistent demand. (Harris, Tr. 7281-82)

221. Use of data from 1990 to Acquisition does not accurately depict market concentration because it fails to take into account that CB&I had not won a job since 1993. (Harris, Tr. 7287).

**c. Bidders on projects**

222. For the Ferndale project that was won by Morse, there were four bidders: Morse, CB&I, PDM and San Luis Tank. (Maw, Tr. 6550.)

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223. For the Tallaboa project that was won by PDM in 1995, the parties did not present sufficient evidence to determine which companies bid or whether competition constrained prices on this project.

224. For both Sea-3 projects, in 1996 and 1998, CB&I and PDM were the only bidders -- with PDM winning and constructing both projects based on a lower price (roughly 4% lower). (Warren, Tr. 2298-2300, 2302-04, 2305, 2306).

225. For the Deer Park project in 2000, CB&I, AT&V, and Matrix bid on the project. PDM was not a bidder. (N. Kelley, Tr. 7083-84).

226. The value of the 2000 Deer Park project built by AT&V is a small fraction of the value of the other LPG tanks sold during this period. (Simpson, Tr. 3394-95).

227. CB&I's acquisition of PDM combines the two strongest sellers of LPG tanks in the United States. (Simpson, Tr. 3406). According to Dr. Simpson: "Prior to the acquisition . . . CB&I's pricing was constrained principally by the presence of PDM EC. When CB&I acquired PDM EC, then CB&I's pricing would be constrained by much weaker competitors and constrained at a higher price." (Simpson, Tr. 3406). Dr. Simpson testified that he believed that CB&I's acquisition of PDM would lead to higher prices for LPG tanks. (Simpson, Tr. 3406).

**3. Respondents were each others' closest competitors in the LPG market**

228. Respondents referred to each other as a "formidable" competitor (CX 216 at CBI-PL-033886) or "major" competitor in the LPG market (CX 116 at PDM-HOU019181).

229. PDM believed CB&I was its "only competition on tanks over 100,000 bbl [barrels]." (CX 303 at CBI/PDM-H 4001285). PDM characterized CB&I as "PDM EC's only competitor on

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domestic cryogenic, LNG, LPG, Ammonia and thermal vacuum projects." (CX 107 at PDM-HOU005016).

230. Scorsone testified that CB&I was "PDM EC's major competitor" for LPG tanks. (Scorsone, Tr. 5157, 5173-74; CX 94 at PDM-HOU017580). Scorsone also admitted that CB&I was PDM's only competitor on domestic LPG projects. (Scorsone, Tr. 5183; CX 660 at 5).

231. Dr. Harris testified that prior to the Acquisition, neither CB&I nor PDM could increase prices of LPG tanks in the United States without risking that each would lose sales to the other. (Harris, Tr. 7539-40, 7543-44).

232. Amy Warren, Contracts Administrator for Fluor testified that, in 1998, the only competitors were PDM and CB&I. (Warren, Tr. 2307-08).

#### **4. Competition in the LPG market from Acquisition to time of trial**

233. There has only been one LPG tank awarded since the Acquisition, the 2001 ABB Lummus project in Port Arthur, TX. CB&I won the Port Arthur, TX project. (Simpson, Tr. 3686, 3829; G. Glenn, Tr. 4088-89, 4156).

234. The Port Arthur project included four ambient-temperature LPG spheres, one low-temperature LPG tank for butadiene and one flat bottom conventional storage tank. The total value of the project was \$ 8.5 million. The LPG tank alone was \$ 1.5 million. (Scorsone, Tr. 5039-40).

235. On the Port Arthur project, CB&I competed against Wyatt and AT&V in bidding for the project. (N. Kelley, Tr. 7086; Scorsone, Tr. 5040). CB&I initially bid a little above a 4 percent margin. ABB Lummus came back to CB&I after the initial round of bidding and informed CB&I that it was 3rd out of 3 bidders. (Scorsone, Tr. 5040).

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236. Since it was instructed to by the customer, CB&I "sharpened its pencils" and developed an innovation whereby CB&I eliminated the need for one additional support column on each sphere. This innovation lowered the cost to the project overall. (Scorsone, Tr. 5040-41).

**5. Recent entry in the LPG market**

**a. AT&V**

237. AT&V constructed the 2000 project for Intercontinental Terminals Co. ("ITC") in Deer Park, Texas. (JX 27 at 117 (N. Kelley Dep.)). AT&V bid on the Port Arthur project in 2001. (N. Kelley, Tr. 7086; Scorsone, Tr. 5040).

238. AT&V is much smaller than CB&I. (CX 460 at CBI-E 007235; JX 23 at Exh. 1, in camera (Cutts, Dep.); Simpson, Tr. 3292-3315). AT&V's annual revenues are only 2-3 percent those of CB&I. (CX 460 at CBI-E 007235; JX 23 at Ex. 1, in camera (Cutts, Dep.); CX 1033 at 28). CB&I employs over 200 engineers. (CX 460 at CBI-E 007235). CB&I estimates that AT&V has only a small engineering staff. (CX 460 at CBI-E 007235).

239. AT&V is limited in its field capacity. (Cutts, Tr. 2375; Simpson, Tr. 3315 (citing JX 23a at 44 (Cutts, Dep.))). Capacity constraints at AT&V recently prevented AT&V from bidding on two cryogenic tanks. (Cutts, Tr. 2375). AT&V is limited in its capacity to bond projects in the United States, which could impede AT&V's ability to bid on large projects. (Cutts, Tr. 2366, 2375). Cutts, Vice President of AT&V, admitted that AT&V cannot compete with CB&I on large scale projects. (Cutts, Tr. 2375).

240. Cutts admits that his firm faces reputational and marketing disadvantages compared to Respondents. (Cutts, Tr. 2421-22). "AT&V is not a household name for cryogenic tanks." (Cutts, Tr. 2385). Cutts contrasts CB&I by comparing it to the "Coca-Cola" brand-name. (Cutts, Tr. 2385). PDM had brand



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name value also and, like CB&I, its name "could obviously break down a lot of walls and barriers." (Cutts, Tr. 2389).

**b. Other domestic manufacturers**

241. Matrix provided a bid on the 2000 Deer Park project for ITC. (N. Kelley, Tr. 7083-84). Matrix is capable of building LPG tanks and would pursue LPG opportunities in the future. (Newmeister, Tr. 2180-82).

242. Wyatt bid on the Port Arthur project. (Scorsone, Tr. 5040).

243. Chattanooga Boiler & Tank ("Chattanooga") has the capability to construct field-erected LPG tanks. (Stetzler, Tr. 6355). Chattanooga is familiar with how to construct LPG tanks. (Stetzler, Tr. 6354-55). Chattanooga builds similar API 650 storage tanks, API 620 storage tanks, and ASME pressure vessels. These tanks are both shop and field-erected. (Stetzler, Tr. 6356-59, 6308-09; RX 181 at 1-10).

244. Dr. Simpson testified that firms such as AT&V, Matrix Services, and Wyatt Field Services would not be able to restore the pre-acquisition level of competition in the LPG market. (Simpson, Tr. 3408-09). Dr. Simpson noted that all three firms lack the building experience and the reputation that PDM possessed. (Simpson, Tr. 3409).

**c. Foreign manufacturers**

245. Foreign tank suppliers build tanks around the world and advertise in U.S. trade journals. (N. Kelley, Tr. 7091, 7126; Harris, Tr. 7288-89, 7293). However, the testimony of one purchaser of LPG tanks, was that he has never sought a bid from a foreign tank supplier because he "didn't know who to go to, I guess. Went to the local boys." (JX 27 at 114 (N. Kelley, Dep.)). Moreover, his experience buying capital equipment is that he gets better pricing from buying equipment locally in the U.S. rather than from another country. (JX 27 at 74-75 (N. Kelley, Dep.)).

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246. Respondents' economic expert Dr. Harris testified that he had no evidence that any foreign firms have chosen to produce LPG Tanks in the U.S. (Harris, Tr. 7778-79). No foreign tank supplier has won any U.S. LPG projects. F. 210, 215.

247. [redacted] testified that "[redacted] could not successfully compete against CB&I for single-containment LNG or LPG tank projects" in the U.S. ([redacted], Tr. 4711, in camera; RX 738 at P15, in camera). [redacted] has "no plans" to compete for single containment LPG tanks. (RX 738 at P15, in camera).

248. TTK has never built an LPG tank in the United States. (Cutts, Tr. 2351). Moreover, TTK is not interested in bidding on LPG tank projects in the United States. (Cutts, Tr. 2431).

249. Dr. Simpson testified that foreign companies, such as TTK, Skanska-Whessoe, and Technigaz, would not be sufficient to restore the pre-acquisition level of competition in the LPG market. (Simpson, Tr. 3407).

## **6. Barriers to entry in the LPG market**

250. LPG tank suppliers must have sufficient personnel to design, engineer and construct an LPG tank. (RX 682 at MCG 000059 ("Texaco will verify that bidder is not overcommitted to perform that work."); Warren, Tr. 2295 (Before allowing a company to bid, Fluor reviews a potential LPG tank supplier's volume to ensure the supplier is capable of managing multiple projects simultaneously, and to ensure there is not too much backlog to prevent Fluor from accessing the supplier's resources promptly as needed); see CX 415 at 2).

251. LPG tank suppliers need sufficient personnel to handle adjustments to possible schedule changes. (Warren, Tr. 2296 (In order to bid on an LPG project, an LPG tank supplier needs enough staff to handle an adjustment if it becomes necessary to shorten the schedule or recover from delays); see CX 415 at 2).

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252. LPG customers want a manufacturer with prior experience, at least in building API 620 tanks, and with experienced personnel. (N. Kelley, Tr. 7131-32). See also N. Kelley, Tr. 7104-05 ("I don't want to be a guinea pig"); JX 27 at 72 (N. Kelley, Dep.) (ITC would "definitely want [an LPG tank supplier] to have had prior experience building an LPG tank before [it] would hire them to build an LPG tank . . .").

253. Matrix's vice president of marketing testified that the LPG market presents the same barriers to entry as the LNG market and would be difficult to penetrate. (Newmeister, Tr. 1609-10).

## **7. Sophistication of customers**

254. Intercontinental Terminals Company ("ITC") is the only recent LPG customer to testify in this case. ITC owns 10 field-erected low temperature tanks. (N. Kelley, Tr. 7093-94). Mr. Norman Kelley, Vice President of ITC, testified that during his 25 years at ITC he has procured LPG tanks over 23 of those 25 years. Tank procurement is Kelley's area of responsibility. (N. Kelley, Tr. 7079-80). Kelley regularly sorts confidential bids from multiple tank suppliers. (N. Kelley, Tr. 7082-83).

## **G. Effects on Competition in the LIN/LOX Market**

### **1. Overview of the LIN/LOX market**

255. LIN/LOX tanks are double-walled tanks made of stainless steel which store liquid oxygen and nitrogen at very low, even cryogenic, temperatures which allows them to be stored in a liquid form. (Stetzler, Tr. 6312). A LIN/LOX tank consists of an outer carbon steel shell and an inner tank, most commonly made out of stainless steel. There is insulation between the two shells to keep the temperature at minus 320 degrees. (Stetzler, Tr. 6312; Kistenmacher, Tr. 833-34).

256. LIN/LOX tanks are most commonly incorporated into the infrastructure of a functioning air separation facility. There are

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no viable substitutes for storing liquid oxygen or nitrogen produced by such a plant. (Hilgar, Tr. 1386).

257. An air separation plant is a plant that liquefies ambient air, then distills the air into its component parts. The component parts of air are the industrial gases: oxygen, nitrogen, and argon. The liquefied gases are later cooled and stored in cryogenic storage tanks. Subsequently, the gases are delivered to the marketplace either in a gaseous form or liquid form. (Kamrath, Tr. 1980; V. Kelley, Tr. 4592; Kistenmacher, Tr. 824-25).

258. The cost to design and fabricate LIN/LOX tanks typically represents five to ten percent of the total cost of an air separation facility. (Hilgar, Tr. 1507). Construction of an air separation facility may cost \$ 18 million. LIN/LOX tanks used at such a facility may cost from \$ 1 to \$ 1.5 million. (Kistenmacher, Tr. 836; Hilgar, Tr. 1507-08).

259. The following construction steps are taken for building LIN/LOX tanks: First, the project is engineered and drawings are developed in connection with the procurement of materials. Second, materials including the raw steel and steel components are procured. Third, steel materials are fabricated in fabrication shops. Next, tool and equipment lists are created and everything including the fabricated materials are shipped to the construction site. The structure is then erected on the project site and tested. (Scorsone, Tr. 4885-86).

260. The engineering phase involves the performance of calculations and an analysis to determine the size and shapes of the various components to be placed in the structure. This phase entails writing the specifications for the various materials and welding processes that will be used. Drawings are created to be used by fabrication shops, construction crews, and subcontractors. (Scorsone, Tr. 4886-87).

261. CB&I does not have an engineering staff that solely works on LIN/LOX projects. CB&I uses its engineers across several product lines. Engineers who design flat-bottom tanks

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also have the capability to design LIN/LOX tanks. CB&I's engineers are located in Pittsburgh, Pennsylvania; Plainfield, Illinois; Houston, Texas; Canada, the Middle East, the Philippines, and Australia. (Scorsone, Tr. 4887-88).

262. The bill of materials contains a list of materials that are sent to the procurement group. The procurement group then procures these materials from a wide variety of vendors. (Scorsone, Tr. 4889-90).

263. The metal materials are fabricated in a fabrication shop by the same personnel and using the same equipment that is used to fabricate other types of tanks. (Scorsone, Tr. 4885; 4892-93).

264. The field-erection process for an industrial tank involves: (1) receiving the material from the fabrication source and the steel mills; (2) establishing a site office; (3) establishing a tool and equipment management system; (4) employing the field labor; (5) erecting the structure in accordance with the plans and contract specifications; and (6) testing the work quality. (Scorsone, Tr. 4895-96).

265. The field construction process used to field-erect a LIN/LOX tank is the same process that is used to erect any type of ambient-temperature flat-bottom tank. (Scorsone, Tr. 4885).

266. The welding processes used on a cryogenic tank are the same as the processes used for an ambient temperature tank. (Scorsone, Tr. 4899). The welding methods used for cryogenic tanks are an open art. (Scorsone, Tr. 4899).

267. CB&I does not regard LIN/LOX work as an important part of its business because it is so small. (Scorsone, Tr. 5016). The total revenue realized in the LIN/LOX market in the last two years for all construction vendors amounted to only approximately \$ 5 million out of \$ 2 1/2 to \$ 3 billion. (Glenn, Tr. 4088). CB&I does not have any salespersons dedicated to the LIN/LOX market. (Scorsone, Tr. 5017).

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268. Currently, there is overcapacity in the LIN/LOX market. Moreover, there will not be air separation plants requiring LIN/LOX tanks constructed in the next few years. (Hilgar, Tr. 1541-43). Demand for field-erected LIN/LOX tanks is not high. (Stetzler, Tr. 6382-83).

**2. Market shares and concentration in the LIN/LOX market prior to Acquisition**

**a. Tank projects awarded**

269. From 1990 to the Acquisition, CB&I, PDM, and Graver built nearly all the LIN/LOX/LAR tanks in the United States. From 1990 to Acquisition, 109 LIN/LOX tanks were constructed, with a total value of [redacted]. CB&I and PDM had a combined market share of 72.8% of the value of LIN/LOX awards. CB&I won 25 tanks (with a total value of [redacted] (33.9% of the total). PDM won 44 tanks (with a total value of [redacted] (38.9% of the total.) Graver won 34 tanks (23.3% of the total value). Matrix won 4 tanks (2.6% of total value), and AT&V won 2 tanks (1.4% of the total value). (Simpson, Tr. 3422, 3429-30; CX 26, in camera; CX 85; CX 155; CX 183; CX 260; CX 282; CX 397, in camera; CX 755; CX 1025, in camera; CX 1170; CX 1210 at 5-6, in camera; CX 1212 at 6, in camera; CX 1321, in camera; CX 1458; Cutts, Tr. 2451).

270. Graver went out of business, in 2001, and is no longer a competitor in the LIN/LOX market. (CX 1546; Hilgar, Tr. 1543). Graver's assets were sold at auction. (Harris, Tr. 7312, 7313).

271. MG Industries purchased [redacted] LIN/LOX tanks between 1994 and 1999. In all but perhaps one of these projects, MG Industries received bids from CB&I, PDM and Graver. (Patterson, Tr. 478-79, in camera).

272. Linde's policy in purchasing LIN/LOX tanks is to have at least three bidders. (Kistenmacher, Tr. 864). CB&I, PDM and Graver bid on tanks built for Linde. (Kistenmacher, Tr. 869.)

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**b. HHI calculations**

273. Dr. Simpson calculated that, using data from 1990 to 2001, CB&I's acquisition of PDM increased LIN/LOX concentration, as measured by the HHI, by 2,635 points, to a level of 5,845. (Simpson, Tr. 3443).

274. Dr. Simpson's HHI calculations in the LIN/LOX market were based on sales from 1990 to the date of the Acquisition. (Simpson, Tr. 3704). Dr. Simpson admitted that he chose 1990 as the beginning date for his HHI analysis because 1990 was the cut off date for discovery and thus his information dated back to 1990. (Simpson, Tr. 3704-05).

275. In the LIN/LOX market, Dr. Simpson admitted that CB&I's spin off from Praxair, Incorporated, in 1997 was a significant competitive change, a fact which would justify beginning the HHI calculation in 1997 after the date of the sale. (Simpson, Tr. 3753).

276. Use of data from 1990 to Acquisition does not accurately depict market concentration because it fails to predict forward from the time of acquisition, fails to consider Praxair's sale of CB&I, and fails to account for recent entry. (Harris, Tr. 7311-12).

**3. Respondents were each others' closest competitors in the LIN/LOX market****a. Respondents' views**

277. In a July 1997 competitor report to Luke Scorsone, PDM's Bill Weber noted that "since last fall, CB&I has been the most aggressive competitor in increasing market share." (CX 108 at PDM-HOU005018).

278. In May 2000, Luke Scorsone warned the Board of PDM that "CB&I has been extremely aggressive on pricing work in North and South America. They have taken certain projects at levels which would be slightly over PDM EC's flat cost." (CX 64

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at PDM-C 1002562).

279. According to an October 2000 e-mail from Bob Lewis, then CB&I's Vice President of Corporate Business Development, PDM had "[a] tendency to bid much lower than the market leaving a lot of money on the table." (CX 632 at CBI-PL 4000160). In April 1997, Rich Kooy compared CB&I and PDM's LIN/LOX prices and recognized that "in North America we [CB&I] could still be very handily undercut (by as much as 10%) by PDM if they wanted to work at a lower price level." (CX 178 at CBI-PL011835).

280. In competing for LIN/LOX jobs, CB&I and PDM would in some instances, set prices that would generate "negative margins." (CX 183). In fact, CB&I lost some projects to PDM because of PDM's "very low" pricing levels. (Crain, Tr. 2592; CX 624).

281. A CB&I document states that "PDM is the driver on negative margins on these LIN/LOX tanks. We understand that PDM can readily price the LIN/LOX work at -6% margin in the Gulf Coast and Southeast . . . Unless there is a reason why PDM would be less aggressive or economical in NV, then I agree with Ron that -2% or -3% should get us on the high side of the target range." (CX 193 at CBI-PL020339).

282. Other documents of Respondents reflect the competitive pressure that PDM regularly placed on CB&I. (See CX 614 at CBI-PL039367 (for LOX tank project for Air Products in Eureka, Nevada, PDM's quoted price was "\$ 100,000 lower than CB&I's and Matrix's price, and almost \$ 200,000 lower than Graver's price"); CX 222 at CBI-PL037594 (PDM won a bid from CB&I for a pair of LIN/LOX tanks by dropping their bid on their best and final offer by \$ 40,000); CX 191 at CBI-PL018948 (Air Products had awarded a LOX tank to PDM, which "was the very low bidder and met all of the technical requirements.")).



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**b. Industry views**

283. William Cutts, Vice President of American Tank & Vessel ("AT&V") agreed that, prior to the merger of CB&I and PDM, customers preferred PDM or CB&I for their LIN/LOX tank projects, "almost exclusively [desiring] one or the other or pitting the two against the other." (Cutts, Tr. 2390).

284. Cleveland Fontenot, Jr., former Vice President of Procurement for Air Liquide Process and Construction ("Air Liquide"), testified that prior to the Acquisition, CB&I and PDM were the two most qualified LIN/LOX/LAR tank suppliers. Air Liquide's bid slate included, "CB&I, PDM and a little bit lower would be Matrix." (Fontenot, Tr. 2021-22). However, Air Liquide "didn't feel as comfortable" with Matrix because the "number of references they had weren't nearly what the other two suppliers [CB&I and PDM] had." (Fontenot, Tr. 2022).

285. David Kamrath, CEO of Air Liquide Process and Construction and a 30-year participant in the industrial gas business, believes that prior to the merger Air Liquide only "had PDM and CB&I" for the construction of LIN/LOX tanks. (Kamrath, Tr. 1988).

**c. Competition between Respondents lead to lower prices**

286. Prior to the Acquisition, Linde used PDM's prices as its "benchmark" to compare other firms' prices. (Fan, Tr. 967). Linde was able to leverage two manufacturers against each other to negotiate pricing and other concessions. (Kistenmacher, Tr. 867-8).

287. MG Industries, a producer of industrial gas products, purchased 16 LIN/LOX tanks in the last nine years. (Patterson, Tr. 338, 341). Before the merger, the same three firms bid on most of MG Industries' LIN/LOX projects: CB&I, PDM and Graver. (Patterson, Tr. 351, 355, 363, 365). On each of MG Industries' LIN/LOX projects after 1997, Mr. Michael Patterson, Director of Engineering, MG Industries, used each of the other

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firms as bargaining chips to obtain lower prices on LIN/LOX tanks. (Patterson, Tr. 351-365).

288. There was vigorous competition between CB&I, PDM and Graver. CB&I and PDM would vigorously undercut each other's prices, to the extent that the firms sold LIN/LOX tanks at negative margins, e.g., -23%, -12%, and -2 to -3%. (CX 136 at CBI 014195-HOU; CX 193 at CBI-PL020339; CX 600 at CBI-PL012354). (See CX 455 at CBI-E 007334, in camera ([redacted])); id. at CBI-E 007335, in camera ([redacted]); id. at CBI-E 007335, in camera ([redacted])

289. In 1997, CB&I, PDM and Graver were competitors for the Rockport, Indiana project. According to Patterson, MG Industries' negotiating tactics "lowered the price." (Patterson, Tr. 351-52). Graver was the lowest bidder for the Rockport project, but after "verbal negotiations" using PDM's and CB&I's bids as leverage, Graver "knocked a few percent off [its] price." (Patterson, Tr. 351-53).

290. CB&I, PDM, and Graver also competed for the contract to the combined Chattanooga and Johnsonville, Tennessee projects in 1997. (Patterson, Tr. 355). PDM was the lowest bidder, with both Graver and CB&I bidding 15 percent higher than PDM. (Patterson, Tr. 356-57; see CX 194 at CBI-PL023449). Patterson informed the bidders that "they were way higher than what it would take to be awarded any of those type projects," and that "if they expected to receive any orders, they would have to significantly lower their price." (Patterson, Tr. 357-58). As a result of Patterson's negotiating, the firms "lowered their price." (Patterson, Tr. 358). The Johnsonville project was later postponed, while the Chattanooga tanks were built. (Patterson, Tr. 356).

291. MG Industries combined the LIN/LOX tanks for the Albany, New York; Delisle, Mississippi; and Johnsonville, Tennessee projects for one bidding process. (Patterson, Tr. 361-62, 355-56). PDM was the lowest bidder, Graver's bid was 4% above PDM's, and CB&I's bid was 7% above PDM's bid.

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(Patterson, Tr. 362). Once again, Patterson used PDM as leverage, informing Graver that "somebody has a better price than they do." (Patterson, Tr. 363). The customer was again successful in promoting the most competitive environment he could, as "Graver dropped the price substantially." (Patterson, Tr. 364).

**4. Competition in the LIN/LOX market from Acquisition to time of trial**

292. Since CB&I's acquisition of PDM in 2001, five LIN/LOX projects have been awarded by LIN/LOX customers. (Scorsone, Tr. 5015-16). The five LIN/LOX projects that have been awarded since the Acquisition are: Midland, North Carolina (BOC Gases); Hillsboro, Oregon (BOC Edwards); Freeport, Texas (Air Liquide); New Johnsonville, Tennessee (MG Industries); and Kirkland, New Mexico (Praxair). (Scorsone, Tr. 5017).

293. Since the Acquisition, of the five LIN/LOX tank projects awarded, AT&V has won three and CB&I has won two. (Harris, Tr. 7308; Scorsone, Tr. 5015-16).

294. Of the five post-Acquisition LIN/LOX projects, four were competitively bid. (Scorsone, Tr. 5017). Of the four competitively bid projects, AT&V bid on three and won all three. (Scorsone, Tr. 5018). CB&I has never won a LIN/LOX project when AT&V was a competitor bidding on the project. (Scorsone, Tr. 5018).

**a. Midland, North Carolina (BOC Gases)**

295. AT&V won both tank awards for the BOC Gases Midland, North Carolina project. (V. Kelley, Tr. 4599; Scorsone, Tr. 5024; RX 273, in camera). In 2000, BOC Gases solicited bids for the Midland LIN/LOX project from PDM, CB&I, AT&V and Chattanooga Boiler & Tank. (V. Kelley, Tr. 4598; Scorsone, Tr. 5024-25; RX 273, in camera).

296. BOC Gases awarded the Midland project to AT&V

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because of low cost and was satisfied with the price because it was below BOC Gas' budget for the project. (V. Kelley, Tr. 4599-601, Tr. 5272, Tr. 5282).

297. Dr. Kistenmacher, Vice President of BOC's successor, Linde BOC Process Plants, was told by his direct partner at BOC ". . . that the price was low in the beginning, but they [AT&V] had many change orders, that in the end the price was higher than of the conventional vendors." (Kistenmacher, Tr. 931-32).

298. BOC Gases had to budget 500 man-hours of additional BOC Gases engineering time to ensure that AT&V delivered the LIN/LOX tanks "on time, on schedule, on budget"; this was AT&V's first experience building LIN/LOX tanks. (JX 28 at 43-46 (V. Kelley, Dep.); RX 290 at CBI 046596-NEW).

**b. Hillsboro, Oregon (BOC Edwards)**

299. AT&V was awarded a LIN/LOX project for BOC Edwards in Hillsboro, Oregon. (Cutts, Tr. 2504-06; V. Kelley, Tr. 5291-92; RX 813).

300. CB&I submitted budget pricing for the LIN/LOX project in Hillsboro, Oregon. (Scorsone, Tr. 5018, 5031). BOC Edwards reviewed the budget prices submitted for the project and determined that AT&V had the low bid. (V. Kelley, Tr. 5292). Based on these budget prices, BOC Edwards awarded the project to AT&V. (V. Kelley, Tr. 5292; Scorsone, Tr. 5031).

**c. Freeport, Texas (Air Liquide)**

301. In 2001, Air Liquide solicited bids for a LIN/LOX project in Freeport, Texas. AT&V, CB&I, Matrix and BSL bid on the project. (Cutts, Tr. 2569; Scorsone, Tr. 5032; RX 627 at 2, in camera).

302. AT&V was awarded the Air Liquide LIN/LOX project in Freeport, Texas. (Kamrath, Tr. 2006; Scorsone, Tr. 5017). [redacted] (Kamrath, Tr. 2235, in camera). [redacted]. (Scorsone,

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Tr. 5023-5024; Kamrath, Tr. 2235, in camera; RX 627 at 2, in camera).

303. Matrix's bid on Air Liquide's Freeport LIN/LOX tank [redacted] (Kamrath, Tr. 2235, in camera).

304. [redacted] (Kamrath, Tr. 2254-55, in camera).

305. [redacted] (Kamrath, Tr. 2241, 2251, 2253, in camera). [redacted] (Kamrath, Tr. 2252, in camera). Air Liquide asked CB&I to complete the project, but CB&I refused. (Scorsone, Tr. 5036).

**d. [redacted] (MG Industries)**

306. In April 2002, MG Industries sought pricing for a LIN/LOX tank project in [redacted]. (Patterson, Tr. 456-57, in camera).

307. Requests for prices were sent to [redacted]. (Patterson, Tr. 456-57, in camera). While [redacted] submitted budget pricing, it did not submit a formal bid. (Stetzler, Tr. 6351). [redacted] (Patterson, Tr. 482, in camera).

308. [redacted] was the lowest bidder. (Patterson, Tr. 457, in camera). [redacted] price was [redacted] higher than [redacted]. (Patterson, Tr. 457, in camera). [redacted] budget price was [redacted] higher than [redacted]. (Patterson, Tr. 457, in camera).

309. [redacted] (Patterson, Tr. 460-62, 482-83, in camera).

310. [redacted] (Patterson, Tr. 460, in camera). [redacted] (Patterson, Tr. 486-87, in camera). [redacted] (Patterson, Tr. 461, in camera).

**e. Kirkland, New Mexico (Praxair)**

311. CB&I was awarded a LIN/LOX project by Praxair in Kirkland, New Mexico pursuant to a partnering agreement.

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(Scorsone, Tr. 5019-20). PDM had entered into an alliance agreement with Praxair which obligated Praxair to award non-union LIN/LOX tank projects to PDM, and PDM was obligated to construct the projects at a 4 percent margin level. (Scorsone, Tr. 5018-19; RX 87 at 4). In 2001, PDM and Praxair agreed to renew the agreement for another three years. (RX 87 at 2). The partnering agreement between Praxair and PDM was transferred to CB&I after the Acquisition. (Scorsone, Tr. 5019).

**5. Recent entry in the LIN/LOX market**

312. No foreign company has ever built a LIN/LOX tank in the United States. (Hilgar, Tr. 1385).

**a. AT&V**

313. AT&V is a recent entrant to the LIN/LOX market. AT&V has won all three LIN/LOX projects that it has bid on. (Scorsone, Tr. 5018). AT&V is committed to pursuing LIN/LOX projects in the United States. (Cutts, Tr. 2332). AT&V has submitted budget pricing for approximately six customers and has formally been pre-qualified as a bidder by one customer and informally pre-qualified by several others. (Cutts, Tr. 2452-53).

314. Reviews of AT&V's price and performance for BOC's Midland project are mixed. One BOC witness testified that he "was satisfied with the price" it received and "satisfied with the work that AT&V did at Midland." (V. Kelley, Tr. 5285). Another testified that, although the price was low in the beginning, because of the many change orders the price ended up higher. (Kistenmacher, Tr. 931-32). In addition, "there was a design run of pipe [on the BOC project] that could have caused liquid oxygen to settle and then dissipate, creating a hazardous atmosphere in that location." and a "welding error" during construction that caused the steel plate that comprises the tank to buckle at a weld joint. (V. Kelley, Tr. 5269, 5273-74).

315. AT&V does not compete on an equal footing with CB&I in the LIN/LOX market. AT&V is much smaller than CB&I. (CX

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460 at CBI-E 007235; JX 23 at Ex. 1 (Cutts, Dep.), in camera; Simpson, Tr. 3292-3315). AT&V's annual revenues are only 2-3 percent of CB&I's revenue. (CX 460 at CBI-E 007235; JX 23 at Ex. 1 (Cutts, Dep.), in camera; CX 1033 at 28). AT&V is capacity constrained. (Simpson, Tr. 3315 (citing JX 23a at 44, (Cutts, Dep.)). AT&V lacks the field capacity to handle more than four LIN tanks at a time or one small LNG project at a time. (Cutts, Tr. 2376). Recently, AT&V had to refuse to bid on two cryogenic tank projects in the United States because of its limited field capacity. (Cutts, Tr. 2375).

316. Cutts admitted that CB&I will outperform AT&V on future projects for years to come. "There would still probably be a few years to catch up... [CB&I] would still probably be able to outperform us a little bit until we had a few years under our belt." (Cutts, Tr. 2380). Cutts stated that AT&V could compete with CB&I only "on certain fronts, on certain scale projects, okay, with certain assistance, if the customers are willing." (Cutts, Tr. 2374).

317. Customers that have done business with AT&V have found that any initial savings are often offset or exceeded by oversight costs and costs related to change orders. (Kistenmacher, Tr. 931-32; Kamrath, Tr. 2254-55, in camera). F. 297-98, 304, 314.

318. Air Products has not qualified AT&V as a LIN/LOX tank supplier, due to its concern over AT&V's performance and poor reputation. (Cutts, Tr. 2355-56; Hilgar, Tr. 1369). Another LIN/LOX customer, [redacted], thinks that [redacted] was "insane for buying a tank from an inexperienced tankee," and testified that it is concerned about working with AT&V, based on word of mouth reports of AT&V's performance on its LIN/LOX projects for [redacted]. (CX 41 at CBI-E 007336; Patterson, Tr. 472, in camera). [redacted] F. 305.

319. In Respondents' competitive profile of AT&V, Respondents state that AT&V's "quality" and "safety" are "poor." (CX 86 at PDM-CH 002617). The document notes that on past projects, AT&V performed poorly in terms of supplying a quality

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tank or sphere and has not met customer safety standards. Kellogg and Bechtel threw AT&V off projects due to poor quality or poor safety practices. Moreover, in the past, Dupont, Shell-Norco and Exxon (Baton Rouge) would not let AT&V bid on their projects. (CX 86 at PDM-CH 002617). Respondents describe AT&V's safety practices as "severely lacking ... and are being labeled as an undesirable risk by many." (CX 263 at CBI-HOO-004606).

**b. Matrix**

320. Matrix is a recent entrant. Although Matrix won only 4 of the 83 awards prior to Acquisition, all 4 of these are recent LIN/LOX construction. In 1997, Praxair awarded Matrix a liquid oxygen and liquid nitrogen "cluster tank" project in Rossford, Ohio over CB&I. Matrix finished the work on time and to the satisfaction of Praxair. (Newmeister, Tr. 2174-75). Matrix built two LIN/LOX tanks for Praxair in Delaware City, Delaware, in 1998. (Newmeister, Tr. 2173; 2176-77). Matrix was awarded the Delaware City LIN/LOX project in 1998 over CB&I and it completed the project on time. (Newmeister, Tr. 2176-77). In 2000, Matrix was awarded a LAR tank for Praxair in East Chicago. Praxair was satisfied with the construction and the project was erected on schedule. (Newmeister, Tr. 2173; 2176-77). Also in 2000, Matrix was awarded a LIN tank by Air Products for a project in Kingsport, Tennessee. Air Products awarded the tank to Matrix over CB&I and PDM, despite the fact that Matrix had never built a tank for Air Products before. (Newmeister, Tr. 2173-74).

321. Matrix has been a high bidder, and consequently non-competitive, on recent LIN/LOX tank projects for several customers, including Air Liquide and Linde. (Newmeister, Tr. 2156-58). (See Fan, Tr. 960-62 (on 2002 project, Matrix bid over [redacted], while CB&I bid [redacted]); Kistenmacher, Tr. 860 (on preliminary bids, Matrix was eliminated from consideration because its pricing was high); Fontenot, Tr. 2029 (CB&I was at least [redacted] Matrix on Air Liquide's recent Longview, Texas project).



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322. Matrix has been told that Matrix has not won these projects either because its pricing has been too high or because the customer did not believe that Matrix was sufficiently qualified. (Newmeister, Tr. 2155-58; Kamrath, Tr. 2000-01 (Matrix's prices have "never been below what we'd seen from any of the other competitors"); Fontenot, Tr. 2022 ("didn't feel comfortable with Matrix"); Hilgar, Tr. 1354, 1382-83 (Matrix has "more limited capacity to produce field-erected cryogenic storage tanks," as compared to CB&I or PDM)).

323. Air Product's supply manager, with responsibility for bidding out LIN/LOX tanks, testified that Matrix cannot replace PDM in the LIN/LOX marketplace from Air Products' perspective. (Hilgar, Tr. 1354).

324. Matrix is a diminished competitor in the LIN/LOX tank market as a result of the sale in August 2000 of its Brown Steel subsidiary, which owned the fabrication facility where Matrix fabricated LIN/LOX tanks. (Newmeister, Tr. 1590-91, 1595). Matrix determined that "once we sold Brown Steel Company, we lost some competitive advantage in the two primary areas, one of which - one of being able to do internal blasting and priming, and the other, impressing." (Newmeister, Tr. 2158-59). By losing its fabrication capability, Matrix is required to subcontract the fabrication work for these tanks, and subcontracting increases Matrix's costs. (Newmeister, Tr. 1569-70, 1590 (As a result of subcontracting its fabrication work, Matrix's "costs will be higher. They won't be as competitive."))).

**c. Chattanooga Boiler & Tank**

325. Chattanooga Boiler & Tank ("Chattanooga") does not effectively compete in the LIN/LOX market. Chattanooga has never built a LIN/LOX tank. (JX 2 at 2 (Respondents stipulate that Chattanooga has never built a LIN/LOX tank); CX 623 at FTC0000399; Stetzler, Tr. 6413-15). Chattanooga has never created any strategic plans or pricing strategy for designing, engineering, fabricating, or erecting LIN/LOX tanks. (Stetzler, Tr. 6421-22, 6426). Mr. Jerry Stetzler, Chattanooga's President,

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testified that the supply of LIN/LOX tanks is "not really a business that we've been participating in." (Stetzler, Tr. 6422).

326. On one occasion when it recently bid on a LIN/LOX project, Chattanooga's price was higher than any other competitor. (CX 189 at CBI-PL015105; [redacted], Tr. 457, in camera) (Chattanooga's price was [redacted] higher than CB&I's).

327. LIN/LOX industry participants question Chattanooga's ability to build a LIN/LOX tank. MG Industries "has doubts" of Chattanooga's "abilities." (CX 41 at CBI-E007336). Cutts testified that AT&V does not consider Chattanooga for LIN/LOX tanks in the United States. (Cutts, Tr. 2333). Scorsone admitted that Chattanooga was never "on the radar screen for competing for LOX/LIN projects." (Scorsone, Tr. 4877).

#### **6. Barriers to entry in the LIN/LOX market**

328. It is very important to MG Industries that its suppliers have prior experience. (Patterson, Tr. 467, in camera).

329. To build a LIN/LOX tank takes very specialized know-how, including knowledge about the material shrinking process and how to avoid cracks. (Kistenmacher, Tr. 852).

330. If a LIN/LOX tank is not constructed properly, severe harm and destruction could occur. (Kistenmacher, Tr. 848).

331. Track record and experience of the vendor are important factors in selecting a manufacturer of LIN/LOX tanks. (Kistenmacher, Tr. 849).

332. A new entrant will need to establish the capability to perform specialized metal fabrication. (Hilgar, Tr. 1343-44 (fabrication of the pieces for a LIN/LOX tank is complex due to "the tolerances and the manufacturing processes. . . . [if the] pieces get to the field and don't fit, you have a major problem"); Kamrath, Tr. 1995 (customer "would be very concerned about how he manages that, the supervision he provides, the standards

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and guidance he provides. It's not something that eliminates a supplier, but certainly it raises a concern.")).

333. A new entrant will need large amounts of cash to conduct physical tests of materials and tank prototypes or components. For example, Matrix spent [redacted] testing cellular glass and rigid insulation systems that form the ground insulation between the inner and outer tanks for a LIN/LOX tank. (Newmeister, Tr. 1584-85; Kamrath, Tr. 2235-36, in camera [redacted])

334. Air Liquide would not buy a LIN/LOX tank from someone who had not built a tank before, because of the risks, including technical and safety risks, and project execution risk. (Kamrath, Tr. 1995-96, 2236-37, in camera; see also Knight, Tr. 2628 (experience building LIN/LOX tanks provides customers with confidence that the product will be designed and built the way it was requested); JX 25 at 83-4 (Hilgar, Dep.) (describing safety hazards associated with LIN/LOX tanks).

### **7. Alleged post-acquisition price increases**

335. In 2002, Linde and Praxair were competing against each other for the same air separation facility. (Scorsone, Tr. 5020). Linde lost the air separation facility to Praxair, therefore Linde did not pursue the pricing for its proposed project any further than the budget pricing stage. (Scorsone, Tr. 5020-21). Praxair won the contract for air separation facility and awarded the LIN/LOX project to CB&I. (Scorsone, Tr. 5019).

#### **a. Linde-New Mexico Project**

336. In 2002, Linde BOC Process Plant LLC ("Linde") requested budget pricing for a proposed 344,000 gallon LIN/LOX tank to be located in New Mexico ("Linde-New Mexico"). (Fan, Tr. 1002, 1064; CX 1344 at LPPI 0000259, LPPI 0000261).

337. Mr. Chung Fan is a proposal manager at Linde BOC Process Plants. (Fan, Tr. 947). In his request for proposal, Fan did not provide the following information: a construction schedule

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(Fan Tr., 1073), where in the state of New Mexico the project would be located (Fan, Tr. 1075), the time of year that the tank would be constructed (Fan, Tr. 1076), the conditions of the project site (Fan, Tr. 1077), or the identity of the end-user (Fan, Tr. 1078; see also RX 860 at CBI 071847). Fan provided only a preliminary nozzle list (Fan, Tr. 1060) and requested that the pricing for the New Mexico project be submitted within two weeks time. (Fan, Tr. 1062). Fan admitted that he did not provide sufficient information to produce a firm-fixed price. (Fan, Tr. 1078).

338. AT&V quoted a price of approximately \$ 600,000. (Fan, Tr. 960-961). Matrix responded with a price of over \$ 900,000. (Fan, Tr. 962). CB&I responded with a budget price of \$ 814,000. (CX 1344 at LPPI 0000261).

339. Fan stated that he did not consider AT&V's price "reliable" because it diverged so widely from CB&I and Matrix. (Fan, Tr. 963). Fan could not see how AT&V could do it so cheaply compared to CB&I. (Fan, Tr. 963). While AT&V's low price has caused some concerns for Linde, there has been pressure within Linde to use AT&V because of their low price. (Fan, Tr. 1016-18).

340. Fan dismissed Matrix because he believed its price was always high. (Fan, Tr. 1019).

341. Fan compared CB&I's budget price on the New Mexico project, which was based on incomplete information and was not the result of any negotiation, to a 3 year old PDM firm fixed price which was the result of significant negotiation, and believed that CB&I's price had gone up. (Fan, Tr. 1019, 1069-70).

342. Fan also compared CB&I's price with a pricing model that Linde routinely uses to distinguish between reasonable and unreasonable price quotes from vendors. (CX 1584; Fan, Tr. 966, 1024). Using his pricing model and the past price information from PDM, Fan concluded that the quote he received from CB&I

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was higher than Linde would have paid to PDM. (Fan, Tr. 1009-10).

343. Prior to April 2002, the time of the New Mexico estimate, Fan had not updated his estimating spreadsheet for approximately two years. (Fan, Tr. 973). Fan stated that he uses the year 1998 as a baseline for his spreadsheet. Fan agreed that the further away from his baseline year of 1998 he gets, the less accurate his estimating attempts become. (Fan, Tr. 1069). Fan stated that his calculations do not account for price changes between the time the project is bid and the time it is awarded because that is not the purpose of his spreadsheet. (Fan, Tr. 1055-56).

344. Fan stated that his method was not accurate enough to determine if CB&I's prices went up because he did not have CB&I's metal pricing. (Fan, Tr. 1056). Fan does not know the quantity of perlite used for any of the tanks in his spreadsheet. (Fan, Tr. 1045). Fan stated that it is very difficult to calculate the amount of perlite and the thickness of the perlite required for a project because it shrinks when the tank is filled with cryogenic fluid. (Fan, Tr. 1045). Fan did not call up perlite suppliers to determine the current rate for perlite. (Fan, Tr. 1049). Fan did not call the foamglass supplier to determine the current rate for foamglass. (Fan, Tr. 1050). Fan did not call the concrete supplier to determine the current rate for concrete. (Fan, Tr. 1050). Fan did not know the thickness of the metal CB&I intended to use for the New Mexico project and attempted to calculate the metal thickness based upon drawings from other non-CB&I tanks. (Fan, Tr. 1047).

**b. Praxair-New Mexico Project 1**

345. On June 15, 2002, CB&I submitted a pricing proposal to Praxair for a [redacted] gallon LIN/LOX tank to be built in Farmington, New Mexico. (CX 1508 at CBI 059657, in camera). Pursuant to the sole-source exclusive partnership agreement Praxair negotiated with CB&I shortly prior to the Acquisition, Praxair is obligated to contract with CB&I for its domestic non-

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union LIN/LOX tanks, and CB&I is required to provide open book pricing with a four percent margin. (Scorsone, Tr. 5019-20).

346. CB&I's quote to Praxair was [redacted]. (CX 1508 at CBI 059657, in camera).

347. CB&I provided a firm fixed price to Praxair pursuant to its partnering agreement; Praxair provided CB&I with all of the detail necessary to arrive at a firm price. (Scorsone, Tr. 5020-21). By contrast, CB&I had submitted a budget price to Linde because Linde had provided minimal detail and omitted the location of the project. (Scorsone, Tr. 5020-22; F.337).

348. The tanks proposed by Linde and Praxair for the same location were drastically different in scope and design. In contrast to the Linde tank, Praxair designed a more slender tank which resulted in an additional horizontal weld seam as well as required thicker steel throughout the tank. (Scorsone, Tr. 5021). The Praxair project scope also included a full-time welding supervisor, an increased 50 hour work week, additional subsistence in order to attract field labor to the remote site, and a more complex nozzle structure. (Scorsone, Tr. 5021-22). Praxair specifically defined the complex nozzle structure they wanted for their tank, while Linde provided only basic information concerning its anticipated nozzle configuration. (Scorsone, Tr. 5022). There are approximately \$ 60,000 worth of additional cost items included in the-Praxair pricing that were not included in the Linde budget price. (Scorsone, Tr. 5022).

**c. Praxair-New Mexico Project 2**

349. On November 6, 2001, after the merger, Praxair asked CB&I to provide a budget price for an LR-60 LIN tank in Farmington, New Mexico. (CX 448 at CBI-E 007391).

350. CB&I estimating staff was instructed to use a 4% profit margin. (CX 448 at CBI-E 007391). CB&I estimating staff was also instructed to use PDM's price on the Colorado Springs tank as a basis for determining the price for the New Mexico project, if

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necessary. (CX 448 at CBI-E 007393). PDM had provided a rough budget price of [redacted] for a 500,000 gallon LOX tank in Colorado Springs, Colorado for Praxair in November 2000. (CX 448 at CBI-E 007391; CX 449 at CBI-E 007401, in camera; see RX 90 at PDM-CH 002717).

351. CB&I submitted "tight budget pricing" of [redacted] for the New Mexico tank on April 30, 2002. (CX 449 at CBI-E 007411, 007403, in camera).

352. CB&I explained to Praxair that the increased price was a result of [redacted] (RX 92 at CBI-E 007401, in camera).

### **8. Sophistication of customers**

353. BOC is an experienced purchaser of LIN/LOX tanks. BOC hired engineering consultants to assist it and AT&V in working through the Midland project. (V. Kelley, Tr. 4619-20).

354. MG Industries has experience purchasing LIN/LOX tanks in the past; it purchased [redacted] such tanks during the 1990s. (Patterson, Tr. 478-79, in camera). During the 1990s, MG Industries would often drive tank costs down by informing vendors that they were higher-priced than other vendors. (Patterson, Tr. 350).

355. Air Liquide Process is experienced at purchasing LIN/LOX tanks both domestically and overseas. (See Kamrath, Tr. 1979-80, 1983-85). [redacted] (Kamrath, Tr. 2235-36, in camera).

## **H. Effects on Competition in the TVC Market**

### **1. Overview of the TVC market**

356. A Thermal Vacuum Chamber ("TVC") is a large metal enclosure used to simulate the vacuum of space for the purpose of testing satellites and satellite components prior-to launch. (Gill, Tr. 179-83; Neary, Tr. 1423-24). A TVC simulates the

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atmospheric and thermal conditions found in space. (Gill, Tr. 183; Proulx, Tr. 1722-23; Thompson, Tr. 2039-40; Higgins, Tr. 1264).

357. A TVC is composed of a large vacuum envelope (or chamber) constructed of stainless steel shaped roughly like a horizontal cylinder with a front door that may swing on a hinge or slide laterally on a rail. (Scully, Tr. 1098-99).

358. A "thermal vacuum system" is the process equipment that goes inside a TVC to simulate extreme heat and cold. (Higgins, Tr. 1263). The thermal vacuum system is comprised of one or more shrouds, vacuum insulated pipe, and cryo pumps or other pumping equipment, which are all controlled by a thermal control unit. (Higgins, Tr. 1263).

359. A TVC is outfitted with two or three different types of vacuum pumps that are used collectively to achieve the vacuum conditions found in space. (Scully, Tr. 1099).

360. The thermal shroud turns the vacuum chamber into a TVC. (Scully, Tr. 1099). This thermal shroud is a black wall found inside the vacuum envelope that cools or heats the contents of the chamber through radiation. (Scully, Tr. 1099-1101).

361. The extreme temperatures required inside a TVC are created by blowing nitrogen through tubes connected to the thermal radiator. (Scully, Tr. 1100; Thompson, Tr. 2039-40).

362. TVCs require field-erection at the facility site. Field-erection is required when the chamber or its pieces become too large to transport to the site. (See Gill, Tr. 187). This field-erection includes transporting the fabricated pieces of the stainless steel chamber to the site, using cranes and riggers to align the pieces, and using welders to weld the chamber pieces together. (Gill, Tr. 186, 268-69; Hart, Tr. 407; see also Newmeister, Tr. 2188-89).



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**2. Market shares and concentration in the TVC market prior to Acquisition**

363. CB&I's acquisition of PDM combined the only two competitors in the market for large field-erected TVCs in the U.S. (Simpson, Tr. 3489 (citing CX 272; CX 857, in camera; CX 264; CX 1040 at PDM-HOU 010889; CX 94 at PDM-HOU 017583)). Since 1960, the only companies that have built TVCs are PDM and CB&I. (Scully, Tr. 1110, 1115 (referencing RX 178); Higgins, Tr. 1267; Newmeister, Tr. 1564).

**a. Tank projects**

364. Only one field-erected TVC has been built since 1990. This was built by PDM in 1996. (Glenn, Tr. 4089, 4160; Scully, Tr. 1165, 1189, 1193).

365. CB&I has not built a field-erected TVC since 1984. (Scorsone, Tr. 5055-56; Glenn, Tr. 4089, 4160; Scully, Tr. 1187-89, 1193; Higgins, Tr. 1276-77). CB&I has never built a mailbox-shaped field-erected TVC. (Scully, Tr. 1193; Neary, Tr. 1467; Scorsone, Tr. 5056).

366. Both CB&I and PDM provided final pricing offers for [redacted] large, field-erected mailbox shaped TVC in 1997 that [redacted] now calls the [redacted]. ([redacted], Tr. 1740, 1901, in camera). In addition, two other companies, [redacted] responded to [redacted] request for proposals. ([redacted], Tr. 1890-91, in camera). [redacted] eliminated these companies from the bidding process because they were not qualified. ([redacted], Tr. 1890-91, in camera).

367. PDM provided a firm fixed price proposal for a large, field-erected TVC for [redacted] Seal Beach facility in 1999. (CX 1573 at 5, in camera; [redacted], Tr. 1925-27, in camera). [redacted] sought a sole-source procurement with PDM without even considering CB&I. ([redacted], Tr. 1927, in camera; Scorsone, Tr. 5081-82, in camera).

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368. Both CB&I and PDM developed specifications for a large field-erected TVC for Spectrum Astro in 1999. (CX 969 at CBI-PL014693; CX 1162 at CBI-ATL000941, in camera; Thompson, Tr. 2047-2048). In November 2000, both CB&I and PDM submitted best and final offers for the Spectrum Astro project. (Thompson, Tr. 2051; Scorsone, Tr. 5115-16). CB&I was selected. CB&I's price was lower than PDM's. (Thompson, Tr. 2051). Spectrum Astro subsequently decided not to proceed with the field-erected TVC project. (Thompson, Tr. 2097, 2103-04). CB&I and PDM were the only companies competing for this project. (Scully, Tr. 1169; Higgins, Tr. 1270).

369. Both CB&I and PDM were asked to provide rough order of magnitude ("ROM") pricing for a large field-erected TVC to TRW in 1999. (Neary, Tr. 1430-31). TRW has not asked for bids. (Gill, Tr. 253). After the Acquisition, TRW requested TVC pricing from Howard Fabrication, a small producer of shop-built TVCs. (Neary, Tr. 1442-43). TRW plans to award the contract for this TVC in late 2003 and begin building it in 2004. (Neary, Tr. 1431, 1471-73, 1501). CB&I, PDM and Howard were the only companies asked to provide ROM pricing. (Neary, 1431-32, 1444).

**b. HHI calculations**

370. Dr. Simpson testified that he would assign a 50-percent market share to CB&I and a 50-percent market share to PDM based on the opinions of market participants, documents, and the history of awarded projects. (Simpson, Tr. 3492-93, 3495-96). Dr. Simpson includes in his HHI analysis the value of the Spectrum Astro project which was awarded to CB&I, but was not built. (Simpson, Tr. 3495). On these bases, Dr. Simpson testified that the Acquisition increased market concentration, as measured by the HHI, by 5000 points to a level of 10,000. (Simpson, Tr. 3494).

371. If CB&I and PDM are assigned market shares based on the dollar value of awarded sales since 1990, CB&I has a 49.3 percent market share, and PDM has a 50.7 percent market share. (Simpson, Tr. 3493-94). Based on the dollar value of TVC awards

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since 1990, CB&I and PDM have a combined share of 100%, and the Acquisition increases market concentration, as measured by the HHI, by 4,999 points to a level of 10,000. (Simpson, Tr. 3494; CX 1210 at 7, in camera; CX 567 at CBI 007139-HOU).

372. While CB&I was awarded a bid in 2000 for Spectrum Astro, a contract was never signed and the project was canceled. (Thompson, Tr. 2097, 2103-04; Scorsone, Tr. 5336-37). Without the proposed Spectrum Astro project included, PDM would have 100% market share and an HHI of 10,000 since 1984. The increase in the HHI would be zero.

373. Demand in the TVC market is extraordinarily thin. (Harris, Tr. 7325).

374. Already thin demand is decreasing for large, field-erected TVCs as the result of consolidation in the aerospace business, the miniaturization of electronic components in satellites, and the change in the economy since the 1990's. (Scully, Tr. 1199-1204).

375. Use of data from 1990 to Acquisition does not accurately predict harm to competition because the market for TVCs is extraordinarily thin. (Harris, Tr. 7325-27).

### **3. Respondents were each others' closest competitors in the TVC market**

#### **a. CB&I's views**

376. CB&I's business and strategic documents refer to PDM as CB&I's "only competitor" for TVC projects in the United States. (CX 212 at CBI-PL031721; see also CX 264 at CBI-H006780 ("only real competitor"); CX 265 at CBI-H007057 ("single USA competitor").

377. CB&I considered PDM to be a "formidable" competitor in the TVC market (CX 216 at CB&I-PL033886, see also CX 212 at CBI-PL031721 (PDM's strategic alliance was "the only

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competition for the thermal vacuum systems market")), and "our major competition if new work emerges" in TVCs. (CX 1040 at PDM-HOU 010889).

378. CB&I purchased XL Technology Systems ("XL") on September 30, 1999 with the hope that XL's technology would help CB&I compete in the field-erected TVC market. (Scully, Tr. 1123-30, 1178, 1189; see also Glenn, Tr. 4161).

379. The purchase of XL in 1999 improved CB&I's competitiveness in the TVC market. (Gill, Tr. 257). CB&I's partnership with XL was a significant factor in CB&I's winning the source selection for the Spectrum Astro project. (Thompson, Tr. 2103; Scully Tr. 1226).

**b. Industry views**

380. John Gill, owner of Howard Fabrication, testified that prior to the Acquisition, "PDM was either number one or number two," and CB&I was, "either number one or number two." (Gill, Tr. 204-205).

381. Kent Higgins, President of Process Systems International, testified that "PDM and CB&I" were the only firms that had the capability to construct TVCs. (Higgins, Tr. 1267).

382. Patrick Neary, Manager of the Environmental Test Organization, testified that Respondents were "the two large field-erected manufacturers" of TVCs. (Neary, Tr. 1430).

383. John Newmeister of Matrix testified that Respondents were the only two firms who have competed in the TVC market. (Newmeister, Tr. 1564).

384. [redacted], Product Manufacturing Factory Planning Manager for [redacted], testified that Respondents were "the lowest risk and best candidates for success." ([redacted], Tr. 1899, 1900, in camera). Other firms lack the expertise to be as cost-

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effective and of equal quality as Respondents. ([redacted], Tr. 1900-01, in camera).

385. David Thompson, CEO of Spectrum Astro, who has "seen most of the TVCs in the industrial base in the [United States]," testified that Spectrum Astro "tried to do a survey of everybody in the country that we thought would be a qualified bidder, and the two bidders that we found at the time were Chicago Bridge and Iron and PDM." (Thompson, Tr. 2039-41). Spectrum Astro saw CB&I and PDM "fighting against each other pretty hard to get our business." (Thompson, Tr. 2115).

386. XL Technologies viewed the competition between Respondents as "always relatively intense." (Scully, Tr. 1175). CB&I's desire to win TVC projects caused the "pricing [of TVCs] to go down." (Scully, Tr. 1175-6). The competition was so "intense" that XL Technologies and its partner CB&I worried that the prices to customers would not return a profit: "the costs incurred to get" a project were so high that "if the price of the system isn't high enough, you've lost your profit before you ever begin the job." (Scully, Tr. 1179-81). Ronald Scully, President of XL Systems, testified that turnkey suppliers for TVCs were limited to Respondents. (Scully, Tr. 1115, 1237).

387. Scully made sales calls to Lockheed on behalf of CB&I and XL Systems ("XL Systems") in 1997 in an attempt to solicit TVC business. (Scully, Tr. 1190). Lockheed employees refused to work with CB&I, because Lockheed believed PDM to be dominant in the industry and the technological leader. (Scully, Tr. 1190-91).

**c. Competition between Respondents lead to lower prices**

388. In [redacted], which is now owned by [redacted], procured a large, field-erected, mailbox-shaped TVC that [redacted] now calls the [redacted]. ([redacted], Tr. 1740, 1901, in camera).

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389. PDM and CB&I each attempted to preempt the competitive bidding process and win the project on a sole-source basis. Bob Swinderman, PDM sales representative, told [redacted] that sole-sourcing the chamber with PDM "would be the cheapest and fastest way" to get the chamber built. ([redacted], Tr. 1889-90, in camera). CB&I echoed the same sentiment, giving similar assurances to [redacted] if it sole-sourced the chamber with CB&I. ([redacted], Tr. 1889-90, in camera)

390. [redacted] testified that he did not want to sole-source the project, as a sole-source arrangement generally resulted in higher costs. ([redacted], Tr. 1890, in camera).

391. Rather than sole-source the project, [redacted] made the specifications for the project available to "all the interested bidders." ([redacted], Tr. 1892, in camera). [redacted]. ([redacted], Tr. 1890-91, in camera).

392. Four companies responded to [redacted] request for proposals: CB&I, PDM, [redacted]. ([redacted], Tr. 1899, in camera). These bidders presented "their conceptual design," cost estimate material, and other information required by [redacted]. ([redacted], Tr. 1892, in camera).

393. [redacted] submitted the lowest bid in response to [redacted] performance specifications. However, [redacted] did not meet [redacted] standards. [redacted] eliminated [redacted] from the bidding because "they did not show that they had a complete wherewithal as to the scope of the project in order to come in at cost," they "did not have clear solutions on some of the items delineated in . . . [redacted] preliminary proposal review," and ". . . they lacked the demonstrated experience of building something of that size." ([redacted], Tr. 1900, in camera).

394. [redacted] also eliminated [redacted] as a possible competitor because ". . . their proposal couldn't meet the spec. . . they took exception to some of our specs." ([redacted], Tr. 1901, in camera).

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395. In addition to the four original bidders, [redacted] also contacted two other suppliers, "[redacted], and requested that they submit proposals for the project. ([redacted], Tr. 1902-1903, in camera). [redacted] refused to submit a bid because "they felt the size of the project was beyond their company's means." ([redacted], Tr. 1903, in camera).

396. The elimination of [redacted] and [redacted] from the competition, and the refusal of [redacted] to submit a bid, left PDM and CB&I as the two down-selected bidders for the [redacted]. ([redacted], Tr. 1892, in camera).

397. [redacted] told CB&I and PDM that they were competing against each other for the [redacted]. ([redacted], Tr. 1909, in camera). [redacted] project manager testified that he wanted CB&I and PDM to know that they were competing against each other because "when you have competitors bidding best and final, one number takes all, [that] is when we would receive the lowest price. . . ." ([redacted], Tr. 1909, in camera).

398. [redacted] asked each company for "cost-saving initiatives, what could be done to reduce costs." ([redacted], Tr. 1907, in camera). As both companies developed their final designs, incorporating their own cost-saving innovations, they used "their expertise as designers and builders to suggest anything that might lower the bottom line cost for the chamber." ([redacted], Tr. 1907-08, in camera).

399. After receiving the final pricing offers for the [redacted] added some items to the TVC specifications. ([redacted], Tr. 1911, in camera). Even though [redacted] believed these additional items "would have increased the price," [redacted] asked CB&I and PDM to "sharpen their pencils and give me their lowest price." ([redacted], Tr. 1911-12, in camera).

400. In response to this last request, CB&I increased its final pricing "a little bit." ([redacted], Tr. 1911, in camera).

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401. Despite the increase in cost from the additional items, "PDM actually lowered their price by . . . over a million dollars." ([redacted], Tr. 1910-11, in camera; see Scully, Tr. 1166 (after the bid was awarded, CB&I learned that, at the last opportunity in the bidding process, PDM had further lowered its price by "something in the order of as much as \$ 2 million"))).

402. PDM bid the [redacted] in 1997 at below cost with the intention of keeping CB&I completely out of the market. (Scully, Tr. 1193-94, 1166).

403. [redacted] perceived, based on comments, that PDM lowered its pricing to demonstrate "technical prowess, boasting rights, so to speak, of having won or the desire to win for future business prospectives that [redacted] contract. . . ." ([redacted], Tr. 1916, in camera).

404. Sometime after [redacted] awarded the contract to PDM, [redacted] talked with Bob Swinderman, the PDM sales representative, about the competition for the [redacted] project:

. . . PDM had felt that CB&I had been out of the market for several years and that if they allowed them to win that particular project, which was a very significant project, that they would be back in and become a significant competitor, and it was important to PDM management that they not win that, and so through telephone calls they developed a price, lowered the price and offered it to [redacted] at the last minute. . . .

(Scully, Tr. 1166).

405. The lowest price was the deciding factor in who won the project. [redacted] awarded the [redacted] contract to PDM and its subcontractor, Chart Industries, primarily because they offered a lower price than the CB&I/XL team. ([redacted], Tr. 1891-93, in camera).



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406. [redacted] testified that his procurement strategy had saved [redacted] below what he had originally estimated as the likely cost of the [redacted]. ([redacted], Tr. 1910, in camera).

**4. Competition in the TVC market from Acquisition to time of trial**

407. [redacted] ([redacted], Tr. 1957, in camera).

408. TRW began its procurement process for its TVC in 1999 by obtaining ROM pricing from CB&I and PDM. TRW plans to award the contract for its TVC in late 2003 and begin building it in 2004. (Neary, Tr. 1431, 1501).

409. Spectrum Astro will likely procure a new TVC in the next 3-4 years. (Thompson, Tr. 2104).

**5. No other companies provide competition in the TVC market**

410. Howard Fabrication is a domestic company that supplies shop-fabricated TVCs and thermal vacuum systems. Howard Fabrication has never supplied, and does not have the capability necessary to supply, a TVC with a diameter greater than 20 feet. (Gill, Tr. 182, 192-93). Gill testified that his company, Howard Fabrication, with \$ 2.5 million in annual revenues, could not effectively compete in the market for TVCs because it was not large enough to purchase the bonds for TVC projects. (Gill, Tr. 200-01, 234).

411. CB&I does not consider Howard capable of fabricating a TVC, let alone having the capability to design, engineer, and field-erect a TVC. (Scorsone, Tr. 5061 ("I think that would be a real stretch for Howard, very much so.")).

412. Mr. Higgins, the President of the Chart division that supplies the systems and equipment attached to TVCs, testified that Chart is not "capable" of field-erecting a TVC by itself. (Higgins, Tr. 1266-67).

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413. Matrix has not expended any significant resources on developing its capability to engineer and design TVCs. (JX 37 at 89-90 (Newmeister, Dep.)).

414. XL Technologies admits that it is not capable of supplying a TVC without partnering with an experienced chamber supplier such as CB&I. (Scully, Tr. 1118, 1134, 1252; see CX 262 at CBI-H004037-38). On February 28, 2002, CB&I sold its XL Technologies subsidiary to Scully. (Scully, Tr. 1130). CB&I did not transfer to XL Technologies the assets, engineering know-how, equipment or personnel necessary to the field-erection of large TVCs. (Scully, Tr. 1132-33).

### **6. Barriers to entry in the TVC market**

415. Mr. Scully, President of XL Technology Systems, testified that TVC customers want experienced suppliers with "knowledge as to how to deal with the architects and the construction people . . . and ability to manage a project." (Scully, Tr. 1147; see also Higgins, Tr. 1272; Proulx, Tr. 1756; Neary, Tr. 1455).

416. New entrants would need to obtain "the ability to fabricate in the field a stainless steel vessel" and satisfy "the quality requirements of leak testing and cleanliness" for a TVC. (Higgins, Tr. 1272-3). A new entrant would need to hire engineers with previous experience in designing TVCs, which are "truly one-of-a-kind designs for very specific applications on very technical products." (Newmeister, Tr. 1612-13).

417. Leaks in a TVC can prevent the user from meeting the vacuum specifications required for satellite testing. ([redacted], Tr. 1904-05, in camera). In addition, defects in the welding of the chamber can lead to the leakage of contaminants into the chamber, which can interfere with the accuracy of the test results. (Scully, Tr. 1143-44). If a TVC fails during a satellite test, the satellite within the chamber can be damaged. (Neary, Tr. 1454; Scully, Tr. 1144). Operational problems with a TVC can have a "bad effect" on the satellite's program schedule, because the test

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may have to be restarted from the beginning after the problem is resolved. (Scully, Tr. 1145-46).

418. A new entrant would need to expend significant resources in developing proposals and price quotations for TVCs. One CB&I document reports that CB&I expended \$ 300,000 in design resources and \$ 190,000 in other resources to prepare its TVC proposal for Orbital Sciences' planned chamber. (CX 235 at CBI-PL060198).

## **7. Alleged post-acquisition anticompetitive behavior**

### **a. Spectrum Astro**

419. In the fall of 1999, Spectrum Astro required a TVC in order to be considered for the Space Based Infrared System (SBIRS) Low Phase 2 Program, sponsored by the United States Air Force. (CX 969 at CBI-PL014693).

420. Mr. William Thompson, Spectrum Astro's president, testified that he competitively bid the project, because "we wanted obviously to get the best price we could get." (Thompson, Tr. 2051). Additionally, Spectrum Astro used a competitive bidding process because "we were looking for technical innovation. We generally find that when we have contractors in competition, they will - it will tend to drive innovation into the system." (Thompson, Tr. 2051).

421. Spectrum Astro retained both CB&I and PDM to develop specifications for a large field-erected TVC; Spectrum Astro also entered into an engineering and design contract with each company in which Spectrum Astro paid each company [redacted] (CX 969 at CBI-PL014693; CX 1162 at CBI-ATL000941, in camera; Thompson, Tr. 2047-2048).

422. The contract was to be awarded according to a "rolling down-select between CB&I and PDM/PSI team." (CX 969 at CBI-PL014693).

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423. Spectrum Astro received initial cost proposals from both CB&I and PDM in May 2000. CB&I and PDM's total cost amounts were \$ 9,929,990 and \$ 10,825,853 respectively. (CX 1570 at 22).

424. In November 2000, both CB&I and PDM submitted best and final offers for the Spectrum Astro project. (Thompson, Tr. 2051; Scorsone, Tr. 5115-16). Of the two offers that were submitted, CB&I's price was lower than PDM's. (Thompson, Tr. 2051). CB&I bid \$ 10,760,880, an increase of 8.4% above its previous cost proposal. (CX 1570 at 9). PDM bid \$ 11,528,900, an increase of 6.5% above its previous cost proposal. (CX 1570 at 5, 37).

425. CB&I's November 2000 offer included a profit margin of 7.77%. (CX 1489 at CBI 060015).

426. After evaluating the proposals submitted by PDM and CB&I, Spectrum Astro elected to proceed with CB&I, in December 2000. (Thompson, Tr. 2061; CX 926 at CBI 007212-HOU).

427. After selecting CB&I for the project, Spectrum Astro proceeded "based upon the price we had in our hands," that is the firm fixed price of approximately \$ 10.7 million. (Thompson, Tr. 2065; CX 1489 at CBI 060015).

428. The price provided to Spectrum Astro in December 2000 expired after 90 days, as is typical in this industry, because costs are expected to escalate or fluctuate beyond the 90 day period. (Scorsone, Tr. 5047-48; Thompson, Tr. 2609).

429. Following the selection of CB&I in December 2000, Spectrum Astro did not immediately award the project because it was working to get financing complete. (Thompson, Tr. 2066).

430. CB&I's price expired 90 days after the source selection, in February, 2001, and Spectrum Astro did not request updated pricing until 10 months later in November, 2001. (Scorsone, Tr.

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5047; see also Thompson, Tr. 2069). For almost one year, the project remained dormant. (Scorsone, Tr. 5048).

431. In November 2001, CB&I provided Spectrum Astro with updated pricing for the Spectrum Astro chamber. (Thompson, Tr. 2069-2070). CB&I's updated price for the Spectrum Astro TVC was \$ 12,019,000 -- almost \$ 1.2 million greater than its price 12 months prior. (Thompson, Tr. 2074; CX 567 at CBI 007139-HOU; Glenn, Tr. 4356-57).

432. CB&I's updated price of \$ 12,019,000 resulted in an 11.7% increase in the price of the chamber from the November 2000 price. (CX 1489 at CBI 060015; CX 1570 at 5).

433. According to a pricing analysis written by Scott O'Leary, Spectrum Astro's chief of facilities, Spectrum Astro was "expecting a decrease in cost due to the decrease in requirements." (CX 1570 at 5; Thompson, Tr. 2095). During the engineering study, "there were some items that were taken out of the design which should have caused the price to go down." (Thompson, Tr. 2071, 2073). Due to other "offsetting kinds of things" in the design, Thompson testified that on balance, he believed the price of the chamber "would have stayed about the same." (Thompson, Tr. 2073).

434. The November 2001 price included an 11.97% profit margin. (CX 1489 at CBI-060015).

435. Scorsone testified that the extra profit included in the November 2001 re-pricing was a means of recovering some of the pre-contract costs, which was consistent with CB&I's policy at the time. (Scorsone, Tr. 5049). Scorsone told CB&I staff to "to insert the precontract costs incurred previously on the bid effort for this project even though those costs had been incurred in the previous year and had been written off." (CX 1492 at CBI 060000; see Scorsone, Tr. 5118, 5120-21; Scully, Tr. 1173-74). Scorsone further testified that another reason for the extra profit was the perceived need to mitigate some of the risks of moving forward with the project. (Scorsone, Tr. 5049). Satellite programs awarded

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by the Government are sometimes delayed. (Thompson, Tr. 2129). As a result, vendors of satellites must take account of the risk that these programs might be cancelled or delayed. (Thompson, Tr. 2129-30). Some of the extra profit was also the result of posturing in the negotiation with Spectrum Astro, because the final terms of the contract were never set. (Scorsone, Tr. 5049-51).

436. Scorsone also testified that the margin was increased to account for the added risk of erecting the "vessel outside of the building and then moving it in [to the building]" with the containment vessel. (Scorsone, Tr. 5122). However, this alternate method of erecting the chamber did not come up until after the November 2001 price increase. (Thompson, Tr. 2078-2079; CX 566 at 2; CX 1570 at 63 (alternate method was discussed in May 2002)). CB&I's comparison of its November 2000 and November 2001 proposals specifically states that estimates did not include "the alternate plan of erecting the chamber outside and then moving it into position." (CX 1489 at CBI 060013).

437. In CB&I's November 13, 2001, updated price quote to Spectrum Astro, Jeff Steimer listed nine reasons for its increase in price. (CX 567 at CBI 007136-HOU, CBI 007137-HOU). On December 19, 2001, CB&I provided Spectrum Astro with a follow-up justification letter to explain the bases for CB&I's price increase. (CX 1570 at 57-59).

438. Neither the November 13th nor the December 19th letter provide as reasons for the price increase the recovery of pre-contract costs previously incurred or risks of having to erect the chamber from outside the building. (CX 1570 at 46-47, 57-59).

439. The November 2001 price expired again after 90 days without Spectrum Astro acting on the new price. (Scorsone, Tr. 5051). After the second price had expired, Spectrum Astro waited six or seven months before requesting an updated price from CB&I. (Scorsone, Tr. 5051). The companies did not have a contract or financing at that point. (Scorsone, Tr. 5051-53).

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440. In May 2002, Spectrum Astro responded to the November 2001 price asking CB&I to try again. (Scorsone, Tr. 5051). On June 25, 2002, CB&I provided Thompson with an updated price in the amount of \$ 11,553,790, a decrease of roughly \$ 500,000 from the previous price update. (Thompson, Tr. 2091-92).

441. CB&I lowered its price in June 2002, because Scorsone was aware that the customer was having difficulty obtaining financing, and he wanted to assist them by making the project more viable with a lower price. (Scorsone, Tr. 5051-53). The June 2002 price lowers the profit margin to 8%. (CX 1489 at CBI 1060015).

442. Spectrum Astro does not plan to proceed with the field-erected TVC project. (Thompson, Tr. 2097, 2103-04). The decision is the result of "government action." (Thompson, Tr. 2097). The lack of financing also influenced the decision. (Thompson, Tr. 2105). It will be a long time before the Spectrum Astro job is actually built, if at all. (Scully, Tr. 1225-26).

443. Instead, Spectrum Astro intends to build a smaller shop-fabricated chamber, a product which CB&I does not build. (Thompson, Tr. 2104-2105).

**b. TRW**

444. In 1999, TRW Space & Electronics ("TRW") decided to procure a TVC, and requested rough order of magnitude ("ROM") pricing from CB&I and PDM. (Neary, Tr. 1430-31).

445. TRW considers Howard Fabrication to be unqualified to compete in the TVC market. Neary testified that Howard Fabrication does not have "the technical competence nor the financial backing" necessary for TRW to award it a TVC project. (Neary, Tr. 1443). After the Acquisition, TRW nevertheless requested pricing from Howard Fabrication because it wanted to maximize competition for the TVC project. (Neary, Tr. 1444).

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446. A CB&I salesman, Mike Miles, called John Gill of Howard Fabrication in mid-October 2002 to set up a meeting to discuss a new opportunity to work together. (Gill, Tr. 242-44). Miles did not indicate the nature of the opportunity during the initial phone call. (Gill, Tr. 242-44, 251-52).

447. Neither Miles nor Gill knew at the beginning of their October 2002 meeting that they had each separately provided very rough order of magnitude pricing on the TRW project. (Gill, Tr. 252-53, 274; Scorsone, Tr. 5059-60).

448. During the October 2002 meeting, Miles mentioned the possibility of Howard serving as a partner or subcontractor with CB&I for purposes of an unnamed proposed TVC project, since Howard Fabrication has worked with PDM as a subcontractor in the past. (Gill, Tr. 246-248, 251-56; Scorsone, Tr. 5059-60).

449. According to Gill, at the October 2002 meeting Miles gave him a copy of design specifications that he recognized as the same specifications that he was given by TRW for its TVC project. (Gill, Tr. 245). Gill told Miles that he knew the job was for TRW and that he had already presented a proposal to TRW for the job. (Gill, Tr. 245, 252-53, 274).

450. Gill testified that, nevertheless, during the October 2002 meeting, Miles asked him whether Howard "could coordinate on making a bid or a price quote to TRW." (Gill, Tr. 247). Gill confirmed that Miles proposed coordinating on the TRW bid after Gill had told him that Howard was bidding on the project. (Gill, Tr. 274).

451. Miles did not make this offer to coordinate on a bid to TRW with the consent or knowledge of management at CB&I. (Scorsone, Tr. 5059-62). Miles is an entry-level salesperson, and not a CB&I executive. (Scorsone, Tr. 5061-62). CB&I was unaware that Howard Fabrication had submitted budget pricing on the TRW project prior to Miles' meeting. (Scorsone, Tr. 5060).



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452. TRW believes that CB&I's proposal to Howard to coordinate on the price and bid to TRW deprives TRW of any chance for relief from CB&I's monopoly price. At trial, Neary of TRW testified that "it's not right" for a bidder to ask a competing bidder to coordinate on making a bid or price quote to TRW. (Neary, Tr. 1451). Neary further testified that "we're not going to get a fair and equitable price. It goes back to why do we even have two competitors. We're at a disadvantage. We're going to get - we're basically hosed, as I would say." (Neary, Tr. 1451).

453. CB&I is still considering using Howard Fabrication as a subcontractor, but would seek the prior approval of the customer before doing so. (Scorsone, Tr. 5060).

c. [redacted]

454. On June 30, 1999, PDM provided [redacted] with a firm fixed price proposal for a large, field-erected TVC for [redacted]. (CX 1573 at 5, in camera; [redacted], Tr. 1925-27, in camera).

455. This firm fixed bid price was [redacted]. ([redacted], Tr. 1927; Scorsone, Tr. 5081-82, in camera).

456. Pre-acquisition, PDM quoted a price of [redacted] in its proposal to [redacted], but the customer chose to postpone the project. (CX 1573 at 5, in camera; [redacted], Tr. 1926, in camera).

457. [redacted] ([redacted], Tr. 1943, in camera). Prices expire because costs change over time. ([redacted], Tr. 1944, in camera). The price of steel and labor costs increased in the interim. ([redacted], Tr. 1952, in camera).

458. In May 2001, [redacted] undertook a study to determine whether it should [redacted]. ([redacted], Tr. 1927-28, in camera).

459. In order to analyze the costs of the two alternatives, [redacted] requested "cost verification from CB&I . . . of the price . . . [redacted] based on PDM's earlier proposal." ([redacted], Tr.

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1929, in camera). [redacted] contacted Dave Lacey of CB&I, asked him to review PDM's prior proposal and submit a renewed price based on the specifications and schedule of the prior bid. ([redacted], Tr. 1930, in camera).

460. [redacted]'s official request was for a firm fixed price renewal of PDM's earlier bid for the TVC. ([redacted], Tr. 1933, 1935, in camera).

461. [redacted] expected the price for the [redacted] TVC project to increase marginally to cover "reasonable inflation." He anticipated the new pricing information to be [redacted] ([redacted], Tr. 1934, in camera).

462. CB&I did not have the information necessary to provide the firm fixed price to [redacted], nor did CB&I want to expend the money necessary to provide a new firm fixed bid price. (Scorsone, Tr. 5084, in camera). [redacted] did not give CB&I a date for the start of construction, the construction schedule, or information required to assess how the chamber would be inserted into the building. ([redacted], Tr. 1945, in camera). Such information would have been necessary for producing a firm fixed bid price. (See Scorsone, Tr. 5000-02).

463. On May 16, 2001, instead of providing a "firm fixed price renewal," CB&I submitted Rough Order of Magnitude "ROM price of [redacted] for a fully commissioned TVC." ([redacted], Tr. 1930-33, 1935-36, in camera; CX 1573 at 3, in camera).

464. The May 16, 2001 letter from CB&I states that "the ROM pricing accuracy can be improved with a more detailed assessment of your needs and resulting work scope. Sometime in the upcoming weeks we would like to discuss more fully your needs and emerging plans for providing services." ([redacted], Tr. 1950, in camera; CX 1573 at 3, in camera).

465. The May 16, 2001 ROM price has a stated accuracy of [redacted]. ([redacted], Tr. 1950-51, in camera).

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466. CB&I's ROM pricing in 2001 represented an increase of [redacted] or over [redacted] from PDM's firm fixed price in 1997. (CX 1573 at 2, in camera; [redacted], Tr. 1935, in camera).

467. [redacted] of [redacted] accepted that the [redacted] price quoted in the May 16, 2001 letter as "the price [redacted] would now have to pay to have that chamber built." ([redacted], Tr. 1933, in camera).

468. [redacted] was "disappointed that the cost had gone up" and that CB&I had not presented the updated price quote as a firm fixed price in its letter. ([redacted], Tr. 1936, in camera).

469. The price quoted by CB&I [redacted]." ([redacted], Tr. 1936, in camera).

470. [redacted] never asked CB&I for a follow-up firm price. ([redacted], Tr. 1947, 1951, in camera).

## **8. Sophistication of customers in the TVC market**

471. [redacted] is a large aerospace company. (Scully, Tr. 1092). [redacted] has five field-erected TVCs and 30 shop-fabricated TVCs. ([redacted], Tr. 1725-26).

472. TRW has five field-erected TVCs and approximately 15 shop-fabricated TVCs. (Neary, Tr. 1422).

473. Spectrum Astro is a satellite manufacturer that competes with large defense contractors. (Thompson, Tr. 2036).

## **I. Factors Across All Product Markets**

### **1. Budget prices versus firm bid prices**

474. A budget price is an initial price quote that can provide the initial basis for selecting a supplier and negotiating a final price. (Neary, Tr.1440 ("We first receive their initial price. Then we select the vendor")).

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475. Budget prices are prepared with less detailed information provided by the customer. (Hall, Tr. 1866; Carling, Tr. 4472; Fan, Tr. 1078). By contrast, a firm fixed bid price is based on very detailed designs. (Carling, Tr. 4472; Scorsone, Tr. 5003). The company providing the firm price is expected to "stand up to their price and do the work for that price." (Carling, Tr. 4472).

476. Bids can be awarded solely on the budget prices. (JX 23 at 27-28 (Cutts Tr.)). For example, Atlanta Gas Light Company selected PDM over CB&I, for an LNG project in 1998, based on budget price bids submitted by CB&I and PDM. (CX 161 at CBI-PL006113-114). PDM outsourced CB&I in the bidding competition "on the basis of their lower budget price." (CX 161 at CBI-PL006113). In another example, Linde BOC used budget prices to compare CB&I's and AT&V's pricing for the Hillsboro LPG project. (V. Kelley, Tr. 5292; Scorsone, Tr. 5031).

477. Budget prices can be close to firm bid prices. See Stetzler, Tr. 6352 ("Budgetary to me means plus or minus 10 percent type of a bid."). When CB&I and PDM competed for a TRW TVC project, CB&I's final price to TRW was within 5 to 10% of the original budgetary price. (Neary, Tr. 1440-41).

478. Generally, budget prices are more imprecise than firm fixed bid prices. (Carling, Tr. 4472; Scorsone, Tr. 4999). When creating budget pricing, estimators use off-the-shelf tank designs of a similar size volume to develop a budget price. (Scorsone, Tr. 4999). Subcontractors are not consulted when developing a budget price. (Scorsone, Tr. 4999-00). Amount of engineering labor required to design a tank are estimated when developing a budget price. (Scorsone, Tr. 5000). Those hours are not calibrated as part of the budget price. (Scorsone, Tr. 5000). These practices reduce the accuracy of the final number in a budget price. (See Scorsone, Tr. 4999-5000).

479. Budget prices include assessments of risk and contingency. (Price, Tr. 608-09; Scorsone, Tr. 5252; Simpson, Tr. 5366). Projects that involve an excessive amount of risk or

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unknown contingencies will receive higher budget prices. (Scorsone, Tr. 5003).

480. Years sometimes elapse between the time when a budget price is submitted and the time when a firm fixed bid price is actually requested. (Scorsone, Tr. 5004).

481. When creating a firm fixed price, estimators use an actual tank design. (Scorsone, Tr. 4999).

482. Firm fixed bid prices require that a customer give the supplier information about the site conditions, as well as allowing someone from the bidding company to tour the job site to examine the access to the site and soil conditions. (Stetzler, Tr. 6353; Glenn, Tr. 4126).

**2. CB&I and PDM recognized each other as each's greatest competitor**

483. PDM was the "single largest" reason CB&I lost business in the United States; competition from PDM accounted for 33% of CB&I's lost business. (Glenn, Tr. 4331; CX 227 at CBI-PL045101; see also CX 23 at PDM-C1002566 (PDM has made "significant market share increases against CB&I in both domestic and international markets")). In March 2000, CB&I reported that "in the last three months our business lost report is showing PDM taking some 13 jobs from [CB&I] at a value of \$ 25 million." (CX 243 at CBI-PL 4004707; see CX 660 at PDM-HOU005014 ("Since the fall of 1996, CB&I has been the most aggressive competitor in increasing market share")).

484. In March 2000, Steve Knott, CB&I's sales manager for the United States, e-mailed CB&I's sales team to lament that PDM is "'eating our lunch' and we know much of it is because of a CB&I cost problem." (CX 243 at CBI-PL 4004707).

485. Knott asked, "What is PDM doing that gives them the ability to be this low, this often? I am not 'coming down' on our group for losing to PDM. We all recognize that we can only sell

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to the market what the market will pay. Given our current system, we are bumping against pricing levels that are dangerously close to our direct cost." (CX 243 at CBI-PL 4004707).

486. Knott concluded that "We need to come up with a strategy to combat the effort PDM is making to erode our market share." (CX 243 at CBI-PL 4004707).

487. In October 2000, CB&I's Bob Lewis wrote to Steve Crain, President of CB&I's Western Hemisphere Operations that PDM was bidding "much lower than the market, leaving a lot of money on the table." (CX 278 at CBI-H 4004204).

488. Handwritten notes from the files of PDM's President note the following: (1) 1996-1997 "focused on more profitable assignments;" (2) 1997-1998 accept "lower gross profit in pursuit of higher revenues;" and (3) 1998-1999 PDM "forced to bid at lower margins" due to "competition w/CB&I" and "seeking more revenues." (CX 76 at PDM-C1006141-3; see also CX 390 at PDM-C 1006145 ("97-98 -> aggressive growth market share - sacrifice margins")).

489. In May 2000, PDM warned its Board of Directors that "CB&I has been extremely aggressive on pricing work in North and South America. They have taken certain projects at levels which would be slightly over PDM EC's flat cost." (CX 64 at PDM-C 1002562).

490. Scorsone confirmed that he told PDM's investment firm, Tanner & Company, about the competition between PDM and CB&I and how the companies were "forced to bid at lower margins" because of this competition. (Scorsone, Tr. 5152).

**3. CB&I and PDM recognized that the Acquisition would reduce competition and lead to higher margins**

491. [redacted] (CX 213 at CB&I-PL033037, in camera).  
[redacted] (CX 213 at CBI-PL033084, in camera).

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492. In 1999, PDM had assessed the benefits of acquiring CB&I and determined that acquiring CB&I would give PDM "Market dominance in Western Hemisphere." (CX 74 at PDM-C 1005941). Scorsone admitted that when he wrote the document he believed PDM could achieve "market dominance" by acquiring CB&I. (Scorsone, Tr. 5169).

493. An August 2000 document, created by a PDM sales person, titled "Benefits of Combining PDM with CB&I," listed the following: (1) "Dominance of the cryogenic (LNG/LOX/LIN) markets;" and (2) "Allows CB&I to have a low cost USA tank producer." (CX 621 at PDM-HOU006702).

494. At the time of the Acquisition, Scorsone thought CB&I/PDM will be a "powerhouse." (CX 72 at PDM-C 1004409). Scorsone later added that CB&I/PDM "will truly be the world leader in storage tanks." (CX 1686 at CBI/PDM-H 4005550; Scorsone, Tr. 5203).

495. An October 2000 PDM document entitled, "PDM Merger Objectives Brainstorm Results." outlined the following objectives: (1) "Create barriers to entry as they can be built;" (2) "Defend an expanding market share;" (3) "Ensure that we do not allow smaller competitors to take share and pursue business in our attractive markets;" (4) "Put plans in place to command premiums for the services we provide;" and (5) "Improve pricing to achieve margin growth from 12.5% to 17%." (CX 101 at PDM-HOU002359-60).

496. On October 26, 2000, Scorsone and other members of the integration team held an "Integration Kick-off Meeting." The "kick-off meeting" agenda prioritized the objectives of the merger: (1) "Ensure that we do not allow smaller competitors to take share and pursue business in our attractive markets;" (2) "Defend an expanding market share;" (3) "Create barriers to entry;" and (4) "Use pricing advantage as necessary to not lose market share to competitors during the merger." (CX 1544 at CBI 057941).

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**4. Entry at prices above pre-merger prices does not restore competition**

497. Both economic experts agree that entry by new firms would not restore the competition lost through an anticompetitive merger if this entry is at a price above the pre-merger price. (Simpson, Tr. 3151-52; Harris, Tr. 7438).

498. A merger of the two strongest suppliers would enable the merged firm to increase price up until the point where other less-strong suppliers begin to constrain it. (Simpson, Tr. 3451). A merger that reduces the number of sellers of LIN/LOX tanks from four to three or from three to two would be likely to result in an increase in price. (Simpson, Tr. 3451).

499. Entry will not keep prices from rising above the pre-acquisition level if entry is only profitable at higher prices. (Harris, Tr. 7451). The mere fact that entry has occurred following an acquisition does not mean that the entry is sufficient to restore the premerger competitive environment. (Harris, Tr. 7436). Entry by firms who can only profitably enter at prices above the competitive level would not restore competition. (Harris, Tr. 7438).

500. The observation that new firms submit bids in a market does not always imply that entry is sufficient. (Simpson, Tr. 3282-84; Harris Tr. 7790-91). The observation that new firms make some investments to sell into a market does not always imply that entry is sufficient. (Simpson, Tr. 3284-88; Harris, Tr. 7791).

**J. Exiting Assets Defense**

**1. PDM background**

501. PDM was founded in 1892 by the Jackson Family. PDM went public in 1965 on the American Stock Exchange. In 1999-2000, the Jackson Family was the primary stockholder of PDM, owning approximately 30 percent of the stock. (Byers, Tr. 6731-



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32; Scorsone, Tr. 4791). PDM's Board consisted of a majority of the Jackson Family and its friends and acquaintances. (Byers, Tr. 6734).

502. PDM operated four lines of business with five divisions - PDM Strockal, Water, Engineered Construction (EC), Bridge, and Steel Distribution. (Byers, Tr. 6731; Scorsone, Tr. 4778-79; G. Glenn, Tr. 4075-76).

503. PDM's EC and Water Divisions were "intertwined" and "meshed together." (Scheman, Tr. 2929-30). PDM's management believed separating EC and Water would be costly and difficult. (Scheman, Tr. 2929). The EC and Water Divisions shared human resource departments, fabrication plants, equipment and construction crews and it was considered impossible to split the two. (Scorsone, Tr. 4779; Byers, Tr. 6780-81, 6800-01). The EC and Water Presidents reported directly to the CEO Bill McKee, rather than exercising complete control over their organizations. (Byers, Tr. 6734).

## **2. PDM decision to sell the company**

504. PDM's Board asked PDM management to consider potential options for the strategic direction of the company's future in Summer 1999. Scorsone, then President of PDM EC, prepared a presentation to the PDM Board in August 1999 about strategies for going forward with the PDM EC Division. (Scorsone, Tr. 4781-82).

505. At a strategic planning meeting, a list of options was devised to provide to the Board. This laundry list included making a major acquisition, buying something unrelated, taking the company private, and selling the company. (Byers, Tr. 6738-40; Scorsone, Tr. 4791).

506. This laundry list of options was presented to the PDM Board in Summer 1999, but no hard decisions were made at that time. (Byers, Tr. 6740). The various options presented to the PDM Board were to maintain the status quo, pursue acquisitions,

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declare a special dividend, conduct a stock repurchase, split into two separate companies, and the sale of the company. (Scheman, Tr. 2917-19).

507. In November or December 1999, the PDM Board indicated to management that it wanted to pursue taking the company private. The Jackson Family would make a tender offer and buy back all shares of PDM except for management's ownership. This plan was never implemented. (Byers, Tr. 6740-41).

508. At the February 2000 Board meeting, the Jackson Family indicated that it wished to take the company private. It was decided that the Family should hire its own investment banker. Polly Townsend, Bill Jackson, Sr.'s daughter, contacted a partner at Tanner & Co. ("Tanner") for an interview. (Byers, Tr. 6741-42; Scheman, Tr. 2911, 6907).

509. In May 2000, PDM decided to sell the company. (Byers, Tr. 6742).

510. In June 2000, PDM interviewed investment firms Goldman Sachs and Tanner to advise on the sale. (Byers, Tr. 6742-6743).

511. Goldman Sachs recommended that PDM pursue "five to ten strategic buyers and 10 to 20 LBO [leveraged buy out] buyers." (Byers, Tr. 6838-39; see also CX 380 at PDM-C 1004026).

512. Tanner recommended that PDM sell off the divisions in pieces rather than in a single transaction to a single purchaser. (Byers, Tr. 6755). Tanner believed that breaking up the company and selling it in parts would result in a higher total value. (Byers, Tr. 6755).

513. Both Goldman Sachs and Tanner made presentations at the same Board meeting on June 1, 2000. Shortly after this

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meeting, Tanner was retained by PDM. (Scheman, Tr. 2914-15, 6907-08; RX 25 at 2).

514. Tanner is no longer retained by PDM. Tanner's assignment concluded in the middle of March 2002 when PDM was acquired by Iron Bridge Holdings. (Scheman, Tr. 6909).

**3. Steps resulting in acquisition**

515. In 2000, Bill McKee, former CEO of PDM, offered to sell PDM EC and Water Divisions to CB&I in a telephone call to Glenn of CB&I. (Glenn, Tr. 4077-78).

516. Peter Scheman, Tanner's representative to PDM, had the responsibility to "coordinate and lead everything." (Scheman, Tr. 6908). Scheman first became involved with PDM at the end of February 2000 or beginning of March 2000 when Tanner was retained as an advisor to the Jackson Family in March 2000. (Scheman, Tr. 2911-12, 6907-08).

517. Tanner & Company prepared an offering memorandum for the sale of the PDM EC Division (Scheman, Tr. 2930-31). Scheman recalled sending the PDM EC offering memorandum to only one company -- CB&I. (Scheman, Tr. 2931).

518. PDM conducted discussions directly with CB&I. (Glenn, Tr. 4077-78). By the time the offering memorandum was completed, negotiations between CBI and PDM were at a point "that it didn't make sense to send it out to other people." (Scheman, Tr. 2931).

519. An e-mail from Scheman to Rich Goodrich, CB&I chief financial officer, dated August 4, 2000, states "We need to determine if there is a deal to be made between PDM and CBI or if we should be contacting other parties who have expressed similar interest." (CX 70 at PDM-C 1002706).

520. Scheman considered CB&I to be a "preemptive buyer" and this meant "that we never went out to other people. Their

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status as a preemptive buyer made it so we didn't go down the route of calling other people." (Scheman, Tr. 2938-40 (Tanner did not believe it was "prudent" to "go out and contact people"); (Tanner and PDM had "reached a point with CB&I where we thought we had a good deal, and we ultimately, I believe, entered into a letter of intent and, therefore, did not show [the offering memorandum] to other people"))).

521. On August 29, 2000, Respondents announced that they had signed a letter of intent for the acquisition of PDM's EC and Water Divisions by CB&I. (CX 285; CX 1565).

522. CB&I initially agreed to pay \$ 93.5 million for PDM EC and Water, which was at the "high end" of Tanner's estimates of PDM's sales value. (CX 521 at TAN 1000328). Tanner believed "it is doubtful that PDM could achieve a value exceeding \$ 93.5 million in an alternative transaction." (CX 521 at TAN 1000329). Rich Byers testified that the final price paid by CB&I for the PDM EC and Water Divisions was \$ 76-77 million (Byers, Tr. 6794).

523. CB&I purchased PDM EC and Water Divisions for more than investment banker Goldman Sachs' valuation for the company and for an amount within the valuation range determined by Tanner. (Byers, Tr. 6843).

524. Alternative buyers would unlikely pay a premium price for PDM EC and Water Divisions because they would face continued tough competition from CB&I. (Scheman, Tr. 2966-67). Handwritten notes of PDM's investment banker state "Need informed buyer willing to fund war wCB&I - unlikely to pay premium." (CX 534 at TAN 1001619). PDM EC and Water Divisions were worth more to CB&I than they were to other firms because of CB&I's ability to utilize PDM's resources and compete on a global basis. (Glenn, Tr. 4261-62).

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**4. Alternatives to acquisition**

525. In July of 2000, PDM announced that it would sell the company. (Scheman, Tr. 2918-20).

526. Financial buyers, who would have maintained PDM as an independent on-going entity, were available and had been recommended by Goldman Sachs and Tanner as alternative buyers. (Byers, Tr. 6744; see also CX 520 at TAN 1003258; CX 380 at PDM-C 1004025).

527. Tanner & Company was given the responsibility to contact potential purchasers. (Byers, Tr. 6758). PDM management was instructed to direct all inquiries to Tanner & Company. (Byers, Tr. 6758).

528. Tanner & Company assembled a preliminary list of potential buyers, in June 2000, including 18 steel companies, 15 engineering and construction companies, and 4 financial buyers. (CX 520 at TAN 1003258). This list was presented to the PDM Board on June 1, 2000. (CX 520 at TAN 1003256).

529. Among the companies identified by Tanner as potential acquirers of PDM EC and Water Divisions were Fluor, Jacobs Engineering, Foster Wheeler, Morrison Knudsen, but to Byers's knowledge, none of these companies were contacted about acquiring PDM EC and Water Divisions. (Byers, Tr. 6806-08). "I don't know of anybody that PDM contacted, anybody other than CB&I and Enron." (Byers, Tr. 6764, 6812).

530. Tanner never contacted any foreign firms in connection with purchasing PDM EC. (Scheman, Tr. 2938-39). Tanner did not contact Skanska/Whessoe, Technigaz, TKK, Tractebel, Mitsubishi, Entrepote, Nooter, or Wiley. (Scheman, Tr. 2938-39; Byers, Tr. 6811-12).

531. Matrix, then the third-largest United States tank constructor, made efforts to buy PDM EC. (Vetal, Tr. 418-19). Matrix's President, Brad Vetal, called PDM's President, William

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McKee, and informed him of Matrix's interest in purchasing PDM EC. (Vetal, Tr. 422). McKee told Vetal that PDM could not talk with Vetal about a sale of the business because PDM already had a buyer, but McKee would call him if that deal fell through. (Vetal, Tr. 422-23; see also RX 168 at TAN 1000654 (handwritten notes of Peter Scheman indicating Vetal had contacted McKee)).

532. A fairness opinion prepared by Tanner, dated February 7, 2001, noted that if CB&I's acquisition of PDM EC and Water Divisions fell through, there were other potential buyers with the interest and adequate resources to purchase PDM EC and Water. (RX 29 at PDM-C 1006327). Other parties had in fact expressed an interest in purchasing PDM EC and Water. (CX 70 at PDM-C 1002706).

533. PDM actively sought buyers for its other divisions. As of August 18, 2000, "over ten parties had received the Confidential Memorandum for Steel Distribution and six groups had received Bridge Division books." (CX 521 at TAN 1000339).

534. On August 20, 2000, Tanner presented to PDM's president additional lists of prospective acquirers for the various PDM divisions, including fourteen parties who initiated contact expressing interest in possible acquisition of the various divisions and 32 prospective financial buyers. (CX 527 at TAN 1002453-2455)

### **5. PDM's financial condition**

535. PDM was a "profitable" company. (Scheman, Tr. 2923; CX 520 at TAN 1003317). The company's Earnings Before Interest, Taxes, Depreciation, and Amortization ("EBITDA") increased from \$ 20.5 million in 1994 to \$ 49.3 million in 1999. (CX 520 at TAN 1003317).

536. The EC and Water Divisions are intertwined, and together were profitable according to the Tanner fairness opinion of February 7, 2001. (RX 29 at PDM-C 1006326). Since the two

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divisions were sold together, it is fair to look at the profitability of the two divisions on a combined basis.

537. PDM's EC Division was profitable, increasing its margin each year from 1996 through 1999 and increasing its EBITDA earnings at a 5-year Combined Annual Growth Rate ("CAGR") of 18.7% on 5-year sales CAGR of 9.5%. (CX 520 at TAN 1003317). The Division's Earnings Before Interest and Taxes ("EBIT") increased from \$ 5.4 million in 1995 to \$ 9.5 million in 1999, a CAGR of 15.3%. (CX 522 at TAN 1003373). Revenues increased from \$ 121.7 million in 1995 to \$ 185.7 million in 1999. (CX 522 at TAN 1003373).

538. PDM EC had its best year ever in 1999. (Scorsone, Tr. 4823-24). As of July 2000, the month before CB&I and PDM signed the acquisition letter of intent, PDM EC projected EBIT of \$ 2 million in 2000. (CX 522 at TAN 1003373).

539. In 2000, the EC Division lost \$ 9 million after making \$ 9.5 million in 1999. (Scheman, Tr. 6920-21; RX 163 at TAN 1000385).

540. As of June 30, 2000, PDM EC had cash of \$ 2.6 million, total assets of \$ 79.2 million, no outstanding long-term debt, and shareholder' equity of \$ 56.8 million. (CX 385 at 30).

541. In September of 2000, Scorsone made a presentation to CB&I and its advisors about PDM EC's future prospects, "assuming that the company was not acquired [by CB&I]." (Scorsone, Tr. 5201; CX 1695 at CB&I/PDM-H 4005659). Scorsone projected PDM EC's earned revenues to be \$ 151 million for 2000, and \$ 168 million for 2001. (CX 1695 at CB&I/PDM-H 4005701; CX 529 at TAN 1000596; see also CX 1713 at CB&I/PDM-H 4015086-89 (projected income from operations increase each year from \$ 6.4 million to \$ 9.1 million, between the years 2001 and 2004)).

542. After Respondents announced the acquisition, PDM EC's earnings for 2000 declined, resulting in a loss for the year of

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about \$ 8 million. (Scorsone, Tr. 4825). After the date of closing, PDM and CB&I ultimately determined that PDM EC's losses approximated \$ 30 million in fiscal year 2000. (Scheman, Tr. 6917, 6921, 6926; Byers, Tr. 6789).

543. A short-term reduction in capital expenditures in the petroleum and petrochemical industries in 1999 negatively impacted all tank suppliers in 2000, including CB&I. (CX 522 at TAN 1003372; CX 529 at TAN 1000596 ("1999 - Down - Mergers in Oil + Gas \* Market Driver (Oil + Gas)").

544. Scorsone, PDM EC's President, Byers, PDM's Vice President of Finance, and PDM's investment banker all believed that PDM EC's poor performance in 2000 would be short-lived, and if PDM EC had remained independent, PDM EC would have returned to profitability the very next year and continued to grow. (Scorsone, Tr. 4838; Byers, Tr. 6899; CX 529 at TAN 1000596 ("2001 - will be good year [for PDM] - the bookings are higher"); (CX 1713 at CBI/PDM-H 4015089) (EC Division predicted to earn gross profits of \$ 20.0 million in 2002, \$ 22.4 million in 2003, and \$ 25.1 million in 2004); see also CX 522 at TAN 1003372 ("This decline is expected to be short lived" PDM EC projects 2001 revenue and EBIT of \$ 168.0 million and \$ 6.1 million, respectively)).

545. As late as February 7, 2001, the date CB&I consummated the acquisition, PDM's management projected that PDM EC would make a profit of \$ 4.8 million in 2001. (Scheman, Tr. 2961-2962; RX 163 at TAN 1000385).

## **6. PDM was not facing liquidation**

546. At the time PDM called CB&I to offer to sell, PDM's reputation in the two lines of business was very good -- they did good work and were recognized in the marketplace by being on everyone's bid lists. (G. Glenn, Tr. 4078).

547. The PDM EC Division was a successful and profitable business and was projected to sustain earnings growth. (CX 1695



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at CB&I/PDM-H 4005701; CX 529 at TAN 1000596; see also CX 1713 at CB&I/PDM-H 4015086-89).

548. Scorsone testified that if the EC Division had not been sold, that it would not have gone out of business, and that it would be profitable in the future. (Scorsone, Tr. 4838).

549. Byers, former VP of Finance for PDM, testified that before making any recommendation to liquidate the PDM EC Division, his fiduciary duties would have required him to investigate to assure himself that there was no alternative purchaser for either PDM or for PDM EC willing to pay more than liquidation value of the business. (Byers, Tr. 6799-800, 6893, 6895). Byers never got to that point. (Byers, Tr. 6800). Byers never investigated whether there was a possibility of another purchaser. (Byers, Tr. 6895).

550. Tanner would have attempted to find alternative purchasers prior to recommending liquidation. (JX 34 at 83 (Scheman, IHT)).

551. PDM's Board of Directors meeting minutes illustrate that PDM had viable alternatives to liquidation. On November 28, 2000, PDM's President, William McKee stated that if the CB&I transaction fell through, PDM would continue its efforts to sell PDM EC and PDM Water Divisions by seeking other purchasers. (CX 1590 at PDM-C 1006065).

552. PDM's Board of Directors never took up the issue of liquidating the PDM EC Division. (Byers, Tr. 6891).

## **K. Remedy**

### **1. Divestiture can restore competition**

553. Divestiture to an appropriate acquirer of the reconstituted assets of PDM EC and PDM Water, as a viable business, would effectively restore competition and remedy any lessening of

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competition that resulted from the acquisition of PDM EC and PDM Water Divisions. (Simpson, Tr. 3608-09).

**2. Assets acquired in the acquisition**

554. CB&I purchased "Tangible Personal Property" from PDM, which included "all design, manufacturing, construction, erection, maintenance, research and development, testing and other machinery and equipment, vehicles, tools, dies, molds, furniture, fixture, office equipment, field equipment, . . . supplies and other tangible personal property (together with all spare and maintenance parts, operating manuals, equipment specifications and diagrams)" used by PDM's EC and Water Divisions. (CX 328 at CBI 001264-CHI).

555. CB&I purchased real property or the leases to real property from PDM EC in the Acquisition in the following locations: Woodland, TX (leased headquarters), except for the subleased Third and Fourth floors; Provo, UT (owned); Fresno, CA (owned); Franklin, TN (owned); and Santa Fe, TX (leased). (CX 385 at 21-23; CX 328 at CBI 001320-CHI). All of the equipment located at these properties was also sold to CB&I in the Acquisition. (CX 328 at CBI 001264-CHI). Several other leases to offices used by the EC Division were transferred as well. (CX 328 at CBI 001265-CHI; CX 333).

556. As of July 2000, the Woodland, TX headquarters' significant equipment consisted of 157 desktop computers, 1 trailer, and 1 X-ray unit. (CX 385 at 21).

557. As of July 2000, the Provo, UT plant's significant equipment consisted of 2 bending machines, 4 blast machines, 2 bulldozers, 4 compressors, 20 cutting machines, 13 dist. box/PWR panels, 6 drill presses, 12 heaters/furnaces, 25 hoists, 3 lathes, 4 milling machines, 29 painting/planers/punchers, 16 positioners, 1 pump, 39 turning rolls, 14 saws, 2 trailers, 79 welders/wire feeders, and 16 X-ray units. (CX 385 at 21).

558. As of July 2000, the Fresno toolhouse's significant

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equipment consisted of 1 bulldozer, 1 burning machine, 8 compressors, 29 dist. box / PWR panels, 4 forklifts, 5 generators, 5 hoists, 1 lathe, 2 milling machines, 1 piece of office equipment, 5 pumps, 1 tractor, 2 trailers, 2 vehicles, 141 welders / wire feeders, 1 welding accessory, and 8 X-ray units. (CX 385 at 22).

559. As of July 2000, the Franklin toolhouse's significant equipment consisted of 1 bulldozer, 31 compressors, 56 dist. box / PWR panels, 2 forklifts, 40 generators, 23 hoists, 5 pieces of office equipment, 1 pump, 10 support towers, 1 tractor, 11 trailers, 1 vehicle, 385 welders / wire feeders, 3 welding accessories, and 7 X-ray units. (CX 385 at 23).

560. As of July 2000, the Santa Fe toolhouse's significant equipment consisted of 18 compressors, 26 dist. box / PWR panels, 16 generators, 5 trailers, 2 vehicles, 273 welders / wire feeders, 5 welding accessories, and 1 X-ray unit. (CX 385 at 23).

561. CB&I purchased real property or the leases to real property from PDM Water in the Acquisition in the following locations: Clive, IA plate fabrication plant and office (owned); Pittsburgh, PA toolhouse (owned); HyCon Birmingham, AL office and toolhouse (owned); HyCon Conroe, TX office and toolhouse (leased); and three other leased office properties. (CX 328 at CBI 001264-CHI, CBI 001265-CHI; CX 332; CX 333). The equipment located at these facilities was also sold to CB&I in the Acquisition. (CX 328 at CBI 001264-CHI).

562. CB&I purchased "Inventories and Stores and Supplies from PDM, which included "all raw materials, components, work-in-progress, finished products, packaging and shipping materials and supplies and other inventories (on-site, off-site and consigned)" used by PDM's EC and Water Divisions. (CX 328 at CBI 001264-CHI - CBI 001265-CHI).

563. CB&I purchased all of PDM EC and Water Divisions' contract rights in the Acquisition, subject to non-assignability issues and exemptions, under Section 2.2.3 and Schedule 2.27 of the Asset Purchase Agreement. (CX 328 at CBI 001265-CHI, CBI

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001319-CHI) The contractual rights transferred include: customer contracts, consulting agreements, alliance and partnering agreements, agency, representative and distribution agreements, licenses; purchase and sales orders, and backlog. Id.

564. CB&I purchased all of PDM's intellectual property rights listed in Schedule 5.1.10 of the PDM Disclosure Schedule and any intellectual property used by the acquired Divisions. (CX 328 at CBI 001265-CHI) The transferred intellectual property rights included all applications and registrations. Id. The "Pitt-DeMoines" and "PDM" names and all variations thereof were licensed to CB&I in the Acquisition. (CX 328 at CBI 001267-CHI).

565. CB&I purchased PDM's customer and contact lists; sales, product, and promotional data, brochures, forms, mailing lists, and advertising materials; vendor lists; project designs and specifications; and computer software. (CX 328 CBI 001266-CHI).

**3. The EC and Water Divisions are inextricably intertwined**

566. PDM EC and PDM Water were inextricably intertwined. (Byers, Tr. 6780 (it is "impossible to split [PDM EC and PDM Water]" in two because "they shared many services. They shared human resources, they shared physical plant."); JX 34 at 33-34 (Scheman, Dep.) ("there was not a bright line that separated the two businesses but in certain places they kind of meshed together.")).

567. PDM EC and PDM Water routinely shared field erection personnel, fabrication facilities, construction resources, and field erection equipment. (Scorsone, Tr. 2852, 4779-80; CX 552 at 43-48 (Braden, Dep.); see Rano, Tr. 5894, 5898 (same engineering processes are used for a flat-bottom tank as is used for an LNG tank)).

568. PDM's EC and Water Divisions shared skilled personnel.

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(CX 552 at 45-47 (Braden, Dep.) (construction crews and project managers would seamlessly transfer from a PDM Water job to a PDM EC job with their tools and equipment); CX 442 at 210 (Knight, Dep.) (tank field-erection crews are switched from cryogenic tanks to flat-bottom tanks)).

569. Sharing resources benefitted both PDM EC and PDM Water because it "facilitated a more steady flow of work, a more consistent flow of work through . . . [the] warehouses [and] fabricating plants." (CX 552 at 52-53 (Braden, Dep.); Scorsone, Tr. 4779-80).

570. Separating the EC and Water Divisions might have cost between \$ 5 and \$ 10 million. (CX 525, TAN-1000406; Scheman, Tr. 6922-23).

571. PDM Water would have difficulty operating independently of PDM EC. (CX 552 at 44 (Braden, Dep.) (splitting PDM Water from PDM EC "would have lessened our ability to stand alone, and certainly would have diminished the profitability of the operation.")).

572. Due to the intermingling of resources, PDM decided to sell the two divisions together, because it was not practical to sell one without the other. (Byers, Tr. 6780-82).

#### **4. Multiple fabrication facilities**

573. Possessing multiple fabrication facilities is advantageous, because it allows a competitor to rationalize its freight costs. (Vetal, Tr. 432-33; see CX 615 at 45 (Knight, IHT) (in competitive situations, a tank supplier benefits from having a fabrication facility located close to a job so that its freight costs are minimal)).

574. Having multiple facilities not only promotes a geographic competitive advantage, but also allows flexibility in fabrication. (CX 442 at 152, 156 (Knight, Dep.) (Tank suppliers with multiple fabrication shops and many field crews can "be

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more flexible in order to meet [changes in customers' schedules]," including needing "the project faster or at a different time period . . .").

575. Each of the former PDM facilities have different fabrication capabilities. (See CX 535 at 181-83 (Scorsone, Dep.); CX 615 at 46 (Knight, IHT) (some fabrication plants cannot fully fabricate storage tanks in the manner required by PDM, because they do not support "certain types of rolling and pressing operations" for thick steel plate)).

### **5. Intellectual property**

576. A viable competitor in the relevant product markets would need intangible as well as tangible assets. (Simpson, Tr. 3608).

577. Intellectual Property rights can give competitors in the relevant markets cost advantages over their rivals. As of March 2000, CB&I possessed over 100 U.S. patents. (CX 230 at CBI-PL 055446). However, such intellectual property is not always necessary to be an effective competitor. (Cutts, Tr. 2563-64 (additional intellectual property was not necessary for AT&V to compete with CB&I for the LIN/LOX projects for BOC)).

### **6. Reputation**

578. There is a great deal of goodwill in the PDM name. (Cutts, Tr. 2389 ("the PDM name, like the CB&I name, could obviously break down a lot of walls and barriers")). A large amount of capital would have to be spent in marketing for a smaller competitor in the relevant industry to build a reputation equivalent to that of PDM. (Cutts, Tr. 2382 (such marketing would cost AT&V a million dollars over the next three years)).

579. Currently, customers are more willing to purchase from CB&I than anyone else, because CB&I has successfully built most of the relevant products. (Cutts, Tr. 2385; CX 258 at CBI-H001816-H001832; CX 1731 at 44 (LNG tank owners do not

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want to purchase from a second-rate company without a track record, because the work is "very specialized, very sophisticated.")). It takes time to build a track record from scratch. (Cutts, Tr. 2372, 2385).

**7. Assignability of contracts**

580. Many of the contracts presently held by CB&I contain non-assignability clauses and key employee provisions that require the customer to approve the assignment of the contract or the replacement of key employees on a project. (Glenn, Tr. 4168-69; Izzo, Tr. 6508).

581. Prior to the Acquisition, PDM received approvals from its customers to transfer its contracts to CB&I. (Byers, Tr. 6804).

**8. Employees**

582. Experienced employees are specially trained and therefore valuable in the relevant industry. Hiring people off the street for skilled PDM field crews is "not economical." (CX 615 at 25, 47 (Knight, IHT)). Skilled field crews and managers must be trained in equipment and procedures. *Id.* at 47, 50; CX 552 at 62 (Braden, Dep.) ("There's a fairly steep learning curve in our business, and to go out and try to fill experienced positions would require some effort . . . . People have to become familiar with our products and our processes. Processes more than anything.")).

583. CB&I hires less skilled field crew personnel on a job to job basis. Field crew workers are free to work for a number of companies (Rano, Tr. 5953), and tend to move from job to job depending on where work is available. (Rano, Tr. 5957). Because field crews are very migratory, CB&I hires its general field labor on a job to job basis. (Glenn, Tr. 4119-20; Rano, Tr. 5917-18, 5953). Using local labor is cheaper than employing traveling workers, because it reduces the need to pay increased expenses associated with room and board for out-of-town workers. (Rano, Tr. 5909-10). CB&I recruits local labor by advertising in the local

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media, and making contacts with local labor leaders and local government officials. (Rano, Tr. 5908-10).

584. At CB&I, the engineering personnel are moved around to various projects depending upon the workload. (CX 497 at 365 (Leventry, Dep.)).

585. Sales representatives in the industry can service both the low temperature and cryogenic tank market and the industrial tank market. (CX 615 at 12, 14 (Knight, IHT)).

**9. A large revenue base is necessary to be a viable competitor**

**a. Bonding**

586. Howard Fabrication's annual revenues, of \$ 2.5 to \$ 3 million, are too small to enable it to compete against CB&I for larger thermal vacuum chamber projects. (Gill, Tr. 181, 199-201).

587. AT&V, which had annual revenues of [redacted], needs "a little more financial strength and bonding capacity" to compete for larger low temperature and cryogenic tank projects. (JX 23 at Ex. 1, in camera).

588. Matrix, which has annual revenues of approximately \$ 190 million, but lacks a larger company to financially back its operations, has difficulty convincing LNG customers that they are a qualified supplier. (CX 460 at CBI-E 007235).

589. LNG customers testified that they would not purchase from a divested entity unless it was able to financially guarantee its work. (Izzo, Tr. 6508 ("The first thing I'd be concerned about with a NewCo is whether I'd put them on my bid list because of ability to bond."); Bryngelson, Tr. 6157 ("Q. . . . So is it beneficial to El Paso to have a company that has size, even if a lot of that size doesn't necessarily come from the revenue generated by building tanks? / A. Yes."); Carling, Tr. 4467-68 ("We expected the lead contractor to stand behind his work, so the



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bonds and the guarantees would have to come from [a divested entity's] parent company.")).

590. As of June 30, 2000, PDM's 6-month revenues were approximately \$ 355 million. (CX 1567 at 3). This base of revenues was sufficient to provide the financial guarantees necessary to compete for LNG and TVC projects. (Carling, Tr. 4529 (PDM was able to provide sufficient financial guarantees to Enron to be employed for an LNG tank built in Penuelas, Venezuela); [redacted], Tr. 1895-96, in camera (PDM had the financial ability to be considered for a TVC project)). However, there were some LNG projects, such as the one in Dabhol, India, that PDM was unwilling to guarantee to the level that the customer required. (Izzo, Tr. 6488-89; Carling Tr. 4529-30).

**b. Equipment used to construct the relevant products**

591. Soon after the Acquisition, CB&I auctioned off a substantial amount of the equipment that it purchased from PDM in an effort to reduce costs. (Scorsone, Tr. 2888).

592. A fully equipped crew requires a great deal of equipment, which costs approximately half a million dollars. (Cutts, Tr. 2388). It typically has a crane, air compressors, welding machines, general rigging equipment and other incidentals. (Cutts, Tr. 2388).

593. Costly automated welding equipment is necessary to be cost competitive in the construction of LNG tanks. (CX 706 at 98 (Newmeister, IHT); see CX 706 at 98-99 (Newmeister, IHT) (CB&I has patented welding equipment that is useful for welding large tanks); see also Cutts, Tr. 2379 (automated equipment is necessary to weld large tanks, but it is expensive to develop)).

594. Specific equipment is necessary for blasting, painting, and pressing capabilities. A large press and a large number of dyes for pressing the dome roofs used for LIN/LOX tanks costs roughly \$ 2 million. See CX 706 at 64-66 (Newmeister, IHT). Additionally the automated blast and paint system used to paint

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the outer tank on a LIN/LOX tank costs roughly \$ 2-3 million. See CX 706 at 64-66 (Newmeister, IHT).

595. In constructing some projects, subcontracting may lower costs, because subcontractors with an expertise in a particular area are able to use a standardized approach and may be better at certain job functions than a general contractor. (Bryngelson, Tr. 6143-44; Cutts, Tr. 2472; Hilgar, Tr. 1537-38).

### III. ANALYSIS AND CONCLUSIONS OF LAW

#### A. Jurisdiction

The Complaint charges Respondents with violations of Section 5 of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 45 and of Section 7 of the Clayton Act, 15 U.S.C. § 18.

Section 5(a)(2) of the FTC Act gives the Commission jurisdiction "to prevent persons, partnerships, or corporations . . . from using unfair methods of competition in or affecting commerce . . ." 15 U.S.C. § 45(a)(2); *Kaiser Aluminum & Chem. Corp. v. FTC*, 652 F.2d 1324, 1327 n.1 (7th Cir. 1981). Respondents are corporations engaged in the interstate sale of large, field-erected cryogenic tanks and thermal vacuum chambers. F. 1-3, 6, 9. Respondents' challenged activities relating to the sale of large, field-erected cryogenic tanks and thermal vacuum chambers have an obvious nexus to interstate commerce. F. 3-5, 7-9. Thus, the Commission has jurisdiction over Respondents and the subject matter of this proceeding, pursuant to Section 5 of the FTC Act.

Section 7 of the Clayton Act prohibits acquisitions, the effect of which "may be substantially to lessen competition, or tend to create a monopoly." 15 U.S.C. § 18. "Section 11(b) of the Clayton Act, 15 U.S.C. § 21(b), expressly vests the Commission with jurisdiction to determine the legality of a corporate acquisition under Section 7 and, if warranted, to order divestiture." *In re R.R. Donnelley & Sons Co.*, 120 F.T.C. 36, 140 (1995); see also *Hospital Corp. of Am. v. FTC*, 807 F.2d 1381,

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1386 (7th Cir. 1986). The February 7, 2001 purchase by CB&I of PDM's Water Division and Engineered Construction Division was a corporate acquisition ("the Acquisition"). F. 10-12. The Commission's jurisdiction includes adjudicating the lawfulness of acquisitions that have already been completed. *In re Coca-Cola Co.*, 117 F.T.C. 795, 911 (1994); see generally *FTC v. Consolidated Foods Corp.*, 380 U.S. 592, 598 (1965). Thus, the Commission has jurisdiction over Respondents and the subject matter of this proceeding, pursuant to Sections 7 and 11 of the Clayton Act.

**B. Burden of Proof and Statutory Framework**

Under Commission Rule of Practice 3.51(c)(1), "an initial decision shall be based on a consideration of the whole record relevant to the issues decided, and shall be supported by reliable and probative evidence." 16 C.F.R. § 3.51(c)(1).<sup>n1</sup> The Commission made amendments to its Rules of Practice, effective May 18, 2001. *FTC Rules of Practice, Interim rules with request for comments*, 66 Fed. Reg. 17,622 (April 3, 2001). Through these amendments, the Commission removed the requirement of Rule 3.51(c)(3) that the initial decision of an ALJ be supported by "substantial" evidence. 66 Fed. Reg. at 17,626. According to *Black's Law Dictionary*, "probative evidence" means having the effect of proof; tending to prove, or actually proving an issue. "Substantial evidence" is defined in *Black's Law Dictionary* as such evidence that a reasonable mind might accept as adequate to support a conclusion. At this level of the proceedings, the difference between probative evidence and substantial evidence is not dispositive. Therefore, all findings of fact in this Initial Decision are supported by reliable and probative evidence.

<sup>n1</sup> Unlike *In re Schering-Plough Corp.*, Docket 9297 (Initial Decision June 27, 2002, available at <http://www.ftc.gov/os/adjpro/d9297/020627id.pdf>), where the complaint was issued on March 30, 2001, prior to the effective date of these amendments, the Complaint in this matter was issued on October 25, 2001, after the effective

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date of the amendments.

The parties' burdens of proof are governed by Commission Rule 3.43(a), Section 556(d) of the Administrative Procedure Act ("APA"), and case law. Pursuant to Commission Rule 3.43(a), "counsel representing the Commission . . . shall have the burden of proof, but the proponent of any factual proposition shall be required to sustain the burden of proof with respect thereto." 16 C.F.R. § 3.43(a). Under the APA, "except as otherwise provided by statute, the proponent of a rule or order has the burden of proof." 5 U.S.C. § 556(d). Further, under the APA, an Administrative Law Judge may not issue an order "except on consideration of the whole record or those parts thereof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence." 5 U.S.C. § 556(d). See also *Steadman v. SEC*, 450 U.S. 91, 102 (1981) (APA establishes preponderance of the evidence standard of proof for formal administrative adjudicatory proceedings).

The Complaint challenges the Acquisition under both Section 7 of the Clayton Act and Section 5 of the FTC Act. The analytical standards for assessing legality in this context are read coextensively. *R.R. Donnelley & Sons*, 120 F.T.C. at 150 n.32; *FTC v. PPG Indus. Inc.*, 798 F.2d 1500, 1501 n.2 (D.C. Cir. 1986) (Section 5 of the FTC Act "may be assumed to be merely repetitive of [Section] 7 of the Clayton Act.").

Section 7 of the Clayton Act prohibits acquisitions, "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly." 15 U.S.C. § 18. See *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 355 (1963) ("The statutory test is whether the effect of the merger 'may be substantially to lessen competition' 'in any section of the country.'"). "Congress used the words 'may be substantially to lessen competition' to indicate that its concern was with probabilities, not certainties." *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962). Complaint Counsel need not prove that

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an anticompetitive effect is a certainty. R.R. Donnelley & Sons, 120 F.T.C. at 150 (citing *California v. American Stores Co.*, 495 U.S. 271, 284 (1990)).

The first step in analyzing a Section 7 case is to determine the "line of commerce" and the "section of the country." 15 U.S.C. § 18. In other words, the first step is to determine the relevant product and geographic markets. R.R. Donnelley & Sons, 120 F.T.C. at 151; *United States v. General Dynamics Corp.*, 415 U.S. 486, 510 (1974) ("delineation of proper geographic and product markets is a necessary precondition to assessment of the probabilities of a substantial effect on competition within them"). "Complaint Counsel bears the burden of proving a relevant market within which anticompetitive effects are likely as a result of the acquisition." R.R. Donnelley & Sons, 120 F.T.C. at 152.

The second step in analyzing a Section 7 case is to determine whether the effect of the acquisition "may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18. The analytical framework by which the government can establish probable effect has three parts, as summarized below.

First, the government has the burden of showing that the Acquisition would produce "a firm controlling an undue percentage share of the relevant market, and would result in a significant increase in the concentration of the firms in that market." *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 715 (D.C. Cir. 2001) (citing *Phila. Nat'l Bank*, 374 U.S. at 363); *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 982 (D.C. Cir. 1990). The government may establish a prima facie case of anticompetitive effect by presenting statistics showing that combining the market shares of CB&I and PDM would significantly increase concentration in the already highly concentrated United States large, field-erected LNG tank, LPG tank, LIN/LOX tank and TVC markets. See *Baker Hughes*, 908 F.2d at 983. Once this showing is made, the government establishes a presumption that the transaction will substantially lessen competition. *Phila. Nat'l Bank*, 374 U.S. at 363; *Baker Hughes*, 908 F.2d at 982 (citing *United States v. Citizens & Southern Nat'l Bank*, 422 U.S. 86,

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120-22 (1975); Heinz, 246 F.3d at 715; In re B.F. Goodrich Co., 110 F.T.C. 207, 303-05 (1988).

Second, "finding a prima facie violation of Section 7 creates a rebuttable presumption of anticompetitive effects and shifts the burden of going forward with evidence to the respondent." B.F. Goodrich Co., 110 F.T.C. at 305; Citizens & Southern Nat'l Bank, 422 U.S. at 120; United States v. Marine Bancorporation, Inc., 418 U.S. 602, 631 (1974). A finding of prima facie illegality on the basis of concentration statistics can be rebutted by a showing that "the merger is not likely to have such anticompetitive effects." In re Weyerhaeuser Co., 106 F.T.C. 172, 278 (1985) (quoting Phila. Nat'l Bank, 374 U.S. at 363).

This second step of the analysis requires that the merger be "functionally viewed, in the context of its particular industry." Brown Shoe, 370 U.S. at 321-22; Weyerhaeuser Co., 106 F.T.C. at 278 ("only a further examination of the particular market -- its structure, history and probable future -- can provide the appropriate setting for judging the probable anticompetitive effect of the merger"). Respondents may "demonstrate unique economic circumstances that undermine the predictive value of the government's statistics." FTC v. Univ. Health, Inc., 938 F.2d 1206, 1218 (11th Cir. 1991). "Nonstatistical evidence which casts doubt on the persuasive quality of the statistics to predict future anticompetitive consequences may be offered to rebut the prima facie case made out by the statistics." Kaiser Aluminum, 652 F.2d at 1341. Factors which may be considered include "ease of entry into the market, the trend of the market either toward or away from concentration, and the continuation of active price competition." *Id.*

Thus, while market share evidence is "an important starting point in merger analysis, it alone is not conclusive in determining the legality of a merger under Section 7." Weyerhaeuser Co., 106 F.T.C. at 278. See also General Dynamics Corp., 415 U.S. at 498; Baker Hughes, 908 F.2d at 992 ("The Herfindahl-Hirschman Index cannot guarantee litigation victories."); Hosp. Corp. of Am., 807 F.2d at 1386 (deciding that market share figures are not

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always decisive in a Section 7 case and that the Commission was prudent in inquiring into the probability of harm to consumers).

Third, if Respondents successfully rebut the presumption of anticompetitive effects, "the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times." *Heinz*, 246 F.3d at 715; *Baker Hughes*, 908 F.2d at 983. Cf *Citizens & Southern Nat'l Bank*, 422 U.S. at 120; *Marine Bancorporation*, 418 U.S. at 631 (upon the government's establishment of a prima facie case under *General Dynamics*, the burden then shifts to the acquiring firm to show that the statistics do not accurately depict competitive conditions). These comparative cases do not indicate that the burden of persuasion shifts from the government, but only that a burden of going forward with the evidence shifts. *Kaiser*, 652 F.2d at 1340 and n.12.

**C. Product Markets**

The proper definition of the product market is a "necessary predicate" to an examination of the competition that may be affected by a merger or acquisition. *Brown Shoe*, 370 U.S. at 335; *R.R. Donnelley & Sons*, 120 F.T.C. at 151. The relevant market is the "area of effective competition" within which the defendant operates. *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327-28 (1961). Product markets may be defined either by "the reasonable interchangeability of use or the cross-elasticity of demand." *Brown Shoe*, 370 U.S. at 325; *Coca Cola Co.*, 117 F.T.C. at 925. See also *Kaiser Aluminum*, 652 F.2d at 1330 ("the clearest indication that products should be included in the same market is if they are actually used by consumers in a readily interchangeable manner."). Complaint Counsel bears the burden of proving a relevant market, within which anticompetitive effects are likely, as a result of the acquisition. *R.R. Donnelley & Sons*, 120 F.T.C. at 152; see also 16 C.F.R. § 3.43(a); 5 U.S.C. § 556(d).

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The parties agree that the relevant product markets are large, field-erected: (1) liquefied natural gas ("LNG") storage tanks (individually, or as a component of an import terminal or an LNG peak shaving plant); (2) refrigerated liquid petroleum gas ("LPG") storage tanks; (3) liquid nitrogen, oxygen and argon ("LIN/LOX") storage tanks; and (4) large (over 20 feet in diameter) thermal vacuum chambers ("TVCs"). F. 19. Therefore, the relevant product markets for assessing the probable effects of competition are large field-erected LNG storage tanks, LPG storage tanks, LIN/LOX storage tanks, and TVCs. F. 18-45.

#### **D. Geographic Market**

The statutory language of Section 7, "any section of the country," equates to the relevant geographic market. *Marine Bancorporation*, 418 U.S. at 620-21; *In re Adventist Health Sys.*, 117 F.T.C. 224, 288 (1994). The relevant geographic market is the "area of effective competition . . . in which the seller operates, and to which the purchaser can practicably turn for supplies." *Tampa Elec. Co.*, 365 U.S. at 327. The Government has the burden of proving the relevant geographic market. *United States v. Connecticut Nat'l Bank*, 418 U.S. 656, 669 (1974); *Adventist*, 117 F.T.C. at 289.

The parties agree that the relevant geographic market in which to analyze the merger is the United States. F. 15. By definition, field-erected LNG, LPG, and LIN/LOX storage tanks, as well as TVCs, must be built "in the field" at customers' sites in the United States. F. 16. It is economically infeasible to import a field-erected storage tank from anywhere outside the United States. F. 17. Therefore, the relevant geographic market for assessing the probable effects of competition is the United States. F. 14-17.

#### **E. Effects on Competition**

The Complaint alleges violations pertaining to four product markets. Before analyzing the effects on competition in each of these markets, the standards by which probable effects are evaluated are set forth with an analysis applicable to all four



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product markets.

Section 7 is "designed to arrest in its incipiency . . . the substantial lessening of competition from the acquisition by one corporation of the whole or any part of the stock" or assets of a competing corporation. *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 589 (1957); *Univ. Health*, 938 F.2d at 1218. "Congress used the words 'may be substantially to lessen competition' to indicate that its concern was with probabilities, not certainties." *Brown Shoe*, 370 U.S. at 323. "But it is to be remembered that § 7 deals in 'probabilities,' not 'ephemeral possibilities.'" *Marine Bancorporation*, 418 U.S. at 623. "Thus, to satisfy section 7, the government must show a reasonable probability that the proposed transaction would substantially lessen competition in the future." *Univ. Health*, 938 F.2d at 1218; *FTC v. Warner Communications Inc.*, 742 F.2d 1156, 1160 (9th Cir. 1984).

The essential question is whether "the probability of such future impact exists at the time of trial." *General Dynamics*, 415 U.S. at 505; *E. I. du Pont*, 353 U.S. at 607 (economic effects of an acquisition are to be measured at the time of suit rather than at the time of acquisition). Thus, although the Clayton Act is an "incipiency" statute, post-acquisition evidence, so long as it "is such that it could not reflect deliberate manipulation by the merged companies temporarily to avoid anticompetitive activity," will be given some consideration. *Lektro-Vend Corp. v. Vendo Co.*, 660 F.2d 255, 276 (7th Cir. 1981); *Consolidated Foods*, 380 U.S. at 598. Complaint Counsel has not demonstrated that Respondents deliberately manipulated the post-acquisition evidence. Further, Complaint Counsel has relied extensively on post-acquisition evidence to argue that, since the Acquisition, CB&I has implemented price increases. Complaint Counsel's Proposed Findings of Fact ("CCPFF") at pp. 103-177. Accordingly, post-acquisition evidence is considered and evaluated.

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**1. Prima facie case**

Assessing the likely competitive effects of the proposed transactions begins by determining the market shares of the merging firms and the level of concentration in the relevant market. *FTC v. Cardinal Health Inc.*, 12 F. Supp. 2d 34, 52 (D.D.C. 1998). The most common method for Complaint Counsel to establish a prima facie case is to show that the acquisition "would produce 'a firm controlling an undue percentage share of the relevant market, and [would] result in a significant increase in the concentration of firms in that market.'" *Univ. Health*, 938 F.2d at 1218 (quoting *Phila. Nat'l Bank*, 374 U.S. at 363). "[A] merger which significantly increases the share and concentration of firms in the relevant market is 'so inherently likely to lessen competition' that it must be considered presumptively invalid and enjoined in the absence of clear evidence to the contrary." *Cardinal Health*, 12 F. Supp. 2d at 52 (quoting *Phila. Nat'l Bank*, 374 U.S. at 363).

Complaint Counsel has established its prima facie case by showing that CB&I's acquisition of PDM's EC and Water Divisions produces a firm controlling an undue percentage share in each of the four relevant markets. Although, as described below, Complaint Counsel's HHI statistics are not sufficiently reliable, Complaint Counsel has presented reliable and probative evidence demonstrating that CB&I and PDM were the number one and two competitors in all four product markets and that no other company provided or is likely to provide effective competition. This showing establishes Complaint Counsel's prima facie case.

**a. The Herfindahl-Hirschman Index ("HHI")**

Market concentration is often measured by the Herfindahl-Hirschman Index ("HHI"). *Heinz*, 246 F.3d at 716; *PPG*, 798 F.2d at 1503; *Univ. Health*, 938 F.2d at 1211 n.12. The Department of Justice and the FTC rely on the HHI in evaluating whether to challenge proposed horizontal mergers. United States Dep't of Justice & Federal Trade Comm'n, *Horizontal Merger Guidelines* §

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§ 1.5, 1.51 (1992), as revised (1997) ("Merger Guidelines"). "The FTC and the Department of Justice, as well as most economists, consider the measure superior to such cruder measures as the four- or eight- firm concentration ratios which merely sum up the market shares of the largest four or eight firms. PPG, 798 F.2d at 1503. See also R.R. Donnelley & Sons, 120 F.T.C. at 182 n.147 (Commission uses HHI as the most economically relevant measure of concentration). The Merger Guidelines are not binding on courts or the Commission. PPG, 798 F.2d at 1503 n.4; R.R. Donnelley & Sons, 120 F.T.C. at 151 n.36. Instead, the Merger Guidelines serve to "describe the analytical process that the Agency will employ in determining whether to challenge a horizontal merger." Merger Guidelines § 0.2.

Although market concentration is often measured by the HHI, there is no requirement that it must be. *United States v. Franklin Elec. Co., Inc.*, 130 F. Supp. 2d 1025, 1033-35 (W.D. Wisc. 2000), provides one example of a merger enjoined without a single reference to HHI. In PPG, the district court was unable to calculate an HHI for the high technology market since the market was growing rapidly, major portions of it lay in the immediate future, and market shares depended upon the success of future bids and the ultimate size of the projects for which they bid. 798 F.2d at 1505. Nevertheless, the court of appeals, without relying on the HHI for the "closest available approximation" market, concluded "the fact that there appear to be only three fully capable firms in that market indicates that the HHI will be very high." *Id.* "Even if one or two other firms were thought capable of expanding or entering, the HHI would still put the market in the highly concentrated range, and the acquisition would cause a great increase in the HHI." *Id.* Where, as in the instant case, the two largest competitors in thin product markets merge, the increase in market concentration and substantial lessening of competition are common sense conclusions.

When the HHI is utilized, the index is calculated by squaring the individual market shares of all the firms in the market and summing up the squares. *Heinz*, 246 F.3d at 716 n.9. Under the Merger Guidelines, a market with a post-merger HHI above 1800

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is considered "highly concentrated" and mergers that increase the HHI in such a market by over 50 points "potentially raise significant competitive concerns." Merger Guidelines § 1.51. Acquisitions producing an increase in the HHI of more than 100 points in highly concentrated markets raise significant competitive concerns. Merger Guidelines § 1.51. The Merger Guidelines define as "unconcentrated" a market with an HHI below 1000, as "moderately concentrated" a market with an HHI between 1000 and 1800, and as "highly concentrated" a market with an HHI over 1800. Merger Guidelines § 1.51. See also PPG, 798 F.2d at 1503. Sufficiently large HHI figures establish a prima facie case that a merger is anticompetitive. Heinz, 246 F.3d at 716; Baker Hughes, 908 F.2d at 982-83.

Complaint Counsel's economic expert, Dr. John Simpson, examined market shares from 1990 to the time of the Acquisition in early 2001 and used this eleven year time period to calculate the HHI in each of the four relevant markets. F. 69, 216-18, 273-74, 370-71. Dr. Simpson provided no valid reason for using 1990 as a starting point, other than that was the starting point of the data that had been provided to him by Complaint Counsel. F. 69, 274.

Complaint Counsel cites to Merger Guidelines § 1.4 as authority for use of the eleven year time period for calculating the HHI. "Typically, annual data are used, but where individual sales are large and infrequent so that annual data may be unrepresentative, the Agency may measure market shares over a longer period of time." Merger Guidelines § 1.4. Nowhere do the Merger Guidelines suggest that using data spanning beyond a decade is an appropriate period of time. Despite this guideline, not a single case was cited to by Complaint Counsel where the government calculated the HHI in any manner other than based on annual sales. The only case found to have calculated HHI based on more than one year of sales is Baker Hughes, discussed *infra*. Instead, Complaint Counsel argues, "evidence that high market shares are sustained over several years is regularly used in antitrust cases to assess market power." Complaint Counsel's Post Trial Brief ("CCPTB") at 14-15 (citing Heinz, 246 F.3d at 712,

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717 (in analyzing barriers to entry, the court noted that there had been no significant entries in decades, yet determined market shares based on annual sales of baby food); *Borden, Inc. v. FTC*, 674 F.2d 498, 511 (6th Cir. 1982) (determining market share over five year period to infer monopoly power; suit not brought under the Clayton Act); *Greyhound Computer Corp. v. IBM Corp.*, 559 F.2d 488, 496-97 (9th Cir. 1977) (in a Sherman Section 2 case, defendant's share of the market in 3 years over a 7 year period was evidence from which the jury could reasonably infer market power)). None of these cases support the proposition that it is appropriate to calculate the HHI based on market data spanning more than a decade.

Sales in the field-erected LNG tank, LPG tank, LIN/LOX tank and TVC markets are sporadic, and a single sale can represent a large percent of market share in any given year. See F. 65, 68, 210, 213, 269, 364. Dr. Barry Harris, Respondents' economic expert, also presented numerous challenges to Dr. Simpson's use of 1990 as the starting point. F. 70, 71, 221, 276, 373, 375. In these unusual markets, mechanical application of the HHI provides misleading results. See Merger Guidelines § 0 ("Because the specific standards set forth in the Guidelines must be applied to a broad range of possible factual circumstances, mechanical application of those standards may provide misleading answers to the economic questions raised under the antitrust laws.").

The arbitrary nature of the HHI is underscored by the fact that choosing a different date achieves a completely different result. CB&I did not build an LNG tank, LPG tank, or TVC between 1996 and the date of the Acquisition, resulting in a change of zero in the HHI in three of the four markets. F. 70, 219, 372. An acquisition resulting in zero change in the HHI would not establish a prima facie case if only HHI were relied upon. See Merger Guidelines, § 1.5 ("Mergers producing an increase in the HHI of less than 50 points, even in highly concentrated markets post-merger, are unlikely to have adverse competitive consequences."); *New York v. Kraft Gen. Foods*, 926 F. Supp. 321, 362 (S.D.N.Y. 1995). This case illustrates the fact that the

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HHI is subject to manipulation which weakens its reliability as an economic indicator.

Although Complaint Counsel places great emphasis on the HHI and the increases to the HHI, Complaint Counsel failed to demonstrate that a valid and credible HHI had been calculated in any of the relevant markets. For the reasons detailed in the following sections on each of the relevant markets, the HHI statistics alone do not conclusively establish Complaint Counsel's prima facie case.

**(i) LNG market**

Dr. Simpson testified that the post-acquisition HHI for LNG tanks is 10,000, with a change of 4,956. F. 68. Dr. Simpson's HHI calculations are of questionable value, because they are based on a period of time of over 10 years and there have been so few sales from 1990 to the Acquisition. F. 65, 69, 71. If data dating back to 1996 is used instead, CB&I had no sales over that time period and the change in the HHI based on sales in the LNG market would be zero. F. 70. Accordingly, the HHI statistics lack reliability and are insufficient to establish Complaint Counsel's prima facie case in the LNG market.

**(ii) LPG market**

Dr. Simpson testified that the post-acquisition HHI for LPG tanks is 8,380, with a change of 3,910. F. 218. Dr. Simpson's HHI calculations are suspect for two reasons. First, he included in his calculation the value of a project that was awarded to CB&I after the Acquisition. F. 216, 217. Second, because CB&I's last pre-acquisition LPG project was awarded in 1993, if data dating back to 1994 or 1996, instead of back to 1990, were used, the change in the HHI based on sales in the LPG market would be zero. F. 219. HHI calculations are not accurate in determining the concentration in the LPG market due to the extraordinarily thin market and almost nonexistent demand. F. 220. Accordingly, the HHI statistics lack reliability and are insufficient to establish Complaint Counsel's prima facie case in the LPG market.

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**(iii) LIN/LOX market**

Dr. Simpson testified that the post-acquisition HHI for LIN/LOX tanks is 5,845, with a change of 2,635. F. 273. Dr. Simpson's HHI calculations in the LIN/LOX market were based on sales from 1990 to the date of the Acquisition. F. 274. There is no principled basis for reaching back to 1990 for calculating the HHI. Unlike the other three markets, where there were only a handful of sales over the eleven year period, in the LIN/LOX market 83 projects, comprising 109 tanks, were awarded during the period from 1990 to the Acquisition. F. 269. Further, Dr. Simpson admitted that CB&I's spin off from Praxair in 1997 was a significant competitive change, a fact which could justify beginning the HHI calculation for the LIN/LOX market in 1997, after the date of that sale. F. 275. Accordingly, the HHI statistics lack reliability and are insufficient to establish Complaint Counsel's prima facie case in the LIN/LOX market.

**(iv) TVC market**

Dr. Simpson testified that the post-acquisition HHI for TVCs is 10,000, with a change of 5,000. F. 370. He arrived at this conclusion by two approaches. First, he assigned a 50-percent market share to CB&I and a 50-percent market share to PDM, based on the opinions of market participants and documents. F. 370. Second, he assigned a 49.3 percent market share to CB&I for a project that was awarded to CB&I by Spectrum Astro, but was not built. F. 371. In actuality, only one TVC was built in the 1990s and this TVC was by PDM. F. 364. The last TVC built by CB&I was in 1984. F. 365. Without the proposed Spectrum Astro project included, PDM would have 100% market share and an HHI of 10,000. The increase in the HHI would be zero. F. 372. Applying different standards results in starkly different results in this extraordinarily thin market. Accordingly, the HHI statistics lack reliability and are insufficient to establish Complaint Counsel's prima facie case in the TVC market.

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**b. Market power in bid markets**

The Supreme Court, in *General Dynamics*, held that evidence of annual sales is relevant as a prediction of future competitive strength in most markets, such as groceries or beer, since distribution systems and brand recognition are such significant factors that one may reasonably suppose that a company which has attracted a given number of sales will retain that competitive strength. 415 U.S. at 501 (referencing *United States v. Von's Grocery*, 384 U.S. 270 (1966); *United States v. Pabst Brewing Co.*, 384 U.S. 546 (1966)). However, in some markets, statistical evidence of past production may not always be the best measure of a company's ability to compete. *Id.* (upholding district court's focus on reserves of coal rather than past production, because the bulk of the coal produced was delivered under long term requirement contracts, which could not be obtained without sufficient coal reserves).

The product markets here are not like groceries or beer. Rather, the four product markets are similar to the market for hardrock hydraulic underground drilling rigs examined in *Baker Hughes*. In *Baker Hughes*, the products were assembled and made to suit each purchaser's needs and specifications. *United States v. Baker Hughes, Inc.*, 731 F. Supp. 3, 8 (D.D.C. 1990). In this case, the large field-erected tanks and TVCs are custom made to suit each purchaser's needs. See generally *supra* Part II.D. In *Baker Hughes*, customers sought bids from several suppliers and placed great emphasis upon a supplier's reputation for quality and service. 731 F. Supp. at 8. In this case, customers generally seek competitive bids from several suppliers for each of the products at issue and place great emphasis upon a supplier's reputation for quality and service. E.g., F. 166-172, 222-26, 250-52, 283, 286. *Baker Hughes* addressed a very thin product market; the overall size of the market ranged from 51 to 61 sales over a three year period. 731 F. Supp. at 9. In this case, in the two years from the Acquisition to trial, one LNG tank, one LPG tank, five LIN/LOX tanks, and zero TVCs have been sold. F. 233, 292, 407-409. Indeed, Complaint Counsel has had to reach back eleven years to



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find more than a handful of sales in three of the four markets. F. 66, 211, 364.

The district court in *Baker Hughes* held, "because of the nature of the products sold and the fact that the volume of business done is relatively small and customers' needs for new equipment are irregular, market shares in the line of commerce alone are not an accurate measure of market dominance." 731 F. Supp. at 9. As in *Baker Hughes*, here because of the nature of the products sold, the fact that the volume of business done is relatively small, and the customer's needs for new equipment are irregular, market shares in the line of commerce alone are not a conclusive measure of market dominance. Thus, other factors besides market shares are analyzed.

"In evaluating monopoly power, it is not market share that counts, but the ability to maintain market share." *United States v. Syufy Enterprises*, 903 F.2d 659, 665-66 (9th Cir. 1990) (emphasis in original). Thus, a more accurate picture of competition arises through an examination not just of the number and the value of the tank projects awarded, but of the competitive pressure each manufacturer is able to exert by bidding. See *Baker Hughes*, 731 F. Supp. at 9 (evaluating numbers of bids over last two years). This approach was used by the Court of Appeals for the Second Circuit in evaluating "the unusual market" of carrier-based aircraft. *Grumman Corp. v. LTV Corp.*, 665 F.2d 10, 12-13 (2d Cir. 1981).

In *Grumman Corp.*, the defendants did not dispute that during the past two decades the acquired and the acquiring companies had been substantial competitors. Defendants argued that there was an "insufficient basis to believe that [the acquired company would] be a competitive factor in the future." *Id.* at 12. Even though the last order for the product in one of the relevant markets had been placed two years earlier and the single domestic purchaser had no current plans to purchase the product from the acquired company, the district court concluded that the acquired company could reasonably be expected to provide competition in the relevant market. *Id.* at 12.

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The court of appeals upheld the district court's finding in Grumman, stating it reflected "an inevitable aspect of an unusual market."

[The relevant product does] not roll off assembly lines like television sets or automobiles. In a market with a single domestic purchaser, which buys intermittently, a court assessing the anti-competitive effect of a horizontal combination must consider future possibilities in assessing whether there exists a significant probability of decreased competition. Whether or not [the acquired company] will sell more [of the relevant product to the single domestic purchaser], the fact remains that it was properly found to be competing to do so. . . . The [purchaser's] rejection of the proposal [to sell a modified version of the product] does not lessen the significance of [the acquired company's] capacity and desire to make it.

Id. at 12-13.

United States v. United Tote, Inc. provides another example of a court, in analyzing an unusual market, basing its opinion not just on a review of past sales, but on an analysis of the companies' ability to constrain competition by bidding. 768 F. Supp. 1071 (D. Del. 1991). In Tote, the relevant product market lines were on-track, off-track, and inter-track totalisator systems and services. Id. at 1069. In those markets, where companies submitted bids to tracks to have their systems used, the court found it to be significant that the two merging companies submitted bids against each other on 49 of the 116 totalisator contracts for which bids were sought. Id. at 1071 (holding that even though the acquired company had never replaced the acquiring company, where the acquiring company was the incumbent, the government's statistical case accurately reflected the state of competition).

Although CB&I has not won projects in three of the four markets from 1996 to the Acquisition, to conclude that CB&I

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does not have market power "ignores the competitive effect they exert simply by being available to compete." Grumman, 665 F.2d at 14. The fact that CB&I and PDM competed against each other consistently through the bid process is more dispositive to the determination of market power than how many projects were won. Thus, in the sections that follow, CB&I's market power is demonstrated through an evaluation of which companies provided competition through bids on recent projects.

**(i) LNG market**

From 1990 to the Acquisition, nine LNG tank projects were awarded in the United States. CB&I won five of these projects and PDM won four. F. 65. For all but two of these projects, no company other than CB&I and PDM submitted bids. F. 72.

**(ii) LPG market**

From 1990 to the Acquisition, eleven LPG tank projects were awarded in the United States. CB&I won five and PDM won four. F. 210. From 1994 to the Acquisition, of the five LPG tank projects built in the United States, CB&I won zero and PDM won three. F. 210. Morse Tank and AT&V each won one. F. 210. For the last four pre-acquisition LPG tank projects for which the parties presented evidence on the companies that submitted bids, CB&I bid on all four projects and PDM bid on three of the four. F. 222-26. On two of these, CB&I and PDM were the only bidders. F. 224. Although CB&I did not win any of the last five LPG projects, both CB&I and PDM were effective competitors through bidding. See Grumman, 665 F.2d at 14.

**(iii) LIN/LOX market**

From 1990 to the Acquisition, 109 LIN/LOX tanks were awarded in the United States. F. 269. CB&I won 25 of the tanks and PDM won 44. F. 269. Graver, which went out of business in 2001 won 34 of the projects. F. 269, 270. CB&I, PDM, and Graver were competing with each other by bidding on LIN/LOX projects. F. 286-88. Because Graver is no longer in the business, it

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is no longer bidding against CB&I and no longer provides competition.

**(iv) TVC market**

From 1990 to the Acquisition, only one field-erected TVC has been built, and this TVC was built by PDM in 1996. F. 364. Both CB&I and PDM provided final pricing offers for [redacted] in 1997. F. 366 (in camera). Both CB&I and PDM submitted best and final offers for the Spectrum Astro project in 1999. F. 368. Both CB&I and PDM were asked to provide rough order of magnitude ("ROM") pricing to TRW in 1999. F. 369. [redacted] sought a sole-source procurement with PDM for its [redacted] facility. F. 367 (in camera). In all but one of these instances, CB&I and PDM were competing against each other. F. 366, 368, 369. In all but one of these instances, no other company was even asked to participate in the bidding process. F. 366-69.

**c. Acquisition of closest competitor**

Regardless of how competition is measured, the decisive issue is that CB&I bought its closest competitor which is not likely to be replaced by an equally cost-effective and qualified competitor in any of the four markets. *Infra* Part III.E.2.c. Without PDM to bid against, CB&I is no longer required to submit the lowest possible bid to win projects. F. 498. Numerous recent D.C. court cases have used this economic principle when evaluating whether to enjoin a proposed merger or acquisition. E.g., *Heinz*, 246 F.3d at 725 (finding that by buying its closest competitor, Heinz would create a "durable duopoly" that "affords both the opportunity and incentive for both firms to coordinate to increase prices"); *FTC v. Libbey, Inc.*, 211 F. Supp. 2d 34, 47 (D.D.C. 2002) (enjoining merger where there was substantial evidence that the proposed merger might effectively eliminate a competitor in the relevant market that was already highly concentrated); *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 169 (D.D.C. 2000) ("A unilateral price increase by Swedish Match is likely after the acquisition because it will eliminate one of Swedish Match's primary direct competitors."); *Cardinal Health*, 12 F. Supp. 2d at 53, 64 (By

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combining with their closest competitors to capture an 80% market share, defendants could "curb downward pricing pressure and adversely affect competition."); *FTC v. Staples Inc.*, 970 F. Supp. 1066, 1082 (D.D.C. 1997) (By eliminating its closest competitor, "this merger would allow Staples to increase prices or otherwise maintain prices at an anti-competitive level."); *FTC v. Coca-Cola Co.*, 641 F. Supp. 1128, 1139 (D.D.C. 1986) ("The stark, unvarnished truth is that the [sought to be acquired] brand has been a staunch effective competitor . . . that [the potential purchaser] has tried to stifle" and is "now seeking to buy."). See also Merger Guidelines n.21 ("A merger involving the first and second lowest-cost sellers could cause prices to rise to the constraining level of the next lowest-cost seller.").

According to the D.C. Circuit Court of Appeals in *Heinz*, "no court has ever approved a merger to duopoly." 246 F.3d at 717 (enjoining merger between the second and third largest sellers of jarred baby food where the higher priced company, Gerber, who was not a participant in the merger, had a 65% market share). In *PPG*, where there "appeared to be only three fully capable firms in [the] market," and "the proposed acquisition would leave two," the Commission's showing of market concentration was "overwhelming," and the proposed merger was enjoined. 798 F.2d at 1505-06. The circumstances in the instant case are similar to those in *Franklin Elec.*, where there were only two manufacturers of the relevant product. 130 F. Supp. 2d at 1033-35. In that case, the defendants argued that market share or percentage of sales was almost irrelevant, because the market was quite different from most consumer markets. *Id.* The court held that the combination "should be viewed" as nothing "other than a merger to monopoly that by definition will have an anticompetitive effect[.]" *Id.*

"One factor that is 'an important consideration when analyzing possible anti-competitive effects' is whether the acquisition 'would result in the elimination of a particularly aggressive competitor in a highly concentrated market . . .'" *Libbey*, 211 F. Supp. 2d at 39, 47 (enjoining a merger where, though the firm to be acquired had only seven percent of the market, it was the

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"most formidable competitor" in the relevant market) (quoting Staples, 970 F. Supp. at 1083). In Grumman, where the acquiring company and the acquired company competed against each other for every opportunity, even though neither company had a significant share of the market, the district court "was entitled to conclude that removing one competitor from this market would tend to substantially lessen competition." 665 F.2d at 15. In this case, Respondents do have a significant share of the market, so, for even stronger reasons, removing a competitor would substantially lessen competition.

As discussed in each of the product market sections below, CB&I bought its closest competitor. Prior to the Acquisition, no other still existing company challenged CB&I's market power. Without resorting to the mechanical HHI analysis, the pre-acquisition market shares controlled by CB&I and PDM and the power each exerted by bidding against the other cannot be ignored. As the evidence in this case demonstrates, lower prices for customers resulted from that pre-acquisition competition. See F. 83-87, 231, 286-91, 388-406. Even Respondents recognized at the time that they were contemplating the Acquisition that combined CB&I and PDM could achieve market dominance. F. 491-96. Accordingly, Complaint Counsel has established a presumption of illegality in all four product markets.

**(i) LNG market**

CB&I and PDM account for all of the sales of LNG tanks in the United States from 1990 to the Acquisition. F. 65. From 1990 to 2001, based on the dollar values of tank projects built, excluding cancelled projects, CB&I accounted for 45.3% and PDM accounted for 54.7% of the market. The combined market share is 100%. F. 68.

Prior to the Acquisition, Respondents were the only two competitors in the LNG market. F. 74. Respondents and industry members viewed CB&I and PDM as the only competitors for LNG tanks. F. 75-82. Customers sought to use competition between CB&I and PDM to obtain lower prices. F. 83-97.

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**(ii) LPG market**

CB&I and its two acquisitions, PDM EC and Morse, account for all but one of the sales of LPG tanks in the United States from 1990 to the time of the Acquisition. F. 210, 214, 215. Dr. Simpson calculated market shares based on sales values from 1990 to 2001 and included the post-acquisition LPG project for BASF in Port Arthur, Texas that was awarded to CB&I. F. 212. Based on Dr. Simpson's data set, PDM had a 34.5% market share, CB&I had a 56.7% market share, Morse Tank had an 8.2% market share, and AT&V had a 0.6% market share. F. 213. By Dr. Simpson's calculations, the combined CB&I and PDM market share from 1990 to the Acquisition is 91.2%. F. 213. n2 On November 30, 2001, CB&I acquired Morse Tank, eliminating the firm that had accounted for the next most substantial share of LPG sales prior to the Acquisition. F. 214.

n2 If the post-acquisition win by CB&I is excluded from the calculations, the market share totals do not vary significantly. The combined CB&I and PDM total would be 90.9%. F. 213.

Respondents viewed each other as their only competition for LPG tanks. F. 228-30. Respondents' expert, Dr. Harris, testified that prior to the Acquisition, neither CB&I nor PDM could increase prices of LPG tanks in the United States without risking losing sales to the other. F. 231.

**(iii) LIN/LOX market**

CB&I and PDM had a combined market share of 72.8% of the value of LIN/LOX awards for the time period of 1990 to the Acquisition. F. 269. Graver had a 23.3% market share, Matrix had a 2.6% market share, and AT&V had a 1.4% market share. F. 269. Graver went out of business, in 2001, and is no longer a competitor in the LIN/LOX market. F. 270.

Prior to the Acquisition, competition between CB&I and PDM

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was very aggressive. Respondents viewed each other as close competitors and in some instances dropped their prices to beat out the other or set prices that would generate "negative margins." F. 277-82. CB&I lost some projects to PDM because of PDM's "very low" pricing levels. F. 280. Prior to the Acquisition and prior to Graver's exit from the business, customers would use the vigorous competition between CB&I, PDM and Graver to obtain lower prices. F. 286-91.

**(iv) TVC market**

CB&I's acquisition of PDM EC combined the only two competitors in the market for large field-erected TVCs in the United States. F. 363. Since 1960, the only companies that have built TVCs are CB&I and PDM. F. 363.

CB&I viewed PDM as its "only competitor" for TVC projects in the United States. F. 376-78. Purchasers of TVCs viewed CB&I and PDM as the only firms with the capability to construct TVCs. F. 380-85. One customer used competition between CB&I and PDM to obtain lower pricing. F. 388-406.

**2. Respondents' rebuttal**

**a. Standards & factors**

Complaint Counsel established its prima facie case. The burden next shifts to Respondents to produce evidence that "show[s] that the market-share statistics [give] an inaccurate account of the acquisition[s] probable effect[] on competition" in the relevant markets. *Citizens & Southern Nat'l Bank*, 422 U.S. at 120; *Phila. Nat'l Bank*, 374 U.S. at 363; *United States v. Waste Mgmt., Inc.*, 743 F.2d 976, 981 (2d Cir. 1984). "The more compelling the prima facie case, the more evidence the defendant must present to rebut it successfully." *Baker Hughes*, 908 F.2d at 991. "Although the ultimate burden of persuasion always rests with the FTC, once a presumption has been established that the proposed transactions will substantially affect competition, the burden of production shifts to the Defendants to rebut the



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presumption." *Cardinal Health*, 12 F. Supp. 2d at 54 (citing *Marine Bancorporation*, 418 U.S. at 613). Respondents are not required to "clearly" disprove future anticompetitive effects, because such a requirement would impermissibly shift the ultimate burden of persuasion. *Baker Hughes*, 908 F.2d at 991.

Respondents may demonstrate unique economic circumstances that undermine the predictive value of the government's statistics. *Univ. Health*, 938 F.2d at 1218 (citing *General Dynamics*, 415 U.S. at 486). In addition to attacking the government's statistics, a respondent may present evidence on a number of factors that "are relevant in determining whether a transaction is likely to lessen competition substantially." *Baker Hughes*, 908 F.2d at 985. These factors include: ease of entry into the market, the trend of the market either toward or away from concentration, the continuation of active price competition, and evidence of customer sophistication. *Univ. Health*, 938 F.2d at 1218; *Kaiser Aluminum*, 652 F.2d at 1341; *Baker Hughes*, 908 F.2d at 986. The acquired firm's weakness is also a factor that a defendant may introduce to rebut the government's prima facie case. *Univ. Health*, 938 F.2d at 1221.

In this case, Respondents contend that the following factors sufficiently rebut the FTC's prima facie case: (1) evidence that Complaint Counsel's concentration statistics are misleading; (2) evidence of actual or potential entry or the existence of low entry barriers; (3) evidence of customer sophistication; and (4) evidence of the weakness of the merging companies. Respondents' Post Trial Brief ("RPTB") at 8-11.

**b. Statistics**

Statistics reflecting market share and concentration, while of great significance, are not conclusive indicators of anticompetitive effects. *Heinz*, 246 F.3d at 717 n.12 (citing *General Dynamics*, 415 U.S. at 498); *Brown Shoe*, 370 U.S. at 322 n.38 ("Statistics reflecting the shares of the market controlled by the industry leaders and the parties to the merger are, of course, the primary index of market power; but only a further

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examination of the particular market - its structure, history and probable future - can provide the appropriate setting for judging the probable anticompetitive effect of the merger."). "The level of market concentration . . . is only the starting point to determine the likelihood of anticompetitive effects, and many other factors affect the likelihood of collusive or unilateral anticompetitive conduct." *Adventist*, 117 F.T.C. at 307 (citing Merger Guidelines, § 2.0; *Baker Hughes*, 908 F.2d at 984, 992 ("the Herfindahl-Hirschman Index cannot guarantee litigation victories.")).

A respondent "may rebut the government's prima facie case by showing that the government's market share statistics overstate the acquired firm's ability to compete in the future and that, discounting the acquired firm's market share to take this into account, the merger would not substantially lessen competition." *Univ. Health*, 938 F.2d at 12121 "Under *General Dynamics*, a substantial existing market share is insufficient to void a merger where that share is misleading as to actual future competitive effect." *Waste Mgmt.*, 743 F.2d at 982. The Supreme Court held that, while the statistical showing proffered by the government in *General Dynamics* was sufficient to support finding an "'undue concentration' in the absence of other considerations, the question . . . is whether . . . other pertinent factors affecting the coal industry and the business of the appellees mandated a conclusion that no substantial lessening of competition occurred or was threatened by the acquisition . . . ." 415 U.S. at 498. Because of fundamental changes in the structure of the relevant market, the statistics relied on by the government in *General Dynamics* were insufficient to sustain its case. 415 U.S. at 501.

This case does not present the situation before the court in *General Dynamics* where the Supreme Court held that the market share statistics that the government used to seek divestiture of the merged firm were insufficient, because in failing to take into account the acquired firm's long-term contractual commitments (coal contracts), the statistics overestimated the acquired firm's ability to compete in the relevant market in the future. *General Dynamics*, 415 U.S. at 500-04. By contrast to *General Dynamics*, where sales made by defendants represented "the obligation to

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fulfill previously negotiated contracts at a previously fixed price" and thus did not represent the exercise of market power, sales made by CB&I and PDM represent CB&I's and PDM's continuing ability to bid for, win, and build tank projects in all four relevant markets.

Nor does this case present the situation before the court in Baker Hughes where the market shares were "volatile and shifting," where there were four domestic firms that each manufactured the relevant products, and where a contract to provide multiple rigs could catapult any one of those firms from fourth to first place. 908 F.2d at 986. As discussed above, in three of the four markets, Respondents were consistently the number one and number two competitors. In the fourth market, LIN/LOX, CB&I and PDM shared the field with Graver. Graver, however, is no longer in the business and is, thus, not able to take shares away from CB&I. *Supra* Part III.E.b. Therefore, this case does not present the situation addressed by the court in Baker Hughes where there were other competitors who were taking away sales and able to continue to take away sales from the merging companies.

As discussed in the previous section, the government's HHI statistics are not reliable and probative evidence. Nevertheless, the deficiencies in the government's HHI statistics do not undermine the evidence presented that CB&I bought its closest competitor or the evidence on CB&I's ability to compete in the future. Accordingly, Respondents have not successfully demonstrated that the government's market share statistics overstate CB&I's ability to compete the relevant markets.

**c. Actual or potential entry****Standards**

"Ease of entry is the ability of other firms to respond to collusive pricing practices by entering to compete in the market." *Cardinal Health*, 12 F. Supp. 2d at 54-55. "Even in highly concentrated markets, if there is sufficient ease of entry, enough

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firms can enter to compete with the merging firms, undercutting any of the likely anti-competitive effects of the proposed mergers." *Id.* If Respondents' evidence regarding entry shows that the Commission's market share statistics give an incorrect prediction of the Acquisition's probable effect on competition because entry into the markets would likely avert any anticompetitive effect by acting as a constraint on CB&I's prices, then Respondents have rebutted the prima facie case. See *Staples*, 970 F. Supp. at 1086.

In *Consolidated Foods*, the Supreme Court held that post-acquisition evidence tending to diminish the probability or impact of anticompetitive effects might be considered in a § 7 case, but that the probative value of such evidence was limited. 380 U.S. at 598. In *General Dynamics*, the Supreme Court held that post-acquisition evidence goes "directly to the question of whether future lessening of competition was probable and the District Court was fully justified in using it." 415 U.S. at 506. "Post-acquisition evidence favorable to a defendant can be an important indicator of the probability of anticompetitive effects where the evidence is such that it could not reflect deliberate manipulation by the merged companies temporarily to avoid anticompetitive activity, and could not reasonably be construed as representing less active market competition than would otherwise have occurred without the questioned acquisition." *Lektro-Vend Corp.*, 660 F.2d at 276. Accordingly, in assessing whether entry will likely avert any anticompetitive effects, post-acquisition evidence is considered.

Complaint Counsel asserts that entry must be timely (within two years); likely to be profitable at pre-merger prices; and sufficient to deter or counteract the possible anticompetitive effects of the Acquisition. CCPTB at 18 (citing Merger Guidelines § § 3.1-3.4; *Coca Cola*, 117 F.T.C. at 953). Respondents assert that evidence regarding actual or potential entry rebuts a prima facie case and that even the mere threat of entry can rebut a prima facie case. RPTB at 9-10 (citing *Baker Hughes*, 908 F.2d at 981). See also *Waste Mgmt.*, 743 F.2d at 983

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("entry by potential competitors may be considered in appraising whether a merger will 'substantially lessen competition").

**Likelihood and timing of entry**

In *Baker Hughes*, the district court reviewed the prospects for future entry and concluded that entry was likely, particularly if the acquisition were to lead to supracompetitive pricing. 908 F.2d at 988. The government appealed this conclusion, asserting that the district court should have required defendants to show clearly that entry would be quick and effective. *Id.* at 988. The court of appeals held that the district court's factual findings amply supported its determination that future entry was likely. *Id.* at 989. Discussing *Baker Hughes*, the court in *Tote* stated, the "crucial aspect" of *Baker Hughes* was "that the leading firm's 'growth suggests that competitors not only can, but probably will, enter or expand if this acquisition leads to higher prices.'" 768 F. Supp. at 1081 (quoting *Baker Hughes*, 908 F.2d at 989). No such inference can be made in this case where the strength of Respondents, the leading firms, is not recent or attributable to any significant changes in the industry, but is grounded on long experience and a proven track record.

Despite characterizing the government's position in *Baker Hughes* that entry must be "quick and effective" as "novel and unduly onerous," the court of appeals found that "if the totality of a defendant's evidence suggests that entry will be slow and ineffective, then the district court is unlikely to find the prima facie case rebutted." *Id.* at 988 (emphasis added). Further, case law developed after *Baker Hughes* illustrates that a "quick and effective" standard for analyzing entry is no longer "novel." In *Tote*, where evidence presented at trial established that it would take 18 to 24 months to study, develop and then adequately debug a truly competitive product and where there was other evidence of factors that complicate a potential entrant's ability to design or modify the relevant product in a timely manner, defendants did not rebut the government's case. 768 F. Supp. at 1073-75. See also *Franklin Elec.*, 130 F. Supp. 2d at 1035-36 (enjoining merger where defendants had "not shown that entry is so easy that [the

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merged entity] could not sustain monopolist profits for some period of time") (emphasis added); *United States v. Calmar, Inc.*, 612 F. Supp. 1298, 1301 (D.N.J. 1985) ("If ease of entry in the market is such that the producers in the market could not long sustain an unjustified price increase, then in spite of a high degree of concentration there has not been a substantial lessening of competition.") (emphases added).

As discussed below, in all four of the relevant markets, the totality of the evidence establishes that potential and actual entry is slow and ineffective and cannot keep these markets competitive. Further, the evidence of entry in this case is not as compelling as the evidence was in *Baker Hughes* where at least two companies had entered the United States market immediately prior to the challenged acquisition and were poised for future expansion. 908 F.2d at 988-89. In *Baker Hughes*, a number of firms competing in Canada and other countries had not penetrated the United States market, but could be expected to do so if the acquisition led to higher prices. *Id.* Although, in this case, there is evidence that there are a number of firms competing worldwide, the evidence does not establish that they can be expected to enter the U.S. market and compete in a timely and effective manner.

### **Constrain pricing**

Entry "must be able to restore competitive pricing -- i.e., it must be effective in offsetting any loss of competition due to the business combination in question." *Coca Cola*, 117 F.T.C. at 953, 960 ("If new entrants cannot sufficiently expand output to prevent existing producers from raising prices, their entry will not be sufficient to prevent a cartel from raising prices."). Where the likely and timely entry is not "sufficient to offset any post-merger pricing practices," defendants' claim of entry and expansion is "insufficient to rebut the Government's prima facie case." *Cardinal Health*, 12 F. Supp. 2d at 58. Even in *Baker Hughes*, the court found potential entry would be sufficient only if it "can keep that market competitive." *Id.* at 988 (emphasis added).

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Respondents have presented evidence that other manufacturers are interested in entering the market and that customers might consider turning to these other sources. An interest of other firms in making sales is not sufficient to restore competition and prevent CB&I from exercising market power. See *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1440 (9th Cir. 1995) (If the output or capacity of the new entrant is insufficient to take significant business away from the predator, [the new entrants] are unlikely to represent a challenge to the predator's market power.") (emphasis added). Rather, the inquiry is focused on whether those firms will actually prevent an exercise of market power. See *Staples*, 970 F. Supp. at 1087-88; *Swedish Match*, 131 F. Supp. 2d at 170; *Coca-Cola*, 117 F.T.C. at 960 (Entrant must "be 'successful' in the sense of being profitable" and "sufficiently expand output to prevent existing producers from raising prices . . ."). The greater weight of evidence in this case establishes that other firms have not prevented and will not prevent CB&I from raising prices after acquiring PDM EC.

Respondents have also presented evidence of companies that have bid on recent projects. However, in most of the examples presented, the other companies' bidding has not exerted sufficient competitive pressure. In *Tote*, the defendants pointed to the example of a company that had submitted a number of bids to tracks and that could have entered the market in seven months. The court held:

despite the fact that ITS is actively bidding in the marketplace, United Tote was unable to offer even a single example of a competitor adjusting its prices in response to an ITS bid. Quite to the contrary, on one recent bid, ITS's price was almost twice that of AmTote's and 50% higher than Autotote's once the cost of buying was converted to the cost of leasing.

*Tote*, 768 F. Supp. at 1083. Thus, the court held that actual entry by ITS was not sufficient, because it would not constrain anticompetitive price increases by incumbents. *Id.* at 1082. In examples set forth below, the evidence in this case establishes

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that, as in Tote, the bids offered by smaller competitors are at higher prices than those of CB&I and thus do not constrain pricing.

**(i) LNG market**

Since the Acquisition, domestic companies partnered with foreign companies are taking steps to enter the United States LNG market. In three of the eleven new or potential LNG projects, foreign manufacturers have even submitted bids or budget pricing. However, in many of the examples presented at trial, the steps that recent or potential entrants have taken are too preliminary to challenge CB&I's market power.

The bidding stages of seven of the recently announced projects are sufficiently advanced to provide a basis for determining that other manufacturers do not constrain CB&I's exercise of market power:

In CMS Energy's planned LNG tank expansion, CB&I was awarded the contract over Skanska/Whessoe which had provided a budget price that was [redacted] than the firm negotiated price submitted by CB&I. F. 102-05 (in camera).

[redacted] F. 106-07 (in camera).

With Poten & Partners, CB&I is negotiating a sole-source contract. F. 108.

For British Petroleum's three separate projects, CB&I is negotiating sole-source contracts. F. 109-13. Testimony from BP's representative that [redacted] (Sawchuck, Tr. 6062-63, 6092 in camera) is not persuasive evidence that these other companies have entered the market.

For Dynegy's Hackberry Facility, the one post-acquisition LNG tank award that CB&I did not win,



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CB&I declined to submit a tank bid only because it did not like the conditions under which it was asked to bid. F. 89-101.

The bidding stages of the other four recently announced projects are not sufficiently advanced to provide a basis for determining that other manufacturers constrain CB&I's exercise of market power. For some of these projects, the recent or potential entrants' level of participation rises only to the level of expressing an interest or participating in preliminary meetings. Thus, the evidence presented on recent or potential entrants' attempts to enter the LNG market does not support a conclusion that recent or potential entry restrains CB&I's market power:

For Yankee Gas' Waterbury project, CB&I has submitted budgetary pricing; Skanska/Whessoe has provided preliminary design solutions, preliminary design data sheets and pricing information; and [redacted] F. 117-32 (in camera). However, Yankee Gas has not yet determined whether Skanska/Whessoe or Technigaz are qualified to bid. F. 129.

For Freeport LNG's project, which is in the early design stages and may never be built, CB&I has sent Freeport LNG a proposal to do the front end engineering and design; Black & Veatch has sent Freeport LNG a letter which indicates that it has formed an alliance with Whessoe to build LNG tanks in the Western Hemisphere; Skanska/Whessoe met with Freeport LNG to discuss contracting strategies and general tank designs and to provide Freeport LNG with marketing materials; TKK/AT&V has made presentations to Freeport LNG on the companies' capabilities and discussed contracting capabilities; and Technigaz/Zachry has approached Freeport LNG to present its alliance. F. 133-40.

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For Williams' Cove Point II project, CB&I has submitted budgetary pricing; TKK, in partnership with DYWIDAG and AT&V, has submitted budgetary pricing. F. 114-16. Testimony from [redacted] is not persuasive evidence that [redacted] has entered the market. ([redacted], Tr. 4693, (in camera)).

Calpine's Humboldt, California facility is "in the early stages of possible development;" there is only a 50% chance that the facility will be built. F. 141. Testimony from Calpine's representative that he believes that Skanska/Whessoe, Technigaz/Zachry, and TKK/AT&V are all competent builders and can build LNG tanks (Izzo, Tr. 6494-500) is not persuasive. CB&I is the only constructor with whom Calpine has had discussions about potentially building this facility. F. 142-43.

Although Respondents presented evidence that TKK/AT&V, Skanska/Whessoe, and Technigaz/Zachry have begun bidding in the U.S. LNG market and that several other manufacturers have taken steps to try to enter the U.S. LNG market, the evidence does not demonstrate that they compete with sufficient force to constrain CB&I.

Further, although Respondents assert that there is a trend toward building double or full containment tanks, and that CB&I is disadvantaged in competing for double or full containment tanks, the evidence does not demonstrate that there is a trend toward double or full containment tanks. F. 57. Respondents have not demonstrated that actual or potential entry is sufficient to challenge CB&I's market power in the LNG market.

**(ii) LPG market**

Respondents presented little evidence of recent entry in the LPG market. Respondents assert that two entrants, AT&V and Matrix, have recently begun to compete for LPG jobs, and that

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Chattanooga Boiler & Tank ("Chattanooga") is poised to enter this market. No evidence or testimony was offered to show that any foreign tank manufacturer has bid on U.S. LPG projects. F. 246. The evidence presented at trial does not demonstrate that these domestic or that foreign manufacturers can constrain CB&I's market power.

From the Acquisition to the time of trial, there has been one LPG project awarded, Port Arthur in 2001. This project was awarded to CB&I. F. 233.

The only still existing company that has built an LPG tank from 1990 to present, AT&V, lacks the capacity to constrain CB&I. Although AT&V was awarded the last pre-acquisition LPG tank project award, Deer Park, in 2000, the value of this project was a fraction of the value of the next largest tank built from 1990-2001. F. 226. AT&V also bid on the only LPG tank awarded since the Acquisition, which was won by CB&I. F. 237. Although AT&V provides some competition by bidding, the greater weight of the evidence demonstrates that AT&V cannot compete with sufficient force to constrain CB&I's market power. F. 238-40.

There is also insufficient evidence to demonstrate that Matrix, Wyatt, or Chattanooga can effectively compete. F. 241-44. Respondents did not present evidence that foreign manufacturers are poised to enter the U.S. LPG market. F. 245-49.

Therefore, Respondents have not demonstrated that actual or potential entry is sufficient to challenge CB&I's market power in the LPG market.

**(iii) LIN/LOX market**

Respondents presented evidence of recent entry by AT&V in the LIN/LOX market. Respondents assert that two other domestic manufacturers, Matrix and Chattanooga, compete in the LIN/LOX market. Respondents do not assert that foreign manufacturers are poised to enter the U.S. LIN/LOX market.

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From the Acquisition to the time of trial, there have been five LIN/LOX projects awarded. AT&V won three; CB&I won two. F. 292-93. In all three of the LIN/LOX projects that AT&V bid on and won, CB&I was also a bidder. F. 294. Respondents presented evidence that AT&V effectively competes against CB&I by bidding at lower prices than CB&I. F. 294.

However, Complaint Counsel presented evidence that AT&V cannot compete on an equal footing with CB&I in the LIN/LOX market as it lacks revenue and field capacity. F. 315. Further, some customers that have done business with AT&V have found that any initial savings are offset or exceeded by oversight costs and costs related to change orders. F. 297-98, 304-05, 314. Other customers have expressed concern with AT&V's performance and reputation. F. 318-19.

The greater weight of the evidence demonstrates that although AT&V has entered the LIN/LOX market and has won three of the five post-acquisition projects, AT&V does not provide the competitive force that PDM once did.

Matrix recently entered the LIN/LOX market, winning 4 recent pre-acquisition LIN/LOX projects. F. 320. However, Matrix has been a high bidder, and consequently non-competitive, on other recent LIN/LOX tank projects for several customers, including Air Liquide and Linde, and is viewed by some customers as not sufficiently qualified. F. 321-23. Moreover, after the sale of its subsidiary which owned the fabrication facility where Matrix fabricated LIN/LOX tanks, Matrix's capacity decreased. F. 324.

Chattanooga has never built a LIN/LOX tank and does not effectively compete in the LIN/LOX market. F. 325. LIN/LOX industry participants question Chattanooga's ability to build a LIN/LOX tank. F. 327. On one occasion when it recently bid on a LIN/LOX project, Chattanooga's price was [redacted] higher than CB&I's. F. 326 (in camera).

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Therefore, Respondents have not demonstrated that actual or potential entry is sufficient to challenge CB&I's market power in the LIN/LOX market.

**(iv) TVC market**

There is no evidence of actual or potential entry in the TVC market. In all but one of the TVC projects for which pricing was requested prior to the Acquisition, no company other than CB&I or PDM was even asked to provide pricing. F. 367-69. In the one instance where two other companies responded to the customer's request for proposals, these manufacturers were eliminated from the bidding process because the customer found them unqualified. F.366. The only company that, post-acquisition, has been asked to provide pricing on a TVC project, Howard Fabrication, was not considered by that customer to have "the technical competence nor the financial backing" necessary to award it a TVC project. F. 445. See also F. 410-11. Industry members testified that the field for manufacturing TVCs is limited to CB&I. F. 380-85. See also F. 412-14.

Therefore, Respondents have not demonstrated that actual or potential entry is sufficient to challenge CB&I's market power in the TVC market.

**d. Barriers to entry**

Determining whether there is ease of entry also entails an analysis of barriers to new firms entering the market or to existing firms expanding into new regions of the market. *Cardinal Health*, 12 F. Supp. 2d at 54 (citing *Baker Hughes*, 908 F.2d at 987). If barriers to entry are low, the threat of outside entry can significantly alter the anticompetitive effects of the merger by deterring the remaining entities from colluding or exercising market power. *Heinz*, 246 F.3d at 717 (citing *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 532-33 (1973); *Baker Hughes*, 908 F.2d at 987 ("In the absence of significant barriers, a company probably cannot maintain supracompetitive pricing for any length of time.")). Low barriers to entry enable a potential

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competitor to deter anticompetitive behavior by firms within the market simply by its ability to enter the market. *Heinz*, 246 F.3d at 717 n.13 (citing *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 581 (1967)).

Expertise in the industry, a fair amount of capital, a positive reputation, and the need to have specialized equipment are all barriers to entry. *Fruehauf Corp. v. FTC*, 603 F.2d 345, 357 (2d Cir. 1979); *Cardinal Health*, F. Supp. 2d at 58; *United States v. Blue Bell, Inc.*, 395 F. Supp. 538, 549 (M.D. Tenn. 1975). In *Kennecott Copper Corp. v. FTC*, 467 F.2d 67, 79 (10th Cir. 1972), the court found that due to the specialized nature of the industry, which required particular knowledge and highly developed equipment, the entry barriers were formidable. See also *FTC v. PPG Indus.*, 628 F. Supp. 881, 885 (D.D.C. 1986) (high entry barriers where witnesses estimated it would take from two to six years to acquire the technological expertise, assemble the trained personnel, and devise the tooling to enter the market as a credible competitor). As set forth for each of the product markets below, these barriers exist in this case.

Another barrier is that most customers already have established relationships with an existing manufacturer. Thus, to persuade those customers to conduct business with it, a new entrant would probably have to undercut the current competitors in the market by selling at lower prices in order to secure new business. *Libbey*, 211 F. Supp. 2d at 48. As set forth for each of the product markets below, this barrier exists in this case.

In some markets, "the need for reliability is so great and the consequences of new product failure so dire that, even if the competitive nature of the market deteriorated, consumers would still be reluctant to switch to new entrants." *Tote*, 768 F. Supp. at 1076 (finding proven ability to provide reliable systems and service an important factor in a racetrack's selection of a totalisator supplier to preserve the track's revenue and goodwill).

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The unwillingness of customers to use a company with an unproven track record is a barrier to entry. See *Tote*, 768 F. Supp. at 1078. As set forth for each of the product markets below, this barrier exists in this case.

Even in *Baker Hughes*, the district court noted that the following facts suggested difficulty of entry and "may handicap new entrants": products that are custom-made are not readily interchangeable or replaceable; buyers tend to return to sellers from whom they have purchased in the past; and customers typically place great importance on assurances of product quality and reliable future service. 908 F.2d at 989 n.10. As set forth for each of the product markets below, these factors exist in this case.

Many witnesses in this case, including those of Respondents, testified that to be successful in these markets, a company has to be large, have experience and know-how, have specialized equipment, and have a fair amount of capital. As set forth below, Complaint Counsel introduced evidence of high barriers to entry in all four markets. These barriers to entry make it unlikely that any potential competitor, or even a small existing competitor in the U.S., such as AT&V, will be able to replace PDM as a competitive force, by filling the capacity that PDM had or by being profitable at pre-acquisition prices at a pricing level that constrains CB&I's ability to raise prices.

**(i) LNG market**

Barriers to entry in the LNG tank market are high. LNG tank suppliers must have sufficient personnel to design, engineer and construct LNG tanks and to handle adjustments to possible schedule changes. F. 166, 169, 172. LNG suppliers must also have sufficient capacity to bond large projects. F. 175-76. Experience and reputation are extremely important in a product market, like the one for LNG tanks, where the values of the projects are so high and where there are tremendous safety considerations. F. 167-173. The evidence establishes that barriers are not low and that entry is not so easy that an existing or potential company could replace PDM in the LNG market.

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**(ii) LPG market**

Barriers to entry in the LPG market, while not as high as in the LNG or TVC markets, still exist. LPG tank suppliers must have sufficient personnel to design, engineer and construct LPG tanks and to handle adjustments to possible schedule changes. F. 250-51. Experience and reputation are important in this market. F. 252. See also F. 253. The evidence establishes that barriers are not low and that entry is not so easy that an existing or potential company could replace PDM in the LPG market.

**(iii) LIN/LOX market**

Barriers to entry in the LIN/LOX market, while also not as high as in the LNG or TVC markets, do exist. LIN/LOX manufacturers must establish the capability to perform specialized metal fabrication and must have sufficient financial capacity to conduct physical tests of materials and tank prototypes or components. F. 329-33. Experience and reputation are also important in this market. F. 328, 331, 334. The evidence establishes that barriers are not low and that entry is not so easy that an existing or potential company could replace PDM in the LIN/LOX market.

**(iv) TVC market**

Barriers to entry in the TVC market are high. No evidence or testimony was offered to show that barriers to entry are low in the large field-erected TVC market. TVC customers want experienced suppliers with knowledge, ability to fabricate in the field a stainless steel vessel, and ability to satisfy the quality requirements of leak testing and cleanliness for a TVC. F. 415-17. A new entrant would need to hire engineers with previous experience in designing TVCs, which are "truly one-of-a-kind designs for very specific applications on very technical products." F. 416. A new entrant would need to expend significant resources in developing proposals and price quotations for TVCs. F. 418. The evidence establishes that barriers are not low and that entry is



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not so easy that an existing or potential company could replace PDM in the TVC market.

**e. Customer sophistication**

"Well-established precedent and the . . . Merger Guidelines recognize that the sophistication and bargaining power of buyers play a significant role in assessing the effects of a proposed transaction." *FTC v. R.R. Donnelley & Sons Co.*, 1990 U.S. Dist. LEXIS 11361, \*10 (D.D.C. 1990). "Although the courts have not yet found that power buyers alone enable a defendant to overcome the government's presumption of anti-competitiveness, courts have found that the existence of power buyers can be considered in their evaluation of an anti-trust case, along with such other factors as the ease of entry and likely efficiencies." *Cardinal Health*, 12 F. Supp. 2d at 58. Some courts have stressed that the existence of power buyers does not necessarily mean that a merger will not result in anticompetitive effects. The court in *Tote* held that the existence of power buyers did not outweigh the potentially damaging effects of a merger on numerous smaller customers. 768 F. Supp. at 1085. Although the larger buyers were not likely to suffer the effects of a lack of competition, the court concluded that the defendants' smaller to mid-size customers without any significant bargaining power would be impermissibly harmed by the proposed merger. *Id.*

In all four of the relevant product markets, the customers purchasing the products are large companies, with sophisticated procurement processes, who generally seek to have two or more bidders for their projects. F. 254, 353-55, 471-73. However, due to the fact that, in three of the four markets, there are very few products purchased and there are confidentiality provisions, past pricing is not well known. E.g., F. 204-07. Thus, most customers do not have significant bargaining power. In the end, although evidence of the sophistication of customers in these markets was presented and has been considered, this does not rebut Complaint Counsel's prima facie case.

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### **f. Weakness of the merging companies**

The acquired firm's weakness is another factor that a defendant may introduce to rebut the government's prima facie case. *Kaiser Aluminum*, 652 F.2d at 1339; *United States v. Int'l Harvester Co.*, 564 F.2d 769, 774 (7th Cir. 1977) ("The prima facie case presented by the Government was rebutted by persuasive evidence, including [the acquired firm's] weakened financial condition."). However, such a defense is credited "only in rare cases, when the defendant makes a substantial showing that the acquired firm's weakness, which cannot be resolved by any competitive means, would cause that firm's market share to reduce to a level that would undermine the government's prima facie case." *Univ. Health*, 938 F.2d at 1221.

Facts presented at trial establish that PDM was not a weak firm. PDM was winning recent tank projects. *Supra* Part III.E.1. Moreover, PDM was a profitable company and PDM's EC Division was profitable. F. 535-45. As of July 2000, the month before CB&I and PDM signed the acquisition letter of intent, PDM EC projected earnings before interest and taxes of \$ 2 million in 2000. F. 538. Accordingly, this factor does not rebut the government's prima facie case.

### **3. Burden of persuasion**

"If the defendant successfully rebuts the presumption [of illegality], the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times." *Baker Hughes*, 908 F.2d at 983; see also *Kaiser Aluminum*, 652 F.2d at 1340 and n.12. Respondents did not successfully rebut Complaint Counsel's presumption of anticompetitiveness and thus the inquiry into whether CB&I's acquisition of PDM EC and Water Divisions violated the Clayton Act may conclude. Nevertheless, although it was not required to do so, Complaint Counsel attempted to show that anticompetitive effects have already occurred in three of the four markets. As set

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forth below, Complaint Counsel's evidence did not prove that CB&I has implemented price increases.

**a. LNG market****(i) Sole-source contracts**

Complaint Counsel argues that CB&I used its position as the only domestic supplier of LNG tanks to force LNG tank purchasers into sole-source arrangements. CCPTB at 37-38. The evidence establishes that three companies have entered sole-source arrangements with CB&I. F. 106-13. Complaint Counsel presented evidence that sole-source arrangements can result in higher profit margins and that one of these customers believed that CB&I was essentially its only choice. F. 111-13. Although the evidence presented at trial did not establish conclusively that the sole-source arrangements have resulted in higher prices, without competitive constraints, higher prices are probable.

**(ii) Memphis Light Gas and Water**

Complaint Counsel argues that recent prices provided for Memphis Light Gas and Water ("MLGW") represent a post-acquisition price increase. Complaint Counsel attempts to compare the competitively bid and negotiated 8% margin projected by CB&I on the 1994 MLGW project to a [redacted] margin included as part of a budget price given to MLGW in 2002. CCPTB at 6, 35 (in camera). This argument is misleading, because it is based entirely on a comparison of apples and oranges. The 1994 price was a fixed, firm price bid that was competitively bid and negotiated, while the 2002 number was a budget price. F. 83, 84, 180-82. Budget prices are preliminary in nature and are often based on broad assumptions of many unknown variables. F. 474-75, 478-79. Complaint Counsel's assertion that CB&I implemented a price increase to MLGW is not supported by sufficient evidence.

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**(iii) Cove Point I**

Complaint Counsel argues that PDM increased its price on the Cove Point expansion in September 2000 in anticipation of the Acquisition. CCPTB at 33-34. Complaint Counsel bases its argument first upon RX 127, a chart prepared by CB&I for a bid review meeting in March 2000, entitled "To Be Completed Prior to Final Proposal Submittal." CCPFF 781 (citing RX 127 at CBI-H008204). While RX 127 contains proposed pricing of [redacted] for the Cove Point project, there is no evidence in the record suggesting that this figure was actually submitted by CB&I or used as a bid for the project. RX 127 (in camera). Complaint Counsel asked no witnesses at trial about this document. Complaint Counsel asserts that PDM initially quoted a price of approximately [redacted]. CCPFF 781 (citing CX 226 at CBI-PL044978, in camera). CX 226 is a CB&I memorandum wherein an employee of CB&I speculates that PDM had provided a "budget of something like [redacted]." (CX 226 at CBI-PL044978, in camera). Based on this speculation, the CB&I employee recommended that CB&I reduce its price to [redacted]. F. 187 (in camera). Speculations made by a CB&I employee about what PDM may have provided as a budget price do not support Complaint Counsel's assertion that PDM bid [redacted]. (In camera). Complaint Counsel then asserts that PDM subsequently bid [redacted]. CCPFF 781 (citing CX 1058 at PDM-HOU 017465, in camera). CX 1058, a summary of pending LNG projects, does not establish conclusively that PDM bid [redacted] million. (CX 1058 at PDM-HOU 017465, in camera). No witnesses at trial were asked about this document.

The evidence does establish that on September 8, 2000, PDM quoted Williams a budget price of [redacted] for a 750,000 barrel tank. F. 192 (in camera). Complaint Counsel compares the September 8, 2000 budget price to the earlier figures to argue that PDM implemented a price increase in September 2000, in anticipation of the Acquisition. CCPFF 793. But because Complaint Counsel has not established that the earlier figures were budget prices or were ever submitted, Complaint Counsel's

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assertion that PDM implemented a price increase in September 8, 2000 is not supported by reliable evidence.

Next, Complaint Counsel argues that PDM increased its price on the Cove Point expansion in November 2000 in anticipation of the Acquisition. CCPTB at 33-34. Complaint Counsel bases this theory on CX 1160, [redacted]. See CCPTB at 33-34. The evidence shows that this document was created for purposes of evaluating an estimate from the estimating department in a formal bid review meeting. Decisions made at the meeting resulted in the November 2, 2000 "as submitted" price. F. 194, 195. The fact that CX 1160 shows a different price on November 2 as compared to the estimated price on November 1 is not probative, since the very nature of the meeting was to review the bid.

Complaint Counsel points to CB&I's actual post-acquisition profit margin for performing the Cove Point project and argues that the actual profit margin has increased in comparison to the March 2000 chart prepared for a bid review meeting. CCPTB at 34. However, the evidence establishes that CB&I will earn a greater than expected margin because [redacted] F. 201-03 (in camera). [redacted] F. 203 (in camera). In addition, Complaint Counsel's arguments pertaining to RX 323, a document not used at trial and CX 906, a document demonstrated by Respondents to be unreliable, are speculative and not supported by reliable evidence.

**(iv) Fairbanks**

Complaint Counsel asserts that the LNG project for Fairbanks Natural Gas, LLC in Alaska ("Fairbanks") in 2002 illustrates that, since the merger, CB&I has raised prices and increased profit margins. CCPFF 955. To support this assertion, Complaint Counsel relies on CX 307, a document that was not introduced in evidence, and on RX 407, a document for which only very limited testimony was introduced. (See Scorsone, Tr. 5331, in camera). The trial transcript is devoid of any specific information about the document including who wrote the document and when, who viewed the document and when, and what the document means.

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The conclusions Complaint Counsel draws from RX 407 are speculative. The conclusions Complaint Counsel draws from CX 307, a document not in evidence, are disregarded.

In addition, Complaint Counsel compares CB&I's budget price for Fairbanks in 2002 to PDM's budget price for BC Gas in 1996 for an LNG tank to be built in Vancouver, British Columbia and argues that the difference between these figures illustrates that CB&I implemented a price increase on the Fairbanks project. CCPFF 977. This argument fails for two reasons. First, CX 791, the document Complaint Counsel asserts represents PDM's budget estimate for the BC project, was not used at trial with any fact witness and Complaint Counsel's expert testified that he did not know how the figures listed on CX 791 were formulated. (Simpson, Tr. 5387-92). Thus, the conclusions Complaint Counsel draws from it are not reliable. Second, the differences between a 1996 budget estimate prepared by PDM for a 1.2 million gallon LNG tank located in Canada and a 2002 budget estimate prepared by CB&I for a 1.0 million gallon LNG tank located in Alaska render a comparison between the two figures meaningless. The 1996 PDM budget estimate appears to have been extrapolated from a 1993 estimate to a different client in a vastly different location. (See CX 791; Simpson Tr. 5390-93). By contrast, CB&I derived the Fairbanks estimate in 2002 using a formal budgetary exercise. (Compare RX 626 to CX 791). Further, Complaint Counsel has not shown that the costs for the BC Gas job (such as material or shipping costs) would be the same as those on the Fairbanks job located deep in interior Alaska. The Fairbanks budget price contained a very high margin figure to account for lack of information and contingencies associated with an Alaska project, such as a cold climate, short construction seasons, and burdensome labor regulations. (RX 626 at CBI 063013; Scorsone, Tr. 5004-06). Indeed, Dr. Simpson acknowledged that these factors would be relevant in any comparison of the two projects. (Simpson, Tr. 5385). Accordingly, Complaint Counsel did not present reliable evidence to support its allegation that the Fairbanks LNG project illustrates that CB&I is raising prices and increasing margins.

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**b. LPG market**

Complaint Counsel does not assert that there have been anticompetitive effects in the LPG market.

**c. LIN/LOX market**

Complaint Counsel asserts that there are three examples of CB&I implementing an 8.7% price increase to Linde and to Praxair. None of Complaint Counsel's allegations are supported by sufficient, reliable evidence.

Complaint Counsel's argument that CB&I implemented its first price increase to Linde in April 2002 is based on testimony from a fact witness' comparison of CB&I's budget price to a three year old PDM firm fixed price and his comparison to an outdated pricing model. F. 341-44. The witness admitted several deficiencies in his pricing model. F. 344. Although the witness may have believed the price was high, the opinion that the price actually increased is not reliable and is disregarded.

Complaint Counsel's argument that CB&I implemented a second price increase to Praxair in June 2002 is based on Complaint Counsel's assertion, with no cites to record evidence, that the difference in CB&I's price to Praxair and CB&I's price to Linde is only [redacted], or less than [redacted]. CCPFF 1075 (in camera). Next, Complaint Counsel hypothesizes that because CB&I's price to Linde increased by 8.7%, and because the Linde tank is similar in size to the Praxair tank, and because CB&I's price to Praxair was close to CB&I's price to Linde, then CB&I's price to Praxair must have increased 8.7%. CCPFF 1072-76. This conclusion is not supported by sufficient probative evidence. First, it is based on Complaint Counsel's theory - that is rejected in the preceding paragraph - that CB&I implemented an 8.7% price increase to Linde in April 2002. Second, because of differences in the details, such as construction schedule, location, conditions of the project site, provided by Praxair and Linde to CB&I and because of differences between the tank specifications, Complaint Counsel's comparison is speculative. F. 336-37, 345,

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347-48. Therefore, Complaint Counsel did not present reliable evidence to support its allegation that CB&I implemented an 8.7% price increase to Praxair in June 2002.

Complaint Counsel's theory of a third instance of an 8.7% price increase to Praxair in April 2002 is based on a comparison between PDM's budget price for a 500,000 gallon LOX tank in Colorado in November 2000 to CB&I's budget price for a LR-60 LIN tank in New Mexico in April 2002. CCPFF 1077-1085. CB&I's estimating staff was instructed to use PDM's price on the Colorado Springs LOX tank as a basis for determining the price for Praxair's New Mexico LIN tank. F. 350. Complaint Counsel compared these two budget prices and concluded that the difference in price amounts to an 8.7% price increase. The documents Complaint Counsel relies upon, CX 448 and CX 449, while admitted into evidence, were never used at trial with any witness. CX 448 does not provide technical specifications, including the proposed tank size. Complaint Counsel has not presented evidence that the design of the Colorado LOX tank and the New Mexico LIN tank are identical. Thus, Complaint Counsel's argument that differences in the prices is the result of an exercise of market power is not supported by reliable and probative evidence. Accordingly, the evidence does not support Complaint Counsel's allegation that CB&I implemented an 8.7% price increase to Praxair in April 2002.

**d. TVC market**

Complaint Counsel alleges that, after the letter of intent for the Acquisition was signed, CB&I and PDM colluded regarding pricing for Spectrum Astro's proposed TVC project. CCPTB at 31-32. Complaint Counsel first points to a handwritten internal note reflecting a conversation between CB&I's Chief Operating Officer and PDM's President of PDM EC calling this project "D.O.A." (CX 1705 at PDM-HOU009169). Complaint Counsel also points to an internal CB&I memorandum from a low-level salesman (Dave Lacey) to support its argument. CCPTB at 31 (citing CX 242, *in camera*). The evidence does not establish that issues of pricing, profit margins, costs or anything else related to



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this project were discussed between PDM and CB&I. (Scorsone, Tr. 4796-97, 5045-46; Scully, Tr. 1217).

Complaint Counsel alleges that, after the Acquisition, CB&I increased its price for the Spectrum Astro project. CCPTB at 32. The evidence presented does not establish this allegation. F. 423-41.

Complaint Counsel alleges that, after the Acquisition, CB&I attempted to coordinate a pricing proposal with Howard Fabrication for TRW's proposed TVC project. CCPTB at 31-32. The evidence presented does not demonstrate that anyone in CB&I's management was aware of or approved such a proposal. F. 446-51.

Complaint Counsel alleges that, after the Acquisition, CB&I increased its price on a [redacted] project. F. 454-70 (in camera). The evidence presented does not conclusively establish this allegation.

**e. Conclusion**

Complaint Counsel's evidence in support of many of its allegations of price increases implemented by CB&I after the Acquisition does not prove that CB&I has in fact increased prices. However, Complaint Counsel is not required to prove that anticompetitive effects have in fact occurred. "The Government is not required to establish with certitude that competition in fact will be substantially lessened." *Crown Zellerbach Corp. v. FTC*, 296 F.2d 800, 823 n.21 (9th Cir. 1961) (citation omitted). Because § 7 deals in "probabilities, not certainties," "the mere nonoccurrence of a substantial lessening of competition in the interval between acquisition and trial does not mean that no substantial lessening will develop thereafter . . . ." *General Dynamics*, 415 U.S. at 505 (quoting *Brown Shoe*, 370 U.S. at 323).

Complaint Counsel did prove that, prior to the Acquisition, in all four product markets, there were two primary competitors, and

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that, as a result of the Acquisition, there is now one dominant firm. A merger of the two strongest suppliers enables CB&I to increase prices up until the point where other less-strong suppliers begin to constrain it. There can be no doubt that CB&I has the ability to exercise market power as a result of its acquisition of the only other competitor that had constrained CB&I. Complaint Counsel presented reliable and probative evidence to carry its burden of persuasion that the probability of a substantial lessening of competition did exist at the time of trial.

**F. Exiting Assets Defense**

Respondents assert an affirmative defense of "exiting assets." Respondents definitively state that "CB&I does not assert the failing firm defense, . . . which requires a showing that the acquired company is 'so depleted and the prospect of rehabilitation so remote' that it is at risk of 'the grave possibility of business failure' and that 'the company that acquires the failing company . . . is the only available purchaser.'" RPTB at 153-54 (quoting *Citizen Publ'g v. United States*, 394 U.S. 131, 138 (1969)).<sup>n3</sup> Rather, Respondents argue that the "exiting assets" defense is a viable defense to Complaint Counsel's allegations. RPTB at 152-55. Respondents acknowledge that "there has been no case since *Olin* asserting the defense until this case was tried." RPTB at 154-55 n.29.

<sup>n3</sup> The criteria for establishing a failing company are not met by PDM. F. 535-45.

Respondents claim that, absent the Acquisition, PDM would have liquidated its EC Division and that there was no potential purchaser other than CB&I. RPTB at 138-52. Under these circumstances, Respondents argue that there has been no substantial lessening of competition, because competition if CB&I had not bought PDM EC is exactly the same as competition after CB&I's acquisition of PDM EC. RPTB at 152-55.

Complaint Counsel asserts that the "exiting assets" defense is not based on any accepted law, but rather upon a 1986 law review

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article, and that the Commission has rejected this defense. Complaint Counsel's Post Trial Reply Brief ("CCPTRB") at 62. Complaint Counsel further asserts that Respondents failed to establish that CB&I was "the only available purchaser" for PDM's EC and Water Divisions, that PDM conducted an "exhaustive" search for alternative buyers, and that PDM's EC Division was actually exiting the market. CCPTRB at 63-70.

The defense presented by Respondents is similar to the one rejected in *United States v. Phillips Petroleum Co.*, 367 F. Supp. 1226, 1258 (C.D. Cal. 1973), where the court rejected the defense that since the acquired company "would have gone out of business on the West Coast anyway, the acquisition of its assets by [defendant] did not result in any anticompetitive effect in the market." *Id.* "Unless the seller objectively comes within the 'failing company' doctrine, it is irrelevant why one corporation sells its assets to another." *Id.*

The exiting assets defense, as described by a law review article, has as its "key element . . . proof that, without the merger, the assets owned by the acquired firm would shortly be leaving the market." John E. Kwoka, Jr. & Frederick R. Warren-Boulton, *Efficiencies, Failing Firms, and Alternatives to Merger: A Policy Synthesis*, 31 *Antitrust Bull.* 431, 446 (1986) (cited in *Olin Corp. v. FTC*, 986 F.2d 1295, 1307 (9th Cir. 1993)). The exiting assets defense was first presented to the Commission in *In re Olin Corp.*, 113 F.T.C. 400 (1990). In *Olin*, the ALJ characterized the exiting assets defense as a "novel policy proposal" and held that, even if the "novel 'exiting assets' doctrine" was accepted, it would not save the challenged acquisition. 113 F.T.C. at 582-84. The ALJ found that there were alternatives short of merger and that the evidence failed to show that the acquired company made an unsuccessful effort to sell its business to a competitively preferable buyer and failed to show that there were no competitively preferable acquirers. *Id.* at 583.

On appeal from the initial decision, the Commission held that the evidence in *Olin* did not establish that the selling company had made the decision to close the relevant business at issue in the

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near future (instead, the evidence showed that the selling company continued to operate the facility in the expectation that the facility could at some point be sold) and that there was no evidence that the selling company had conducted an exhaustive effort to sell the assets at issue. Olin, 113 F.T.C. at 618. Based on these factual findings, the Commission concluded "the facts would not support the description of the proposed defense, even if we adopted the defense, and we decline to do so in this case." Id.

On appeal from the Commission's decision, the Court of Appeals for the Ninth Circuit did not adopt the exiting assets defense either. Rather, it characterized the defense as "novel," stated that the Commission had indicated that it was not inclined to recognize this defense, and held that the "burden of proof is undoubtedly on Olin to establish any such defense." 986 F.2d at 1307 (emphasis added).

A finding that the assets would not be exiting the relevant market "shortly" is sufficient to sustain a ruling that CB&I did not establish an "exiting assets" defense. See Olin, 986 F.2d at 1307 (The Ninth Circuit did not need to determine whether or not less anticompetitive alternatives to the merger existed.). In Olin, the respondent had not demonstrated that assets would be exiting the market shortly where: (1) the evidence did not establish that the selling company had made the decision to close the business in the near future; and (2) there was no evidence that the selling company had conducted an exhaustive effort to sell the relevant assets to any companies other than respondent. Olin, 113 F.T.C. at 618 (emphasis added).

To the extent that an exiting assets defense is legally recognizable, the facts presented in the instant case do not support the proposed defense. First, Respondents did not establish that PDM would have closed the business in the near future. Second, Respondents did not establish that PDM had conducted an exhaustive effort to sell the EC Division to any company other than CB&I.

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Because Olin is the only case law found specifically addressing an exiting assets defense, cases analyzing failing company or failing division defenses are utilized. Cases analyzing a failing company defense hold that intent to leave the market is not sufficient to establish the defense. E.g., Phillips Petroleum, 367 F. Supp. at 1260 (subjective statements of management intention or desire by management to exit the business does not satisfy the defense); Warner Communications, 742 F.2d at 1165 ("a company's stated intention to leave the market or its financial weakness does not in itself justify a merger"); Blue Bell, 395 F. Supp. at 550 (company's intention to divest itself of a certain division is immaterial).

Respondents' argument that PDM intended to leave the market is not supported by the evidence presented at trial. Mr. Scorsone, the former President of PDM EC, testified that if the EC Division had not been sold, it would not have gone out of business, and that it would be profitable in the future. F. 548. Mr. Byers, former V.P. of Finance for PDM, testified that before making any recommendation to liquidate the PDM EC Division, his fiduciary duties would have required him to investigate to assure himself that there was no alternative purchaser for either PDM or PDM EC willing to pay more than the liquidation value of the business. F. 549. PDM's investment banker, Tanner & Company ("Tanner"), would also have attempted to find alternative purchasers prior to recommending liquidation. F. 550. PDM's President, William McKee, stated that if the CB&I transaction fell through, PDM would have continued its efforts to sell the PDM EC and PDM Water Divisions by seeking other purchasers. F. 551. Finally, PDM's Board of Directors never took up the issue of liquidating the PDM EC Division. F. 552.

Thus, the evidence does not establish that PDM had made the decision to close the business in the near future. Respondents' defense may be rejected on this basis. Citizen Publ'g, 394 U.S. at 136 (rejecting defense where there was "no indication that the owners of the Citizen were contemplating a liquidation").

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In addition, Respondents did not present sufficient evidence to demonstrate that PDM conducted an exhaustive effort to sell the package of assets sold to CB&I. Respondents have not made a "clear showing" that PDM "undertook a well conceived and thorough canvas of the industry such as to ferret out viable alternative partners." *United States v. Pabst Brewing Co.*, 296 F. Supp. 994, 1002 (E.D. Wis. 1969) (defendant had burden of proving that it had made every reasonable effort to explore alternative possibilities).

Tanner assembled a preliminary list of potential buyers, including 18 steel companies, 15 engineering and construction companies, and 4 financial buyers. F. 528. This list was presented to the PDM Board on June 1, 2000. F. 528. Among the companies identified by Tanner as potential acquirers of PDM EC were Fluor, Jacobs Engineering, Foster Wheeler, and Morrison Knudsen. F. 529. However, to Mr. Byers' knowledge, none of these companies were contacted about acquiring PDM. F. 529. Tanner never contacted any foreign firms regarding the purchase of PDM EC. F. 530.

In July of 2000, PDM announced that it would sell the company. F. 525. Tanner prepared an offering memorandum for the sale of the PDM EC Division. F. 517. This offering memorandum was sent to only one company -- CB&I. F. 517. By the time the offering memorandum was completed, negotiations between CB&I and PDM were at a point "that it didn't make sense to send it out to other people." F. 518.

These efforts in no way rise to the level sufficient to sustain the proposed defense. For example, in *California v. Sutter Health Sys.*, the defendant's efforts to seek offers from other potential purchasers satisfied an element of a failing company defense where defendant proved that it had conducted a three-year "extensive good faith search for purchasers" in which it "formulated a detailed and thorough proposal process and sought out numerous potential partners." 130 F. Supp. 2d 1109, 1136 (N.D. Cal. 2001). One "expression of interest" came only after the defendant "repeatedly contacted" the potential buyer who

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"failed to make any offer in response to these inquiries." *Id.* Further, the efforts taken by PDM were even less exhaustive than those found to be insufficient in *FTC v. Harbour Group Invs.*, 1990 U.S. Dist. LEXIS 15542, \*12-13 (D.D.C. Nov. 19, 1990), where the efforts made by the investment banker did not comport with its normal exhaustive search; where the offering materials were minimal, containing a brief two page executive summary with financial information and product brochures attached; and the search consisted of minimal exploratory phone calls, with little follow-up or attention by the brokers who were responsible for the search.

Financial buyers, who would have maintained PDM as an independent on-going entity, were available and had been recommended by Goldman Sachs and by Tanner as alternative buyers. F. 526. Matrix, then the third-largest United States tank constructor, made efforts to buy PDM EC. F. 531. Tanner's fairness opinion, dated February 7, 2001, noted that if CB&I's acquisition of PDM EC and Water Divisions fell through, there were other potential buyers with the interest and adequate resources to purchase PDM EC. F. 532.

Because Respondents have not presented sufficient evidence to demonstrate that PDM had made the decision to close the business in the near future and that PDM had conducted an exhaustive effort to sell the assets sold to CB&I, Respondents have not demonstrated that the assets would be exiting the market shortly. Thus, to the extent that exiting assets is a viable defense, Respondents have not met their burden of establishing it.

**G. Summary of Liability**

Count I of the Complaint charges that "the effect of the Acquisition may be substantially to lessen competition or tend to create a monopoly in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45." Count II of the Complaint charges that "CB&I and PDM, through the Acquisition and the Acquisition agreement described in Paragraph 8 [of the Complaint], have engaged in

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unfair methods of competition in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45." Complaint Counsel has presented reliable and probative evidence to support Counts I and II of the Complaint.

## **H. Remedy**

### **1. Standard**

Complaint Counsel has established that the acquisition of PDM's Water and EC Divisions by CB&I may substantially lessen competition in the relevant markets and, thus, has established that Respondents violated Section 7 of the Clayton Act. Pursuant to Section 11(b) of the Clayton Act:

If upon such hearing the Commission . . . shall be of the opinion that any of the provisions of [Section 7] have been or are being violated, it shall . . . issue and cause to be served on such person an order requiring such person to cease and desist from such violations, and divest itself of the . . . assets, held . . . in the manner and within the time fixed by said order." 15 U.S.C. § 21(b) (emphasis added).

Through Section 11 of the Clayton Act, Congress expressly directed the FTC to issue orders requiring that a violator of § 7 divest itself of the assets held in violation of the Clayton Act. *Am. Stores*, 495 U.S. at 284-85 and n.11; *FTC v. Western Meat Co.*, 272 U.S. 554, 559 (1926) (Commission has a duty to issue an order directing that a violator of § 7 "cease and desist therefrom and divest itself of what it had no right to hold.").

Under both the text of the Clayton Act and Supreme Court precedent, divestiture is the usual and proper remedy where a violation of § 7 has been found. *E.I. du Pont*, 366 U.S. at 329 ("The very words of § 7 suggest that an undoing of the acquisition is a natural remedy."); *Ford Motor Co. v. United States*, 405 U.S. 562, 573 (1972) ("Complete divestiture is particularly appropriate where asset or stock acquisitions violate



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the antitrust laws."); *Am. Stores*, 495 U.S. at 285 n.11 (A person who is allowed to continue holding ownership over stock or assets that created a Section 7 violation would be engaging in a perpetual violation, thus divestiture is the only effective remedy.). See also *United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 662 (1964) (directing the district court to order divestiture without delay). "Of the very few litigated § 7 cases which have been reported, most decreed divestiture as a matter of course." *E.I. du Pont*, 366 U.S. at 330.

Respondents argue that Complaint Counsel's proposed remedy is not appropriate because Complaint Counsel has not met a burden of presenting evidence relating to the effectiveness of the proposed remedy. RPTB at 158-59 (relying principally on *United States v. Microsoft*, 253 F.3d 34, 46 (D.C. Cir. 2001)). In *Microsoft*, a case brought under the Sherman Act, the Court of Appeals for the D.C. Circuit reversed the district court order of remedy based in large part on the district court's failure to take evidence concerning remedy. See *id.* at 103. However, as the *Microsoft* Court recognized, merger cases are different from monopolization cases:

By and large, cases upon which plaintiffs rely in arguing for the split of *Microsoft* have involved the dissolution of entities formed by mergers and acquisitions. On the contrary, the Supreme Court has clarified that divestiture "has traditionally been the remedy for Sherman Act violations whose heart is intercorporate combination and control," and that "complete divestiture is particularly appropriate where asset or stock acquisitions violate the antitrust laws."

*Microsoft*, 253 F.3d at 105 (citations omitted) (emphasis added). Thus, *Microsoft* is distinguishable and does not impose on Complaint Counsel the burden of presenting evidence related to the effectiveness of Complaint Counsel's proposed remedy for this violation of the Clayton Act.

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To the contrary, "it is well settled that once the Government has successfully borne the considerable burden of establishing a violation of law, all doubts as to the remedy are to be resolved in its favor." *E.I. du Pont*, 366 U.S. at 334. In a merger case, "absent clear proof, which is generally likely to come only at the compliance stage when a good faith effort to divest has been made, the presumption should be that an acquired competitive entity can be viably restored to its preacquisition status." *In re RSR Corp.*, 88 F.T.C. 800, 894 (1976), *aff'd* 602 F.2d 1317 (9th Cir. 1979).

Consistent with the Commission's "duty" to order divestiture, *Am. Stores*, 495 U.S. at 285 n.11, the Commission has held that "the burden rests with the respondent to demonstrate that a remedy other than full divestiture would adequately redress any violation which is found." *In re Fruehauf Corp.*, 90 F.T.C. 891, 892 n.1 (1977). In *In re Diamond Alkali Co.*, after stating that the most appropriate remedy to redress a Section 7 violation is "generally divestiture," the Commission held, "exceptions to the general rule can be reasonably invoked . . . only when the proof of their probable efficacy is clear and convincing." 72 F.T.C. 700, 742 (1967).

In the absence of proof to the contrary the assumption of this Commission must be that "only divestiture can reasonably be expected to restore competition and make the affected markets whole again." Moreover, if an order of divestiture appears to the Commission to be in all likelihood the most effective available remedy, the Commission need not justify its order beforehand by showing that it will unquestionably restore competition.

*Id.* (citation omitted).

The Commission has ordered divestiture of integrated assets in consummated merger cases numerous times where violations of the Clayton Act have been found. E.g., *Olin*, 113 F.T.C. at 619; *In re Crown Zellerbach Corp.*, 54 F.T.C. 769, 808 (1957), *aff'd*,

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296 F.2d 800 (9th Cir. 1961); *In re Ekco Prods. Co.*, 65 F.T.C. 1163, 1228-29 (1964), *aff'd* 347 F.2d 745 (7th Cir. 1965). In this case, Respondents have not presented compelling arguments or sufficient evidence to depart from the usual remedy of divestiture.

## 2. Divestiture is the appropriate remedy

"In section 7 cases, the principal purpose of relief is to restore competition to the state in which it existed prior to, and would have continued to exist but for, the illegal merger." *In re B.F. Goodrich*, 110 F.T.C. at 345. The foremost function of divestiture is "the liquidation of the illegally acquired market power." *United States v. Greater Buffalo Press, Inc.*, 402 U.S. 549, 556 (1971) (citing *Schine Chain Theatres v. United States*, 334 U.S. 110, 127-29 (1948)). Divestiture is limited to assets that were purchased in the illegal acquisition. *Reynolds Metals Co. v. FTC*, 309 F.2d 223, 230-31 (D.C. Cir. 1962); *Luria Bros. & Co. v. FTC*, 389 F.2d 847, 865 (3rd Cir. 1968) (An order can only be directed at assets obtained by the buyer "as a result of the illegal acquisition.").

Complaint Counsel, relying on *Ford*, 405 U.S. at 573 and n.8, urges additional equitable relief to create a viable entity that operates independently of CB&I. Nowhere does *Ford* refer to the use of such relief to increase the competitiveness of the marketplace beyond the level existing prior to the merger. Further, *Ford* concerned the equitable powers of a district court. *Id.* Specific provisions of Complaint Counsel's proposed order that are designed to force CB&I to give up any after acquired assets or to do more than "restore competition to the state in which it existed prior to . . . the illegal merger[.]" *B.F. Goodrich*, 110 F.T.C. at 345, are rejected.

The record in this case includes evidence on the structure, composition, and competitive viability of PDM and CB&I premerger, the PDM assets and personnel acquired by CB&I, and the disposition of those assets and personnel. F. 545-65. Upon consideration of the entire record in this case, divestiture is hereby ordered.

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**a. Complete divestiture**

To "ensure that the package of assets divested is sufficient to give its acquirer a real chance at competitive success," the Commission may order broad divestiture. *Olin*, 113 F.T.C. at 619-20. In *Olin*, the Commission ordered the respondent to divest a facility that manufactured the relevant product, isocyanurate (ISOS) and a product outside the relevant market, cyanuric acid (CA). The ISOS and CA facilities were located at the same plant. The respondent in *Olin* failed to introduce evidence that the facilities were separate, stand-alone operations, rather than integrated facilities that share common facilities of power, emission control, receiving and shipping, and other functions. *Id.* Because both facilities were intertwined, both were ordered to be divested. *Id.*

In the instant case, the evidence clearly establishes that PDM's EC and Water Divisions are closely interrelated. F. 566-72. The same personnel, equipment, and fabrication facilities are generally used in the construction of the products of both groups. F. 566-69. The dispositive point is that the assets of both divisions were acquired together by CB&I. F. 554-65. PDM did not find it practical or value optimizing to split the EC and Water Divisions when it evaluated the best course of action for the assets prior to the Acquisition. F. 570-72. Although only the products made by the EC Division are within the affected lines of commerce, the Water Division must be divested along with the EC Division.

**3. Relief**

The record in this case includes evidence on the assets CB&I acquired from PDM. F. 554-65. The evidence establishes that CB&I acquired intellectual property, technology and know-how and other intangible assets related to the relevant products from PDM. F. 564-65. Evidence also establishes that CB&I acquired a number of outstanding contracts from PDM. F. 563.

Upon consideration of the entire record, relief designed to restore competition as it existed prior to the Acquisition is hereby

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ordered. The attached Order, discussed below, is designed to remedy the anticompetitive effects arising from the Acquisition.

Paragraph II.A.1 orders CB&I to divest all assets, title, properties, interest, rights and privileges purchased from PDM in the Acquisition. CB&I is also ordered to divest all assets that have been purchased by CB&I to replace or maintain assets purchased in the Acquisition. See *B.F. Goodrich*, 110 F.T.C. at 344 (ordering divestiture of all additions and improvements); *Ekco*, 65 F.T.C. at 1228-29 (ordering assets acquired, together with all additions thereto and replacements therefore to be divested).

Paragraphs II.A.2-4 order CB&I to divest all intellectual property or rights to such intellectual property as were purchased by CB&I from PDM in the Acquisition. See *Ekco*, 347 F.2d at 754 (intellectual property subject to divestiture when acquired in contravention of Section 7). Any rights that CB&I acquired to the PDM name shall also be divested. See *Ford*, 405 U.S. at 574.

Paragraphs II.A.5-6 order CB&I to divest all contracts formerly held by PDM and obtained by CB&I in the Acquisition that have not been fully performed. A lag-time provision of 180 days, after the Order becomes final, is included for construction contracts. Complaint Counsel's proposed order sought the divestiture of "45% of the total combined dollar value of CB&I's Tank Business Customer Contracts." Complaint Counsel's Proposed Order ("CCPO") at II.C.3. Such requested relief would require the divestiture of assets not obtained in the Acquisition. This is not appropriate. *Luria Bros.*, 389 F.2d at 865; *Reynolds Metals*, 309 F.2d at 231 ("no basis for ordering divestiture of after acquired properties"). Accordingly, the Order does not require CB&I to divest a portion of its backlog of work or customer contracts entered into by CB&I post-acquisition.

Paragraph II.B. of the Order requires that "if at all possible, irrespective of loss suffered by CB&I, the divested assets shall be sold as a viable going concern that will enhance competition in the relevant markets." For bonding purposes, to be a viable competitor in the LNG market, a company must have a substantial

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revenue base. F. 586-90. Therefore, to comply with the Order, the Acquirer, if at all possible, must possess the necessary revenue base to actively compete in the LNG market.

The divestiture sale shall be conducted in "good faith," Paragraph II.D., and CB&I is ordered to maintain the assets to be divested, Paragraph V. In conjunction, these provisions prohibit CB&I from disclosing or making available any proprietary information regarding the divested assets to any person, except as is necessary to effect the sale.

Complaint Counsel also sought to require CB&I to transfer 45% of its total full time employees to the Acquirer. CCPO at II.F. Although educated, experienced, and knowledgeable employees are required to build the relevant products, F. 582-85, unlike other necessary assets, such as tools, building supplies, and mechanical equipment, employees are not owned by the company for which they work. Furthermore, Complaint Counsel has cited no authority supporting the proposition that at-will employees are assets that may be divested. Accordingly, this proposed measure is not included in the Order. The Order does, at Paragraph IV, preclude CB&I from granting incentives to its employees or enforcing any non-compete clauses in its employees' contracts in order to prevent its employees from transferring to the Acquiring company.

Paragraph VII orders a divestiture trustee. Complaint Counsel sought both a "monitor trustee," CCPO at V, whose responsibility would be to ensure that Respondents comply with the terms of the Order; and a "divestiture trustee," CCPO at VI, who would be appointed to accomplish the divestiture, in the event that CB&I fails to divest in the manner and time required by the Order. Complaint Counsel has failed to cite any litigated case where a monitor trustee has been ordered. Although monitor trustees have been used recently to monitor compliance with divestiture agreements where respondents have entered into consent decrees with the FTC, e.g., *Solvay*, 2002 FTC LEXIS 34, \*47 (2002), *America Online, Inc.*, 2001 FTC LEXIS 44, \*37 (2001), this is not persuasive. *E.I. du Pont*, 366 U.S. at 330 n.12 ("the

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circumstances surrounding . . . negotiated [consent decrees] are so different that they cannot be persuasively cited in a litigation context"). A contingent divestiture trustee is ordered; a monitor trustee is not.

Complaint Counsel sought to require CB&I to provide technical assistance and administrative services to the Acquirer. CCPO at II.I-J. Requiring technical assistance and administrative services may provide an opportunity for anticompetitive behavior. In addition, Complaint Counsel did not demonstrate that technical assistance or administrative services are not available from a source other than CB&I. These assets were not expressly acquired by CB&I in the Acquisition. (See CX 328). Therefore, the Order does not require this relief.

Complaint Counsel did not seek to prohibit Respondents from future acquisitions of all or any part of the stock or assets of, or any interest in, any producer of the relevant products. Therefore, such a prohibition is not included in the Order.

**IV. SUMMARY OF CONCLUSIONS OF LAW**

1. The Federal Trade Commission ("FTC") has jurisdiction over the subject matter of this proceeding and over Respondents Chicago Bridge & Iron Company, N.V., Chicago Bridge and Iron Company, and Pitt-Des Moines, Inc. ("PDM"), pursuant to Section 5 of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 45, and Sections 7 and 11 of the Clayton Act, 15 U.S.C. §§ 18, 21(b).

2. Chicago Bridge & Iron Company N.V., and Chicago Bridge & Iron Company, a corporation (collectively, "CB&I") is a corporation, as "corporation" is defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44.

3. Respondents were engaged in commerce, as "commerce" is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12, and affected commerce, as "commerce" is defined in Section 4 of the FTC Act, as amended, 15 U.S.C. § 44.

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4. On or about February 7, 2001, CB&I acquired PDM's Water and Engineered Construction ("EC") Divisions, ("the Acquisition"). The Acquisition is a transaction subject to Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the FTC Act, 15 U.S.C. § 45.

5. Section 7 of the Clayton Act prohibits any acquisition of stock or assets "where in any line of commerce . . . in any section of the country, the effect of such acquisition may be substantially to lessen competition or to tend to create a monopoly." 15 U.S.C. § 18.

6. Section 7 of the Clayton Act is designed to arrest in its incipency the substantial lessening of competition from the acquisition by one corporation of the assets of a competing corporation. Section 7 does not require proof from Complaint Counsel that a merger has caused higher prices in the affected market. To satisfy Section 7, Complaint Counsel need only show a reasonable probability that the proposed transaction would substantially lessen competition in the future.

7. The appropriate lines of commerce within which to evaluate the probable competitive effects of the Acquisition are: large, field-erected: (1) liquefied natural gas ("LNG") storage tanks (individually, or as a component of an import terminal or a LNG peak shaving plant); (2) refrigerated liquid petroleum gas ("LPG") storage tanks; (3) liquid nitrogen, oxygen and argon ("LIN/LOX") storage tanks; and (4) large (over 20 feet in diameter) thermal vacuum chambers ("TVCs").

8. The appropriate section of the country within which to evaluate the probable competitive effects of the Acquisition is the United States.

9. The government has the burden of showing that the Acquisition would produce a firm controlling an undue percentage share of the relevant markets and would result in a significant increase in the concentration of the firms in those markets. A merger which significantly increases the share and



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concentration of firms in the relevant markets is so inherently likely to lessen competition that it is considered presumptively invalid.

10. Complaint Counsel established its prima facie case by showing that the Acquisition produces a firm controlling an undue percentage share in each of the four relevant markets. Complaint Counsel established that CB&I and PDM were the number one and two competitors in all four product markets and that no other company provides effective competition.

11. Finding a prima facie violation of Section 7 creates a rebuttable presumption of anticompetitive effects and shifts the burden of going forward with evidence to Respondents. Respondents have the burden of producing evidence that shows that the market share statistics supporting the prima facie case give an inaccurate account of the Acquisition's probable effects on competition.

12. Respondents have not demonstrated that the market share statistics give an inaccurate prediction of the Acquisition's probable effects on competition.

13. Respondents may rebut the prima facie case by demonstrating that entry by other firms would likely avert the Acquisition's probable effects on competition by acting as a constraint on CB&I's exercise of market power. Respondents may rebut the prima facie case by demonstrating that barriers to entry are so low that the threat of entry can significantly alter the anticompetitive effects of the merger by deterring the remaining entities from exercising market power.

14. Respondents have not demonstrated that actual or potential entrants constrain CB&I's exercise of market power. Due to high barriers, entry by new manufacturers or the expansion of existing manufacturers is not likely to avert the anticompetitive effects of the Acquisition in the relevant markets.

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15. Respondents have not produced any significant evidence rebutting the presumption of a violation of Section 7 of the Clayton Act.

16. Because Respondents did not produce evidence sufficient to rebut the presumption of a violation of Section 7 of the Clayton Act, the burden of producing further evidence of anticompetitive effects did not shift to Complaint Counsel.

17. Respondents have presented an exiting assets defense. To the extent that an exiting assets defense is a valid defense, Respondents have not demonstrated that PDM EC's assets would have left the market in the near future or that PDM had conducted an exhaustive effort to sell the EC Division to a company other than CB&I.

18. The Acquisition is likely to increase CB&I's ability to raise prices unilaterally in the relevant markets because the Acquisition eliminates competition from PDM, CB&I's closest competitor. The Acquisition is a merger involving the first and second lowest-cost sellers which could cause prices to rise to the constraining level of the next lowest-cost seller.

19. The Acquisition violates Section 7 of the Clayton Act because "the effect of such acquisition may be substantially to lessen competition or to tend to create a monopoly." 15 U.S.C. § 18. The Acquisition also constitutes an unfair method of competition in or affecting commerce in violation of Section 5 of the FTC Act. 15 U.S.C. § 45.

20. Complaint Counsel met its burden of proof in support of Count I and Count II of the Complaint.

21. Divestiture is the proper remedy.

22. Complete divestiture of all assets acquired in the Acquisition is required to restore competition as it existed prior to the Acquisition.

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23. Relief designed to restore competition as it existed prior to the Acquisition is appropriate.

24. The Order entered hereinafter is necessary and appropriate to remedy the violations of law found to exist.

**ORDER****I.**

**IT IS HEREBY ORDERED** that for the purposes of this Order, the following definitions shall apply:

A. "Acquirer" means an entity approved by the Commission who purchases the assets divested, pursuant to this Order.

B. "Acquisition" means the transaction consummated on February 7, 2001, whereby CB&I purchased PDM's Water and Engineered Construction ("EC") Divisions.

C. "CB&I" means Chicago Bridge & Iron Company N.V. and Chicago Bridge & Iron Company, individually and collectively.

D. "Chicago Bridge & Iron Company N.V." means Chicago Bridge & Iron Company, N.V.; its directors, officers, employees, agents and representatives, predecessors, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by Chicago Bridge & Iron Company N.V.; and the respective directors, officers, employees, agents and representatives, successors, and assigns of each.

E. "Chicago Bridge & Iron Company" means Chicago Bridge & Iron Company; its directors, officers, employees, agents and representatives, predecessors, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by Chicago Bridge & Iron Company; and the respective directors, officers, employees, agents and representatives, successors, and assigns of each.

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F. "Commission" means Federal Trade Commission.

G. "Divestiture Trustee" means a person, with experience and expertise in acquisitions and divestitures, appointed by the Commission to effect the divestiture requirements of this Order.

H. "PDM" means Pitt-Des Moines, Inc.; its directors, officers, employees, agents and representatives, predecessors, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by Pitt-Des Moines, Inc.; and the respective directors, officers, employees, agents and representatives, successors, and assigns of each.

**II.**

**IT IS FURTHER ORDERED** that:

A. No later than one hundred and eighty (180) days from the date that this Order becomes final, CB&I shall completely divest all assets, title, properties, interest, rights and privileges, of whatever nature, purchased from PDM in the Acquisition. This divestiture shall be complete and shall include, but is not limited to, all buildings, machinery, equipment, raw material reserves, inventory, customer lists, trade names, trademarks, patents, and any other assets, of whatever description, that were acquired by CB&I from PDM in the Acquisition.

1. Complete divestiture shall include any assets that have been purchased by CB&I to replace or maintain assets purchased in the Acquisition.

2. Complete divestiture shall include any intellectual property or any rights to intellectual property as were purchased by CB&I from PDM in the Acquisition. Any rights acquired by CB&I to the "Pitt-Des Moines," "PDM," "Pitt-Des Moines EC," "PDM EC," "Pitt-Des Moines Water," and "PDM Water" names or any other variation of these names shall be divested.

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3. Complete divestiture shall include a worldwide, royalty-free, perpetual, irrevokable, transferable, sublicensable, non-exclusive license to all intellectual property that was (1) created in part by former PDM employees who became employed by CB&I as a result of the Acquisition or (2) was premised in part upon intellectual property formerly owned by PDM and transferred to CB&I in the Acquisition.

4. Complete divestiture shall include a worldwide, royalty-free, perpetual, irrevokable license to any intellectual property owned by CB&I that would block Acquirer's legal use of the intellectual property that shall be required to be licensed to Acquirer, pursuant to Paragraph II.A.3 of this Order.

5. Complete divestiture shall include the assignment of all construction contracts formerly held by PDM and obtained by CB&I in the Acquisition that have not been fully performed by CB&I one hundred and eighty (180) days after this Order becomes final. Acquirer shall compensate CB&I in quantum meruit for any work completed under these contracts by CB&I prior to assignment. If a third party's consent must be obtained to assign any of these contracts, CB&I must use all available means, in good faith, to obtain such consent.

6. Complete divestiture shall include all non-construction contracts formerly held by PDM and obtained by CB&I in the Acquisition that have either not been fully performed by CB&I or that have not yet expired. These contracts include, but are not limited to, sales representative agreements, cooperation agreements, license agreements, partnership agreements, term employment contracts, and leases. If a third party's consent must be obtained to assign any of these contracts, CB&I must use all

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available means, in good faith, to obtain such consent.

B. If at all possible, irrespective of loss suffered by CB&I, the divested assets shall be sold as a viable going concern that will enhance competition in the relevant markets.

C. Prior to the execution of the divestiture sale, a full accounting of all assets purchased in the Acquisition shall be provided to the Commission. The accounting shall disclose the approximate value, both at the time of the Acquisition and at the time that this Order becomes final; the current location; and the current condition of all of the assets purchased in the Acquisition. In the event that an asset is no longer in the possession of CB&I, any consideration received for the sale of such an asset shall be disclosed.

D. The divestiture sale shall be conducted in good faith, at no minimum price, and in compliance with the laws of the United States. The Acquirer, a divestiture agreement, and the manner of the sale must be approved by the Commission prior to the execution of the divestiture sale. The divestiture agreement shall not vary from or contradict, or be interpreted to vary from or contradict, the terms of this Order.

E. The divested assets shall not be sold or transferred, directly or indirectly, to any entity that at the time that this Order becomes final is a substantial stockholder, officer, director, employee, agent of, or otherwise directly or indirectly connected with or under the control or influence of CB&I.

**III.**

**IT IS FURTHER ORDERED** that CB&I shall comply with all terms of the divestiture agreement to be approved by the Commission, pursuant to Paragraph II.D of this Order. The divestiture agreement shall be deemed incorporated by reference into this Order, and any failure by CB&I to comply with the terms of the divestiture agreement shall constitute a failure to comply

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with this Order.

#### IV.

**IT IS FURTHER ORDERED** that CB&I shall, from the date that this Order becomes final and extending for a period of two (2) years after the divestiture required by Paragraph II.A of this Order is completed: (1) not offer or provide any incentive to any employee of CB&I to decline employment with the Acquirer; (2) waive any non-compete clauses in CB&I employees' contracts that would prevent such employees from seeking employment with the Acquirer.

#### V.

**IT IS FURTHER ORDERED** that from the date that this Order becomes final, until such time as the divestiture required by Paragraph II.A of this Order is completed, CB&I shall take all measures necessary to maintain all assets ordered to be divested in their accounted for condition and to prevent any further deterioration, except normal wear and tear, so as to not impair the assets' operating viability, marketability, or confidentiality, if applicable.

#### VI.

**IT IS FURTHER ORDERED** that:

A. CB&I shall, within sixty (60) days from the date that this Order becomes final and every sixty (60) days thereafter, for one (1) year from the date that the divestiture required by Paragraph II.A of this Order is completed, submit in writing to the Commission a verified compliance report. Each report shall set forth, in detail, the manner and form in which CB&I intends to comply, is complying, or has complied with each of the requirements of this Order.

B. CB&I shall include in the compliance reports, among other relevant information requested by the Commission, a description

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of all substantive contracts or negotiations relating to the divestiture, both oral and written; the identity of all potential Acquirers; copies of all written communications (including email) to and from such entities regarding the divestiture; internal documents and communications relating to the divestiture; and a statement that the provisions of this Order have been and are being fully complied with.

**VII.**

**IT IS FURTHER ORDERED** that:

A. If CB&I has not fully complied with Section II.A of this Order within one hundred and eighty (180) days of this Order becoming final, the Commission may, at its discretion and at any time thereafter, appoint a Divestiture Trustee to fulfill the requirements of Paragraph II.A. This provision by no means hinders either the Commission or the U.S. Attorney General from seeking civil penalties or a court-appointed trustee for any violation of this Order by CB&I.

B. If a Divestiture Trustee is appointed, that Divestiture Trustee shall have the following powers, duties, authority, and responsibilities:

1. Subject to the prior approval of the Commission, the Divestiture Trustee shall have the exclusive authority to effect the divestiture, in accordance with the requirements of this Order, for which the Divestiture Trustee has been appointed.
2. Within ten (10) days of the Divestiture Trustee's appointment, CB&I shall grant the Divestiture Trustee, with the prior approval of the Commission, all of the rights and powers necessary to effect the divestiture for which the Divestiture Trustee has been appointed.



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3. The Divestiture Trustee shall have twelve (12) months, from the date that the Commission approves the grant of rights and powers, to complete the divestiture in accordance with this Order. This temporal duration may be extended for good cause or extenuating circumstances with the consent of the Commission.

4. CB&I shall provide the Divestiture Trustee with full and complete access to personnel, books, records, facilities, or any other information that is related to the assets ordered to be divested. CB&I shall cooperate with the Divestiture Trustee in good faith and comply with any reasonable requests for the production of additional relevant information. Should CB&I delay or hinder the Divestiture Trustee, the duration of time lost due to the delay or hindrance shall be credited to the twelve-month temporal deadline for completion of the divestiture.

5. Best efforts shall be used by the Divestiture Trustee to negotiate the most favorable price and terms available for the assets being divested; but at the same time, the Divestiture Trustee shall seek to submit the proposed sales contracts to the Commission as promptly as possible at no minimum price. If the Divestiture Trustee receives good faith offers from more than one eligible potential Acquirer, and if the Commission approves more than one of these entities, the Divestiture Trustee shall divest the assets to the Acquirer that is selected by CB&I from those approved by the Commission. However, if CB&I does not respond within five (5) business days to the Commission's request for such a selection, the Divestiture Trustee shall have complete discretion in choosing the Acquirer from those entities approved by the Commission.

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6. The Divestiture Trustee shall serve without bond or other security, at the cost and expense of CB&I, on such reasonable and customary terms and conditions as the Commission may set. The Divestiture Trustee shall have the authority to employ, at the cost and expense of CB&I, such consultants, accountants, attorneys, investment bankers, business brokers, appraisers, and other representatives and assistants as are necessary to carry out the Divestiture Trustee's duties and responsibilities. The Divestiture Trustee shall account for all consideration derived from the sale and all expenses incurred. Upon approval by the Commission of the Divestiture Trustee's accounting, all remaining fees and expenses shall be paid and the remainder of the consideration shall be distributed at the discretion of CB&I. Following the final distribution, the Divestiture Trustee's power and authority shall be terminated.

7. CB&I shall indemnify and hold the Divestiture Trustee harmless against any losses, claims, damages, liabilities, or expenses arising out of or in connection with the performances of the Divestiture Trustee's duties. This indemnification shall include all reasonable fees for counsel and other expenses incurred in connection with the preparation for or defense of any claim, whether or not resulting in any liability, except to the extent that such liabilities, losses, damages, claims, or expenses result from gross negligence or willful misconduct by the Divestiture Trustee. This indemnification shall be inclusive of all agents of or entities retained by the Divestiture Trustee, pursuant to Paragraph VII.B.6 of this Order.

8. The Commission may appoint a substitute in the event that the Divestiture Trustee fails to perform in a diligent manner, acts with gross negligence, or engages in willful misconduct.

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9. The Divestiture Trustee shall have no obligation or authority to operate or maintain the assets ordered to be divested.

10. The Divestiture Trustee shall report to the Commission, in writing, every sixty (60) days to inform it of the Divestiture Trustee's efforts to complete the ordered divestiture.

C. The Commission may, at the request of the Divestiture Trustee, issue such additional orders or directions, within the scope of this Order, as may be necessary or appropriate to further the completion of the divestiture.

**VIII.**

**IT IS FURTHER ORDERED** that CB&I shall provide a copy of this Order to each of CB&I's officers, employees, or agents possessing managerial responsibility relating to any of the provisions contained in this Order, no later than ten (10) days after the date that this Order becomes final.

**IX.**

**IT IS FURTHER ORDERED** that CB&I shall notify the Commission at least thirty (30) days prior to any proposed change in the corporate structure or financial condition of CB&I that could affect compliance with the requirements of this Order, including, but not limited to, dissolution, assignment, sale, merger, sale or dissolution of subsidiaries, or bankruptcy.

**X.**

**IT IS FURTHER ORDERED** that, for the purpose of determining or securing compliance with this Order, subject to any legally recognized privilege, and upon written request with reasonable notice, CB&I shall permit any authorized agent of the Commission:

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A. Access, during office hours and in the presence of counsel, to all relevant facilities and documents. Such documents that may be inspected and copied include, but are not limited to, non-privileged books, ledgers, accounts, and correspondence memoranda that are in the possession of or under the control of CB&I and relate to any matter contained in this Order.

B. Access to interview CB&I's officers, directors, or employees who may possess information relevant to any matter contained in this Order. Counsel may be present for such interviews.

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**INITIAL DECISION**

By D. Michael Chappell, Administrative Law Judge

**I. INTRODUCTION****A. Federal Trade Commission Complaint**

The Federal Trade Commission ("FTC") issued its Complaint in this matter on October 25, 2001. The Complaint charges that Chicago Bridge & Iron Company N.V., a foreign corporation, Chicago Bridge & Iron Company, a corporation (collectively, "CB&I") and Pitt-Des Moines, Inc. ("PDM"), a corporation, entered into an agreement in violation of Section 5 of the Federal Trade Commission Act ("FTC Act"), as amended. 15 U.S.C. § 45. The Complaint alleges that on or about February 7, 2001, CB&I acquired, pursuant to agreement with PDM, PDM's Water Division and Engineered Construction ("EC") Division for approximately \$ 84 million ("the Acquisition"). The Complaint alleges that the relevant geographic market is the United States as a whole and that the relevant product markets are large, field-erected: (1) liquefied natural gas ("LNG") storage tanks (individually, or as a component of an import terminal or a LNG peak shaving plant); (2) refrigerated liquid petroleum gas ("LPG") storage tanks; (3) liquid nitrogen, oxygen and argon ("LIN/LOX") storage tanks; and (4) thermal vacuum chambers ("TVCS").

The Complaint charges two violations. Count I alleges the effect of the Acquisition may be substantially to lessen competition or tend to create a monopoly in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the FTC Act. Count II alleges that CB&I and PDM ("Respondents"), through the Acquisition and the Acquisition agreement have engaged in unfair methods of competition in or affecting commerce in violation of Section 5 of the FTC Act.

**B. Respondents' Answers**

Following the issuance of the Complaint, the parties filed

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three joint motions seeking extensions of time for Respondents to file the Answer to the Complaint. In each motion, the parties represented an extension was needed in order for the parties to pursue settlement of this action. CB&I and PDM each filed an Answer on February 4, 2002. Respondents denied most of the allegations of the Complaint. CB&I admitted that on February 7, 2001, CB&I completed its acquisition of certain assets of PDM related to its Water Division and Engineered Construction Division. Respondents asserted that the Acquisition has caused a repositioning, which has given an incentive to previously dormant competitors to invest in this business to attempt to replace PDM as a bidder in the relevant markets.

### **C. Procedural History**

On August 29, 2000, CB&I and PDM entered into a letter of intent for CB&I to acquire PDM's Engineered Construction and Water Divisions. Respondents made their filings under the Hart-Scott-Rodino Act ("HSR"), 15 U.S.C. § 18a, on September 12, 2000. The initial waiting period under HSR expired on October 12, 2000.

The FTC did not seek a preliminary injunction in a U.S. district court, pursuant to Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), to halt CB&I's impending acquisition. On February 7, 2001, CB&I completed its acquisition of certain assets of PDM's Water Division and Engineered Construction Division.

On October 25, 2001, the FTC issued its Complaint. After extensive pretrial discovery, the administrative trial in this case commenced on November 12, 2002. By Order signed on June 18, 2002 by the previous Administrative Law Judge in this litigation, Respondents' motion for a 60 day extension was granted, extending the deadline for filing the Initial Decision to December 25, 2002. By Order issued December 17, 2002, because the trial in this matter was then still proceeding, an additional 60 day extension was granted, extending the deadline for filing the Initial Decision to February 24, 2003.

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The administrative trial concluded on January 16, 2003. On January 21, 2003, the parties filed a joint motion to extend the deadline for filing the Initial Decision. By Order dated January 28, 2003, extraordinary circumstances were found to exist sufficient to extend the deadline for filing the Initial Decision by an additional 60 days, to April 28, 2003. The January 28, 2003 Order also revised the post trial briefing schedule and closed the hearing record pursuant to Commission Rule 3.44(c). On April 24, 2003, in response to a request made pursuant to Commission Rule 3.51(a), the Commission issued an Order extending the time to file the Initial Decision until June 12, 2003.

**D. Evidence**

The Initial Decision is based on the transcript of the testimony, the exhibits properly admitted in evidence, and proposed findings of fact and conclusions of law and replies thereto filed by the parties. Citations to specific numbered Findings of Fact in this Initial Decision are designated by "F."

The parties submitted extensive post-trial briefs and reply briefs. The Initial Decision addresses only material issues of fact and law. Proposed findings of fact not included in the Initial Decision were rejected, either because they were not supported by the evidence or because they were not dispositive to the determination of the allegations of the Complaint. The Commission has held that Administrative Law Judges are not required to discuss the testimony of each witness or all exhibits that are presented during the administrative adjudication. In *re Amrep Corp.*, 102 F.T.C. 1362, 1670 (1983). Administrative adjudicators are "not required to make subordinate findings on every collateral contention advanced, but only upon those issues of fact, law, or discretion which are 'material.'" *Minneapolis & St. Louis Ry. Co. v. United States*, 361 U.S. 173, 193-94 (1959).

On March 7, 2003, Respondents filed a motion to strike, seeking an order striking certain exhibits that were never admitted into evidence and striking a number of Complaint Counsel's Proposed Findings of Fact ("CCPFF") from the record. Complaint

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Counsel filed its opposition to the motion to strike on March 13, 2003. By separate Order issued June 12, 2003, Respondents' motion was granted. For the reasons set forth in that Order, proposed findings of fact that fail to cite any evidence or that cite to documents, graphs, or charts not in evidence have been disregarded.

Many of the documents and parts of the oral testimony were received into the record in camera. Where an entire document or where certain trial testimony was given in camera treatment, but the portion of the document or the trial testimony utilized in this Initial Decision does not rise to the level necessary for in camera treatment, such information is disclosed in the public version of this Initial Decision, pursuant to Commission Rule 3.45(a) (the ALJ "may disclose such in camera material to the extent necessary for the proper disposition of the proceeding"). Material that has been given in camera treatment is indicated in bold font and brackets in the in camera version and is redacted from the public version of the Initial Decision, in accordance with 16 C.F.R. § 3.45(f).

### **E. Summary**

As fully set forth below, Complaint Counsel has established by reliable and probative evidence that the effect of the Acquisition of PDM's EC and Water Divisions by CB&I may be to substantially lessen competition in the relevant markets. CB&I's asserted exiting assets defense fails as a matter of fact and law. Complaint Counsel has met its burden of proof on Count I and Count II of the Complaint. The appropriate remedy is divestiture.

## **II. FINDINGS OF FACT**

### **A. Respondents**

#### **1. Chicago Bridge and Iron**

1. Respondent Chicago Bridge & Iron Company N.V. is a



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foreign corporation organized and existing under the laws of the Netherlands, with its principal place of business at Polarisavenue 31, 2132 JH Hoofddorp, The Netherlands. (Complaint P1; Answer P1).

2. Respondent Chicago Bridge & Iron Company ("CB&I"), a wholly owned subsidiary of Chicago Bridge & Iron Company N.V., is a corporation, as "corporation" is defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44, organized and existing under the laws of the State of Delaware, with its principal place of business at 1501 North Division Street, Plainfield, Illinois 60544. (Complaint P2; Answer P2).

3. Among other products and services, CB&I is engaged in the business of designing, engineering, manufacturing and constructing field-erected LNG, LPG and LIN/LOX storage tanks and TVCs in the United States and abroad. (CX 1033 at 6; CX 212 at CBI-PL 031711).

4. In 1999, prior to the merger, CB&I had revenues of \$ 674 million; in 2000, revenues were \$ 612 million; in 2001, after the merger with PDM, revenues were approximately \$ 1.081 billion. (CX 1033 at 22). CB&I's acquisition of Howe Baker, Inc. (a process contractor operating in gas refining and processing) in December 2000 accounts for an increase in CB&I's revenues. (Glenn, Tr. 4086, 4403-05).

5. CB&I's acts and practices, including the acts and practices alleged in the Complaint, are in or affect commerce as "commerce" is defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44. (Complaint P7; CB&I Answer at P7).

## **2. Pitt-Des Moines**

6. Pitt-Des Moines, Inc. ("PDM") was a corporation organized and existing under the laws of the Commonwealth of Pennsylvania, publicly traded on the American Stock Exchange, with its principal place of business at 1450 Lake Robbins Drive,

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Suite 400, the Woodlands, Texas, 77380. (CX 328 at CBI 001253-CHI; CX 21 at PDM-C 1000003; Byers, Tr. 6732). PDM's headquarters was located at 10200 Grogan's Mill Road, Suite 300, the Woodlands, Texas, 77380. (CX 661 at PDM-HOU017554).

7. In 1999, PDM had a total revenue of \$ 629 million and Earnings Before Interest and Taxes ("EBIT") of \$ 41 million. (CX 520 at TAN 1003289; Scheman, Tr. 2915-16). In 2000, PDM had a total revenue of \$ 659 million and EBIT of \$ 76 million. (CX 520 at TAN 1003289; Scheman, Tr. 2915-16). In 1999, PDM's EC and Water Divisions had total revenues of \$ 281 million and EBIT of \$ 16.1 million. (CX 525 at TAN 1000385). In 2000, PDM's EC and Water Divisions had total revenues of \$ 268 million and EBIT of \$ 0.7 million. (CX 525 at TAN 1000385).

8. Prior to the Acquisition, PDM was a diversified company with several divisions, two of which were PDM Engineered Construction (PDM EC) and PDM Water. Both divisions were acquired by CB&I. (CX 328 at CBI 001253-CHI).

9. Among other products and services, PDM was engaged in the business of designing, engineering, manufacturing and constructing field-erected LNG, LPG and LIN/LOX storage tanks and TVCs in the United States and abroad. (CX 522 at TAN 1003371; CX 850 at PDM-HOU 0129192-0129195, 0129199; CX 911 at CBI 028717-HOU -028726).

### **B. The Acquisition**

10. In August 2000, CB&I offered \$ 93.5 million to PDM. (CX 521 at TAN 1000328). On August 29, 2000, CB&I and PDM entered into a letter of intent for CB&I to acquire PDM's Engineered Construction and Water Divisions. (CX 21 at PDM-C 1000003).

11. CB&I's initial offer of \$ 93.5 million to PDM was negotiated downward to \$ 84 million in December of 2000 because of financial losses suffered by PDM EC in 2000. (Byers,

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Tr. 6789-90). CB&I's purchase price of \$ 84 million was eventually lowered to approximately \$ 76 to \$ 77 million because of losses in PDM's foreign subsidiary, PDM Venezuela, that did not become apparent until after the transaction was consummated. (Byers, Tr. 6793-94).

12. Respondents made their filings under the Hart-Scott-Rodino Act ("HSR") on September 12, 2000. (CX 56 at PDM-HOU 002331). The initial waiting period under HSR expired on October 12, 2000. (CX 56 at PDM-HOU 002331). The Federal Trade Commission did not seek an injunction to prevent CB&I from purchasing PDM EC and PDM Water. On February 7, 2001, CB&I acquired PDM EC and PDM Water ("the Acquisition"). (Byers, Tr. 6764-66).

13. The Complaint in this matter was filed on October 26, 2001. On November 12, 2002, the administrative trial began before D. Michael Chappell, Administrative Law Judge. (Tr. 4).

### **C. The Relevant Geographic Market**

14. The relevant geographic market is the United States. F. 15-17.

15. The parties agree that the relevant geographic market in which to analyze the merger is the United States. (Respondents' Position on Each Element of the Case, October 21, 2002, p.1). Complaint Counsel's expert, Dr. John Simpson, and Respondents' expert, Dr. Barry Harris, agree that the relevant geographic market in which to assess the impact of the Acquisition is the United States. (Simpson, Tr. 3035 (LNG); Harris, Tr. 7192 (LNG); Simpson, Tr. 3361-62 (LPG) (citing CX 116); Harris, Tr. 7280 (LPG); Simpson, Tr. 3421 (LIN/LOX); Harris, Tr. 7300-01 (LIN/LOX); Simpson, Tr. 3488 (TVC); Harris, Tr. 7324 (TVC)).

16. By definition, field-erected LNG, LPG and LIN/LOX storage tanks and TVCs must be built at customers' sites in the United States. "LNG tanks are purchased as part of a larger facility that is designed to supply natural gas to gas users in a

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particular area. As a consequence, the LNG tanks have to be located in a particular locality." (Simpson, Tr. 3034). "LIN/LOX/LAR tanks are purchased as part of a facility that makes liquefied gas, and those facilities are built close to a customer." (Simpson, Tr. 3420).

17. It is economically infeasible to import a field-erected storage tank from anywhere outside the United States. (Kistenmacher, Tr. 840, 881).

#### **D. The Relevant Product Markets**

18. The relevant product markets in which to analyze the Acquisition are large, field-erected: (1) liquefied natural gas ("LNG") storage tanks (individually, or as a component of an import terminal or an LNG peak shaving plant); (2) refrigerated liquid petroleum gas ("LPG") storage tanks; (3) liquid nitrogen, oxygen and argon ("LIN/LOX") storage tanks; and (4) large (over 20 feet in diameter) TVCs ("TVCs"). F. 19-45.

19. Respondents agree that the relevant product markets are field-erected LNG storage tanks, LPG storage tanks, and LIN/LOX storage tanks, and TVCs. (Respondents' Position on Each Element of the Case, October 21, 2002, p.1). Complaint Counsel's expert, Dr. John Simpson, and Respondents' expert, Dr. Barry Harris, agree on the relevant product markets, except that Dr. Harris believes that spheres should not be included in the LIN/LOX market. (Harris, Tr. 7301-02, 7192-95, 7280, 7324). (Simpson, Tr. 2989 (LNG); Harris, Tr. 7192 (LNG); Simpson, Tr. 3356-57 (LPG); Harris, Tr. 7280 (LPG); Simpson, Tr. 3416-17 (LIN/LOX); Harris, Tr. 7300 (LIN/LOX); Simpson, Tr. 3483 (TVC); Harris, Tr. 7324 (TVC)).

#### **1. LNG tanks and facilities**

20. Liquefied natural gas ("LNG") is natural gas that has been converted to a liquid by cooling and condensing the natural gas to about -162 [degrees] C (-260 [degrees] F). (Glenn, Tr. 4066; CX 1259 at CBI-HWH030454). LNG is composed primarily of

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methane (typically at least 90%), but may also contain ethane, propane and heavier hydrocarbons. (Kistenmacher, Tr. at 889; CX 1259 at CBI-HWH030464). Neither LNG, nor its vapor, can explode by common ignition sources in an unconfined environment. (CX 1259 at CBI-HWH030469). LNG weighs approximately 45% as much as the same volume of water. (See CX 1259 at CBI-HWH030465).

**a. LNG tanks**

21. LNG storage tanks are a type of cryogenic tank that stores natural gas at a temperature of -260 [degrees] F. (Kistenmacher, Tr. 879; CX 1074 at CBI-001243-PLA). Due to these very cold temperatures, LNG storage tanks are made of 9% nickel steel which has certain crack arresting properties when containing LNG at low temperatures, and is less brittle than carbon steel. (Kistenmacher, Tr. 881-82; CX 1074 at CBI-001245-PLA; Glenn, Tr. 4109-10).

22. The purpose of an LNG tank is to contain natural gas in liquid form. (Glenn, Tr. 4066; Price, Tr. 530). When stored at ambient temperatures (i.e. room temperature), natural gas takes a gaseous form. (CX 1259 at CBI-HWH030454). When liquefied, natural gas is far easier to store, as natural gas in gaseous form takes up 600 times the volume of its liquid equivalent. (CX 1259 at CBI-HWH030454).

23. LNG tanks typically are double-walled and often use perlite insulation between the two shells and may have some form of concrete containment for safety reasons. (Glenn, Tr. 4110; Kistenmacher, Tr. 881-82; CX 1074 at CBI-001243-PLA). The outer walls of single containment tanks are carbon steel and the inner walls are nine percent nickel steel. (CX 1074 at CBI-001243-PLA).

24. An LNG tank often has a diameter of 200 feet or more and can store millions of gallons of LNG. (Price, Tr. 524-525; Kistenmacher, Tr. 879; CX 176 at CBI-PL010926, in camera; CX 162 at CBI-PL006153; Puckett, Tr. 4566; J. Kelly, Tr. 6260).

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**b. LNG import terminals**

25. LNG import terminals are "facilities to receive an LNG tanker, offload LNG into LNG storage tanks, take the LNG from those storage tanks over time, vaporize it, pressurize the gas, and send it out into a pipeline." (Bryngelson, Tr. 6170). The terminals include storage tanks, ship loading/unloading facilities, send-out facilities and vapor handling systems. (CX 650 at CBI/PDM-H4019758). LNG is stored in the tanks, pumped out, vaporized and injected into pipelines for transmission to end users. (CX 853 at PDM-HOU011487).

**c. LNG peak shaving plants**

26. LNG peak shaving plants store LNG to provide an emergency reserve of LNG in the event that gas customers experience a severe shortage of natural gas. (CX 650 at CBI/PDM-H4019758). LNG peak shaving plants consist of a liquefaction unit, where the gas is turned into liquid, and LNG storage tanks. (Kistenmacher, Tr. 884-85). In LNG peak shaving facilities, natural gas from a pipeline is refrigerated in the liquefaction unit and stored in liquid form in an LNG tank during the warmer months when demand and prices are low. (CX 142 at CBI 000241-HOU). As gas demand increases in colder months, the stored LNG is heated, vaporized and put back into the supply stream to meet heating demand peaks, when prices are high. (CX 142 at CBI 000241-HOU; Hall, Tr. 1775-1776).

27. LNG tanks in peak-shaving facilities are similar to, but tend to be smaller than, LNG tanks used at import terminals. (Glenn, Tr. 4070; Bryngelson, Tr. 6141-42).

28. Luke Scorsone, President of CB&I Industrial and former President of PDM-EC, could not cite a single instance in which a potential customer of an LNG tank tried to get a lower price by threatening to switch to an alternative to an LNG tank. (Scorsone, Tr. 2845).

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29. The large tanks required for LNG storage are much too large to practically shop-fabricate and ship to the site. (Andrukiewicz, Tr. 6697-98). Shop-fabricated tanks cannot provide the storage levels required for LNG facilities. A shop-fabricated tank provides less than 1% of the storage that a field-erected LNG tank provides. (RX 6 at CBI-PL 031593). Shop-built tanks have size limitations and are "not a direct substitute for larger quantities of LNG." (Davis, Tr. 3184). LNG tanks designed to hold above a certain volume of LNG must be field-erected. (Blaumueller, Tr. 287). The largest shop-built tanks "would pale in comparison to field tanks." (Davis Tr. 3184-85). For example, 420 shop erected tanks would be required to replace one large LNG tank. (Price, Tr. 536-37).

**2. LPG tanks**

30. Liquid petroleum gas ("LPG") tanks are field-erected, refrigerated tanks that store liquefied gases such as propane, butane, propylene and butadiene at refrigerated temperatures of around -50 [degrees] F. (Warren, Tr. 2275, 2306; CX 258 at CBI-H001793; CX 650 at CBI/PDM-H 4019758; CX 993 at PDM-HOU021479).

31. The LPG market does not include pressure vessels or tanks which store gases that are liquified using pressure and stored at ambient temperatures. There are two types of high pressure storage tanks used to store liquid petroleum gasses -- bullets and field-erected pressure spheres. Bullets are ambient temperature, low pressure spheres or storage vessels that are usually built in a shop. Pressure spheres are ambient temperature pressure vessels supported by columns or plate skirts. (JX 37 at 19 (Newmeister, Dep.)). These two types of storage tanks are not in the LPG market because they are not economic substitutes for field-erected, refrigerated tanks (which comply with the API 620, Appendix R standard). (JX 27 at 39-39, 141-42 (N. Kelley, Dep.); Crider, Tr. 6720).

32. LPG customers are oil and petrochemical companies, such as Marathon, Enron, and Texaco; owners of LPG terminals, such

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as Sea-3, CMS Energy, and Intercontinental Terminals Co., that import/export LPG and transfer the LPG between ships and storage tanks via pipelines; and engineering, procurement, and construction ("EPC") contractors, such as Fluor, who subcontract tank suppliers to build LPG tanks for larger facilities. (CX 993 at PDM-HOU-021484).

### 3. LIN/LOX tanks

33. LIN is an industry expression for liquid nitrogen. A LIN tank is a special tank that stores liquid nitrogen at atmospheric pressure. LOX is the industry expression for liquid oxygen. A LOX tank stores liquid oxygen. (Kamrath Tr. 1982-83); V. Kelley Tr. 4596). LAR is the industry expression for liquid argon and a LAR tank stores liquefied argon. (Patterson, Tr. 340-41). Tanks to hold LIN, LOX or LAR are commonly referred to as LIN/LOX tanks. (Patterson, Tr. 340-41).

34. LIN/LOX tanks are field-erected cryogenic tanks that store various liquid gas products at cryogenic temperatures, typically at -300 [degrees] F or lower. (CX 650 at CBI/PDM-H4019758). LIN/LOX tanks typically hold 400,000 to 1,000,000 gallons and cost \$ 500,000 to \$ 1 million each. (CX 170 at CBI-PL009650).

35. The LIN/LOX market does not include spheres, which are constructed in a different manner, serve different functions, and are not a substitute for LIN/LOX tanks. (Harris, Tr. 7301-02).

36. LIN/LOX tanks typically include an inner and outer shell of steel material. (JX 37 at 13 (Newmeister, Dep.)). The inner tank is made of stainless steel to withstand cryogenic temperatures without becoming brittle and cracking. (Kistenmacher, Tr. 835). Between the two shells is perlite insulation. (Kistenmacher, Tr. 833-834). LIN/LOX tanks have dome roofs, safety relief valves and nozzles that connect to piping and other equipment. They are built to withstand wind and seismic conditions. (Kistenmacher, Tr. 864).



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#### 4. Thermal Vacuum Chambers

37. A thermal vacuum chamber ("TVC") is a large metal enclosure used to simulate the vacuum of space for the purpose of testing satellites and satellite components prior to launch. (Gill, Tr. 179-83; Neary, Tr. 1423-24). A TVC simulates the atmospheric and thermal conditions found in space. (Gill, Tr. 183; Proulx, Tr. 1722-23; Thompson, Tr. 2039-40; Higgins, Tr. 1264).

38. During a test, air is pumped out of the enclosure and, within the enclosure, liquid or gaseous nitrogen circulates through pipes to heat or cool the interior environment. Controls allow users to adjust the temperature and vacuum conditions inside the enclosure so that satellites can be tested in a space-like environment. (Thompson, Tr. 2039-40). Temperatures simulated within the chamber can range "from minus 180 degrees C to plus 150 degrees C" and the vacuum can range from  $1 \times 10^{-6}$  torr to  $1 \times 10^{-8}$  torr. (Higgins, Tr. 1262; Scully, Tr. 1143).

39. The customers of field-erected TVCs are aerospace companies such as Boeing Satellite Systems ("Boeing"), Raytheon Systems, Spectrum Astro and TRW Space & Electronics ("TRW"); and government agencies, such as NASA. TVCs are used to test satellites purchased by the Department of Defense, NASA and commercial buyers. (Neary, Tr. 1420; Glenn, Tr. 4074-75; see also CX 1196 at PDM-HOU011524-011525 (list of PDM customers)).

40. "Customers are typically testing satellites costing \$ 50MM to \$ 200MM in TVCs costing \$ 5MM - \$ 20MM." (CX 212 at

CBI-PL031718). The satellites sold by TRW range in value from \$ 750 million to \$ 1.5 billion, while those sold by Spectrum Astro, a smaller satellite manufacturer, range in value from \$ 10 million to \$ 55 million. (Neary, Tr. 1420-21; Thompson, Tr. 2038).

41. TVCs are the only satellite testing equipment capable of

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simulating the vacuum and thermal conditions of outer space. (Higgins, Tr. 1262-63). Other testing chambers are not substitutes for TVCs because they only simulate other conditions. (Scully, Tr. 1139; Proulx, Tr. 1729). Large satellite customers require that manufacturers test their satellites in TVCs. (Neary, Tr. 1424).

42. Scorsone could not recall an instance in which a potential customer of a TVC tried to get a lower price by threatening to switch to an alternative. (CX 646 at 76-77 (Scorsone, IHT)).

43. The construction of a shop-fabricated TVC is "markedly different" from the construction of a field-erected TVC. (Scully, Tr. 1101-02; Gill, Tr. 235). "In shop-built chambers, all of the equipment and capability, personnel capability, lies within the confines of the shop." (Scully, Tr. 1103). However, some shop-built TVCs still require field-erection, including for example, the small field-erected chambers being built by XL/Votaw for Raytheon Systems. (Hart, Tr. 406-07). In contrast, field-erected chambers require a crew that "virtually lives in the field for elongated periods of time. . . . It's a vastly different technology than what a shop-built chamber requires." (Scully, Tr. 1103).

44. Satellites above a certain size cannot be tested in shop-fabricated TVCs. (Scully, Tr. 1139; Neary, Tr. 1425). Consequently, shop-fabricated TVCs are not an alternative to large, field-erected TVCs for testing large satellites. (Scully, Tr. 1140).

45. Other products, such as "thermal cycling chambers" and "altitude chambers" are not functional equivalents because they cannot mimic the conditions a satellite will face in space. (Neary, Tr. 1463-64; see Scully, Tr. 1135-39).

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**E. Effects on Competition in the LNG Market****1. Overview of the LNG market**

46. Construction of an LNG tank is "highly specialized" work. (Hall, Tr. 1831; Kistenmacher, Tr. 881; see Andrukiewicz, Tr. 6702 ("just in my own knowledge of LNG we're talking about a cryogenic fluid that is stored at minus 260 degrees Fahrenheit, clearly has different handling characteristics than the oil tank that may be located in my basement for heating fuel. So clearly there is a degree of specialized -- in fact, the preliminary engineering report speaks to the specialty nature of the construction of these facilities."). When addressing his investors, Mr. Gerald Glenn, Chairman, President and CEO of CB&I, emphasized that "a lot of owners out there, if they go to build a sophisticated project, like an LNG project or an LNG tank, they don't want to take a chance on a low price and a potential second class job or shoddy welding or any of that kind of stuff. The kind of work that we do is very specialized, very sophisticated." (CX 1731 at 44).

47. There is special expertise required in constructing an LNG tank, because "you would have to use the right welding technique to weld that particular type steel," which is a "different type of welding technique from ordinary carbon steel." (Hall, Tr. 1792). LNG tanks require sophisticated engineering analysis to take into account expansion and contraction because of differences in temperatures. (Newmeister, Tr. 1566; Kistenmacher, Tr. 881).

48. The engineering of an LNG tank entails special challenges. The inner tank of an LNG tank holds cryogenic fluid at a very low temperature while the outer tank is at ambient temperature. (Kistenmacher, Tr. 842). The inner tank shrinks when it comes into contact with the cryogenic fluid and there are differential rates of shrinking between the inner and outer tank. (Kistenmacher, Tr. 842). Consequently, an LNG tank engineer must have very specialized knowledge relating to how tank materials behave during the shrinking process; how to design piping for the tank; and how to avoid cracking of the tank components. (Kistenmacher, Tr. 842).

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49. PDM EC used three fabrication facilities located in Warren, Pennsylvania, Clive, Iowa, and Provo, Utah. (Scorsone, Tr. 4892). CB&I Industrial utilizes fabrication shops in Houston, Texas and Provo, Utah. (Scorsone, Tr. 4893).

50. In assembling its labor force, CB&I uses a core team of 4-5 management employees, including a project manager and two or three key people to begin the project. (Rano, Tr. 5917-18, 5952-53). CB&I recruits local labor, workers who live less than 100 miles from the jobsite, to help construct the facility. (Rano, Tr. 5906-07).

51. To build a field-erected LNG tank requires constructing the foundation. (Rano, Tr. 5920). CB&I subcontracts the foundation work to a company with an expertise in concrete work. (Rano, Tr. 5920).

52. The field-erection process for an industrial tank involves erecting the structure in accordance with the plans and contract specifications and testing the work quality. (Scorsone, Tr. 4895-96). The construction of LNG tanks involves rigging, which is the practice of attaching cables, slings, and ropes to pieces and hoisting them into position. (Scorsone, Tr. 4897-98).

53. To weld a field-erected LNG tank, two different welding processes are used: (1) hand welding, in which the welder holds the welding cable in his hand; and (2) submerged arc welding, which involves the use of a welding machine. (Rano, Tr. 5930-31). These welding processes are not only used for LNG tanks, but also for LPG tanks, water tanks, and oil tanks. (Rano, Tr. 5931). Construction of LNG tanks requires welders trained in procedures unique to welding 9% nickel steel (a special alloy that is not widely used), that can weld together the tank's large steel pieces with a precision that eliminates leaks. (Cutts, Tr. 2379; Kistenmacher, Tr. 881-82; Fabel, Tr. 1628-29, in camera; Hall, Tr. 1792; JX 30 at 180-81 (Outtrim Dep.)). A CB&I due diligence report on PDM's construction practices states that "CB&I has some of the best welders in the industry . . . Over the years CB&I

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has felt that our welding expertise is one of our core strengths." (CX 1357 at CBI-H 4000270-271).

54. Mr. W. T. Cutts, Vice President with American Tank & Vessel, Inc. ("AT&V"), states that LNG tanks are ". . . built out of fairly sophisticated materials. You don't just weld them up any old way. And its actually automated equipment that you weld them up with. The equipment is quite expensive to develop. You can go buy it, but the stuff you buy has to be modified and tailored, and then you have to build procedures around it. So it's not like you can go buy an automobile. It's unique equipment and the procedures that go with that make it very unique. . . ." (Cutts, Tr. 2379). Peter Rano, a CB&I vice president, testified that CB&I considers its welding procedures for LNG projects to be proprietary work product which it does not want to fall into the hands of its competitors. (Rano, Tr. 6028-29).

## **2. Demand in the LNG market**

55. The LNG tank market is a "worldwide market" in which a few LNG contractors compete against each other all over the world. (Eyer mann, Tr. 6994; J. Kelly, Tr. 6262). Demand for LNG in the United States had been very small over the past 20 to 30 years. (Glenn, Tr. 4091; Carling, Tr. 4513; J. Kelly, Tr. 6263). However, demand for LNG facilities has increased since the 1990s, as a number of companies are developing LNG import terminals in the U.S., the Caribbean, and Mexico. (Scorsone, Tr. 4934; Jolly, Tr. 4701-02, in camera). See generally F. 88-143. CB&I believes demand is rising and will continue to rise over the next 10 to 20 years, due to rising gas prices. (Glenn, Tr. 4091). [redacted] (Outtrim, Tr. 699, in camera).

56. There are three basic types of LNG tanks: (1) single containment; (2) double containment; and (3) full containment. (Puckett, Tr. 4541; Bryngelson, Tr. 6170-71).

57. Single containment LNG tanks store LNG in a nine percent nickel steel inner tank that is surrounded by a low earthen dike which would contain LNG in case of a leak. (Puckett, Tr.

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4541; Bryngelson, Tr. 6170-71; CX 1074 at CBI 001243-PLA). Double containment tanks have the same nine percent nickel steel inner tank as a single containment tank, but offer a concrete outer tank to contain spillage from the inner tank. (Price, Tr. 530-32; CX 1074 at CBI 001243-PLA). Full containment tanks consist of a self-supporting inner tank and the outer tank used in a double-containment tank, but also include a concrete roof, so that the inner tank is completely encapsulated in a concrete shell. (CX 1074 at CBI 001243-PLA). Full containment tanks are designed to contain both the spillage of refrigerated liquid and the vapor resulting from leakage. (CX 1074 at CBI 001243-PLA- 1244).

58. With the exception of the tank built by PDM for Enron in Puerto Rico, all LNG tanks that have been built in the United States are single containment tanks. (CX 1645; Glenn, Tr. 4110-4111; Jolly, Tr. 4701-02, 4708-09, in camera).

59. Customers view full and double containment tanks as safer than single-containment tanks. (Glenn, Tr. 4112-13; Hall, Tr. 1843; Scorsone, Tr. 4922).

60. An owner can site a double and full containment LNG tank on a smaller piece of property than it could for a single containment tank in order to comply with federal laws relating to vapor dispersion and thermal radiation in the event of a spill. (Scorsone, Tr. 4922). Full-containment tanks are more likely to be used "if you are closer to population in more of an urban setting or close to an urban setting, full-containment typically is used just for the extra bit of safety it has." (Bryngelson, Tr. 6133).

61. Full-containment tanks are 30-100% more expensive than single-containment tanks. (RX 157 at BP 02 004; CX 124 at PDM-HOU2011156; CX 1075 at CBI-001240-PLA; CX 1161 at CBI/PDM-H4008131-133, in camera; JX 23a at 89 (Cutts, Dep.); Jolly, Tr. 4724-25, in camera).

62. Two expansion projects in Cove Point, Maryland ("Cove Point I," Williams Energy) and Lake Charles, Louisiana (CMS Energy) specify the use of additional single containment tanks.

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(Eyermann, Tr. 7053-54). Southern Natural Gas, an affiliate of El Paso, is planning on building a single containment LNG tank at Elba Island, Georgia. (Bryngelson, Tr. 6214). Memphis Light Gas & Water will likely build a single containment tank when it expands its current facility. (Hall, Tr. 1831, 1842). The tanks for Dynegy's Hackberry facility will be full containment tanks. (Puckett, Tr. 4541-42). Cheniere Energy's Freeport LNG tank will be double containment. (Eyermann, Tr. 6968). Williams Energy's Cove Point II tanks will be full containment. (Scorsone, Tr. 4987-88). Yankee Gas and Calpine have not determined what types of tanks will be built. (Andrukiewicz, Tr. 6464-65; Izzo, Tr. 6522).

### **3. Market shares and concentration in the LNG market prior to Acquisition**

#### **a. Tank projects awarded**

63. There are four LNG import terminals in the United States: Everett, Massachusetts; Cove Point, Maryland; Elba Island, Georgia; and Lake Charles, Louisiana. (Glenn, Tr. 4068-69). PDM constructed the storage tanks for the Cove Point, Maryland and Lake Charles, Louisiana terminals. (CX 853 at PDM-HOU011488). CB&I constructed an LNG tank in Everett, Massachusetts and built three LNG tanks in Elba Island, Georgia. (CX 154 at CBI-PL002958, 961).

64. There are seventy five LNG peak shaving plants in the United States. (CX 125, at CBI-HOU 2017163-167). CB&I and PDM have constructed all but six of these. (CX 125, at CBI-HOU 2017163-167). The last time a firm other than CB&I or PDM built an LNG tank in the United States was in 1975, by Graver, a company that is now out of business. (CX 125 at PDM-HOU2017165; CX 1546).

65. From 1990 to the Acquisition, there have been nine LNG tank projects awarded. Of the nine awarded projects, CB&I won five projects and PDM won four. A project for [redacted] and a project for Atlanta Gas Light Co. were subsequently canceled. (Simpson, Tr. 3046, 3052-54; CX 1210, in camera; CX 824; CX

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1212, in camera; CX 26 at CBI-PL069530, in camera; RX 757).

66. LNG tank awards to CB&I are: South Carolina Pipeline Corp. (1991); Liquid Carbonic (1992); Memphis Light Gas & Water ("MLGW") (1995); [redacted]; Pine Needle LNG Co. (1995). LNG tank awards to PDM are: Citizens Gas & Coke Utility (1991); Enron (1997); Atlanta Gas Light Co. (1998); Cove

Point I (2001). (Simpson, Tr. 3046, 3052-3055; CX 1210, in camera; CX 824; CX 1212, in camera; CX 26 at CBI-PL069530, in camera; RX 757).

67. No foreign company has ever built an LNG tank in the United States. (Jolly, Tr. 4683, in camera; CX 125).

**b. HHI calculations**

68. From 1990 to Acquisition, CB&I's market share, based on sales, is 45.3%. PDM's market share, based on sales is 54.7%. (See Simpson, Tr. 3055-58; CX 1646). The combined market share of the two companies is 100%. Assigning shares based on sales, Dr. Simpson testified that the premerger HHI was 5,044, the change in the HHI as a result of the Acquisition was 4,956, and the post-acquisition HHI is 10000. (Simpson, Tr. 3055 (referencing CX 1646)).

69. Dr. Simpson calculated LNG HHI based on data from 1990 to Acquisition. (Simpson, Tr. 3703). Dr. Simpson admitted that he chose 1990 as the beginning date for his HHI analysis because 1990 was the cut-off date for discovery and thus his information dated back to 1990. (Simpson, Tr. 3704-05).

70. If data dating back to 1996 instead is used to calculate HHI, CB&I had no sales over that time period and the change in the HHI based on sales in the LNG market would be zero. (Harris, Tr. 7228; Simpson, Tr. 3721-22, 3743-44).



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71. The LNG tank market is a thin market, with very few data points to look at. (Harris, Tr. 7218).

**c. Bidders on projects**

72. For all but two LNG tank projects from 1990 to Acquisition (MLGW and Atlanta Gas & Co.), no company other than CB&I and PDM submitted bids. (Simpson, Tr. 3670; CX 161 at CBI-PL006114).

73. On the 1994 MLGW LNG tank, in addition to CB&I, PDM, Lotepro/Whessoe International, and Black & Veatch/Toyo Kanetsu K.K provided bids. (Hall, Tr. 1804-05).

**4. Respondents were each others' closest competitors in the LNG market**

74. Dr. Harris acknowledges that prior to the merger, United States LNG tanks were built entirely by CB&I and PDM. (Harris Tr. 7196, 7521-22). According to Dr. Harris, "until roughly 2001 I guess, the competitors in the market, . . . were almost entirely limited to CB&I and PDM." (Harris, Tr. 7220).

**a. Respondents' views**

75. An LNG/Aerospace marketing presentation, dated November 2000, states that CB&I was "PDM's competition for LNG tanks alone." (CX 116 at PDM-HOU019176).

76. PDM's 2000 Business Plan states that "CB&I is PDM EC's domestic competition for LNG tanks." (CX 94 at PDM-HOU017580).

77. PDM characterized CB&I as "PDM EC's only competitor on domestic cryogenic, LNG, LPG, Ammonia and thermal vacuum projects." (CX 107 at PDM-HOU005016).

78. In a 1997 PDM Customer Briefing, PDM determined that

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with "only two capable LNG tank builders in the U.S. (PDM and CB&I) our teaming with Air Products has essentially put Lotepro and other liquefaction design companies out of the LNG business in the domestic U.S." (CX 113 at PDM-HOU014838).

**b. Industry views**

79. Industry participants recognize that prior to the merger, CB&I and PDM built nearly all of the field-erected LNG tanks in the United States. (Kistenmacher, Tr. 891; Outtrim, Tr. 714-15, in camera ("From 1965 through '97 or so, the only two companies pretty much across the board that built LNG plants in the United States were PDM and CB&I"); Cutts, Tr. 2390 (CB&I and PDM "dominated the marketplace significantly and the interpretation by most people would have been that any large cryogenic projects in the United States would have been built by CB&I or PDM.")).

80. Robert Davis, Director of HYCO Services for Air Products, testified that "virtually all, with just very few exceptions, of the LNG tanks in this country had been built by CB&I and PDM." (Davis, Tr. 3131-32).

81. John Newmeister, Vice President of Marketing and Business Development at Matrix Services, Inc., explained that historically the suppliers of LNG tanks in the U.S. were "CB&I, PDM and possibly Graver," but with Graver's exit and CB&I's acquisition of PDM, "the list of qualified LNG tank suppliers decreased to one." (Newmeister, Tr. 2166).

82. Brian Price, Vice President of LNG Technology for Black & Veatch, who competed against CB&I and PDM for the MLGW LNG project, saw first-hand that "the two competitors with the lowest prices were CB&I and PDM." (Price, Tr. 558).

**c. Competition between Respondents lead to lower prices**

83. In 1994, MLGW sought bids for the construction of a peak-shaving plant in Capleville, Tennessee. (Hall, Tr. 1778). Mr. James Clay Hall, project engineer and manager for MLGW,

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believed that "essentially we had two viable companies in the United States that could compete" for the project - CB&I and PDM. (Hall, Tr. 1799-1800). Nevertheless, MLGW encouraged Black & Veatch, an engineering firm, "to team up with a foreign tank builder to compete," and also encouraged Lotepro, a German engineering firm, to compete in the bidding process. (Hall, Tr. 1799).

84. PDM was the lowest bidder for the MLGW project, but PDM's bid was rejected as non-conforming to the specifications. (Price, Tr. 560; Hall, Tr. 1877-78). The prices quoted by CB&I and PDM were comparable. (Hall, Tr. 1876). CB&I provided the next lowest bid at \$ 10,500,000. (Price, Tr. 560; Kistenmacher, Tr. 899; CX 829 at 5). Lotepro/Whessoe International's bid for the LNG tank was \$ 15,000,000. (Kistenmacher, Tr. 899; CX 829 at 5). Black & Veatch/Toyo Kanetsu K.K.'s bid for the LNG tank was \$ 16,700,000. (Price, Tr. 648).

85. The tank was awarded to CB&I and included an [redacted]. (Harris, Tr. 7501; CX 906 at CVI 031076-HOU, in camera).

86. In 1998, Atlanta Gas Light Company ("Atlanta") sent requests for bids to CB&I, PDM/Air Products, and a third competitor, Marlborough Enterprises, for a proposed LNG peak shaving facility. According to CB&I, "[Atlanta] considered the Marlborough bid more of a courtesy proposal with the real competition between CB&I and PDM/AP." (CX 161 at CBI-PL006113). Atlanta awarded the business to PDM because it offered a lower price than CB&I [redacted] and a shorter construction schedule. (CX 161 at CBI-PL006114; CX 1321 at CBI-PL 069518, in camera). The Atlanta project was never built. (Simpson, Tr. 3054).

87. In 2000, CB&I and PDM competed against each other to win a 750,000 barrel LNG tank for Columbia LNG to be built at Cove Point. (CX 293 at CBI/PDM-H 4008141). Prior to the Acquisition, CB&I and PDM bidding against each other constrained pricing for the Cove Point project. F. 184-85.

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### **5. Competition in the LNG market from Acquisition to time of trial**

88. The parties presented evidence on numerous LNG projects announced recently. LNG projects that are outside the United States are outside the relevant geographic market. Findings relating to tank projects in the relevant market follow.

#### **a. Dynegy's Hackberry Facility**

89. Dynegy is currently scheduled to build a large LNG import facility that will be located on the Calcasieu River, south of Lake Charles, Louisiana, in the town of Hackberry. (Puckett, Tr. 4539). The facility will contain three LNG full containment tanks, two docks for receiving LNG ships, pump and vaporization capacity of 1.5 billion cubic feet per day, and roughly 30 miles of pipeline to move the gas from the terminal to other interstate pipelines for delivery. (Puckett, Tr. 4539-40). When completed, the Hackberry facility will be the largest LNG regasification facility in the United States. (Puckett, Tr. 4540).

90. Dynegy estimates that the approximate dollar value for the entire project is somewhere between \$ 550 to \$ 700 million. (Puckett, Tr. 4565). Dynegy estimates that each of the three LNG tanks will cost around \$ 40 or \$ 50 million. (Puckett Tr. 4566).

91. Dynegy asked four tank builders, Toyo Kanetsu K.K. ("TKK"), S.N. Technigaz ("Technigaz"), Skanska AB ("Skanska")/Whessoe International ("Whessoe"), and CB&I, to provide lump-sum turnkey bids for the construction of the Hackberry LNG tanks. (Puckett, Tr. 4552-53).

92. As part of the bid procedure, Dynegy required CB&I to submit its drawings, technical information and a firm price to Black & Veatch, Dynegy's consultant. (Glenn, Tr. 4130-31).

93. Black & Veatch had concerns that if a domestic tank manufacturer did not participate in the bid contest, Dynegy would

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receive higher prices for the tanks. (Price, Tr. 622).

94. CB&I met with Dynegy and indicated that it was uncomfortable providing a bid given that Black & Veatch, a major competitor, was acting as the EPC contractor, and was under contract with Skanska/Whessoe. Skanska/Whessoe was a bidder for the LNG tanks. (Glenn, Tr. 4411). CB&I did not want Skanska to obtain its bidding information or to gain access to its prices and designs. (Puckett, Tr. 4577-78). Further, given these circumstances, CB&I believed that its chances of being awarded the project were slim. (Glenn, Tr. 4411). Prior to the bid due date, CB&I indicated to Dynegy that it was not going to submit a bid, however, CB&I was prepared to submit a proposal to cover the construction of the entire project on a turnkey basis. (Puckett, Tr. 4559). CB&I told Dynegy that the "project as structured does not fit our corporate strategy." (CX 139 at CBI 019779-HOU).

95. Generally, "turnkey, design build projects typically return higher margins than standalone storage tank projects." (CX 660 at PDM-HOU 005013). Scorsone agreed that industry participants view a turnkey project to result in "higher margins." (Scorsone, Tr. 2812-13).

96. CB&I sent Dynegy a letter expressing its decision not to submit a tank-only bid. (Glenn, Tr. 4133-34; RX 143). In its letter, CB&I again offered to construct the Hackberry facility on a turnkey basis. (RX 143). Dynegy rejected CB&I's second attempt to propose a turnkey approach. (Puckett, Tr. 4559-60).

97. After learning of CB&I's decision not to bid, Dynegy further solicited a tank-only bid by offering to let CB&I submit its bid directly to Dynegy and promising not to share the information with Black & Veatch. (Puckett, Tr. 4578; Glenn, Tr. 4134-35; RX 144).

98. Dynegy received bids sometime after February 1, 2002 from TKK/AT&V, Skanska/Whessoe, and Technigaz/Zachry. (Puckett, Tr. 4556). All three of the bids Dynegy received met its

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technical expectations and were within Dynegy's expected price range. (Puckett, Tr. 4557).

99. CB&I decided that if Dynegy would accept and evaluate the bids itself, CB&I would submit a tank-only bid. (Glenn, Tr. 4136). CB&I communicated its decision to Dynegy within two to three weeks after it received Dynegy's offer. (Glenn, Tr. 4136). CB&I requested to submit a tank-only bid in March of 2002. (Glenn, Tr. 4412; Puckett, Tr. 4578).

100. Dynegy responded to CB&I's request by informing CB&I that Dynegy was satisfied with the three tank-only bids it had received and telling CB&I that it was too late in the process to accept its bid. (Puckett, Tr. 4559-60; Glenn, Tr. 4137).

101. [redacted] (Jolly, Tr. 4690-91, in camera). [redacted] (Jolly, Tr. 4760, in camera).

**b. CMS Energy, Lake Charles, Louisiana Expansion**

102. CMS Energy ("CMS") is planning to build one single containment tank expansion to its existing Lake Charles, Louisiana facility. (J. Kelly, Tr. 6260). The CMS expansion project will involve constructing an LNG tank on a site that already contains numerous single containment LNG tanks. (Eyermann, Tr. 7053-54).

103. [redacted] (J. Kelly, Tr. 6284, 6292, in camera). [redacted] (J. Kelly, Tr. 6293, in camera).

104. [redacted] (RX 595 at CBI 060850, in camera). [redacted] (Scorsone, Tr. 5075-76, in camera) [redacted] (RX 595 at CBI 060850, in camera).

105. CMS Energy has awarded the tank portion of the contract to CB&I over Skanska/Whessoe. (Glenn, Tr. 4399).

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**c. El Paso/Southern LNG: Elba Island**

106. [redacted] (Scorsone, Tr. 5077-78, in camera). [redacted] (Scorsone, Tr. 5078, in camera).

107. [redacted] (RX 640 at CBI 069126, in camera). [redacted] (Scorsone, Tr. 5079, in camera).

**d. Poten & Partners**

108. CB&I is negotiating a sole-source contract to construct an LNG import terminal for Poten & Partners in the Northeastern United States. (Glenn, Tr. 4399).

**e. British Petroleum**

109. British Petroleum ("BP") is a global petrochemical company based in Britain with operations all over the world. (JX 33 at 19-20 (Sawchuk, Dep.)). BP is evaluating the possibility of constructing three new LNG import terminal facilities in the United States. (JX 33 at 9-10 (Sawchuk, Dep.)).

110. BP has decided to work with CB&I on the front end development of these projects. (Glenn, Tr. 4180). If BP is satisfied with CB&I's pricing, schedule and terms and if the projects move forward, BP has indicated that CB&I will be awarded those jobs. (Glenn, Tr. 4180).

111. Generally, a sole-source supplier can earn higher margins than if competing against other firms in a competitive bidding situation. (See Kamrath, Tr. 2030 ("we found that always a competitive bid resulted in a better cost for us, lower cost [than 'sole sourcing']"); Outtrim, Tr. 720-21, in camera (cost of sole-sourced LNG tank from CB&I was [redacted] more than comparable facilities). However, using one contractor may provide an owner with greater flexibility, lower costs, and may save time when a project is under development. (Bryngelson, Tr. 6134; Scorsone, Tr. 4959).

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112. In an internal memorandum discussing the status of BP's LNG re-gas terminals and storage tanks and status of work with CB&I, BP noted, "there is less competition than we would like on a regional basis. Since their acquisition of PDM, CB&I now dominate the US market." (CX 693 at BP 01 027). Having assessed the firms that could supply the LNG tanks as a subcontractor or as a main contractor, BP asked what would be the best way of going forward. BP's "key choices in the US will be: - do we form a closer relationship with CB&I in order to guarantee access to the resources we need for our US regas projects? - or do we deepen the market in the US by encouraging competition?" (CX 693 at BP 01 028).

113. In an internal memorandum assessing competition in the LNG market in August 2001, BP stated: "since the acquisition of PDM, a couple of companies have come forward to state that they can build LNG tanks in the US. . . . [However], the reality for today is that in the US, [CB&I is] the leading company in the LNG Tank business and the other competitors will need to demonstrate their capabilities in this market." (CX 691 at BP 10 032).

**f. Cove Point II**

114. Williams Energy ("Williams") has plans to add between four and six new LNG tanks to its existing Cove Point facility in Cove Point, Maryland ("Cove Point II expansion").

(Scorsone, Tr. 4987-88). These additional tanks are required to be full-containment designs because of property limitations at Cove Point. (Scorsone, Tr. 4988).

115. CB&I has submitted budgetary pricing for the Cove Point II expansion. (Scorsone, Tr. 4962; Glenn, Tr. 4148).

116. TKK, in partnership with DYWIDAG and AT&V, submitted budgetary pricing to Halliburton KBR for the Cove Point II expansion. (RX 185 at TWC 000003). Under this arrangement, TKK would execute the engineering, procurement,



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and select vendors/subcontractors. (RX 185 at TWC 000036). AT&V will be responsible, under TKK's direct control, for site construction and fabrication of materials done in the U.S. (RX 185 at TWC 000036). DYWIDAG will be responsible for the civil engineering aspects of the facility. (RX 185 at TWC 000035).

**g. Yankee Gas**

117. In 2001, Yankee Gas, a natural gas distribution company, initiated plans to construct an LNG peak shaving facility in Waterbury, Connecticut. (JX 21 at 17-18 (Andrukiewicz, Dep.); Andrukiewicz, Tr. 6439-40).

118. During the first quarter of 2001, Yankee Gas retained the services of CHI Engineering ("CHI"), a consulting firm, to perform a preliminary engineering and budget study. (JX 21 at 23 (Andrukiewicz, Dep.); CX 1507 at CBI 059483).

119. On April 23, 2001, CHI issued a request for prices exclusively for the LNG tank portion of the project rather than "facility turnkey pricing." (CX 1507 at CBI 059483). CHI's request was sent to CB&I, Skanska/Whessoe and Technigaz. (JX 21 at 24 (Andrukiewicz, Dep.)).

120. On May 4, 2001, CB&I wrote Chris Beschler, VP of Operations at Yankee Gas, that CB&I wanted to do the work on a turnkey basis but also expressed that CB&I would be "an excellent choice to support any project Yankee Gas Services Company may have in the LNG industry." (CX 417 at CBI 026845-HOU). Eric Frey, CB&I's representative to Yankee Gas, intended to "make every effort to restructure how the project will be bid and executed." (CX 430 at CBI 026934-HOU).

121. CB&I submitted its budgetary pricing to CHI on June 12, 2001. (RX 4 at 4). CB&I submitted rough pricing because: (1) the owner requested "broad" numbers; and (2) CB&I viewed CHI as a potential competitor. (CX 1507 at CBI 059483).

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122. On October 26, 2001, Yankee Gas requested that CB&I submit a proposal for contracting for the facility directly to Yankee Gas. (CX 1507 at CBI 059484; see also CX 787 at CBI 065244, in camera) ([redacted]).

123. CB&I's budget estimate for the Yankee Gas project anticipates a margin of [redacted]. (RX 54 at CBI 026812-HOU, in camera; CX 421 at CBI 026843-HOU; Scorsone, Tr. 5317, in camera). CB&I cited the price paid for the Cove Point LNG tank in setting the price for Yankee Gas. (CX 421 at CBI 026843-HOU [redacted]).

124. [redacted] (CX 787 at CBI 065242, in camera).

125. CHI sent a second request of prices for the liquefaction process. (CX 1507, at CBI 059483). CHI received pricing information from Whessoe and Technigaz. (JX 21 at 24 (Andrukiewicz, Dep.); CX 1507 at CBI 059484).

126. Skanska/Whessoe sent CHI Engineering information regarding the Waterbury facility that included: preliminary design solutions; preliminary design data sheets complete with design drawings; and pricing information. (Andrukiewicz, Tr. 6445; RX 4 at 2). Skanska/Whessoe provided pricing information as part of its submission. (Andrukiewicz, Tr. 6446).

127. [redacted] (Jolly, Tr.4693, in camera). On June 12, 2001, in response to a request from Yankee Gas' consultant CHI Engineering, the alliance submitted a preliminary pricing proposal for an LNG storage tank. (RX 4 at 3). [redacted] (Jolly, Tr. 4693, in camera). [redacted] provided pricing information as part of its submission. (Andrukiewicz, Tr. 6446).

128. CHI no longer has a "contractual relationship" with Yankee Gas. (Andrukiewicz, Tr. 6460). CHI has been replaced by SEA Consultants. (Id. at 6445). Yankee Gas will "look to SEA to provide us with the potential builders of this facility." (Id. at 6452).

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129. Yankee Gas has not determined whether Skanska/Whessoe or Technigaz are qualified to bid; the "pre-qualification" process has not started. (Andrukiewicz, Tr. 6451). SEA Consultants, the consultant that replaced CHI, will be responsible for evaluating the potential builders. (Andrukiewicz, Tr. 6451-52). At this stage, Yankee Gas has not "built the criteria by which we will evaluate any particular contract constructor of any component of the plant." (Andrukiewicz, Tr. 6453).

130. In the preliminary engineering report CHI submitted to Yankee Gas, CHI specifically proposed a double containment tank, with a concrete roof, in which both the inner tank and outer tank would be made of concrete. (Andrukiewicz, Tr. 6464-65). Mr. Andrukiewicz of Yankee Gas testified that Yankee Gas has "made no commitment on tank design." (Andrukiewicz, Tr. 6464-65).

131. An April 12, 2002 CB&I internal memo prepared by Eric Frey, the sales representative to Yankee Gas, states Yankee Gas was beginning to realize that concrete inner tanks were not common and not the norm and that more conventional designs using steel as the product container were equally as safe (or safer) and probably less expensive. Yankee Gas agreed to do their best to get the concrete inner tank requirement removed. (CX 1507 at CBI 059484).

132. CB&I has stated it might not bid on the Yankee Gas project if the design calls for a double concrete wall full containment LNG tank. (Scorsone, Tr. 4989-90; Glenn, Tr. 4141).

**h. Freeport LNG**

133. The Freeport LNG project is in the early design stages and may never be built. (Eyermann, Tr. 7043-44). At the time of trial, Freeport LNG had not yet filed for FERC approval of the terminal. (Eyermann, Tr. 6977).

134. Freeport LNG and its predecessor Cheniere Energy have never built an LNG facility before. (Eyermann, Tr. 7033).

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Freeport LNG has not obtained any bids or selected a supplier for the LNG tanks planned for the Freeport, TX import terminal. (Eyermann, Tr. 7029). Mr. Volker Eyermann, LNG Technical Director of Cheniere Energy Company, has never been involved in evaluating or selecting an LNG tank supplier for a project, and has never reviewed the prices submitted by LNG tank bidders. (Eyermann, Tr. 7025-7028).

135. CB&I sent Freeport LNG a proposal to do the front end engineering and design to the level of detail that is required for FERC and as a first phase for the operation. (Eyermann, Tr. 7049-50). CB&I sought a sole-source arrangement; it wanted to be the complete engineer on the whole project from the start through the EPC contracting. (Eyermann, Tr. 7069).

136. Black & Veatch sent Freeport LNG a letter which indicated that it had formed an alliance with Whessoe to build LNG tanks in the Western Hemisphere. (Eyermann, Tr. 6992). Based on this document, Freeport LNG believes that Black & Veatch and Whessoe are "serious and trying to compete." (Eyermann, Tr. 6992).

137. Skanska/Whessoe met with Freeport LNG in August 2002 to discuss contracting strategies and general tank designs. (Eyermann, Tr. 6983). Skanska/Whessoe provided Freeport LNG with marketing materials. (Eyermann, Tr. 6983). Freeport LNG believes Skanska's worldwide LNG director expressed interest in competing for the Freeport LNG project. (Eyermann, Tr. 6981-82). Freeport LNG knows that Skanska/Whessoe has built LNG tanks in Dabhol, India, Trinidad, and Greece, and that Whessoe did a "very good" job on the Dabhol project. (Eyermann, Tr. 6980-81). Freeport LNG believes that Skanska/Whessoe is a potential supplier of LNG tanks and plans to solicit a bid from Skanska/Whessoe for the Freeport LNG project. (Eyermann, Tr. 6993).

138. TKK/AT&V approached Freeport LNG in 2001 for the proposed LNG project in Freeport, Texas. (Eyermann, Tr. 7000-01). TKK/AT&V prepared presentations on the companies'

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capabilities, and discussed contracting capabilities. (Eyermann, Tr. 7000-01). Freeport LNG perceives that AT&V has quality welders which will be sufficient to perform the proposed LNG project in Freeport, Texas. (Eyermann, Tr. 7001-02). Freeport LNG also believes that TKK is a qualified tank constructor with the ability to adapt to different working conditions in different countries. (Eyermann, Tr. 7000, 7004-05). Freeport LNG plans on soliciting bids from TKK/AT&V, even though the partnership has never constructed a field-erected LNG tank in the U.S. (Eyermann, Tr. 7005).

139. Technigaz/Zachry approached Freeport LNG to present its alliance. (Eyermann, Tr. 6994). The alliance sent Freeport LNG marketing materials describing its expertise in liquefied gas facilities and Technigaz's experience building LNG tanks. (Eyermann, Tr. 6996-98). Freeport LNG believes that Technigaz is "keenly interested" in working on the Freeport LNG project. (Eyermann, Tr. 6996-98).

140. S&B contacted Freeport LNG and indicated it had combined its efforts with Daewoo to compete in the American market for LNG tanks. (Eyermann, Tr. 6976-77). Representatives from S&B and Daewoo had a meeting with Freeport LNG to discuss its capabilities, experience with current projects, and contracting strategies. (Eyermann, Tr. 6976-77; 7008). S&B and Daewoo also presented various brochures to Freeport LNG. (Eyermann, Tr. 7008). Based on these discussions, Freeport LNG requested Daewoo's LNG tank drawings to be used in connection with Freeport LNG's FERC application for its proposed LNG facility in Freeport, Texas. (Eyermann, Tr. 6976-77).

**i. Calpine, Humboldt Bay**

141. Calpine's Humboldt, California facility is "in the early stages of possible development;" there is only a 50% chance that the facility will be built. (Izzo, Tr. 6521-22). Calpine expects that new LNG tanks in the United States will be "at least double containment if not full containment," but if FERC authorizes the construction of a single containment LNG tank at Humboldt Bay,

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Calpine will not build a double or full containment tank. (Izzo, Tr. 6492, 6522-23).

142. Calpine has not spoken to Skanska/Whessoe, Zachry/Technigaz or AT&V/TKK about the Calpine project. (Izzo, Tr. 6524-25). Mr. Lawrence Izzo, Calpine's Senior Vice President, testified that he would have to "guess" as to whether any of these three firms will provide a bid to Calpine, what the price will be, and how they would compare to CB&I's price. (Izzo, Tr. 6525). Izzo admits that he knows "nothing firsthand" about AT&V's capabilities, and that he has never "worked with any foreign firm on a U.S. LNG project." (Izzo, Tr. 6520, 6539). Whessoe is the only foreign firm with which Izzo has first-hand knowledge about its construction performance and prices, and this was based on Whessoe's work in India. (Izzo, Tr. 6519).

143. The only firms with which Izzo has worked with on a U.S. LNG construction project are CB&I and PDM. (Izzo, Tr. 6514-16). Further, the only firm with which Izzo has discussed the project is CB&I. (Izzo, Tr. 6524-25).

## **6. Recent entry in the LNG market**

### **a. TKK/AT&V**

144. Toyo Kanetsu K.K. ("TKK") is a Japanese company involved in the construction of low temperature and cryogenic tanks. (RX 872 at 2). TKK has completed 72 LNG storage tanks throughout the world. (RX 772 at 2-21; RX 818). TKK has built more double containment and full containment LNG tanks than any other constructor in the world. (Cutts, Tr. 2572-73). TKK's annual sales are approximately 34.9 billion Yen. (RX 872 at 24).

145. American Tank & Vessel, Inc. ("AT&V") is an engineering and construction firm that was incorporated in 1982. (RX 818). AT&V, based in Mobile, Alabama, offers complete turnkey services for, and has extensive experience in, the engineering, design, and fabrication of tanks, vessels and spheres. (RX 31 at 9; Carling, Tr. 4489). AT&V has engineering facilities

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in Birmingham, Alabama; Houston, Texas; George County, Mississippi; and Mobile, Alabama. (RX 31 at 1). AT&V has fabrication facilities in George County, Mississippi and Houston, Texas. (RX 31 at 1).

146. TTK has extensive LNG experience outside the U.S., but has never built an LNG tank in the United States. (Cutts, Tr. 2336). AT&V has never built an LNG tank of any kind. (Cutts, Tr. 2393-94).

147. TTK has teamed with AT&V to supply LNG tanks in the United States. (Cutts, Tr. 2437-38). Pursuant to this partnership, TTK will "carry the lead responsibility" for engineering and design of the LNG tank. (Cutts, Tr. 2327). AT&V will supply the field labor for the erection of the LNG tank and share some of the responsibility for estimating the costs of the project. (Cutts, Tr. 2327-28). TTK will train AT&V employees on how to construct LNG tanks, including the use of TTK's welding equipment. (Cutts, Tr. 2379). Cutts anticipates that the newly trained AT&V employees will need a few years of experience constructing LNG tanks before they work as efficiently as experienced CB&I employees. (Cutts Tr., 2379-80). TTK's sales force will supplement AT&V's sales force in the LNG area. (Cutts, Tr. 2570).

148. AT&V has undertaken steps to research, design, and develop procedures associated with scheduling, welding technology, and general construction sequencing for LNG tanks. (Cutts, Tr. 2440). AT&V has researched and developed techniques to weld nine percent nickel steel. (Cutts, Tr. 2464).

149. Prior to its alliance with TTK, one LNG customer, BP, expressed that it did not view AT&V as an LNG tank supplier. AT&V "will need to demonstrate [its] capabilities in this market" first. (CX 691 at BP 01 032).

150. TTK/AT&V provided a bid to Dynegy for its Hackberry facility which met Dynegy's technical expectations [redacted]. F. 100-01. TTK, in partnership with DYWIDAG and AT&V, has

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submitted budgetary pricing to Halliburton KBR for the Cove Point II expansion. F. 116. TKK/AT&V approached Freeport LNG to present their capabilities. F. 138.

**b. Skanska/Whessoe**

151. Skanska AB ("Skanska") is one of the world's largest construction groups, and is a well-established Swedish based civil contractor that has operated internationally for more than 50 years. (RX 839 at 4; RX 870 at 25). In 2002, Engineering News Record ("ENR"), a leading industry publication, ranked Skanska as the number one contractor in the world. (RX 736 at 1). Skanska earned an annual revenue of more than \$ 14 billion in 2001. (RX 736 at 1). In August of 2000, Skanska acquired Whessoe International ("Whessoe"). (RX 770 at 33).

152. Whessoe is a 200 year old engineering and construction firm with a well established reputation in the international LNG business. (RX 908 at 1). Whessoe has been involved in various aspects of LNG storage for facilities throughout the world including India, Spain, Greece and Algeria. (RX 839 at 5-8).

153. Skanska/Whessoe has never built an LNG tank in the United States. (Eyermann, Tr. 6993).

154. Skanska/Whessoe is poised as a specialist EPC company combining contracting and risk management with engineering and design skills to offer its clients a complete package in the design and construction of facilities for cryogenic gas storage and handling. (RX 870 at 5). Skanska/Whessoe combines the engineering and construction skills of Skanska Construction with the design, engineering and procurement skill of Whessoe International. (RX 870 at 6). From its UK base, Skanska/Whessoe operates worldwide to design and build LNG tanks and terminals. (RX 870 at 5).

155. PDM noted Whessoe's historically poor performance in communications with consultants. In August 1999, Luke Scorsone wrote that he expected a potential customer, Unocal, to look



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favorably upon PDM relative to Whessoe on a project, "given that Noell Whessoe has performed poorly at Trinidad and Dabhol." (CX 115 at PDM-HOU017554).

156. Skanska/Whessoe provided a bid to Dynegy for its Hackberry facility which met Dynegy's technical expectations [redacted]. F. 100-01. [redacted]. F. 103, 105. Skanska/Whessoe provided pricing information and preliminary design solution for the Yankee Gas project. F. 126. Skanska/Whessoe met with Freeport LNG to discuss contracting strategies and general tank designs. F. 137. Skanska/Whessoe spoke to [redacted] a number of times regarding its capabilities and desire to construct LNG tanks in the United States. (Sawchuck, Tr. 6087, in camera).

**c. Technigaz/Zachry**

157. French based SN Technigaz and its parent company earn an annual revenue of more than \$ 3 billion and employ about 20,000 people. (Jolly, Tr. 4438). Technigaz has considerable experience in the design and construction of LNG tanks worldwide. (RX 43 at ZCC000005). Technigaz is one of the world's leading suppliers of liquefied gas facilities. (RX 773 at 1-2). Technigaz offers a broad range of services including: feasibility studies and conceptual design, basic and detail engineering, project management, procurement, quality control, construction, coordination of subcontractors, supervision and technical assistance, commissioning and start-up, and operation. (RX 773 at 3).

158. Technigaz has never built an LNG tank in the U.S. (Jolly, Tr. 4719, in camera). Technigaz currently has eight full-containment LNG tanks under construction around the world: Spain, Egypt and India. (Jolly, Tr. 4440). Technigaz believes it is the "largest contractor today in full-containment tanks worldwide." (Jolly, Tr. 4689, in camera).

159. [redacted] (Jolly, Tr. 4757, RX 738 at FTC001537 (Jolly, Dec.), in camera). [redacted] (RX 738 at FTC 001535 (Jolly, Dec.), in camera).

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160. Texas-based Zachry Construction Corporation is a leading United States construction company, with sales of around \$ 1.7 billion and more than 14,000 employees in 2001. (RX 43 at ZC 000002). In 2001, Zachry was ranked eighteenth in the annual ranking of top construction contractors by ENR. (RX 871 at 71). Zachry placed fifteenth overall among construction firms that also sold their own design work. (RX 871 at 71).

161. Zachry is an experienced civil contractor in the United States with licensed engineers and access to local labor in the United States. (Price, Tr. 656-57). Zachry began as a civil constructor and therefore has a great deal of knowledge about concrete construction. (Fahel, Tr. 1682-83, in camera). Zachry has unlimited bonding capacity. (RX 45 at ZCC 000039).

162. Zachry has never constructed an LNG tank. (Fahel, Tr. 1402).

163. In June or July of 2001, Technigaz took a step toward entering the United States market for LNG tanks by entering into a Memorandum of Understanding ("Memorandum") with Zachry. (Jolly, Tr. 4685, in camera). A press release announcing the joint venture was issued in January of 2002. (RX 43 at ZCC000002). In the press release, the alliance held itself out as pooling Technigaz's recognized turnkey LNG project expertise and broad-based knowledge of the market with Zachry's construction capabilities and strong positions in the Americas. (RX 43 at ZCC000002).

164. Since signing the Memorandum, Technigaz/Zachry [redacted] (Jolly, Tr. 4692, in camera; Fahel, Tr. 1650-51, 1689, in camera). Technigaz/Zachry provided a bid for Dynegy's Hackberry facility which met Dynegy's technical expectations [redacted] F. 100-01. [redacted] F. 127. Technigaz/Zachry approached Freeport LNG to present its expertise in liquefied gas facilities and Technigaz's experience building LNG tanks. F. 139.

165. Mr. Jean-Pierre Jolly, Vice President of Marketing at SN Technigaz, stated that [redacted] (RX 738 at FTC001536 (Jolly,

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Dec.); see also Jolly, Tr. 4753-54, in camera).

### **7. Barriers to entry in the LNG market**

166. LNG tanks are "built out of fairly sophisticated materials. You don't just weld them up any old way . . . . The equipment is quite expensive to develop. You can go buy it, but the stuff you buy has to be modified and tailored, and then you have to build procedures around it. So it's not like you can go buy an automobile. It's unique equipment . . . ." (Cutts, Tr. 2379).

167. There are "tremendous safety considerations" regarding LNG tanks. (Price, Tr. 564-65). If LNG should leak from a tank, the vaporized LNG could lead to fires and death, and liability for losses. (Bryngelson, Tr. 6234-35; see also Blaumueller, Tr. 293-94).

168. To avoid catastrophes, customers seek experienced tank suppliers. "If you're going to be handling something like liquefied natural gas, you don't want some amateur putting it together. The results can be catastrophic." (Hall, Tr. 1789). Dr. Hans Kistenmacher, a vice president at Linde BOC Process Plants ("Linde"), testified that risks associated with leakage causes Lotepro to subcontract the design and construction of LNG tanks to companies that have a long track record of experience in constructing these facilities. (Kistenmacher, Tr. 903-05).

169. Companies, such as Black & Veatch and Air Products, that provide the liquefaction systems and other components, but not the LNG tanks, do not want to partner with an inexperienced LNG tank supplier. (CX 157 at CBI-PL003348 (Black & Veatch "are looking to partner on a project with a firm which has better experience"); Davis, Tr. 3190-01 (Air Products chose to partner with PDM "because we needed to have somebody who would be competent to work with and capable of project execution, and they had demonstrated those capabilities.")).

170. There is a learning curve in building LNG tanks, because "any time you perform work for the first time you would incur

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experience that you can improve when you perform the same work the second or third time or subsequent times." (Fahel, Tr. 1637-38, in camera).

171. Builders of LNG tanks benefit from learning by doing. Samuel Leventry, CB&I's Vice President of Technology Services, testified: "Again, if you have the same people doing the same work more continuously there's going to be some efficiencies in that." (CX 497 at 68 (Leventry, Dep.); CX 392 at 4).

172. CB&I has worked many "years" to "streamline its processes" and lower its costs. (CX 392 at 3). Experience can reduce a firm's costs. A Strengths, Weaknesses, Opportunities, and Threats ("SWOT") Analysis of CB&I acknowledges that its precontract costs for LNG projects has decreased as CB&I moves up the experience curve. (CX 629 at CBI-PL033069, in camera).

173. Newmeister of Matrix testified that if it were to enter the LNG tank market, it would be likely to operate at a higher cost level than an experienced supplier like CB&I for some time while it learned from its mistakes. (Newmeister, Tr. 1605-06).

174. A new entrant would be disadvantaged by not having a fabrication facility. [redacted] testified that the lack of a fabrication plant currently obstructs the [redacted] partnership's penetration of the LNG market. ([redacted], Tr. 1635-37, in camera). Companies that have fabrication capabilities have lower total installed cost because they would not have to incur the additional markup that's normally associated with a third party subcontractor. ([redacted], Tr. 1635-37 in camera). [redacted] considered that its pricing will be perhaps higher than others who have their own fabrication facilities. ([redacted], Tr. 1635-37 in camera).

175. A new entrant must have a sufficiently large revenue base to enhance the tank supplier's ability to offer the financial guarantees necessary to win contracts. (CX 891 at 43, 47 (Glenn, Dep.); Izzo, Tr. 6511-12). Customers require the tank supplier "to provide a bond to the contractor . . . that guarantees the project

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will get finished." (Stetzler, Tr. 6385). An entrant's ability to bond a project, or bonding capacity, "has to do with your financial strength, and also the size of your company." (Stetzler, Tr. 6385).

176. LNG facility contracts often impose large liquidated damage provisions on the constructor if the project is completed late. (CX 891 at 46 (Glenn, Dep.); Izzo, Tr. 6485-86; Bryngelson, Tr. 6154-55). Customers want suppliers with a large asset base, because there is a larger target to go after if the contractor is late in completing the project and the customer sues for liquidated damages. (Bryngelson, Tr. 6154-55; JX 27 at 69 (N. Kelley, Dep.); Izzo, Tr. 6485-86; CX 1121 at CBI-HWH 053087).

## **8. Alleged post-acquisition price increases**

### **a. MLGW**

177. In 2002, Memphis Light Gas & Water ("MLGW") sought budgetary prices for another LNG peak shaving tank. (Hall, Tr. 1824-1825). In January 2002, MLGW contacted CB&I's Eric Frey, a business development manager. MLGW called CB&I because MLGW has a "working relationship with CB&I", Hall has "contacts there," and MLGW believed CB&I is the ["only ones (sic)"] that can provide ["reliable"] tank pricing in the United States. (Hall, Tr. 1825-27). MLGW did not contact other LNG firms because MLGW cannot "trust" the pricing information from foreign firms. (Hall, Tr. 1827-28). Hall stated

that he would need a lot of additional information from Whessoe and TTK to determine if they were viable competitors in the U.S. (Hall, Tr. 1832-33, 1846-48, 1853-54).

178. On January 15, 2002, Marty Smith, CB&I's Vice President of Global LNG Sales, instructed Frey to quote MLGW [redacted] for a 300,000 barrel tank. (RX 732 at CBI 071501, in camera; CX 422 at CBI-E 009500, in camera; Scorsone, Tr. 5323, in camera). Smith explained that Frey's original estimate was [redacted]. (CX 422 at CBI-E 009500, in camera.) Smith also

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instructed Frey [redacted] (CX 422 at CBI-E 009500, in camera).

179. On January 15, 2002, Frey e-mailed Smith with the proposal to quote MLGW a price that [redacted] (RX 732 at CBI 071501, in camera).

180. Margins contained in budget prices are not representative of the actual profit margin that CB&I seeks in fixed, firm price bids. (Scorsone, Tr. 5003). Because CB&I's internal budget documentation does not contain a line item for these contingencies and uncertainties that exist when preparing budget pricing, CB&I accounts for these contingencies in the margin line calculation of the budget estimate. (Scorsone, Tr. 5002-03). Thus, although a margin line item on a budget price may be [redacted], this does not mean that CB&I will seek a [redacted] profit margin if, and when, a firm, fixed price bid is submitted. (Scorsone, Tr. 5003).

181. On January 16, 2002, Frey quoted MLGW a budget price of [redacted], almost [redacted] higher than what Frey had originally prepared. (RX 732 at CBI 071499-500, in camera; CX 422 at CBI-E 009500, in camera; Scorsone, Tr. 5323, in camera). [redacted] (RX 732 at CBI 071499, in camera). [redacted] (CX 422 at CBI-E 009500, in camera).

182. The budget price CB&I provided "was not a buying offer." (Scorsone, Tr. 5250). Rather, the estimate that CB&I provided to MLGW was a SWAG -- a "scientific wild assed guess." (Hall, Tr. 1865-66). Hall testified that MLGW did not provide CB&I nearly enough information to receive an accurate price, and agreed that "volumes more" information would be required for this purpose. (Hall, Tr. 1865-66). Because MLGW was asking CB&I to "extrapolate" into the future, and because it did not provide detailed information, Hall was not expecting a number of more than plus or minus 40% accuracy. (Hall, Tr. 1866-68).

183. On July 17, 2002, Clay Hall of MLGW e-mailed Frey to comment that "we all know that CB&I/PDM is, in fact, the only

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qualified US based firm capable of executing the work." (CX 786 at CBI 065153). Hall added that MLGW is "concerned about where we're going to get competition for our bids in the next few years . . . because we don't see anyone out there with experience that could come into the market and compete with CB&I/PDM." (Hall, Tr. 1830).

**b. Cove Point I**

184. In 2000, CB&I and PDM competed against each other for a 750,000 barrel LNG tank for Columbia LNG ("Columbia") to be built at Cove Point. (CX 293 at CBI/PDM-H 4008141).

185. In January 2000, PDM's Mike Miles announced to PDM staff working on the Cove Point bid, including Jeff Steimer, that (a) "PDM is bidding against CB&I on this one;" and (b) PDM needed a "very competitive price to be successful." (CX 293 at CBI/PDM-H 4008141).

186. On March 29, 2000, Gary Marine of CB&I relayed minutes of a meeting that he had with a representative from Columbia. (CX 226 at CBI-PL0 44978, in camera). Marine wrote: "I told him I bet that by getting two bids, they saved a lot of money over whatever budget they had previously (from PDM). I told him I guessed the price came down at least [redacted] million, and he said it was more like [redacted] million. So PDM had given them a budget of something like [redacted] million for this work." (CX 226 at CBI-PL044978, in camera).

187. Marine advised that CB&I should reduce its price to [redacted] (CX 226 at CBI-PL044979, in camera).

188. Columbia sold Cove Point to Williams Energy ("Williams") in June of 2000. (See CX 863 at CBI/PDM-H 4018410; Harris, Tr. 7724-25). In June of 2000, PDM's Miles reminded the team that Cove Point was a "very competitive situation," and, "in accordance with Luke's [Scorsone's] direction," emphasized the need to get to "the lowest price possible" and to "save every dollar we can." (CX 863 at

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CBI/PDM-H 4018410).

189. Williams considered an increase in the size of the Cove Point tank from 750,000 barrels to 850,000 barrels and initiated a second phase of bidding for the 850,000 barrel tank. (CX 863 at CBI/PDM-H 4018410; Scorsone, Tr. 4964-66).

190. On August 29, 2000, CB&I and PDM agreed to merge. (CX 21 at PDM-C 1000003).

191. Williams' modifications of the project's specifications and increasing the tank size from 750,000 barrels to 850,000 barrels required PDM to re-design and re-price the tank. (Scorsone, Tr. 4964). The re-design took approximately 200 hours, and the follow-up estimating for the project took between 100 and 200 hours. (Scorsone, Tr. 4964).

192. CB&I did not submit a price on the 850,000 barrel tank. (Scorsone, Tr. 4965).

193. On September 8, 2000, PDM quoted Williams a budget price of [redacted] for an 850,000 barrel tank and [redacted] for a 750,000 barrel tank. (CX 1388 at CBI/PDM-H 4015363, in camera).

194. After the September 8, 2000 budget price, PDM prepared a new estimate for the 850,000 barrel tank because the "tank geometry changed." (Scorsone, Tr. 4966).

195. PDM held a bid review meeting to discuss the re-estimated cost of the 850,000 barrel tank for the Cove Point facility. (Scorsone, Tr. 4967-68). The participants at the meeting included Luke Scorsone, acting as the chair of the meeting; Steve Owens, Vice President of Operations for PDM; Jeff Steimer, the sales representative for the project; Mike Wilson, a manager of PDM's estimating group; Kurt Schneider, a manager of the engineering group; and Ron Blum, who was the head of sales. (Scorsone, Tr. 4968). As reflected on a document created for evaluating an estimate in a formal bid review meeting, the



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materials estimate and engineering estimate were revised at the bid review meeting. (Scorsone, Tr. 4971-73; CX-1160 at CBI/PDM-H 4007485, in camera). PDM's management team increased the cost estimates for the Cove Point project because there was "a very uncertain start date for this project . . . ." (Scorsone, Tr. 4978).

196. [redacted]. (CX 1160 at CBI/PDM-H 4007486-7487, in camera). [redacted] (CX 1160 at CBI/PDM-H 4007486-7487, in camera).

197. Overall, Steimer viewed the November 2 [redacted] bid for Cove Point as [redacted]. (CX 1160 at CBI/PDM-H 4007486, in camera).

198. Neither Scorsone nor the bid review group agreed with Steimer's comments with respect to the revised estimates for fabrication, field-erection, subcontracting, and project management or regarding the final bid submitted to Williams. (Scorsone, Tr. 4981-82).

199. PDM entered into sole-source negotiations with, and was granted a letter of intent by, Williams to construct the expansion of the Cove Point facility. (Scorsone, Tr. 4963). The letter of intent was ultimately transferred into a negotiated contract after PDM was acquired by CB&I in February 2001. (Scorsone, Tr. 4963).

200. The price of the Cove Point project that CB&I is constructing for Williams is currently at [redacted]. (Scorsone, Tr. 5333, in camera). Since November 3, 2001, the price increased from [redacted] to [redacted] for the 850,000 barrel tank. (Scorsone, Tr. 5333-34, in camera). Scorsone testified that this increase occurred because: [redacted] (Scorsone, Tr. 5334, in camera).

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201. The current price of [redacted] million includes a gross profit margin of [redacted]. (Scorsone, Tr. 5334, in camera). The gross profit margin includes SG&A (sales and general administrative) costs plus profit. (Scorsone, Tr. 5335, in camera).

202. PDM's November 2, 2000 bid of [redacted] anticipates a profit of [redacted], or [redacted] on the sold price. (CX 1160 at CBI/PDM-H 4007485, in camera).

203. Scorsone testified that CB&I was able to increase its profit due to [redacted] (Scorsone, Tr. 5336, in camera). [redacted] (Scorsone, Tr. 5337, in camera). [redacted] (Scorsone, Tr. 5337-38, in camera).

### **9. Sophistication of customers**

204. LNG owners do not routinely purchase LNG tanks. (Bryngelson Tr. 6060-61, 6208) (the last time El Paso purchased an LNG tank was in the late 1970's or early 1980's); (Eyermann, Tr. 7033) (Freeport LNG and its predecessor Cheniere Energy have never built an LNG facility before); (J. Kelly, Tr. 6257) (the tanks at CMS's only U.S. LNG terminal were built in the late 1970's).

205. Most owners of LNG facilities are not very knowledgeable about procuring LNG tanks. (Outtrim, Tr. 705, in camera; see CX 1507 at CBI 059484 (Yankee Gas must hire someone to evaluate pricing because "they know very little about the LNG industry and they were banking heavily on the report from CHI); CX 138 at CBI 019913-HOU ("Dynergy is not willing to take bids directly themselves since they do not have the staff, experience, and knowledge to analyze the bids and make an informed selection."); (JX 26 at 53 (J. Kelly Dep.) [redacted]

206. Past pricing for LNG tanks is "not something that's well known." (Bryngelson, Tr. 6207). Because of confidentiality provisions, "experienced engineering firms such as Kellogg . . . can provide a rough benchmark, but that's about the best we can do." (Bryngelson, Tr. 6239).

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207. Even with open book sole-source contracts, customers do not know how a supplier's pricing compares to that of other suppliers. Bryngelson of El Paso, which has an open book contract with CB&I for its Bahamas LNG terminal, admits to being "in the dark in terms of knowing what the costs are for LNG tanks suppliers." (Bryngelson, Tr. 6238, see also 6177-78).

**F. Effects on Competition in the LPG Market****1. Overview of the LPG market**

208. Typically, LPG tanks are manufactured the same way as LNG tanks, but for storage at a lower temperature. (G. Glenn, Tr. 4073).

209. The time needed to fabricate and construct an LPG tank varies. For a small LPG tank, construction can take 8 to 10 weeks of fabrication in the shop -- from buying steel, fabricating, and preparing to send out the pieces. The tank construction process can take 16 weeks in the field. Finally, the remaining site work and piping systems occur after the tank is completed. (N. Kelley, Tr. 7109-10). In an example of a large LPG tank, 60 weeks to field-erect the tank was scheduled. (Maw, Tr. 6634).

**2. Market shares and concentration in the LPG market prior to Acquisition****a. Tank projects awarded**

210. From 1990 to the Acquisition, CB&I and PDM built the majority of LPG tanks constructed in the United States. Of the eleven LPG tank projects awarded in the United States between 1990 and 2001, CB&I won five and PDM won four. From 1994 to the Acquisition, of the five LPG tank projects built in the United States, CB&I won zero and PDM won three. Morse Tank and AT&V each won one in 1994 and 2000, respectively. (CX 486; CX 824; CX 1210, in camera; CX 1212 at 7, in camera; CX 397, in camera; (CX 396 at 2, in camera; RX 757; Simpson, Tr. 3368, 3372-3375).

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211. LPG tank awards to CB&I are: Texaco Chemical (1990); Intercontinental Terminals (1991); Mitsui & Co. (1991); Hess Oil (1992); and Koch Refining (1993). LPG tank awards to PDM are: Koch Hydrocarbons (1991); Enron (1995); Sea-3 (1996); Sea-3 (1998). (CX 486; CX 824; CX 1210, in camera; CX 1212 at 7, in camera; CX 397, in camera; (CX 396 at 2, in camera; RX 757; Simpson, Tr. 3368, 3372-3375).

212. Dr. Simpson's calculated each company's market share from 1990 through 2001. In his calculation, he included the 2001 LPG project for BASF in Port Arthur, Texas that CB&I won. (Simpson, Tr. 3375). The Port Arthur project was awarded post-acquisition. (Simpson, Tr. 3686, 3829).

213. Using data dating back to 1990 and including a post-acquisition win by CB&I, Dr. Simpson calculated the data to the advantage of Complaint Counsel to conclude that, based on sales, PDM had a 34.5 percent market share, CB&I had a 56.7 percent market share, Morse Tank had an 8.2 percent market share, and AT&V had a 0.6 percent market share. (Simpson, Tr. 3404). Using this time frame, the combined market share of the merged company is 91.2 percent. (Simpson, Tr. 3404-3405). If the post-acquisition win is excluded, the combined market share of the merged company is 90.9 percent. (See CX 486; CX 824; CX 1210, in camera; CX 1212 at 7, in camera; CX 397, in camera; CX 396 at 2, in camera; RX 757; Simpson, Tr. 3368, 3372-3375).

214. On November 30, 2001, CB&I acquired Morse Tank, the firm that had accounted for the next most substantial share of LPG sales prior to the Acquisition. (Maw, Tr. 6545). If Morse's market share is added to CB&I's market share, the combined market share of Morse, CB&I and PDM is nearly 100%. See F. 213.

215. Respondents' expert, Dr. Harris acknowledged that CB&I and its two acquisitions, PDM and Morse, account for all but one of the sales of LPG tanks in the United States from 1990 to the time of the Acquisition. (Harris, Tr. 7522).

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**b. HHI calculations**

216. Complaint Counsel's expert, Dr. John Simpson, calculated the HHI index for the LPG market from 1990 to early 2001. (Simpson, Tr. 3368).

217. Dr. Simpson's HHI calculation included the 2001 LPG project for BASF in Port Arthur, Texas that CB&I won. (Simpson, Tr. 3375). The Port Arthur project was awarded post-acquisition. (Simpson, Tr. 3686, 3829).

218. Dr. Simpson calculated that, using data from 1990 to 2001, CB&I's acquisition of PDM increased LPG market concentration, as measured by the HHI, by 3911 points to a level of 8380. (Simpson, Tr. 3404-3405).

219. If data dating back to 1994 is used and the 2001 post-acquisition win by CB&I is excluded, Dr. Simpson acknowledged that CB&I had no sales over that time period and that the change in the HHI based on sales in the LPG market would be zero. (Simpson, Tr. 3746-47).

220. Competition in the LPG market is extraordinarily thin, and the market is almost nonexistent. (Harris, Tr. 7281-82). HHI calculations are not accurate in determining the concentration in the LPG market due to the extraordinarily thin market and almost nonexistent demand. (Harris, Tr. 7281-82)

221. Use of data from 1990 to Acquisition does not accurately depict market concentration because it fails to take into account that CB&I had not won a job since 1993. (Harris, Tr. 7287).

**c. Bidders on projects**

222. For the Ferndale project that was won by Morse, there were four bidders: Morse, CB&I, PDM and San Luis Tank. (Maw, Tr. 6550.)

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223. For the Tallaboa project that was won by PDM in 1995, the parties did not present sufficient evidence to determine which companies bid or whether competition constrained prices on this project.

224. For both Sea-3 projects, in 1996 and 1998, CB&I and PDM were the only bidders -- with PDM winning and constructing both projects based on a lower price (roughly 4% lower). (Warren, Tr. 2298-2300, 2302-04, 2305, 2306).

225. For the Deer Park project in 2000, CB&I, AT&V, and Matrix bid on the project. PDM was not a bidder. (N. Kelley, Tr. 7083-84).

226. The value of the 2000 Deer Park project built by AT&V is a small fraction of the value of the other LPG tanks sold during this period. (Simpson, Tr. 3394-95).

227. CB&I's acquisition of PDM combines the two strongest sellers of LPG tanks in the United States. (Simpson, Tr. 3406). According to Dr. Simpson: "Prior to the acquisition . . . CB&I's pricing was constrained principally by the presence of PDM EC. When CB&I acquired PDM EC, then CB&I's pricing would be constrained by much weaker competitors and constrained at a higher price." (Simpson, Tr. 3406). Dr. Simpson testified that he believed that CB&I's acquisition of PDM would lead to higher prices for LPG tanks. (Simpson, Tr. 3406).

**3. Respondents were each others' closest competitors in the LPG market**

228. Respondents referred to each other as a "formidable" competitor (CX 216 at CBI-PL-033886) or "major" competitor in the LPG market (CX 116 at PDM-HOU019181).

229. PDM believed CB&I was its "only competition on tanks over 100,000 bbl [barrels]." (CX 303 at CBI/PDM-H 4001285). PDM characterized CB&I as "PDM EC's only competitor on

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domestic cryogenic, LNG, LPG, Ammonia and thermal vacuum projects." (CX 107 at PDM-HOU005016).

230. Scorsone testified that CB&I was "PDM EC's major competitor" for LPG tanks. (Scorsone, Tr. 5157, 5173-74; CX 94 at PDM-HOU017580). Scorsone also admitted that CB&I was PDM's only competitor on domestic LPG projects. (Scorsone, Tr. 5183; CX 660 at 5).

231. Dr. Harris testified that prior to the Acquisition, neither CB&I nor PDM could increase prices of LPG tanks in the United States without risking that each would lose sales to the other. (Harris, Tr. 7539-40, 7543-44).

232. Amy Warren, Contracts Administrator for Fluor testified that, in 1998, the only competitors were PDM and CB&I. (Warren, Tr. 2307-08).

#### **4. Competition in the LPG market from Acquisition to time of trial**

233. There has only been one LPG tank awarded since the Acquisition, the 2001 ABB Lummus project in Port Arthur, TX. CB&I won the Port Arthur, TX project. (Simpson, Tr. 3686, 3829; G. Glenn, Tr. 4088-89, 4156).

234. The Port Arthur project included four ambient-temperature LPG spheres, one low-temperature LPG tank for butadiene and one flat bottom conventional storage tank. The total value of the project was \$ 8.5 million. The LPG tank alone was \$ 1.5 million. (Scorsone, Tr. 5039-40).

235. On the Port Arthur project, CB&I competed against Wyatt and AT&V in bidding for the project. (N. Kelley, Tr. 7086; Scorsone, Tr. 5040). CB&I initially bid a little above a 4 percent margin. ABB Lummus came back to CB&I after the initial round of bidding and informed CB&I that it was 3rd out of 3 bidders. (Scorsone, Tr. 5040).

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236. Since it was instructed to by the customer, CB&I "sharpened its pencils" and developed an innovation whereby CB&I eliminated the need for one additional support column on each sphere. This innovation lowered the cost to the project overall. (Scorsone, Tr. 5040-41).

**5. Recent entry in the LPG market**

**a. AT&V**

237. AT&V constructed the 2000 project for Intercontinental Terminals Co. ("ITC") in Deer Park, Texas. (JX 27 at 117 (N. Kelley Dep.)). AT&V bid on the Port Arthur project in 2001. (N. Kelley, Tr. 7086; Scorsone, Tr. 5040).

238. AT&V is much smaller than CB&I. (CX 460 at CBI-E 007235; JX 23 at Exh. 1, in camera (Cutts, Dep.); Simpson, Tr. 3292-3315). AT&V's annual revenues are only 2-3 percent those of CB&I. (CX 460 at CBI-E 007235; JX 23 at Ex. 1, in camera (Cutts, Dep.); CX 1033 at 28). CB&I employs over 200 engineers. (CX 460 at CBI-E 007235). CB&I estimates that AT&V has only a small engineering staff. (CX 460 at CBI-E 007235).

239. AT&V is limited in its field capacity. (Cutts, Tr. 2375; Simpson, Tr. 3315 (citing JX 23a at 44 (Cutts, Dep.)). Capacity constraints at AT&V recently prevented AT&V from bidding on two cryogenic tanks. (Cutts, Tr. 2375). AT&V is limited in its capacity to bond projects in the United States, which could impede AT&V's ability to bid on large projects. (Cutts, Tr. 2366, 2375). Cutts, Vice President of AT&V, admitted that AT&V cannot compete with CB&I on large scale projects. (Cutts, Tr. 2375).

240. Cutts admits that his firm faces reputational and marketing disadvantages compared to Respondents. (Cutts, Tr. 2421-22). "AT&V is not a household name for cryogenic tanks." (Cutts, Tr. 2385). Cutts contrasts CB&I by comparing it to the "Coca-Cola" brand-name. (Cutts, Tr. 2385). PDM had brand



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name value also and, like CB&I, its name "could obviously break down a lot of walls and barriers." (Cutts, Tr. 2389).

**b. Other domestic manufacturers**

241. Matrix provided a bid on the 2000 Deer Park project for ITC. (N. Kelley, Tr. 7083-84). Matrix is capable of building LPG tanks and would pursue LPG opportunities in the future. (Newmeister, Tr. 2180-82).

242. Wyatt bid on the Port Arthur project. (Scorsone, Tr. 5040).

243. Chattanooga Boiler & Tank ("Chattanooga") has the capability to construct field-erected LPG tanks. (Stetzler, Tr. 6355). Chattanooga is familiar with how to construct LPG tanks. (Stetzler, Tr. 6354-55). Chattanooga builds similar API 650 storage tanks, API 620 storage tanks, and ASME pressure vessels. These tanks are both shop and field-erected. (Stetzler, Tr. 6356-59, 6308-09; RX 181 at 1-10).

244. Dr. Simpson testified that firms such as AT&V, Matrix Services, and Wyatt Field Services would not be able to restore the pre-acquisition level of competition in the LPG market. (Simpson, Tr. 3408-09). Dr. Simpson noted that all three firms lack the building experience and the reputation that PDM possessed. (Simpson, Tr. 3409).

**c. Foreign manufacturers**

245. Foreign tank suppliers build tanks around the world and advertise in U.S. trade journals. (N. Kelley, Tr. 7091, 7126; Harris, Tr. 7288-89, 7293). However, the testimony of one purchaser of LPG tanks, was that he has never sought a bid from a foreign tank supplier because he "didn't know who to go to, I guess. Went to the local boys." (JX 27 at 114 (N. Kelley, Dep.)). Moreover, his experience buying capital equipment is that he gets better pricing from buying equipment locally in the U.S. rather than from another country. (JX 27 at 74-75 (N. Kelley, Dep.)).

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246. Respondents' economic expert Dr. Harris testified that he had no evidence that any foreign firms have chosen to produce LPG Tanks in the U.S. (Harris, Tr. 7778-79). No foreign tank supplier has won any U.S. LPG projects. F. 210, 215.

247. [redacted] testified that "[redacted] could not successfully compete against CB&I for single-containment LNG or LPG tank projects" in the U.S. ([redacted], Tr. 4711, in camera; RX 738 at P15, in camera). [redacted] has "no plans" to compete for single containment LPG tanks. (RX 738 at P15, in camera).

248. TKK has never built an LPG tank in the United States. (Cutts, Tr. 2351). Moreover, TKK is not interested in bidding on LPG tank projects in the United States. (Cutts, Tr. 2431).

249. Dr. Simpson testified that foreign companies, such as TKK, Skanska-Whessoe, and Technigaz, would not be sufficient to restore the pre-acquisition level of competition in the LPG market. (Simpson, Tr. 3407).

## **6. Barriers to entry in the LPG market**

250. LPG tank suppliers must have sufficient personnel to design, engineer and construct an LPG tank. (RX 682 at MCG 000059 ("Texaco will verify that bidder is not overcommitted to perform that work."); Warren, Tr. 2295 (Before allowing a company to bid, Fluor reviews a potential LPG tank supplier's volume to ensure the supplier is capable of managing multiple projects simultaneously, and to ensure there is not too much backlog to prevent Fluor from accessing the supplier's resources promptly as needed); see CX 415 at 2).

251. LPG tank suppliers need sufficient personnel to handle adjustments to possible schedule changes. (Warren, Tr. 2296 (In order to bid on an LPG project, an LPG tank supplier needs enough staff to handle an adjustment if it becomes necessary to shorten the schedule or recover from delays); see CX 415 at 2).

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252. LPG customers want a manufacturer with prior experience, at least in building API 620 tanks, and with experienced personnel. (N. Kelley, Tr. 7131-32). See also N. Kelley, Tr. 7104-05 ("I don't want to be a guinea pig"); JX 27 at 72 (N. Kelley, Dep.) (ITC would "definitely want [an LPG tank supplier] to have had prior experience building an LPG tank before [it] would hire them to build an LPG tank . . .").

253. Matrix's vice president of marketing testified that the LPG market presents the same barriers to entry as the LNG market and would be difficult to penetrate. (Newmeister, Tr. 1609-10).

## **7. Sophistication of customers**

254. Intercontinental Terminals Company ("ITC") is the only recent LPG customer to testify in this case. ITC owns 10 field-erected low temperature tanks. (N. Kelley, Tr. 7093-94). Mr. Norman Kelley, Vice President of ITC, testified that during his 25 years at ITC he has procured LPG tanks over 23 of those 25 years. Tank procurement is Kelley's area of responsibility. (N. Kelley, Tr. 7079-80). Kelley regularly sorts confidential bids from multiple tank suppliers. (N. Kelley, Tr. 7082-83).

## **G. Effects on Competition in the LIN/LOX Market**

### **1. Overview of the LIN/LOX market**

255. LIN/LOX tanks are double-walled tanks made of stainless steel which store liquid oxygen and nitrogen at very low, even cryogenic, temperatures which allows them to be stored in a liquid form. (Stetzler, Tr. 6312). A LIN/LOX tank consists of an outer carbon steel shell and an inner tank, most commonly made out of stainless steel. There is insulation between the two shells to keep the temperature at minus 320 degrees. (Stetzler, Tr. 6312; Kistenmacher, Tr. 833-34).

256. LIN/LOX tanks are most commonly incorporated into the infrastructure of a functioning air separation facility. There are

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no viable substitutes for storing liquid oxygen or nitrogen produced by such a plant. (Hilgar, Tr. 1386).

257. An air separation plant is a plant that liquefies ambient air, then distills the air into its component parts. The component parts of air are the industrial gases: oxygen, nitrogen, and argon. The liquefied gases are later cooled and stored in cryogenic storage tanks. Subsequently, the gases are delivered to the marketplace either in a gaseous form or liquid form. (Kamrath, Tr. 1980; V. Kelley, Tr. 4592; Kistenmacher, Tr. 824-25).

258. The cost to design and fabricate LIN/LOX tanks typically represents five to ten percent of the total cost of an air separation facility. (Hilgar, Tr. 1507). Construction of an air separation facility may cost \$ 18 million. LIN/LOX tanks used at such a facility may cost from \$ 1 to \$ 1.5 million. (Kistenmacher, Tr. 836; Hilgar, Tr. 1507-08).

259. The following construction steps are taken for building LIN/LOX tanks: First, the project is engineered and drawings are developed in connection with the procurement of materials. Second, materials including the raw steel and steel components are procured. Third, steel materials are fabricated in fabrication shops. Next, tool and equipment lists are created and everything including the fabricated materials are shipped to the construction site. The structure is then erected on the project site and tested. (Scorsone, Tr. 4885-86).

260. The engineering phase involves the performance of calculations and an analysis to determine the size and shapes of the various components to be placed in the structure. This phase entails writing the specifications for the various materials and welding processes that will be used. Drawings are created to be used by fabrication shops, construction crews, and subcontractors. (Scorsone, Tr. 4886-87).

261. CB&I does not have an engineering staff that solely works on LIN/LOX projects. CB&I uses its engineers across several product lines. Engineers who design flat-bottom tanks

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also have the capability to design LIN/LOX tanks. CB&I's engineers are located in Pittsburgh, Pennsylvania; Plainfield, Illinois; Houston, Texas; Canada, the Middle East, the Philippines, and Australia. (Scorsone, Tr. 4887-88).

262. The bill of materials contains a list of materials that are sent to the procurement group. The procurement group then procures these materials from a wide variety of vendors. (Scorsone, Tr. 4889-90).

263. The metal materials are fabricated in a fabrication shop by the same personnel and using the same equipment that is used to fabricate other types of tanks. (Scorsone, Tr. 4885; 4892-93).

264. The field-erection process for an industrial tank involves: (1) receiving the material from the fabrication source and the steel mills; (2) establishing a site office; (3) establishing a tool and equipment management system; (4) employing the field labor; (5) erecting the structure in accordance with the plans and contract specifications; and (6) testing the work quality. (Scorsone, Tr. 4895-96).

265. The field construction process used to field-erect a LIN/LOX tank is the same process that is used to erect any type of ambient-temperature flat-bottom tank. (Scorsone, Tr. 4885).

266. The welding processes used on a cryogenic tank are the same as the processes used for an ambient temperature tank. (Scorsone, Tr. 4899). The welding methods used for cryogenic tanks are an open art. (Scorsone, Tr. 4899).

267. CB&I does not regard LIN/LOX work as an important part of its business because it is so small. (Scorsone, Tr. 5016). The total revenue realized in the LIN/LOX market in the last two years for all construction vendors amounted to only approximately \$ 5 million out of \$ 2 1/2 to \$ 3 billion. (Glenn, Tr. 4088). CB&I does not have any salespersons dedicated to the LIN/LOX market. (Scorsone, Tr. 5017).

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268. Currently, there is overcapacity in the LIN/LOX market. Moreover, there will not be air separation plants requiring LIN/LOX tanks constructed in the next few years. (Hilgar, Tr. 1541-43). Demand for field-erected LIN/LOX tanks is not high. (Stetzler, Tr. 6382-83).

## **2. Market shares and concentration in the LIN/LOX market prior to Acquisition**

### **a. Tank projects awarded**

269. From 1990 to the Acquisition, CB&I, PDM, and Graver built nearly all the LIN/LOX/LAR tanks in the United States. From 1990 to Acquisition, 109 LIN/LOX tanks were constructed, with a total value of [redacted]. CB&I and PDM had a combined market share of 72.8% of the value of LIN/LOX awards. CB&I won 25 tanks (with a total value of [redacted] (33.9% of the total). PDM won 44 tanks (with a total value of [redacted] (38.9% of the total.) Graver won 34 tanks (23.3% of the total value). Matrix won 4 tanks (2.6% of total value), and AT&V won 2 tanks (1.4% of the total value). (Simpson, Tr. 3422, 3429-30; CX 26, in camera; CX 85; CX 155; CX 183; CX 260; CX 282; CX 397, in camera; CX 755; CX 1025, in camera; CX 1170; CX 1210 at 5-6, in camera; CX 1212 at 6, in camera; CX 1321, in camera; CX 1458; Cutts, Tr. 2451).

270. Graver went out of business, in 2001, and is no longer a competitor in the LIN/LOX market. (CX 1546; Hilgar, Tr. 1543). Graver's assets were sold at auction. (Harris, Tr. 7312, 7313).

271. MG Industries purchased [redacted] LIN/LOX tanks between 1994 and 1999. In all but perhaps one of these projects, MG Industries received bids from CB&I, PDM and Graver. (Patterson, Tr. 478-79, in camera).

272. Linde's policy in purchasing LIN/LOX tanks is to have at least three bidders. (Kistenmacher, Tr. 864). CB&I, PDM and Graver bid on tanks built for Linde. (Kistenmacher, Tr. 869.)

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**b. HHI calculations**

273. Dr. Simpson calculated that, using data from 1990 to 2001, CB&I's acquisition of PDM increased LIN/LOX concentration, as measured by the HHI, by 2,635 points, to a level of 5,845. (Simpson, Tr. 3443).

274. Dr. Simpson's HHI calculations in the LIN/LOX market were based on sales from 1990 to the date of the Acquisition. (Simpson, Tr. 3704). Dr. Simpson admitted that he chose 1990 as the beginning date for his HHI analysis because 1990 was the cut off date for discovery and thus his information dated back to 1990. (Simpson, Tr. 3704-05).

275. In the LIN/LOX market, Dr. Simpson admitted that CB&I's spin off from Praxair, Incorporated, in 1997 was a significant competitive change, a fact which would justify beginning the HHI calculation in 1997 after the date of the sale. (Simpson, Tr. 3753).

276. Use of data from 1990 to Acquisition does not accurately depict market concentration because it fails to predict forward from the time of acquisition, fails to consider Praxair's sale of CB&I, and fails to account for recent entry. (Harris, Tr. 7311-12).

**3. Respondents were each others' closest competitors in the LIN/LOX market****a. Respondents' views**

277. In a July 1997 competitor report to Luke Scorsone, PDM's Bill Weber noted that "since last fall, CB&I has been the most aggressive competitor in increasing market share." (CX 108 at PDM-HOU005018).

278. In May 2000, Luke Scorsone warned the Board of PDM that "CB&I has been extremely aggressive on pricing work in North and South America. They have taken certain projects at levels which would be slightly over PDM EC's flat cost." (CX 64

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at PDM-C 1002562).

279. According to an October 2000 e-mail from Bob Lewis, then CB&I's Vice President of Corporate Business Development, PDM had "[a] tendency to bid much lower than the market leaving a lot of money on the table." (CX 632 at CBI-PL 4000160). In April 1997, Rich Kooy compared CB&I and PDM's LIN/LOX prices and recognized that "in North America we [CB&I] could still be very handily undercut (by as much as 10%) by PDM if they wanted to work at a lower price level." (CX 178 at CBI-PL011835).

280. In competing for LIN/LOX jobs, CB&I and PDM would in some instances, set prices that would generate "negative margins." (CX 183). In fact, CB&I lost some projects to PDM because of PDM's "very low" pricing levels. (Crain, Tr. 2592; CX 624).

281. A CB&I document states that "PDM is the driver on negative margins on these LIN/LOX tanks. We understand that PDM can readily price the LIN/LOX work at -6% margin in the Gulf Coast and Southeast . . . Unless there is a reason why PDM would be less aggressive or economical in NV, then I agree with Ron that -2% or -3% should get us on the high side of the target range." (CX 193 at CBI-PL020339).

282. Other documents of Respondents reflect the competitive pressure that PDM regularly placed on CB&I. (See CX 614 at CBI-PL039367 (for LOX tank project for Air Products in Eureka, Nevada, PDM's quoted price was "\$ 100,000 lower than CB&I's and Matrix's price, and almost \$ 200,000 lower than Graver's price"); CX 222 at CBI-PL037594 (PDM won a bid from CB&I for a pair of LIN/LOX tanks by dropping their bid on their best and final offer by \$ 40,000); CX 191 at CBI-PL018948 (Air Products had awarded a LOX tank to PDM, which "was the very low bidder and met all of the technical requirements.")).



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**b. Industry views**

283. William Cutts, Vice President of American Tank & Vessel ("AT&V") agreed that, prior to the merger of CB&I and PDM, customers preferred PDM or CB&I for their LIN/LOX tank projects, "almost exclusively [desiring] one or the other or pitting the two against the other." (Cutts, Tr. 2390).

284. Cleveland Fontenot, Jr., former Vice President of Procurement for Air Liquide Process and Construction ("Air Liquide"), testified that prior to the Acquisition, CB&I and PDM were the two most qualified LIN/LOX/LAR tank suppliers. Air Liquide's bid slate included, "CB&I, PDM and a little bit lower would be Matrix." (Fontenot, Tr. 2021-22). However, Air Liquide "didn't feel as comfortable" with Matrix because the "number of references they had weren't nearly what the other two suppliers [CB&I and PDM] had." (Fontenot, Tr. 2022).

285. David Kamrath, CEO of Air Liquide Process and Construction and a 30-year participant in the industrial gas business, believes that prior to the merger Air Liquide only "had PDM and CB&I" for the construction of LIN/LOX tanks. (Kamrath, Tr. 1988).

**c. Competition between Respondents lead to lower prices**

286. Prior to the Acquisition, Linde used PDM's prices as its "benchmark" to compare other firms' prices. (Fan, Tr. 967). Linde was able to leverage two manufacturers against each other to negotiate pricing and other concessions. (Kistenmacher, Tr. 867-8).

287. MG Industries, a producer of industrial gas products, purchased 16 LIN/LOX tanks in the last nine years. (Patterson, Tr. 338, 341). Before the merger, the same three firms bid on most of MG Industries' LIN/LOX projects: CB&I, PDM and Graver. (Patterson, Tr. 351, 355, 363, 365). On each of MG Industries' LIN/LOX projects after 1997, Mr. Michael Patterson, Director of Engineering, MG Industries, used each of the other

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firms as bargaining chips to obtain lower prices on LIN/LOX tanks. (Patterson, Tr. 351-365).

288. There was vigorous competition between CB&I, PDM and Graver. CB&I and PDM would vigorously undercut each other's prices, to the extent that the firms sold LIN/LOX tanks at negative margins, e.g., -23%, -12%, and -2 to -3%. (CX 136 at CBI 014195-HOU; CX 193 at CBI-PL020339; CX 600 at CBI-PL012354). (See CX 455 at CBI-E 007334, in camera ([redacted])); id. at CBI-E 007335, in camera ([redacted]); id. at CBI-E 007335, in camera ([redacted])

289. In 1997, CB&I, PDM and Graver were competitors for the Rockport, Indiana project. According to Patterson, MG Industries' negotiating tactics "lowered the price." (Patterson, Tr. 351-52). Graver was the lowest bidder for the Rockport project, but after "verbal negotiations" using PDM's and CB&I's bids as leverage, Graver "knocked a few percent off [its] price." (Patterson, Tr. 351-53).

290. CB&I, PDM, and Graver also competed for the contract to the combined Chattanooga and Johnsonville, Tennessee projects in 1997. (Patterson, Tr. 355). PDM was the lowest bidder, with both Graver and CB&I bidding 15 percent higher than PDM. (Patterson, Tr. 356-57; see CX 194 at CBI-PL023449). Patterson informed the bidders that "they were way higher than what it would take to be awarded any of those type projects," and that "if they expected to receive any orders, they would have to significantly lower their price." (Patterson, Tr. 357-58). As a result of Patterson's negotiating, the firms "lowered their price." (Patterson, Tr. 358). The Johnsonville project was later postponed, while the Chattanooga tanks were built. (Patterson, Tr. 356).

291. MG Industries combined the LIN/LOX tanks for the Albany, New York; Delisle, Mississippi; and Johnsonville, Tennessee projects for one bidding process. (Patterson, Tr. 361-62, 355-56). PDM was the lowest bidder, Graver's bid was 4% above PDM's, and CB&I's bid was 7% above PDM's bid.

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(Patterson, Tr. 362). Once again, Patterson used PDM as leverage, informing Graver that "somebody has a better price than they do." (Patterson, Tr. 363). The customer was again successful in promoting the most competitive environment he could, as "Graver dropped the price substantially." (Patterson, Tr. 364).

**4. Competition in the LIN/LOX market from Acquisition to time of trial**

292. Since CB&I's acquisition of PDM in 2001, five LIN/LOX projects have been awarded by LIN/LOX customers. (Scorsone, Tr. 5015-16). The five LIN/LOX projects that have been awarded since the Acquisition are: Midland, North Carolina (BOC Gases); Hillsboro, Oregon (BOC Edwards); Freeport, Texas (Air Liquide); New Johnsonville, Tennessee (MG Industries); and Kirkland, New Mexico (Praxair). (Scorsone, Tr. 5017).

293. Since the Acquisition, of the five LIN/LOX tank projects awarded, AT&V has won three and CB&I has won two. (Harris, Tr. 7308; Scorsone, Tr. 5015-16).

294. Of the five post-Acquisition LIN/LOX projects, four were competitively bid. (Scorsone, Tr. 5017). Of the four competitively bid projects, AT&V bid on three and won all three. (Scorsone, Tr. 5018). CB&I has never won a LIN/LOX project when AT&V was a competitor bidding on the project. (Scorsone, Tr. 5018).

**a. Midland, North Carolina (BOC Gases)**

295. AT&V won both tank awards for the BOC Gases Midland, North Carolina project. (V. Kelley, Tr. 4599; Scorsone, Tr. 5024; RX 273, in camera). In 2000, BOC Gases solicited bids for the Midland LIN/LOX project from PDM, CB&I, AT&V and Chattanooga Boiler & Tank. (V. Kelley, Tr. 4598; Scorsone, Tr. 5024-25; RX 273, in camera).

296. BOC Gases awarded the Midland project to AT&V

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because of low cost and was satisfied with the price because it was below BOC Gas' budget for the project. (V. Kelley, Tr. 4599-601, Tr. 5272, Tr. 5282).

297. Dr. Kistenmacher, Vice President of BOC's successor, Linde BOC Process Plants, was told by his direct partner at BOC ". . . that the price was low in the beginning, but they [AT&V] had many change orders, that in the end the price was higher than of the conventional vendors." (Kistenmacher, Tr. 931-32).

298. BOC Gases had to budget 500 man-hours of additional BOC Gases engineering time to ensure that AT&V delivered the LIN/LOX tanks "on time, on schedule, on budget"; this was AT&V's first experience building LIN/LOX tanks. (JX 28 at 43-46 (V. Kelley, Dep.); RX 290 at CBI 046596-NEW).

**b. Hillsboro, Oregon (BOC Edwards)**

299. AT&V was awarded a LIN/LOX project for BOC Edwards in Hillsboro, Oregon. (Cutts, Tr. 2504-06; V. Kelley, Tr. 5291-92; RX 813).

300. CB&I submitted budget pricing for the LIN/LOX project in Hillsboro, Oregon. (Scorsone, Tr. 5018, 5031). BOC Edwards reviewed the budget prices submitted for the project and determined that AT&V had the low bid. (V. Kelley, Tr. 5292). Based on these budget prices, BOC Edwards awarded the project to AT&V. (V. Kelley, Tr. 5292; Scorsone, Tr. 5031).

**c. Freeport, Texas (Air Liquide)**

301. In 2001, Air Liquide solicited bids for a LIN/LOX project in Freeport, Texas. AT&V, CB&I, Matrix and BSL bid on the project. (Cutts, Tr. 2569; Scorsone, Tr. 5032; RX 627 at 2, in camera).

302. AT&V was awarded the Air Liquide LIN/LOX project in Freeport, Texas. (Kamrath, Tr. 2006; Scorsone, Tr. 5017). [redacted] (Kamrath, Tr. 2235, in camera). [redacted]. (Scorsone,

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Tr. 5023-5024; Kamrath, Tr. 2235, in camera; RX 627 at 2, in camera).

303. Matrix's bid on Air Liquide's Freeport LIN/LOX tank [redacted] (Kamrath, Tr. 2235, in camera).

304. [redacted] (Kamrath, Tr. 2254-55, in camera).

305. [redacted] (Kamrath, Tr. 2241, 2251, 2253, in camera). [redacted] (Kamrath, Tr. 2252, in camera). Air Liquide asked CB&I to complete the project, but CB&I refused. (Scorsone, Tr. 5036).

**d. [redacted] (MG Industries)**

306. In April 2002, MG Industries sought pricing for a LIN/LOX tank project in [redacted]. (Patterson, Tr. 456-57, in camera).

307. Requests for prices were sent to [redacted]. (Patterson, Tr. 456-57, in camera). While [redacted] submitted budget pricing, it did not submit a formal bid. (Stetzler, Tr. 6351). [redacted] (Patterson, Tr. 482, in camera).

308. [redacted] was the lowest bidder. (Patterson, Tr. 457, in camera). [redacted] price was [redacted] higher than [redacted]. (Patterson, Tr. 457, in camera). [redacted] budget price was [redacted] higher than [redacted]. (Patterson, Tr. 457, in camera).

309. [redacted] (Patterson, Tr. 460-62, 482-83, in camera).

310. [redacted] (Patterson, Tr. 460, in camera). [redacted] (Patterson, Tr. 486-87, in camera). [redacted] (Patterson, Tr. 461, in camera).

**e. Kirkland, New Mexico (Praxair)**

311. CB&I was awarded a LIN/LOX project by Praxair in Kirkland, New Mexico pursuant to a partnering agreement.

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(Scorsone, Tr. 5019-20). PDM had entered into an alliance agreement with Praxair which obligated Praxair to award non-union LIN/LOX tank projects to PDM, and PDM was obligated to construct the projects at a 4 percent margin level. (Scorsone, Tr. 5018-19; RX 87 at 4). In 2001, PDM and Praxair agreed to renew the agreement for another three years. (RX 87 at 2). The partnering agreement between Praxair and PDM was transferred to CB&I after the Acquisition. (Scorsone, Tr. 5019).

**5. Recent entry in the LIN/LOX market**

312. No foreign company has ever built a LIN/LOX tank in the United States. (Hilgar, Tr. 1385).

**a. AT&V**

313. AT&V is a recent entrant to the LIN/LOX market. AT&V has won all three LIN/LOX projects that it has bid on. (Scorsone, Tr. 5018). AT&V is committed to pursuing LIN/LOX projects in the United States. (Cutts, Tr. 2332). AT&V has submitted budget pricing for approximately six customers and has formally been pre-qualified as a bidder by one customer and informally pre-qualified by several others. (Cutts, Tr. 2452-53).

314. Reviews of AT&V's price and performance for BOC's Midland project are mixed. One BOC witness testified that he "was satisfied with the price" it received and "satisfied with the work that AT&V did at Midland." (V. Kelley, Tr. 5285). Another testified that, although the price was low in the beginning, because of the many change orders the price ended up higher. (Kistenmacher, Tr. 931-32). In addition, "there was a design run of pipe [on the BOC project] that could have caused liquid oxygen to settle and then dissipate, creating a hazardous atmosphere in that location." and a "welding error" during construction that caused the steel plate that comprises the tank to buckle at a weld joint. (V. Kelley, Tr. 5269, 5273-74).

315. AT&V does not compete on an equal footing with CB&I in the LIN/LOX market. AT&V is much smaller than CB&I. (CX

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460 at CBI-E 007235; JX 23 at Ex. 1 (Cutts, Dep.), in camera; Simpson, Tr. 3292-3315). AT&V's annual revenues are only 2-3 percent of CB&I's revenue. (CX 460 at CBI-E 007235; JX 23 at Ex. 1 (Cutts, Dep.), in camera; CX 1033 at 28). AT&V is capacity constrained. (Simpson, Tr. 3315 (citing JX 23a at 44, (Cutts, Dep.)). AT&V lacks the field capacity to handle more than four LIN tanks at a time or one small LNG project at a time. (Cutts, Tr. 2376). Recently, AT&V had to refuse to bid on two cryogenic tank projects in the United States because of its limited field capacity. (Cutts, Tr. 2375).

316. Cutts admitted that CB&I will outperform AT&V on future projects for years to come. "There would still probably be a few years to catch up... [CB&I] would still probably be able to outperform us a little bit until we had a few years under our belt." (Cutts, Tr. 2380). Cutts stated that AT&V could compete with CB&I only "on certain fronts, on certain scale projects, okay, with certain assistance, if the customers are willing." (Cutts, Tr. 2374).

317. Customers that have done business with AT&V have found that any initial savings are often offset or exceeded by oversight costs and costs related to change orders. (Kistenmacher, Tr. 931-32; Kamrath, Tr. 2254-55, in camera). F. 297-98, 304, 314.

318. Air Products has not qualified AT&V as a LIN/LOX tank supplier, due to its concern over AT&V's performance and poor reputation. (Cutts, Tr. 2355-56; Hilgar, Tr. 1369). Another LIN/LOX customer, [redacted], thinks that [redacted] was "insane for buying a tank from an inexperienced tankee," and testified that it is concerned about working with AT&V, based on word of mouth reports of AT&V's performance on its LIN/LOX projects for [redacted]. (CX 41 at CBI-E 007336; Patterson, Tr. 472, in camera). [redacted] F. 305.

319. In Respondents' competitive profile of AT&V, Respondents state that AT&V's "quality" and "safety" are "poor." (CX 86 at PDM-CH 002617). The document notes that on past projects, AT&V performed poorly in terms of supplying a quality

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tank or sphere and has not met customer safety standards. Kellogg and Bechtel threw AT&V off projects due to poor quality or poor safety practices. Moreover, in the past, Dupont, Shell-Norco and Exxon (Baton Rouge) would not let AT&V bid on their projects. (CX 86 at PDM-CH 002617). Respondents describe AT&V's safety practices as "severely lacking ... and are being labeled as an undesirable risk by many." (CX 263 at CBI-HOO-004606).

**b. Matrix**

320. Matrix is a recent entrant. Although Matrix won only 4 of the 83 awards prior to Acquisition, all 4 of these are recent LIN/LOX construction. In 1997, Praxair awarded Matrix a liquid oxygen and liquid nitrogen "cluster tank" project in Rossford, Ohio over CB&I. Matrix finished the work on time and to the satisfaction of Praxair. (Newmeister, Tr. 2174-75). Matrix built two LIN/LOX tanks for Praxair in Delaware City, Delaware, in 1998. (Newmeister, Tr. 2173; 2176-77). Matrix was awarded the Delaware City LIN/LOX project in 1998 over CB&I and it completed the project on time. (Newmeister, Tr. 2176-77). In 2000, Matrix was awarded a LAR tank for Praxair in East Chicago. Praxair was satisfied with the construction and the project was erected on schedule. (Newmeister, Tr. 2173; 2176-77). Also in 2000, Matrix was awarded a LIN tank by Air Products for a project in Kingsport, Tennessee. Air Products awarded the tank to Matrix over CB&I and PDM, despite the fact that Matrix had never built a tank for Air Products before. (Newmeister, Tr. 2173-74).

321. Matrix has been a high bidder, and consequently non-competitive, on recent LIN/LOX tank projects for several customers, including Air Liquide and Linde. (Newmeister, Tr. 2156-58). (See Fan, Tr. 960-62 (on 2002 project, Matrix bid over [redacted], while CB&I bid [redacted]); Kistenmacher, Tr. 860 (on preliminary bids, Matrix was eliminated from consideration because its pricing was high); Fontenot, Tr. 2029 (CB&I was at least [redacted] Matrix on Air Liquide's recent Longview, Texas project).



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322. Matrix has been told that Matrix has not won these projects either because its pricing has been too high or because the customer did not believe that Matrix was sufficiently qualified. (Newmeister, Tr. 2155-58; Kamrath, Tr. 2000-01 (Matrix's prices have "never been below what we'd seen from any of the other competitors"); Fontenot, Tr. 2022 ("didn't feel comfortable with Matrix"); Hilgar, Tr. 1354, 1382-83 (Matrix has "more limited capacity to produce field-erected cryogenic storage tanks," as compared to CB&I or PDM)).

323. Air Product's supply manager, with responsibility for bidding out LIN/LOX tanks, testified that Matrix cannot replace PDM in the LIN/LOX marketplace from Air Products' perspective. (Hilgar, Tr. 1354).

324. Matrix is a diminished competitor in the LIN/LOX tank market as a result of the sale in August 2000 of its Brown Steel subsidiary, which owned the fabrication facility where Matrix fabricated LIN/LOX tanks. (Newmeister, Tr. 1590-91, 1595). Matrix determined that "once we sold Brown Steel Company, we lost some competitive advantage in the two primary areas, one of which - one of being able to do internal blasting and priming, and the other, impressing." (Newmeister, Tr. 2158-59). By losing its fabrication capability, Matrix is required to subcontract the fabrication work for these tanks, and subcontracting increases Matrix's costs. (Newmeister, Tr. 1569-70, 1590 (As a result of subcontracting its fabrication work, Matrix's "costs will be higher. They won't be as competitive."))).

**c. Chattanooga Boiler & Tank**

325. Chattanooga Boiler & Tank ("Chattanooga") does not effectively compete in the LIN/LOX market. Chattanooga has never built a LIN/LOX tank. (JX 2 at 2 (Respondents stipulate that Chattanooga has never built a LIN/LOX tank); CX 623 at FTC0000399; Stetzler, Tr. 6413-15). Chattanooga has never created any strategic plans or pricing strategy for designing, engineering, fabricating, or erecting LIN/LOX tanks. (Stetzler, Tr. 6421-22, 6426). Mr. Jerry Stetzler, Chattanooga's President,

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testified that the supply of LIN/LOX tanks is "not really a business that we've been participating in." (Stetzler, Tr. 6422).

326. On one occasion when it recently bid on a LIN/LOX project, Chattanooga's price was higher than any other competitor. (CX 189 at CBI-PL015105; [redacted], Tr. 457, in camera) (Chattanooga's price was [redacted] higher than CB&I's).

327. LIN/LOX industry participants question Chattanooga's ability to build a LIN/LOX tank. MG Industries "has doubts" of Chattanooga's "abilities." (CX 41 at CBI-E007336). Cutts testified that AT&V does not consider Chattanooga for LIN/LOX tanks in the United States. (Cutts, Tr. 2333). Scorsone admitted that Chattanooga was never "on the radar screen for competing for LOX/LIN projects." (Scorsone, Tr. 4877).

#### **6. Barriers to entry in the LIN/LOX market**

328. It is very important to MG Industries that its suppliers have prior experience. (Patterson, Tr. 467, in camera).

329. To build a LIN/LOX tank takes very specialized know-how, including knowledge about the material shrinking process and how to avoid cracks. (Kistenmacher, Tr. 852).

330. If a LIN/LOX tank is not constructed properly, severe harm and destruction could occur. (Kistenmacher, Tr. 848).

331. Track record and experience of the vendor are important factors in selecting a manufacturer of LIN/LOX tanks. (Kistenmacher, Tr. 849).

332. A new entrant will need to establish the capability to perform specialized metal fabrication. (Hilgar, Tr. 1343-44 (fabrication of the pieces for a LIN/LOX tank is complex due to "the tolerances and the manufacturing processes. . . . [if the] pieces get to the field and don't fit, you have a major problem"); Kamrath, Tr. 1995 (customer "would be very concerned about how he manages that, the supervision he provides, the standards

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and guidance he provides. It's not something that eliminates a supplier, but certainly it raises a concern.")).

333. A new entrant will need large amounts of cash to conduct physical tests of materials and tank prototypes or components. For example, Matrix spent [redacted] testing cellular glass and rigid insulation systems that form the ground insulation between the inner and outer tanks for a LIN/LOX tank. (Newmeister, Tr. 1584-85; Kamrath, Tr. 2235-36, in camera [redacted])

334. Air Liquide would not buy a LIN/LOX tank from someone who had not built a tank before, because of the risks, including technical and safety risks, and project execution risk. (Kamrath, Tr. 1995-96, 2236-37, in camera; see also Knight, Tr. 2628 (experience building LIN/LOX tanks provides customers with confidence that the product will be designed and built the way it was requested); JX 25 at 83-4 (Hilgar, Dep.) (describing safety hazards associated with LIN/LOX tanks).

## **7. Alleged post-acquisition price increases**

335. In 2002, Linde and Praxair were competing against each other for the same air separation facility. (Scorsone, Tr. 5020). Linde lost the air separation facility to Praxair, therefore Linde did not pursue the pricing for its proposed project any further than the budget pricing stage. (Scorsone, Tr. 5020-21). Praxair won the contract for air separation facility and awarded the LIN/LOX project to CB&I. (Scorsone, Tr. 5019).

### **a. Linde-New Mexico Project**

336. In 2002, Linde BOC Process Plant LLC ("Linde") requested budget pricing for a proposed 344,000 gallon LIN/LOX tank to be located in New Mexico ("Linde-New Mexico"). (Fan, Tr. 1002, 1064; CX 1344 at LPPI 0000259, LPPI 0000261).

337. Mr. Chung Fan is a proposal manager at Linde BOC Process Plants. (Fan, Tr. 947). In his request for proposal, Fan did not provide the following information: a construction schedule

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(Fan Tr., 1073), where in the state of New Mexico the project would be located (Fan, Tr. 1075), the time of year that the tank would be constructed (Fan, Tr. 1076), the conditions of the project site (Fan, Tr. 1077), or the identity of the end-user (Fan, Tr. 1078; see also RX 860 at CBI 071847). Fan provided only a preliminary nozzle list (Fan, Tr. 1060) and requested that the pricing for the New Mexico project be submitted within two weeks time. (Fan, Tr. 1062). Fan admitted that he did not provide sufficient information to produce a firm-fixed price. (Fan, Tr. 1078).

338. AT&V quoted a price of approximately \$ 600,000. (Fan, Tr. 960-961). Matrix responded with a price of over \$ 900,000. (Fan, Tr. 962). CB&I responded with a budget price of \$ 814,000. (CX 1344 at LPPI 0000261).

339. Fan stated that he did not consider AT&V's price "reliable" because it diverged so widely from CB&I and Matrix. (Fan, Tr. 963). Fan could not see how AT&V could do it so cheaply compared to CB&I. (Fan, Tr. 963). While AT&V's low price has caused some concerns for Linde, there has been pressure within Linde to use AT&V because of their low price. (Fan, Tr. 1016-18).

340. Fan dismissed Matrix because he believed its price was always high. (Fan, Tr. 1019).

341. Fan compared CB&I's budget price on the New Mexico project, which was based on incomplete information and was not the result of any negotiation, to a 3 year old PDM firm fixed price which was the result of significant negotiation, and believed that CB&I's price had gone up. (Fan, Tr. 1019, 1069-70).

342. Fan also compared CB&I's price with a pricing model that Linde routinely uses to distinguish between reasonable and unreasonable price quotes from vendors. (CX 1584; Fan, Tr. 966, 1024). Using his pricing model and the past price information from PDM, Fan concluded that the quote he received from CB&I

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was higher than Linde would have paid to PDM. (Fan, Tr. 1009-10).

343. Prior to April 2002, the time of the New Mexico estimate, Fan had not updated his estimating spreadsheet for approximately two years. (Fan, Tr. 973). Fan stated that he uses the year 1998 as a baseline for his spreadsheet. Fan agreed that the further away from his baseline year of 1998 he gets, the less accurate his estimating attempts become. (Fan, Tr. 1069). Fan stated that his calculations do not account for price changes between the time the project is bid and the time it is awarded because that is not the purpose of his spreadsheet. (Fan, Tr. 1055-56).

344. Fan stated that his method was not accurate enough to determine if CB&I's prices went up because he did not have CB&I's metal pricing. (Fan, Tr. 1056). Fan does not know the quantity of perlite used for any of the tanks in his spreadsheet. (Fan, Tr. 1045). Fan stated that it is very difficult to calculate the amount of perlite and the thickness of the perlite required for a project because it shrinks when the tank is filled with cryogenic fluid. (Fan, Tr. 1045). Fan did not call up perlite suppliers to determine the current rate for perlite. (Fan, Tr. 1049). Fan did not call the foamglass supplier to determine the current rate for foamglass. (Fan, Tr. 1050). Fan did not call the concrete supplier to determine the current rate for concrete. (Fan, Tr. 1050). Fan did not know the thickness of the metal CB&I intended to use for the New Mexico project and attempted to calculate the metal thickness based upon drawings from other non-CB&I tanks. (Fan, Tr. 1047).

**b. Praxair-New Mexico Project 1**

345. On June 15, 2002, CB&I submitted a pricing proposal to Praxair for a [redacted] gallon LIN/LOX tank to be built in Farmington, New Mexico. (CX 1508 at CBI 059657, in camera). Pursuant to the sole-source exclusive partnership agreement Praxair negotiated with CB&I shortly prior to the Acquisition, Praxair is obligated to contract with CB&I for its domestic non-

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union LIN/LOX tanks, and CB&I is required to provide open book pricing with a four percent margin. (Scorsone, Tr. 5019-20).

346. CB&I's quote to Praxair was [redacted]. (CX 1508 at CBI 059657, in camera).

347. CB&I provided a firm fixed price to Praxair pursuant to its partnering agreement; Praxair provided CB&I with all of the detail necessary to arrive at a firm price. (Scorsone, Tr. 5020-21). By contrast, CB&I had submitted a budget price to Linde because Linde had provided minimal detail and omitted the location of the project. (Scorsone, Tr. 5020-22; F.337).

348. The tanks proposed by Linde and Praxair for the same location were drastically different in scope and design. In contrast to the Linde tank, Praxair designed a more slender tank which resulted in an additional horizontal weld seam as well as required thicker steel throughout the tank. (Scorsone, Tr. 5021). The Praxair project scope also included a full-time welding supervisor, an increased 50 hour work week, additional subsistence in order to attract field labor to the remote site, and a more complex nozzle structure. (Scorsone, Tr. 5021-22). Praxair specifically defined the complex nozzle structure they wanted for their tank, while Linde provided only basic information concerning its anticipated nozzle configuration. (Scorsone, Tr. 5022). There are approximately \$ 60,000 worth of additional cost items included in the-Praxair pricing that were not included in the Linde budget price. (Scorsone, Tr. 5022).

**c. Praxair-New Mexico Project 2**

349. On November 6, 2001, after the merger, Praxair asked CB&I to provide a budget price for an LR-60 LIN tank in Farmington, New Mexico. (CX 448 at CBI-E 007391).

350. CB&I estimating staff was instructed to use a 4% profit margin. (CX 448 at CBI-E 007391). CB&I estimating staff was also instructed to use PDM's price on the Colorado Springs tank as a basis for determining the price for the New Mexico project, if

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necessary. (CX 448 at CBI-E 007393). PDM had provided a rough budget price of [redacted] for a 500,000 gallon LOX tank in Colorado Springs, Colorado for Praxair in November 2000. (CX 448 at CBI-E 007391; CX 449 at CBI-E 007401, in camera; see RX 90 at PDM-CH 002717).

351. CB&I submitted "tight budget pricing" of [redacted] for the New Mexico tank on April 30, 2002. (CX 449 at CBI-E 007411, 007403, in camera).

352. CB&I explained to Praxair that the increased price was a result of [redacted] (RX 92 at CBI-E 007401, in camera).

### **8. Sophistication of customers**

353. BOC is an experienced purchaser of LIN/LOX tanks. BOC hired engineering consultants to assist it and AT&V in working through the Midland project. (V. Kelley, Tr. 4619-20).

354. MG Industries has experience purchasing LIN/LOX tanks in the past; it purchased [redacted] such tanks during the 1990s. (Patterson, Tr. 478-79, in camera). During the 1990s, MG Industries would often drive tank costs down by informing vendors that they were higher-priced than other vendors. (Patterson, Tr. 350).

355. Air Liquide Process is experienced at purchasing LIN/LOX tanks both domestically and overseas. (See Kamrath, Tr. 1979-80, 1983-85). [redacted] (Kamrath, Tr. 2235-36, in camera).

## **H. Effects on Competition in the TVC Market**

### **1. Overview of the TVC market**

356. A Thermal Vacuum Chamber ("TVC") is a large metal enclosure used to simulate the vacuum of space for the purpose of testing satellites and satellite components prior-to launch. (Gill, Tr. 179-83; Neary, Tr. 1423-24). A TVC simulates the

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atmospheric and thermal conditions found in space. (Gill, Tr. 183; Proulx, Tr. 1722-23; Thompson, Tr. 2039-40; Higgins, Tr. 1264).

357. A TVC is composed of a large vacuum envelope (or chamber) constructed of stainless steel shaped roughly like a horizontal cylinder with a front door that may swing on a hinge or slide laterally on a rail. (Scully, Tr. 1098-99).

358. A "thermal vacuum system" is the process equipment that goes inside a TVC to simulate extreme heat and cold. (Higgins, Tr. 1263). The thermal vacuum system is comprised of one or more shrouds, vacuum insulated pipe, and cryo pumps or other pumping equipment, which are all controlled by a thermal control unit. (Higgins, Tr. 1263).

359. A TVC is outfitted with two or three different types of vacuum pumps that are used collectively to achieve the vacuum conditions found in space. (Scully, Tr. 1099).

360. The thermal shroud turns the vacuum chamber into a TVC. (Scully, Tr. 1099). This thermal shroud is a black wall found inside the vacuum envelope that cools or heats the contents of the chamber through radiation. (Scully, Tr. 1099-1101).

361. The extreme temperatures required inside a TVC are created by blowing nitrogen through tubes connected to the thermal radiator. (Scully, Tr. 1100; Thompson, Tr. 2039-40).

362. TVCs require field-erection at the facility site. Field-erection is required when the chamber or its pieces become too large to transport to the site. (See Gill, Tr. 187). This field-erection includes transporting the fabricated pieces of the stainless steel chamber to the site, using cranes and riggers to align the pieces, and using welders to weld the chamber pieces together. (Gill, Tr. 186, 268-69; Hart, Tr. 407; see also Newmeister, Tr. 2188-89).



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**2. Market shares and concentration in the TVC market prior to Acquisition**

363. CB&I's acquisition of PDM combined the only two competitors in the market for large field-erected TVCs in the U.S. (Simpson, Tr. 3489 (citing CX 272; CX 857, in camera; CX 264; CX 1040 at PDM-HOU 010889; CX 94 at PDM-HOU 017583)). Since 1960, the only companies that have built TVCs are PDM and CB&I. (Scully, Tr. 1110, 1115 (referencing RX 178); Higgins, Tr. 1267; Newmeister, Tr. 1564).

**a. Tank projects**

364. Only one field-erected TVC has been built since 1990. This was built by PDM in 1996. (Glenn, Tr. 4089, 4160; Scully, Tr. 1165, 1189, 1193).

365. CB&I has not built a field-erected TVC since 1984. (Scorsone, Tr. 5055-56; Glenn, Tr. 4089, 4160; Scully, Tr. 1187-89, 1193; Higgins, Tr. 1276-77). CB&I has never built a mailbox-shaped field-erected TVC. (Scully, Tr. 1193; Neary, Tr. 1467; Scorsone, Tr. 5056).

366. Both CB&I and PDM provided final pricing offers for [redacted] large, field-erected mailbox shaped TVC in 1997 that [redacted] now calls the [redacted]. ([redacted], Tr. 1740, 1901, in camera). In addition, two other companies, [redacted] responded to [redacted] request for proposals. ([redacted], Tr. 1890-91, in camera). [redacted] eliminated these companies from the bidding process because they were not qualified. ([redacted], Tr. 1890-91, in camera).

367. PDM provided a firm fixed price proposal for a large, field-erected TVC for [redacted] Seal Beach facility in 1999. (CX 1573 at 5, in camera; [redacted], Tr. 1925-27, in camera). [redacted] sought a sole-source procurement with PDM without even considering CB&I. ([redacted], Tr. 1927, in camera; Scorsone, Tr. 5081-82, in camera).

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368. Both CB&I and PDM developed specifications for a large field-erected TVC for Spectrum Astro in 1999. (CX 969 at CBI-PL014693; CX 1162 at CBI-ATL000941, in camera; Thompson, Tr. 2047-2048). In November 2000, both CB&I and PDM submitted best and final offers for the Spectrum Astro project. (Thompson, Tr. 2051; Scorsone, Tr. 5115-16). CB&I was selected. CB&I's price was lower than PDM's. (Thompson, Tr. 2051). Spectrum Astro subsequently decided not to proceed with the field-erected TVC project. (Thompson, Tr. 2097, 2103-04). CB&I and PDM were the only companies competing for this project. (Scully, Tr. 1169; Higgins, Tr. 1270).

369. Both CB&I and PDM were asked to provide rough order of magnitude ("ROM") pricing for a large field-erected TVC to TRW in 1999. (Neary, Tr. 1430-31). TRW has not asked for bids. (Gill, Tr. 253). After the Acquisition, TRW requested TVC pricing from Howard Fabrication, a small producer of shop-built TVCs. (Neary, Tr. 1442-43). TRW plans to award the contract for this TVC in late 2003 and begin building it in 2004. (Neary, Tr. 1431, 1471-73, 1501). CB&I, PDM and Howard were the only companies asked to provide ROM pricing. (Neary, 1431-32, 1444).

**b. HHI calculations**

370. Dr. Simpson testified that he would assign a 50-percent market share to CB&I and a 50-percent market share to PDM based on the opinions of market participants, documents, and the history of awarded projects. (Simpson, Tr. 3492-93, 3495-96). Dr. Simpson includes in his HHI analysis the value of the Spectrum Astro project which was awarded to CB&I, but was not built. (Simpson, Tr. 3495). On these bases, Dr. Simpson testified that the Acquisition increased market concentration, as measured by the HHI, by 5000 points to a level of 10,000. (Simpson, Tr. 3494).

371. If CB&I and PDM are assigned market shares based on the dollar value of awarded sales since 1990, CB&I has a 49.3 percent market share, and PDM has a 50.7 percent market share. (Simpson, Tr. 3493-94). Based on the dollar value of TVC awards

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since 1990, CB&I and PDM have a combined share of 100%, and the Acquisition increases market concentration, as measured by the HHI, by 4,999 points to a level of 10,000. (Simpson, Tr. 3494; CX 1210 at 7, in camera; CX 567 at CBI 007139-HOU).

372. While CB&I was awarded a bid in 2000 for Spectrum Astro, a contract was never signed and the project was canceled. (Thompson, Tr. 2097, 2103-04; Scorsone, Tr. 5336-37). Without the proposed Spectrum Astro project included, PDM would have 100% market share and an HHI of 10,000 since 1984. The increase in the HHI would be zero.

373. Demand in the TVC market is extraordinarily thin. (Harris, Tr. 7325).

374. Already thin demand is decreasing for large, field-erected TVCs as the result of consolidation in the aerospace business, the miniaturization of electronic components in satellites, and the change in the economy since the 1990's. (Scully, Tr. 1199-1204).

375. Use of data from 1990 to Acquisition does not accurately predict harm to competition because the market for TVCs is extraordinarily thin. (Harris, Tr. 7325-27).

### **3. Respondents were each others' closest competitors in the TVC market**

#### **a. CB&I's views**

376. CB&I's business and strategic documents refer to PDM as CB&I's "only competitor" for TVC projects in the United States. (CX 212 at CBI-PL031721; see also CX 264 at CBI-H006780 ("only real competitor"); CX 265 at CBI-H007057 ("single USA competitor").

377. CB&I considered PDM to be a "formidable" competitor in the TVC market (CX 216 at CB&I-PL033886, see also CX 212 at CBI-PL031721 (PDM's strategic alliance was "the only

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competition for the thermal vacuum systems market")), and "our major competition if new work emerges" in TVCs. (CX 1040 at PDM-HOU 010889).

378. CB&I purchased XL Technology Systems ("XL") on September 30, 1999 with the hope that XL's technology would help CB&I compete in the field-erected TVC market. (Scully, Tr. 1123-30, 1178, 1189; see also Glenn, Tr. 4161).

379. The purchase of XL in 1999 improved CB&I's competitiveness in the TVC market. (Gill, Tr. 257). CB&I's partnership with XL was a significant factor in CB&I's winning the source selection for the Spectrum Astro project. (Thompson, Tr. 2103; Scully Tr. 1226).

**b. Industry views**

380. John Gill, owner of Howard Fabrication, testified that prior to the Acquisition, "PDM was either number one or number two," and CB&I was, "either number one or number two." (Gill, Tr. 204-205).

381. Kent Higgins, President of Process Systems International, testified that "PDM and CB&I" were the only firms that had the capability to construct TVCs. (Higgins, Tr. 1267).

382. Patrick Neary, Manager of the Environmental Test Organization, testified that Respondents were "the two large field-erected manufacturers" of TVCs. (Neary, Tr. 1430).

383. John Newmeister of Matrix testified that Respondents were the only two firms who have competed in the TVC market. (Newmeister, Tr. 1564).

384. [redacted], Product Manufacturing Factory Planning Manager for [redacted], testified that Respondents were "the lowest risk and best candidates for success." ([redacted], Tr. 1899, 1900, in camera). Other firms lack the expertise to be as cost-

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effective and of equal quality as Respondents. ([redacted], Tr. 1900-01, in camera).

385. David Thompson, CEO of Spectrum Astro, who has "seen most of the TVCs in the industrial base in the [United States]," testified that Spectrum Astro "tried to do a survey of everybody in the country that we thought would be a qualified bidder, and the two bidders that we found at the time were Chicago Bridge and Iron and PDM." (Thompson, Tr. 2039-41). Spectrum Astro saw CB&I and PDM "fighting against each other pretty hard to get our business." (Thompson, Tr. 2115).

386. XL Technologies viewed the competition between Respondents as "always relatively intense." (Scully, Tr. 1175). CB&I's desire to win TVC projects caused the "pricing [of TVCs] to go down." (Scully, Tr. 1175-6). The competition was so "intense" that XL Technologies and its partner CB&I worried that the prices to customers would not return a profit: "the costs incurred to get" a project were so high that "if the price of the system isn't high enough, you've lost your profit before you ever begin the job." (Scully, Tr. 1179-81). Ronald Scully, President of XL Systems, testified that turnkey suppliers for TVCs were limited to Respondents. (Scully, Tr. 1115, 1237).

387. Scully made sales calls to Lockheed on behalf of CB&I and XL Systems ("XL Systems") in 1997 in an attempt to solicit TVC business. (Scully, Tr. 1190). Lockheed employees refused to work with CB&I, because Lockheed believed PDM to be dominant in the industry and the technological leader. (Scully, Tr. 1190-91).

**c. Competition between Respondents lead to lower prices**

388. In [redacted], which is now owned by [redacted], procured a large, field-erected, mailbox-shaped TVC that [redacted] now calls the [redacted]. ([redacted], Tr. 1740, 1901, in camera).

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389. PDM and CB&I each attempted to preempt the competitive bidding process and win the project on a sole-source basis. Bob Swinderman, PDM sales representative, told [redacted] that sole-sourcing the chamber with PDM "would be the cheapest and fastest way" to get the chamber built. ([redacted], Tr. 1889-90, in camera). CB&I echoed the same sentiment, giving similar assurances to [redacted] if it sole-sourced the chamber with CB&I. ([redacted], Tr. 1889-90, in camera)

390. [redacted] testified that he did not want to sole-source the project, as a sole-source arrangement generally resulted in higher costs. ([redacted], Tr. 1890, in camera).

391. Rather than sole-source the project, [redacted] made the specifications for the project available to "all the interested bidders." ([redacted], Tr. 1892, in camera). [redacted]. ([redacted], Tr. 1890-91, in camera).

392. Four companies responded to [redacted] request for proposals: CB&I, PDM, [redacted]. ([redacted], Tr. 1899, in camera). These bidders presented "their conceptual design," cost estimate material, and other information required by [redacted]. ([redacted], Tr. 1892, in camera).

393. [redacted] submitted the lowest bid in response to [redacted] performance specifications. However, [redacted] did not meet [redacted] standards. [redacted] eliminated [redacted] from the bidding because "they did not show that they had a complete wherewithal as to the scope of the project in order to come in at cost," they "did not have clear solutions on some of the items delineated in . . . [redacted] preliminary proposal review," and ". . . they lacked the demonstrated experience of building something of that size." ([redacted], Tr. 1900, in camera).

394. [redacted] also eliminated [redacted] as a possible competitor because ". . . their proposal couldn't meet the spec. . . they took exception to some of our specs." ([redacted], Tr. 1901, in camera).

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395. In addition to the four original bidders, [redacted] also contacted two other suppliers, "[redacted], and requested that they submit proposals for the project. ([redacted], Tr. 1902-1903, in camera). [redacted] refused to submit a bid because "they felt the size of the project was beyond their company's means." ([redacted], Tr. 1903, in camera).

396. The elimination of [redacted] and [redacted] from the competition, and the refusal of [redacted] to submit a bid, left PDM and CB&I as the two down-selected bidders for the [redacted]. ([redacted], Tr. 1892, in camera).

397. [redacted] told CB&I and PDM that they were competing against each other for the [redacted]. ([redacted], Tr. 1909, in camera). [redacted] project manager testified that he wanted CB&I and PDM to know that they were competing against each other because "when you have competitors bidding best and final, one number takes all, [that] is when we would receive the lowest price. . . ." ([redacted], Tr. 1909, in camera).

398. [redacted] asked each company for "cost-saving initiatives, what could be done to reduce costs." ([redacted], Tr. 1907, in camera). As both companies developed their final designs, incorporating their own cost-saving innovations, they used "their expertise as designers and builders to suggest anything that might lower the bottom line cost for the chamber." ([redacted], Tr. 1907-08, in camera).

399. After receiving the final pricing offers for the [redacted] added some items to the TVC specifications. ([redacted], Tr. 1911, in camera). Even though [redacted] believed these additional items "would have increased the price," [redacted] asked CB&I and PDM to "sharpen their pencils and give me their lowest price." ([redacted], Tr. 1911-12, in camera).

400. In response to this last request, CB&I increased its final pricing "a little bit." ([redacted], Tr. 1911, in camera).

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401. Despite the increase in cost from the additional items, "PDM actually lowered their price by . . . over a million dollars." ([redacted], Tr. 1910-11, in camera; see Scully, Tr. 1166 (after the bid was awarded, CB&I learned that, at the last opportunity in the bidding process, PDM had further lowered its price by "something in the order of as much as \$ 2 million"))).

402. PDM bid the [redacted] in 1997 at below cost with the intention of keeping CB&I completely out of the market. (Scully, Tr. 1193-94, 1166).

403. [redacted] perceived, based on comments, that PDM lowered its pricing to demonstrate "technical prowess, boasting rights, so to speak, of having won or the desire to win for future business prospectives that [redacted] contract. . . ." ([redacted], Tr. 1916, in camera).

404. Sometime after [redacted] awarded the contract to PDM, [redacted] talked with Bob Swinderman, the PDM sales representative, about the competition for the [redacted] project:

. . . PDM had felt that CB&I had been out of the market for several years and that if they allowed them to win that particular project, which was a very significant project, that they would be back in and become a significant competitor, and it was important to PDM management that they not win that, and so through telephone calls they developed a price, lowered the price and offered it to [redacted] at the last minute. . . .

(Scully, Tr. 1166).

405. The lowest price was the deciding factor in who won the project. [redacted] awarded the [redacted] contract to PDM and its subcontractor, Chart Industries, primarily because they offered a lower price than the CB&I/XL team. ([redacted], Tr. 1891-93, in camera).



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406. [redacted] testified that his procurement strategy had saved [redacted] below what he had originally estimated as the likely cost of the [redacted]. ([redacted], Tr. 1910, in camera).

**4. Competition in the TVC market from Acquisition to time of trial**

407. [redacted] ([redacted], Tr. 1957, in camera).

408. TRW began its procurement process for its TVC in 1999 by obtaining ROM pricing from CB&I and PDM. TRW plans to award the contract for its TVC in late 2003 and begin building it in 2004. (Neary, Tr. 1431, 1501).

409. Spectrum Astro will likely procure a new TVC in the next 3-4 years. (Thompson, Tr. 2104).

**5. No other companies provide competition in the TVC market**

410. Howard Fabrication is a domestic company that supplies shop-fabricated TVCs and thermal vacuum systems. Howard Fabrication has never supplied, and does not have the capability necessary to supply, a TVC with a diameter greater than 20 feet. (Gill, Tr. 182, 192-93). Gill testified that his company, Howard Fabrication, with \$ 2.5 million in annual revenues, could not effectively compete in the market for TVCs because it was not large enough to purchase the bonds for TVC projects. (Gill, Tr. 200-01, 234).

411. CB&I does not consider Howard capable of fabricating a TVC, let alone having the capability to design, engineer, and field-erect a TVC. (Scorsone, Tr. 5061 ("I think that would be a real stretch for Howard, very much so.")).

412. Mr. Higgins, the President of the Chart division that supplies the systems and equipment attached to TVCs, testified that Chart is not "capable" of field-erecting a TVC by itself. (Higgins, Tr. 1266-67).

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413. Matrix has not expended any significant resources on developing its capability to engineer and design TVCs. (JX 37 at 89-90 (Newmeister, Dep.)).

414. XL Technologies admits that it is not capable of supplying a TVC without partnering with an experienced chamber supplier such as CB&I. (Scully, Tr. 1118, 1134, 1252; see CX 262 at CBI-H004037-38). On February 28, 2002, CB&I sold its XL Technologies subsidiary to Scully. (Scully, Tr. 1130). CB&I did not transfer to XL Technologies the assets, engineering know-how, equipment or personnel necessary to the field-erection of large TVCs. (Scully, Tr. 1132-33).

## **6. Barriers to entry in the TVC market**

415. Mr. Scully, President of XL Technology Systems, testified that TVC customers want experienced suppliers with "knowledge as to how to deal with the architects and the construction people . . . and ability to manage a project." (Scully, Tr. 1147; see also Higgins, Tr. 1272; Proulx, Tr. 1756; Neary, Tr. 1455).

416. New entrants would need to obtain "the ability to fabricate in the field a stainless steel vessel" and satisfy "the quality requirements of leak testing and cleanliness" for a TVC. (Higgins, Tr. 1272-3). A new entrant would need to hire engineers with previous experience in designing TVCs, which are "truly one-of-a-kind designs for very specific applications on very technical products." (Newmeister, Tr. 1612-13).

417. Leaks in a TVC can prevent the user from meeting the vacuum specifications required for satellite testing. ([redacted], Tr. 1904-05, in camera). In addition, defects in the welding of the chamber can lead to the leakage of contaminants into the chamber, which can interfere with the accuracy of the test results. (Scully, Tr. 1143-44). If a TVC fails during a satellite test, the satellite within the chamber can be damaged. (Neary, Tr. 1454; Scully, Tr. 1144). Operational problems with a TVC can have a "bad effect" on the satellite's program schedule, because the test

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may have to be restarted from the beginning after the problem is resolved. (Scully, Tr. 1145-46).

418. A new entrant would need to expend significant resources in developing proposals and price quotations for TVCs. One CB&I document reports that CB&I expended \$ 300,000 in design resources and \$ 190,000 in other resources to prepare its TVC proposal for Orbital Sciences' planned chamber. (CX 235 at CBI-PL060198).

## **7. Alleged post-acquisition anticompetitive behavior**

### **a. Spectrum Astro**

419. In the fall of 1999, Spectrum Astro required a TVC in order to be considered for the Space Based Infrared System (SBIRS) Low Phase 2 Program, sponsored by the United States Air Force. (CX 969 at CBI-PL014693).

420. Mr. William Thompson, Spectrum Astro's president, testified that he competitively bid the project, because "we wanted obviously to get the best price we could get." (Thompson, Tr. 2051). Additionally, Spectrum Astro used a competitive bidding process because "we were looking for technical innovation. We generally find that when we have contractors in competition, they will - it will tend to drive innovation into the system." (Thompson, Tr. 2051).

421. Spectrum Astro retained both CB&I and PDM to develop specifications for a large field-erected TVC; Spectrum Astro also entered into an engineering and design contract with each company in which Spectrum Astro paid each company [redacted] (CX 969 at CBI-PL014693; CX 1162 at CBI-ATL000941, in camera; Thompson, Tr. 2047-2048).

422. The contract was to be awarded according to a "rolling down-select between CB&I and PDM/PSI team." (CX 969 at CBI-PL014693).

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423. Spectrum Astro received initial cost proposals from both CB&I and PDM in May 2000. CB&I and PDM's total cost amounts were \$ 9,929,990 and \$ 10,825,853 respectively. (CX 1570 at 22).

424. In November 2000, both CB&I and PDM submitted best and final offers for the Spectrum Astro project. (Thompson, Tr. 2051; Scorsone, Tr. 5115-16). Of the two offers that were submitted, CB&I's price was lower than PDM's. (Thompson, Tr. 2051). CB&I bid \$ 10,760,880, an increase of 8.4% above its previous cost proposal. (CX 1570 at 9). PDM bid \$ 11,528,900, an increase of 6.5% above its previous cost proposal. (CX 1570 at 5, 37).

425. CB&I's November 2000 offer included a profit margin of 7.77%. (CX 1489 at CBI 060015).

426. After evaluating the proposals submitted by PDM and CB&I, Spectrum Astro elected to proceed with CB&I, in December 2000. (Thompson, Tr. 2061; CX 926 at CBI 007212-HOU).

427. After selecting CB&I for the project, Spectrum Astro proceeded "based upon the price we had in our hands," that is the firm fixed price of approximately \$ 10.7 million. (Thompson, Tr. 2065; CX 1489 at CBI 060015).

428. The price provided to Spectrum Astro in December 2000 expired after 90 days, as is typical in this industry, because costs are expected to escalate or fluctuate beyond the 90 day period. (Scorsone, Tr. 5047-48; Thompson, Tr. 2609).

429. Following the selection of CB&I in December 2000, Spectrum Astro did not immediately award the project because it was working to get financing complete. (Thompson, Tr. 2066).

430. CB&I's price expired 90 days after the source selection, in February, 2001, and Spectrum Astro did not request updated pricing until 10 months later in November, 2001. (Scorsone, Tr.

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5047; see also Thompson, Tr. 2069). For almost one year, the project remained dormant. (Scorsone, Tr. 5048).

431. In November 2001, CB&I provided Spectrum Astro with updated pricing for the Spectrum Astro chamber. (Thompson, Tr. 2069-2070). CB&I's updated price for the Spectrum Astro TVC was \$ 12,019,000 -- almost \$ 1.2 million greater than its price 12 months prior. (Thompson, Tr. 2074; CX 567 at CBI 007139-HOU; Glenn, Tr. 4356-57).

432. CB&I's updated price of \$ 12,019,000 resulted in an 11.7% increase in the price of the chamber from the November 2000 price. (CX 1489 at CBI 060015; CX 1570 at 5).

433. According to a pricing analysis written by Scott O'Leary, Spectrum Astro's chief of facilities, Spectrum Astro was "expecting a decrease in cost due to the decrease in requirements." (CX 1570 at 5; Thompson, Tr. 2095). During the engineering study, "there were some items that were taken out of the design which should have caused the price to go down." (Thompson, Tr. 2071, 2073). Due to other "offsetting kinds of things" in the design, Thompson testified that on balance, he believed the price of the chamber "would have stayed about the same." (Thompson, Tr. 2073).

434. The November 2001 price included an 11.97% profit margin. (CX 1489 at CBI-060015).

435. Scorsone testified that the extra profit included in the November 2001 re-pricing was a means of recovering some of the pre-contract costs, which was consistent with CB&I's policy at the time. (Scorsone, Tr. 5049). Scorsone told CB&I staff to "to insert the precontract costs incurred previously on the bid effort for this project even though those costs had been incurred in the previous year and had been written off." (CX 1492 at CBI 060000; see Scorsone, Tr. 5118, 5120-21; Scully, Tr. 1173-74). Scorsone further testified that another reason for the extra profit was the perceived need to mitigate some of the risks of moving forward with the project. (Scorsone, Tr. 5049). Satellite programs awarded

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by the Government are sometimes delayed. (Thompson, Tr. 2129). As a result, vendors of satellites must take account of the risk that these programs might be cancelled or delayed. (Thompson, Tr. 2129-30). Some of the extra profit was also the result of posturing in the negotiation with Spectrum Astro, because the final terms of the contract were never set. (Scorsone, Tr. 5049-51).

436. Scorsone also testified that the margin was increased to account for the added risk of erecting the "vessel outside of the building and then moving it in [to the building]" with the containment vessel. (Scorsone, Tr. 5122). However, this alternate method of erecting the chamber did not come up until after the November 2001 price increase. (Thompson, Tr. 2078-2079; CX 566 at 2; CX 1570 at 63 (alternate method was discussed in May 2002)). CB&I's comparison of its November 2000 and November 2001 proposals specifically states that estimates did not include "the alternate plan of erecting the chamber outside and then moving it into position." (CX 1489 at CBI 060013).

437. In CB&I's November 13, 2001, updated price quote to Spectrum Astro, Jeff Steimer listed nine reasons for its increase in price. (CX 567 at CBI 007136-HOU, CBI 007137-HOU). On December 19, 2001, CB&I provided Spectrum Astro with a follow-up justification letter to explain the bases for CB&I's price increase. (CX 1570 at 57-59).

438. Neither the November 13th nor the December 19th letter provide as reasons for the price increase the recovery of pre-contract costs previously incurred or risks of having to erect the chamber from outside the building. (CX 1570 at 46-47, 57-59).

439. The November 2001 price expired again after 90 days without Spectrum Astro acting on the new price. (Scorsone, Tr. 5051). After the second price had expired, Spectrum Astro waited six or seven months before requesting an updated price from CB&I. (Scorsone, Tr. 5051). The companies did not have a contract or financing at that point. (Scorsone, Tr. 5051-53).

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440. In May 2002, Spectrum Astro responded to the November 2001 price asking CB&I to try again. (Scorsone, Tr. 5051). On June 25, 2002, CB&I provided Thompson with an updated price in the amount of \$ 11,553,790, a decrease of roughly \$ 500,000 from the previous price update. (Thompson, Tr. 2091-92).

441. CB&I lowered its price in June 2002, because Scorsone was aware that the customer was having difficulty obtaining financing, and he wanted to assist them by making the project more viable with a lower price. (Scorsone, Tr. 5051-53). The June 2002 price lowers the profit margin to 8%. (CX 1489 at CBI 1060015).

442. Spectrum Astro does not plan to proceed with the field-erected TVC project. (Thompson, Tr. 2097, 2103-04). The decision is the result of "government action." (Thompson, Tr. 2097). The lack of financing also influenced the decision. (Thompson, Tr. 2105). It will be a long time before the Spectrum Astro job is actually built, if at all. (Scully, Tr. 1225-26).

443. Instead, Spectrum Astro intends to build a smaller shop-fabricated chamber, a product which CB&I does not build. (Thompson, Tr. 2104-2105).

**b. TRW**

444. In 1999, TRW Space & Electronics ("TRW") decided to procure a TVC, and requested rough order of magnitude ("ROM") pricing from CB&I and PDM. (Neary, Tr. 1430-31).

445. TRW considers Howard Fabrication to be unqualified to compete in the TVC market. Neary testified that Howard Fabrication does not have "the technical competence nor the financial backing" necessary for TRW to award it a TVC project. (Neary, Tr. 1443). After the Acquisition, TRW nevertheless requested pricing from Howard Fabrication because it wanted to maximize competition for the TVC project. (Neary, Tr. 1444).

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446. A CB&I salesman, Mike Miles, called John Gill of Howard Fabrication in mid-October 2002 to set up a meeting to discuss a new opportunity to work together. (Gill, Tr. 242-44). Miles did not indicate the nature of the opportunity during the initial phone call. (Gill, Tr. 242-44, 251-52).

447. Neither Miles nor Gill knew at the beginning of their October 2002 meeting that they had each separately provided very rough order of magnitude pricing on the TRW project. (Gill, Tr. 252-53, 274; Scorsone, Tr. 5059-60).

448. During the October 2002 meeting, Miles mentioned the possibility of Howard serving as a partner or subcontractor with CB&I for purposes of an unnamed proposed TVC project, since Howard Fabrication has worked with PDM as a subcontractor in the past. (Gill, Tr. 246-248, 251-56; Scorsone, Tr. 5059-60).

449. According to Gill, at the October 2002 meeting Miles gave him a copy of design specifications that he recognized as the same specifications that he was given by TRW for its TVC project. (Gill, Tr. 245). Gill told Miles that he knew the job was for TRW and that he had already presented a proposal to TRW for the job. (Gill, Tr. 245, 252-53, 274).

450. Gill testified that, nevertheless, during the October 2002 meeting, Miles asked him whether Howard "could coordinate on making a bid or a price quote to TRW." (Gill, Tr. 247). Gill confirmed that Miles proposed coordinating on the TRW bid after Gill had told him that Howard was bidding on the project. (Gill, Tr. 274).

451. Miles did not make this offer to coordinate on a bid to TRW with the consent or knowledge of management at CB&I. (Scorsone, Tr. 5059-62). Miles is an entry-level salesperson, and not a CB&I executive. (Scorsone, Tr. 5061-62). CB&I was unaware that Howard Fabrication had submitted budget pricing on the TRW project prior to Miles' meeting. (Scorsone, Tr. 5060).



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452. TRW believes that CB&I's proposal to Howard to coordinate on the price and bid to TRW deprives TRW of any chance for relief from CB&I's monopoly price. At trial, Neary of TRW testified that "it's not right" for a bidder to ask a competing bidder to coordinate on making a bid or price quote to TRW. (Neary, Tr. 1451). Neary further testified that "we're not going to get a fair and equitable price. It goes back to why do we even have two competitors. We're at a disadvantage. We're going to get - we're basically hosed, as I would say." (Neary, Tr. 1451).

453. CB&I is still considering using Howard Fabrication as a subcontractor, but would seek the prior approval of the customer before doing so. (Scorsone, Tr. 5060).

c. [redacted]

454. On June 30, 1999, PDM provided [redacted] with a firm fixed price proposal for a large, field-erected TVC for [redacted]. (CX 1573 at 5, in camera; [redacted], Tr. 1925-27, in camera).

455. This firm fixed bid price was [redacted]. ([redacted], Tr. 1927; Scorsone, Tr. 5081-82, in camera).

456. Pre-acquisition, PDM quoted a price of [redacted] in its proposal to [redacted], but the customer chose to postpone the project. (CX 1573 at 5, in camera; [redacted], Tr. 1926, in camera).

457. [redacted] ([redacted], Tr. 1943, in camera). Prices expire because costs change over time. ([redacted], Tr. 1944, in camera). The price of steel and labor costs increased in the interim. ([redacted], Tr. 1952, in camera).

458. In May 2001, [redacted] undertook a study to determine whether it should [redacted]. ([redacted], Tr. 1927-28, in camera).

459. In order to analyze the costs of the two alternatives, [redacted] requested "cost verification from CB&I . . . of the price . . . [redacted] based on PDM's earlier proposal." ([redacted], Tr.

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1929, in camera). [redacted] contacted Dave Lacey of CB&I, asked him to review PDM's prior proposal and submit a renewed price based on the specifications and schedule of the prior bid. ([redacted], Tr. 1930, in camera).

460. [redacted]'s official request was for a firm fixed price renewal of PDM's earlier bid for the TVC. ([redacted], Tr. 1933, 1935, in camera).

461. [redacted] expected the price for the [redacted] TVC project to increase marginally to cover "reasonable inflation." He anticipated the new pricing information to be [redacted] ([redacted], Tr. 1934, in camera).

462. CB&I did not have the information necessary to provide the firm fixed price to [redacted], nor did CB&I want to expend the money necessary to provide a new firm fixed bid price. (Scorsone, Tr. 5084, in camera). [redacted] did not give CB&I a date for the start of construction, the construction schedule, or information required to assess how the chamber would be inserted into the building. ([redacted], Tr. 1945, in camera). Such information would have been necessary for producing a firm fixed bid price. (See Scorsone, Tr. 5000-02).

463. On May 16, 2001, instead of providing a "firm fixed price renewal," CB&I submitted Rough Order of Magnitude "ROM price of [redacted] for a fully commissioned TVC." ([redacted], Tr. 1930-33, 1935-36, in camera; CX 1573 at 3, in camera).

464. The May 16, 2001 letter from CB&I states that "the ROM pricing accuracy can be improved with a more detailed assessment of your needs and resulting work scope. Sometime in the upcoming weeks we would like to discuss more fully your needs and emerging plans for providing services." ([redacted], Tr. 1950, in camera; CX 1573 at 3, in camera).

465. The May 16, 2001 ROM price has a stated accuracy of [redacted]. ([redacted], Tr. 1950-51, in camera).

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466. CB&I's ROM pricing in 2001 represented an increase of [redacted] or over [redacted] from PDM's firm fixed price in 1997. (CX 1573 at 2, in camera; [redacted], Tr. 1935, in camera).

467. [redacted] of [redacted] accepted that the [redacted] price quoted in the May 16, 2001 letter as "the price [redacted] would now have to pay to have that chamber built." ([redacted], Tr. 1933, in camera).

468. [redacted] was "disappointed that the cost had gone up" and that CB&I had not presented the updated price quote as a firm fixed price in its letter. ([redacted], Tr. 1936, in camera).

469. The price quoted by CB&I [redacted]." ([redacted], Tr. 1936, in camera).

470. [redacted] never asked CB&I for a follow-up firm price. ([redacted], Tr. 1947, 1951, in camera).

## **8. Sophistication of customers in the TVC market**

471. [redacted] is a large aerospace company. (Scully, Tr. 1092). [redacted] has five field-erected TVCs and 30 shop-fabricated TVCs. ([redacted], Tr. 1725-26).

472. TRW has five field-erected TVCs and approximately 15 shop-fabricated TVCs. (Neary, Tr. 1422).

473. Spectrum Astro is a satellite manufacturer that competes with large defense contractors. (Thompson, Tr. 2036).

## **I. Factors Across All Product Markets**

### **1. Budget prices versus firm bid prices**

474. A budget price is an initial price quote that can provide the initial basis for selecting a supplier and negotiating a final price. (Neary, Tr.1440 ("We first receive their initial price. Then we select the vendor")).

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475. Budget prices are prepared with less detailed information provided by the customer. (Hall, Tr. 1866; Carling, Tr. 4472; Fan, Tr. 1078). By contrast, a firm fixed bid price is based on very detailed designs. (Carling, Tr. 4472; Scorsone, Tr. 5003). The company providing the firm price is expected to "stand up to their price and do the work for that price." (Carling, Tr. 4472).

476. Bids can be awarded solely on the budget prices. (JX 23 at 27-28 (Cutts Tr.)). For example, Atlanta Gas Light Company selected PDM over CB&I, for an LNG project in 1998, based on budget price bids submitted by CB&I and PDM. (CX 161 at CBI-PL006113-114). PDM outsourced CB&I in the bidding competition "on the basis of their lower budget price." (CX 161 at CBI-PL006113). In another example, Linde BOC used budget prices to compare CB&I's and AT&V's pricing for the Hillsboro LPG project. (V. Kelley, Tr. 5292; Scorsone, Tr. 5031).

477. Budget prices can be close to firm bid prices. See Stetzler, Tr. 6352 ("Budgetary to me means plus or minus 10 percent type of a bid."). When CB&I and PDM competed for a TRW TVC project, CB&I's final price to TRW was within 5 to 10% of the original budgetary price. (Neary, Tr. 1440-41).

478. Generally, budget prices are more imprecise than firm fixed bid prices. (Carling, Tr. 4472; Scorsone, Tr. 4999). When creating budget pricing, estimators use off-the-shelf tank designs of a similar size volume to develop a budget price. (Scorsone, Tr. 4999). Subcontractors are not consulted when developing a budget price. (Scorsone, Tr. 4999-00). Amount of engineering labor required to design a tank are estimated when developing a budget price. (Scorsone, Tr. 5000). Those hours are not calibrated as part of the budget price. (Scorsone, Tr. 5000). These practices reduce the accuracy of the final number in a budget price. (See Scorsone, Tr. 4999-5000).

479. Budget prices include assessments of risk and contingency. (Price, Tr. 608-09; Scorsone, Tr. 5252; Simpson, Tr. 5366). Projects that involve an excessive amount of risk or

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unknown contingencies will receive higher budget prices. (Scorsone, Tr. 5003).

480. Years sometimes elapse between the time when a budget price is submitted and the time when a firm fixed bid price is actually requested. (Scorsone, Tr. 5004).

481. When creating a firm fixed price, estimators use an actual tank design. (Scorsone, Tr. 4999).

482. Firm fixed bid prices require that a customer give the supplier information about the site conditions, as well as allowing someone from the bidding company to tour the job site to examine the access to the site and soil conditions. (Stetzler, Tr. 6353; Glenn, Tr. 4126).

**2. CB&I and PDM recognized each other as each's greatest competitor**

483. PDM was the "single largest" reason CB&I lost business in the United States; competition from PDM accounted for 33% of CB&I's lost business. (Glenn, Tr. 4331; CX 227 at CBI-PL045101; see also CX 23 at PDM-C1002566 (PDM has made "significant market share increases against CB&I in both domestic and international markets")). In March 2000, CB&I reported that "in the last three months our business lost report is showing PDM taking some 13 jobs from [CB&I] at a value of \$ 25 million." (CX 243 at CBI-PL 4004707; see CX 660 at PDM-HOU005014 ("Since the fall of 1996, CB&I has been the most aggressive competitor in increasing market share")).

484. In March 2000, Steve Knott, CB&I's sales manager for the United States, e-mailed CB&I's sales team to lament that PDM is "'eating our lunch' and we know much of it is because of a CB&I cost problem." (CX 243 at CBI-PL 4004707).

485. Knott asked, "What is PDM doing that gives them the ability to be this low, this often? I am not 'coming down' on our group for losing to PDM. We all recognize that we can only sell

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to the market what the market will pay. Given our current system, we are bumping against pricing levels that are dangerously close to our direct cost." (CX 243 at CBI-PL 4004707).

486. Knott concluded that "We need to come up with a strategy to combat the effort PDM is making to erode our market share." (CX 243 at CBI-PL 4004707).

487. In October 2000, CB&I's Bob Lewis wrote to Steve Crain, President of CB&I's Western Hemisphere Operations that PDM was bidding "much lower than the market, leaving a lot of money on the table." (CX 278 at CBI-H 4004204).

488. Handwritten notes from the files of PDM's President note the following: (1) 1996-1997 "focused on more profitable assignments;" (2) 1997-1998 accept "lower gross profit in pursuit of higher revenues;" and (3) 1998-1999 PDM "forced to bid at lower margins" due to "competition w/CB&I" and "seeking more revenues." (CX 76 at PDM-C1006141-3; see also CX 390 at PDM-C 1006145 ("97-98 -> aggressive growth market share - sacrifice margins")).

489. In May 2000, PDM warned its Board of Directors that "CB&I has been extremely aggressive on pricing work in North and South America. They have taken certain projects at levels which would be slightly over PDM EC's flat cost." (CX 64 at PDM-C 1002562).

490. Scorsone confirmed that he told PDM's investment firm, Tanner & Company, about the competition between PDM and CB&I and how the companies were "forced to bid at lower margins" because of this competition. (Scorsone, Tr. 5152).

**3. CB&I and PDM recognized that the Acquisition would reduce competition and lead to higher margins**

491. [redacted] (CX 213 at CB&I-PL033037, in camera).  
[redacted] (CX 213 at CBI-PL033084, in camera).

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492. In 1999, PDM had assessed the benefits of acquiring CB&I and determined that acquiring CB&I would give PDM "Market dominance in Western Hemisphere." (CX 74 at PDM-C 1005941). Scorsone admitted that when he wrote the document he believed PDM could achieve "market dominance" by acquiring CB&I. (Scorsone, Tr. 5169).

493. An August 2000 document, created by a PDM sales person, titled "Benefits of Combining PDM with CB&I," listed the following: (1) "Dominance of the cryogenic (LNG/LOX/LIN) markets;" and (2) "Allows CB&I to have a low cost USA tank producer." (CX 621 at PDM-HOU006702).

494. At the time of the Acquisition, Scorsone thought CB&I/PDM will be a "powerhouse." (CX 72 at PDM-C 1004409). Scorsone later added that CB&I/PDM "will truly be the world leader in storage tanks." (CX 1686 at CBI/PDM-H 4005550; Scorsone, Tr. 5203).

495. An October 2000 PDM document entitled, "PDM Merger Objectives Brainstorm Results." outlined the following objectives: (1) "Create barriers to entry as they can be built;" (2) "Defend an expanding market share;" (3) "Ensure that we do not allow smaller competitors to take share and pursue business in our attractive markets;" (4) "Put plans in place to command premiums for the services we provide;" and (5) "Improve pricing to achieve margin growth from 12.5% to 17%." (CX 101 at PDM-HOU002359-60).

496. On October 26, 2000, Scorsone and other members of the integration team held an "Integration Kick-off Meeting." The "kick-off meeting" agenda prioritized the objectives of the merger: (1) "Ensure that we do not allow smaller competitors to take share and pursue business in our attractive markets;" (2) "Defend an expanding market share;" (3) "Create barriers to entry;" and (4) "Use pricing advantage as necessary to not lose market share to competitors during the merger." (CX 1544 at CBI 057941).

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#### **4. Entry at prices above pre-merger prices does not restore competition**

497. Both economic experts agree that entry by new firms would not restore the competition lost through an anticompetitive merger if this entry is at a price above the pre-merger price. (Simpson, Tr. 3151-52; Harris, Tr. 7438).

498. A merger of the two strongest suppliers would enable the merged firm to increase price up until the point where other less-strong suppliers begin to constrain it. (Simpson, Tr. 3451). A merger that reduces the number of sellers of LIN/LOX tanks from four to three or from three to two would be likely to result in an increase in price. (Simpson, Tr. 3451).

499. Entry will not keep prices from rising above the pre-acquisition level if entry is only profitable at higher prices. (Harris, Tr. 7451). The mere fact that entry has occurred following an acquisition does not mean that the entry is sufficient to restore the premerger competitive environment. (Harris, Tr. 7436). Entry by firms who can only profitably enter at prices above the competitive level would not restore competition. (Harris, Tr. 7438).

500. The observation that new firms submit bids in a market does not always imply that entry is sufficient. (Simpson, Tr. 3282-84; Harris Tr. 7790-91). The observation that new firms make some investments to sell into a market does not always imply that entry is sufficient. (Simpson, Tr. 3284-88; Harris, Tr. 7791).

### **J. Exiting Assets Defense**

#### **1. PDM background**

501. PDM was founded in 1892 by the Jackson Family. PDM went public in 1965 on the American Stock Exchange. In 1999-2000, the Jackson Family was the primary stockholder of PDM, owning approximately 30 percent of the stock. (Byers, Tr. 6731-



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32; Scorsone, Tr. 4791). PDM's Board consisted of a majority of the Jackson Family and its friends and acquaintances. (Byers, Tr. 6734).

502. PDM operated four lines of business with five divisions - PDM Strockal, Water, Engineered Construction (EC), Bridge, and Steel Distribution. (Byers, Tr. 6731; Scorsone, Tr. 4778-79; G. Glenn, Tr. 4075-76).

503. PDM's EC and Water Divisions were "intertwined" and "meshed together." (Scheman, Tr. 2929-30). PDM's management believed separating EC and Water would be costly and difficult. (Scheman, Tr. 2929). The EC and Water Divisions shared human resource departments, fabrication plants, equipment and construction crews and it was considered impossible to split the two. (Scorsone, Tr. 4779; Byers, Tr. 6780-81, 6800-01). The EC and Water Presidents reported directly to the CEO Bill McKee, rather than exercising complete control over their organizations. (Byers, Tr. 6734).

## **2. PDM decision to sell the company**

504. PDM's Board asked PDM management to consider potential options for the strategic direction of the company's future in Summer 1999. Scorsone, then President of PDM EC, prepared a presentation to the PDM Board in August 1999 about strategies for going forward with the PDM EC Division. (Scorsone, Tr. 4781-82).

505. At a strategic planning meeting, a list of options was devised to provide to the Board. This laundry list included making a major acquisition, buying something unrelated, taking the company private, and selling the company. (Byers, Tr. 6738-40; Scorsone, Tr. 4791).

506. This laundry list of options was presented to the PDM Board in Summer 1999, but no hard decisions were made at that time. (Byers, Tr. 6740). The various options presented to the PDM Board were to maintain the status quo, pursue acquisitions,

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declare a special dividend, conduct a stock repurchase, split into two separate companies, and the sale of the company. (Scheman, Tr. 2917-19).

507. In November or December 1999, the PDM Board indicated to management that it wanted to pursue taking the company private. The Jackson Family would make a tender offer and buy back all shares of PDM except for management's ownership. This plan was never implemented. (Byers, Tr. 6740-41).

508. At the February 2000 Board meeting, the Jackson Family indicated that it wished to take the company private. It was decided that the Family should hire its own investment banker. Polly Townsend, Bill Jackson, Sr.'s daughter, contacted a partner at Tanner & Co. ("Tanner") for an interview. (Byers, Tr. 6741-42; Scheman, Tr. 2911, 6907).

509. In May 2000, PDM decided to sell the company. (Byers, Tr. 6742).

510. In June 2000, PDM interviewed investment firms Goldman Sachs and Tanner to advise on the sale. (Byers, Tr. 6742-6743).

511. Goldman Sachs recommended that PDM pursue "five to ten strategic buyers and 10 to 20 LBO [leveraged buy out] buyers." (Byers, Tr. 6838-39; see also CX 380 at PDM-C 1004026).

512. Tanner recommended that PDM sell off the divisions in pieces rather than in a single transaction to a single purchaser. (Byers, Tr. 6755). Tanner believed that breaking up the company and selling it in parts would result in a higher total value. (Byers, Tr. 6755).

513. Both Goldman Sachs and Tanner made presentations at the same Board meeting on June 1, 2000. Shortly after this

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meeting, Tanner was retained by PDM. (Scheman, Tr. 2914-15, 6907-08; RX 25 at 2).

514. Tanner is no longer retained by PDM. Tanner's assignment concluded in the middle of March 2002 when PDM was acquired by Iron Bridge Holdings. (Scheman, Tr. 6909).

### **3. Steps resulting in acquisition**

515. In 2000, Bill McKee, former CEO of PDM, offered to sell PDM EC and Water Divisions to CB&I in a telephone call to Glenn of CB&I. (Glenn, Tr. 4077-78).

516. Peter Scheman, Tanner's representative to PDM, had the responsibility to "coordinate and lead everything." (Scheman, Tr. 6908). Scheman first became involved with PDM at the end of February 2000 or beginning of March 2000 when Tanner was retained as an advisor to the Jackson Family in March 2000. (Scheman, Tr. 2911-12, 6907-08).

517. Tanner & Company prepared an offering memorandum for the sale of the PDM EC Division (Scheman, Tr. 2930-31). Scheman recalled sending the PDM EC offering memorandum to only one company -- CB&I. (Scheman, Tr. 2931).

518. PDM conducted discussions directly with CB&I. (Glenn, Tr. 4077-78). By the time the offering memorandum was completed, negotiations between CBI and PDM were at a point "that it didn't make sense to send it out to other people." (Scheman, Tr. 2931).

519. An e-mail from Scheman to Rich Goodrich, CB&I chief financial officer, dated August 4, 2000, states "We need to determine if there is a deal to be made between PDM and CBI or if we should be contacting other parties who have expressed similar interest." (CX 70 at PDM-C 1002706).

520. Scheman considered CB&I to be a "preemptive buyer" and this meant "that we never went out to other people. Their

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status as a preemptive buyer made it so we didn't go down the route of calling other people." (Scheman, Tr. 2938-40 (Tanner did not believe it was "prudent" to "go out and contact people"); (Tanner and PDM had "reached a point with CB&I where we thought we had a good deal, and we ultimately, I believe, entered into a letter of intent and, therefore, did not show [the offering memorandum] to other people"))).

521. On August 29, 2000, Respondents announced that they had signed a letter of intent for the acquisition of PDM's EC and Water Divisions by CB&I. (CX 285; CX 1565).

522. CB&I initially agreed to pay \$ 93.5 million for PDM EC and Water, which was at the "high end" of Tanner's estimates of PDM's sales value. (CX 521 at TAN 1000328). Tanner believed "it is doubtful that PDM could achieve a value exceeding \$ 93.5 million in an alternative transaction." (CX 521 at TAN 1000329). Rich Byers testified that the final price paid by CB&I for the PDM EC and Water Divisions was \$ 76-77 million (Byers, Tr. 6794).

523. CB&I purchased PDM EC and Water Divisions for more than investment banker Goldman Sachs' valuation for the company and for an amount within the valuation range determined by Tanner. (Byers, Tr. 6843).

524. Alternative buyers would unlikely pay a premium price for PDM EC and Water Divisions because they would face continued tough competition from CB&I. (Scheman, Tr. 2966-67). Handwritten notes of PDM's investment banker state "Need informed buyer willing to fund war wCB&I - unlikely to pay premium." (CX 534 at TAN 1001619). PDM EC and Water Divisions were worth more to CB&I than they were to other firms because of CB&I's ability to utilize PDM's resources and compete on a global basis. (Glenn, Tr. 4261-62).

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**4. Alternatives to acquisition**

525. In July of 2000, PDM announced that it would sell the company. (Scheman, Tr. 2918-20).

526. Financial buyers, who would have maintained PDM as an independent on-going entity, were available and had been recommended by Goldman Sachs and Tanner as alternative buyers. (Byers, Tr. 6744; see also CX 520 at TAN 1003258; CX 380 at PDM-C 1004025).

527. Tanner & Company was given the responsibility to contact potential purchasers. (Byers, Tr. 6758). PDM management was instructed to direct all inquiries to Tanner & Company. (Byers, Tr. 6758).

528. Tanner & Company assembled a preliminary list of potential buyers, in June 2000, including 18 steel companies, 15 engineering and construction companies, and 4 financial buyers. (CX 520 at TAN 1003258). This list was presented to the PDM Board on June 1, 2000. (CX 520 at TAN 1003256).

529. Among the companies identified by Tanner as potential acquirers of PDM EC and Water Divisions were Fluor, Jacobs Engineering, Foster Wheeler, Morrison Knudsen, but to Byers's knowledge, none of these companies were contacted about acquiring PDM EC and Water Divisions. (Byers, Tr. 6806-08). "I don't know of anybody that PDM contacted, anybody other than CB&I and Enron." (Byers, Tr. 6764, 6812).

530. Tanner never contacted any foreign firms in connection with purchasing PDM EC. (Scheman, Tr. 2938-39). Tanner did not contact Skanska/Whessoe, Technigaz, TKK, Tractebel, Mitsubishi, Entrepouse, Nooter, or Wiley. (Scheman, Tr. 2938-39; Byers, Tr. 6811-12).

531. Matrix, then the third-largest United States tank constructor, made efforts to buy PDM EC. (Vetal, Tr. 418-19). Matrix's President, Brad Vetal, called PDM's President, William

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McKee, and informed him of Matrix's interest in purchasing PDM EC. (Vetal, Tr. 422). McKee told Vetal that PDM could not talk with Vetal about a sale of the business because PDM already had a buyer, but McKee would call him if that deal fell through. (Vetal, Tr. 422-23; see also RX 168 at TAN 1000654 (handwritten notes of Peter Scheman indicating Vetal had contacted McKee)).

532. A fairness opinion prepared by Tanner, dated February 7, 2001, noted that if CB&I's acquisition of PDM EC and Water Divisions fell through, there were other potential buyers with the interest and adequate resources to purchase PDM EC and Water. (RX 29 at PDM-C 1006327). Other parties had in fact expressed an interest in purchasing PDM EC and Water. (CX 70 at PDM-C 1002706).

533. PDM actively sought buyers for its other divisions. As of August 18, 2000, "over ten parties had received the Confidential Memorandum for Steel Distribution and six groups had received Bridge Division books." (CX 521 at TAN 1000339).

534. On August 20, 2000, Tanner presented to PDM's president additional lists of prospective acquirers for the various PDM divisions, including fourteen parties who initiated contact expressing interest in possible acquisition of the various divisions and 32 prospective financial buyers. (CX 527 at TAN 1002453-2455)

### **5. PDM's financial condition**

535. PDM was a "profitable" company. (Scheman, Tr. 2923; CX 520 at TAN 1003317). The company's Earnings Before Interest, Taxes, Depreciation, and Amortization ("EBITDA") increased from \$ 20.5 million in 1994 to \$ 49.3 million in 1999. (CX 520 at TAN 1003317).

536. The EC and Water Divisions are intertwined, and together were profitable according to the Tanner fairness opinion of February 7, 2001. (RX 29 at PDM-C 1006326). Since the two

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divisions were sold together, it is fair to look at the profitability of the two divisions on a combined basis.

537. PDM's EC Division was profitable, increasing its margin each year from 1996 through 1999 and increasing its EBITDA earnings at a 5-year Combined Annual Growth Rate ("CAGR") of 18.7% on 5-year sales CAGR of 9.5%. (CX 520 at TAN 1003317). The Division's Earnings Before Interest and Taxes ("EBIT") increased from \$ 5.4 million in 1995 to \$ 9.5 million in 1999, a CAGR of 15.3%. (CX 522 at TAN 1003373). Revenues increased from \$ 121.7 million in 1995 to \$ 185.7 million in 1999. (CX 522 at TAN 1003373).

538. PDM EC had its best year ever in 1999. (Scorsone, Tr. 4823-24). As of July 2000, the month before CB&I and PDM signed the acquisition letter of intent, PDM EC projected EBIT of \$ 2 million in 2000. (CX 522 at TAN 1003373).

539. In 2000, the EC Division lost \$ 9 million after making \$ 9.5 million in 1999. (Scheman, Tr. 6920-21; RX 163 at TAN 1000385).

540. As of June 30, 2000, PDM EC had cash of \$ 2.6 million, total assets of \$ 79.2 million, no outstanding long-term debt, and shareholder' equity of \$ 56.8 million. (CX 385 at 30).

541. In September of 2000, Scorsone made a presentation to CB&I and its advisors about PDM EC's future prospects, "assuming that the company was not acquired [by CB&I]." (Scorsone, Tr. 5201; CX 1695 at CB&I/PDM-H 4005659). Scorsone projected PDM EC's earned revenues to be \$ 151 million for 2000, and \$ 168 million for 2001. (CX 1695 at CB&I/PDM-H 4005701; CX 529 at TAN 1000596; see also CX 1713 at CB&I/PDM-H 4015086-89 (projected income from operations increase each year from \$ 6.4 million to \$ 9.1 million, between the years 2001 and 2004)).

542. After Respondents announced the acquisition, PDM EC's earnings for 2000 declined, resulting in a loss for the year of

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about \$ 8 million. (Scorsone, Tr. 4825). After the date of closing, PDM and CB&I ultimately determined that PDM EC's losses approximated \$ 30 million in fiscal year 2000. (Scheman, Tr. 6917, 6921, 6926; Byers, Tr. 6789).

543. A short-term reduction in capital expenditures in the petroleum and petrochemical industries in 1999 negatively impacted all tank suppliers in 2000, including CB&I. (CX 522 at TAN 1003372; CX 529 at TAN 1000596 ("1999 - Down - Mergers in Oil + Gas \* Market Driver (Oil + Gas)")).

544. Scorsone, PDM EC's President, Byers, PDM's Vice President of Finance, and PDM's investment banker all believed that PDM EC's poor performance in 2000 would be short-lived, and if PDM EC had remained independent, PDM EC would have returned to profitability the very next year and continued to grow. (Scorsone, Tr. 4838; Byers, Tr. 6899; CX 529 at TAN 1000596 ("2001 - will be good year [for PDM] - the bookings are higher"); (CX 1713 at CBI/PDM-H 4015089) (EC Division predicted to earn gross profits of \$ 20.0 million in 2002, \$ 22.4 million in 2003, and \$ 25.1 million in 2004); see also CX 522 at TAN 1003372 ("This decline is expected to be short lived" PDM EC projects 2001 revenue and EBIT of \$ 168.0 million and \$ 6.1 million, respectively)).

545. As late as February 7, 2001, the date CB&I consummated the acquisition, PDM's management projected that PDM EC would make a profit of \$ 4.8 million in 2001. (Scheman, Tr. 2961-2962; RX 163 at TAN 1000385).

## **6. PDM was not facing liquidation**

546. At the time PDM called CB&I to offer to sell, PDM's reputation in the two lines of business was very good -- they did good work and were recognized in the marketplace by being on everyone's bid lists. (G. Glenn, Tr. 4078).

547. The PDM EC Division was a successful and profitable business and was projected to sustain earnings growth. (CX 1695



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at CB&I/PDM-H 4005701; CX 529 at TAN 1000596; see also CX 1713 at CB&I/PDM-H 4015086-89).

548. Scorsone testified that if the EC Division had not been sold, that it would not have gone out of business, and that it would be profitable in the future. (Scorsone, Tr. 4838).

549. Byers, former VP of Finance for PDM, testified that before making any recommendation to liquidate the PDM EC Division, his fiduciary duties would have required him to investigate to assure himself that there was no alternative purchaser for either PDM or for PDM EC willing to pay more than liquidation value of the business. (Byers, Tr. 6799-800, 6893, 6895). Byers never got to that point. (Byers, Tr. 6800). Byers never investigated whether there was a possibility of another purchaser. (Byers, Tr. 6895).

550. Tanner would have attempted to find alternative purchasers prior to recommending liquidation. (JX 34 at 83 (Scheman, IHT)).

551. PDM's Board of Directors meeting minutes illustrate that PDM had viable alternatives to liquidation. On November 28, 2000, PDM's President, William McKee stated that if the CB&I transaction fell through, PDM would continue its efforts to sell PDM EC and PDM Water Divisions by seeking other purchasers. (CX 1590 at PDM-C 1006065).

552. PDM's Board of Directors never took up the issue of liquidating the PDM EC Division. (Byers, Tr. 6891).

## **K. Remedy**

### **1. Divestiture can restore competition**

553. Divestiture to an appropriate acquirer of the reconstituted assets of PDM EC and PDM Water, as a viable business, would effectively restore competition and remedy any lessening of

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competition that resulted from the acquisition of PDM EC and PDM Water Divisions. (Simpson, Tr. 3608-09).

## **2. Assets acquired in the acquisition**

554. CB&I purchased "Tangible Personal Property" from PDM, which included "all design, manufacturing, construction, erection, maintenance, research and development, testing and other machinery and equipment, vehicles, tools, dies, molds, furniture, fixture, office equipment, field equipment, . . . supplies and other tangible personal property (together with all spare and maintenance parts, operating manuals, equipment specifications and diagrams)" used by PDM's EC and Water Divisions. (CX 328 at CBI 001264-CHI).

555. CB&I purchased real property or the leases to real property from PDM EC in the Acquisition in the following locations: Woodland, TX (leased headquarters), except for the subleased Third and Fourth floors; Provo, UT (owned); Fresno, CA (owned); Franklin, TN (owned); and Santa Fe, TX (leased). (CX 385 at 21-23; CX 328 at CBI 001320-CHI). All of the equipment located at these properties was also sold to CB&I in the Acquisition. (CX 328 at CBI 001264-CHI). Several other leases to offices used by the EC Division were transferred as well. (CX 328 at CBI 001265-CHI; CX 333).

556. As of July 2000, the Woodland, TX headquarters' significant equipment consisted of 157 desktop computers, 1 trailer, and 1 X-ray unit. (CX 385 at 21).

557. As of July 2000, the Provo, UT plant's significant equipment consisted of 2 bending machines, 4 blast machines, 2 bulldozers, 4 compressors, 20 cutting machines, 13 dist. box/PWR panels, 6 drill presses, 12 heaters/furnaces, 25 hoists, 3 lathes, 4 milling machines, 29 painting/planers/punchers, 16 positioners, 1 pump, 39 turning rolls, 14 saws, 2 trailers, 79 welders/wire feeders, and 16 X-ray units. (CX 385 at 21).

558. As of July 2000, the Fresno toolhouse's significant

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equipment consisted of 1 bulldozer, 1 burning machine, 8 compressors, 29 dist. box / PWR panels, 4 forklifts, 5 generators, 5 hoists, 1 lathe, 2 milling machines, 1 piece of office equipment, 5 pumps, 1 tractor, 2 trailers, 2 vehicles, 141 welders / wire feeders, 1 welding accessory, and 8 X-ray units. (CX 385 at 22).

559. As of July 2000, the Franklin toolhouse's significant equipment consisted of 1 bulldozer, 31 compressors, 56 dist. box / PWR panels, 2 forklifts, 40 generators, 23 hoists, 5 pieces of office equipment, 1 pump, 10 support towers, 1 tractor, 11 trailers, 1 vehicle, 385 welders / wire feeders, 3 welding accessories, and 7 X-ray units. (CX 385 at 23).

560. As of July 2000, the Santa Fe toolhouse's significant equipment consisted of 18 compressors, 26 dist. box / PWR panels, 16 generators, 5 trailers, 2 vehicles, 273 welders / wire feeders, 5 welding accessories, and 1 X-ray unit. (CX 385 at 23).

561. CB&I purchased real property or the leases to real property from PDM Water in the Acquisition in the following locations: Clive, IA plate fabrication plant and office (owned); Pittsburgh, PA toolhouse (owned); HyCon Birmingham, AL office and toolhouse (owned); HyCon Conroe, TX office and toolhouse (leased); and three other leased office properties. (CX 328 at CBI 001264-CHI, CBI 001265-CHI; CX 332; CX 333). The equipment located at these facilities was also sold to CB&I in the Acquisition. (CX 328 at CBI 001264-CHI).

562. CB&I purchased "Inventories and Stores and Supplies from PDM, which included "all raw materials, components, work-in-progress, finished products, packaging and shipping materials and supplies and other inventories (on-site, off-site and consigned)" used by PDM's EC and Water Divisions. (CX 328 at CBI 001264-CHI - CBI 001265-CHI).

563. CB&I purchased all of PDM EC and Water Divisions' contract rights in the Acquisition, subject to non-assignability issues and exemptions, under Section 2.2.3 and Schedule 2.27 of the Asset Purchase Agreement. (CX 328 at CBI 001265-CHI, CBI

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001319-CHI) The contractual rights transferred include: customer contracts, consulting agreements, alliance and partnering agreements, agency, representative and distribution agreements, licenses; purchase and sales orders, and backlog. Id.

564. CB&I purchased all of PDM's intellectual property rights listed in Schedule 5.1.10 of the PDM Disclosure Schedule and any intellectual property used by the acquired Divisions. (CX 328 at CBI 001265-CHI) The transferred intellectual property rights included all applications and registrations. Id. The "Pitt-DeMoines" and "PDM" names and all variations thereof were licensed to CB&I in the Acquisition. (CX 328 at CBI 001267-CHI).

565. CB&I purchased PDM's customer and contact lists; sales, product, and promotional data, brochures, forms, mailing lists, and advertising materials; vendor lists; project designs and specifications; and computer software. (CX 328 CBI 001266-CHI).

**3. The EC and Water Divisions are inextricably intertwined**

566. PDM EC and PDM Water were inextricably intertwined. (Byers, Tr. 6780 (it is "impossible to split [PDM EC and PDM Water]" in two because "they shared many services. They shared human resources, they shared physical plant."); JX 34 at 33-34 (Scheman, Dep.) ("there was not a bright line that separated the two businesses but in certain places they kind of meshed together.")).

567. PDM EC and PDM Water routinely shared field erection personnel, fabrication facilities, construction resources, and field erection equipment. (Scorsone, Tr. 2852, 4779-80; CX 552 at 43-48 (Braden, Dep.); see Rano, Tr. 5894, 5898 (same engineering processes are used for a flat-bottom tank as is used for an LNG tank)).

568. PDM's EC and Water Divisions shared skilled personnel.

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(CX 552 at 45-47 (Braden, Dep.) (construction crews and project managers would seamlessly transfer from a PDM Water job to a PDM EC job with their tools and equipment); CX 442 at 210 (Knight, Dep.) (tank field-erection crews are switched from cryogenic tanks to flat-bottom tanks)).

569. Sharing resources benefitted both PDM EC and PDM Water because it "facilitated a more steady flow of work, a more consistent flow of work through . . . [the] warehouses [and] fabricating plants." (CX 552 at 52-53 (Braden, Dep.); Scorsone, Tr. 4779-80).

570. Separating the EC and Water Divisions might have cost between \$ 5 and \$ 10 million. (CX 525, TAN-1000406; Scheman, Tr. 6922-23).

571. PDM Water would have difficulty operating independently of PDM EC. (CX 552 at 44 (Braden, Dep.) (splitting PDM Water from PDM EC "would have lessened our ability to stand alone, and certainly would have diminished the profitability of the operation.")).

572. Due to the intermingling of resources, PDM decided to sell the two divisions together, because it was not practical to sell one without the other. (Byers, Tr. 6780-82).

#### **4. Multiple fabrication facilities**

573. Possessing multiple fabrication facilities is advantageous, because it allows a competitor to rationalize its freight costs. (Vetal, Tr. 432-33; see CX 615 at 45 (Knight, IHT) (in competitive situations, a tank supplier benefits from having a fabrication facility located close to a job so that its freight costs are minimal)).

574. Having multiple facilities not only promotes a geographic competitive advantage, but also allows flexibility in fabrication. (CX 442 at 152, 156 (Knight, Dep.) (Tank suppliers with multiple fabrication shops and many field crews can "be

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more flexible in order to meet [changes in customers' schedules]," including needing "the project faster or at a different time period . . .").

575. Each of the former PDM facilities have different fabrication capabilities. (See CX 535 at 181-83 (Scorsone, Dep.); CX 615 at 46 (Knight, IHT) (some fabrication plants cannot fully fabricate storage tanks in the manner required by PDM, because they do not support "certain types of rolling and pressing operations" for thick steel plate)).

### **5. Intellectual property**

576. A viable competitor in the relevant product markets would need intangible as well as tangible assets. (Simpson, Tr. 3608).

577. Intellectual Property rights can give competitors in the relevant markets cost advantages over their rivals. As of March 2000, CB&I possessed over 100 U.S. patents. (CX 230 at CBI-PL 055446). However, such intellectual property is not always necessary to be an effective competitor. (Cutts, Tr. 2563-64 (additional intellectual property was not necessary for AT&V to compete with CB&I for the LIN/LOX projects for BOC)).

### **6. Reputation**

578. There is a great deal of goodwill in the PDM name. (Cutts, Tr. 2389 ("the PDM name, like the CB&I name, could obviously break down a lot of walls and barriers")). A large amount of capital would have to be spent in marketing for a smaller competitor in the relevant industry to build a reputation equivalent to that of PDM. (Cutts, Tr. 2382 (such marketing would cost AT&V a million dollars over the next three years)).

579. Currently, customers are more willing to purchase from CB&I than anyone else, because CB&I has successfully built most of the relevant products. (Cutts, Tr. 2385; CX 258 at CBI-H001816-H001832; CX 1731 at 44 (LNG tank owners do not

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want to purchase from a second-rate company without a track record, because the work is "very specialized, very sophisticated.")). It takes time to build a track record from scratch. (Cutts, Tr. 2372, 2385).

### **7. Assignability of contracts**

580. Many of the contracts presently held by CB&I contain non-assignability clauses and key employee provisions that require the customer to approve the assignment of the contract or the replacement of key employees on a project. (Glenn, Tr. 4168-69; Izzo, Tr. 6508).

581. Prior to the Acquisition, PDM received approvals from its customers to transfer its contracts to CB&I. (Byers, Tr. 6804).

### **8. Employees**

582. Experienced employees are specially trained and therefore valuable in the relevant industry. Hiring people off the street for skilled PDM field crews is "not economical." (CX 615 at 25, 47 (Knight, IHT)). Skilled field crews and managers must be trained in equipment and procedures. *Id.* at 47, 50; CX 552 at 62 (Braden, Dep.) ("There's a fairly steep learning curve in our business, and to go out and try to fill experienced positions would require some effort . . . . People have to become familiar with our products and our processes. Processes more than anything.")).

583. CB&I hires less skilled field crew personnel on a job to job basis. Field crew workers are free to work for a number of companies (Rano, Tr. 5953), and tend to move from job to job depending on where work is available. (Rano, Tr. 5957). Because field crews are very migratory, CB&I hires its general field labor on a job to job basis. (Glenn, Tr. 4119-20; Rano, Tr. 5917-18, 5953). Using local labor is cheaper than employing traveling workers, because it reduces the need to pay increased expenses associated with room and board for out-of-town workers. (Rano, Tr. 5909-10). CB&I recruits local labor by advertising in the local

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media, and making contacts with local labor leaders and local government officials. (Rano, Tr. 5908-10).

584. At CB&I, the engineering personnel are moved around to various projects depending upon the workload. (CX 497 at 365 (Leventry, Dep.)).

585. Sales representatives in the industry can service both the low temperature and cryogenic tank market and the industrial tank market. (CX 615 at 12, 14 (Knight, IHT)).

**9. A large revenue base is necessary to be a viable competitor**

**a. Bonding**

586. Howard Fabrication's annual revenues, of \$ 2.5 to \$ 3 million, are too small to enable it to compete against CB&I for larger thermal vacuum chamber projects. (Gill, Tr. 181, 199-201).

587. AT&V, which had annual revenues of [redacted], needs "a little more financial strength and bonding capacity" to compete for larger low temperature and cryogenic tank projects. (JX 23 at Ex. 1, in camera).

588. Matrix, which has annual revenues of approximately \$ 190 million, but lacks a larger company to financially back its operations, has difficulty convincing LNG customers that they are a qualified supplier. (CX 460 at CBI-E 007235).

589. LNG customers testified that they would not purchase from a divested entity unless it was able to financially guarantee its work. (Izzo, Tr. 6508 ("The first thing I'd be concerned about with a NewCo is whether I'd put them on my bid list because of ability to bond."); Bryngelson, Tr. 6157 ("Q. . . . So is it beneficial to El Paso to have a company that has size, even if a lot of that size doesn't necessarily come from the revenue generated by building tanks? / A. Yes."); Carling, Tr. 4467-68 ("We expected the lead contractor to stand behind his work, so the



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bonds and the guarantees would have to come from [a divested entity's] parent company.")).

590. As of June 30, 2000, PDM's 6-month revenues were approximately \$ 355 million. (CX 1567 at 3). This base of revenues was sufficient to provide the financial guarantees necessary to compete for LNG and TVC projects. (Carling, Tr. 4529 (PDM was able to provide sufficient financial guarantees to Enron to be employed for an LNG tank built in Penuelas, Venezuela); [redacted], Tr. 1895-96, in camera (PDM had the financial ability to be considered for a TVC project)). However, there were some LNG projects, such as the one in Dabhol, India, that PDM was unwilling to guarantee to the level that the customer required. (Izzo, Tr. 6488-89; Carling Tr. 4529-30).

**b. Equipment used to construct the relevant products**

591. Soon after the Acquisition, CB&I auctioned off a substantial amount of the equipment that it purchased from PDM in an effort to reduce costs. (Scorsone, Tr. 2888).

592. A fully equipped crew requires a great deal of equipment, which costs approximately half a million dollars. (Cutts, Tr. 2388). It typically has a crane, air compressors, welding machines, general rigging equipment and other incidentals. (Cutts, Tr. 2388).

593. Costly automated welding equipment is necessary to be cost competitive in the construction of LNG tanks. (CX 706 at 98 (Newmeister, IHT); see CX 706 at 98-99 (Newmeister, IHT) (CB&I has patented welding equipment that is useful for welding large tanks); see also Cutts, Tr. 2379 (automated equipment is necessary to weld large tanks, but it is expensive to develop)).

594. Specific equipment is necessary for blasting, painting, and pressing capabilities. A large press and a large number of dyes for pressing the dome roofs used for LIN/LOX tanks costs roughly \$ 2 million. See CX 706 at 64-66 (Newmeister, IHT). Additionally the automated blast and paint system used to paint

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the outer tank on a LIN/LOX tank costs roughly \$ 2-3 million. See CX 706 at 64-66 (Newmeister, IHT).

595. In constructing some projects, subcontracting may lower costs, because subcontractors with an expertise in a particular area are able to use a standardized approach and may be better at certain job functions than a general contractor. (Bryngelson, Tr. 6143-44; Cutts, Tr. 2472; Hilgar, Tr. 1537-38).

### **III. ANALYSIS AND CONCLUSIONS OF LAW**

#### **A. Jurisdiction**

The Complaint charges Respondents with violations of Section 5 of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 45 and of Section 7 of the Clayton Act, 15 U.S.C. § 18.

Section 5(a)(2) of the FTC Act gives the Commission jurisdiction "to prevent persons, partnerships, or corporations . . . from using unfair methods of competition in or affecting commerce . . ." 15 U.S.C. § 45(a)(2); *Kaiser Aluminum & Chem. Corp. v. FTC*, 652 F.2d 1324, 1327 n.1 (7th Cir. 1981). Respondents are corporations engaged in the interstate sale of large, field-erected cryogenic tanks and thermal vacuum chambers. F. 1-3, 6, 9. Respondents' challenged activities relating to the sale of large, field-erected cryogenic tanks and thermal vacuum chambers have an obvious nexus to interstate commerce. F. 3-5, 7-9. Thus, the Commission has jurisdiction over Respondents and the subject matter of this proceeding, pursuant to Section 5 of the FTC Act.

Section 7 of the Clayton Act prohibits acquisitions, the effect of which "may be substantially to lessen competition, or tend to create a monopoly." 15 U.S.C. § 18. "Section 11(b) of the Clayton Act, 15 U.S.C. § 21(b), expressly vests the Commission with jurisdiction to determine the legality of a corporate acquisition under Section 7 and, if warranted, to order divestiture." *In re R.R. Donnelley & Sons Co.*, 120 F.T.C. 36, 140 (1995); see also *Hospital Corp. of Am. v. FTC*, 807 F.2d 1381,

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1386 (7th Cir. 1986). The February 7, 2001 purchase by CB&I of PDM's Water Division and Engineered Construction Division was a corporate acquisition ("the Acquisition"). F. 10-12. The Commission's jurisdiction includes adjudicating the lawfulness of acquisitions that have already been completed. *In re Coca-Cola Co.*, 117 F.T.C. 795, 911 (1994); see generally *FTC v. Consolidated Foods Corp.*, 380 U.S. 592, 598 (1965). Thus, the Commission has jurisdiction over Respondents and the subject matter of this proceeding, pursuant to Sections 7 and 11 of the Clayton Act.

**B. Burden of Proof and Statutory Framework**

Under Commission Rule of Practice 3.51(c)(1), "an initial decision shall be based on a consideration of the whole record relevant to the issues decided, and shall be supported by reliable and probative evidence." 16 C.F.R. § 3.51(c)(1).<sup>n1</sup> The Commission made amendments to its Rules of Practice, effective May 18, 2001. *FTC Rules of Practice, Interim rules with request for comments*, 66 Fed. Reg. 17,622 (April 3, 2001). Through these amendments, the Commission removed the requirement of Rule 3.51(c)(3) that the initial decision of an ALJ be supported by "substantial" evidence. 66 Fed. Reg. at 17,626. According to *Black's Law Dictionary*, "probative evidence" means having the effect of proof; tending to prove, or actually proving an issue. "Substantial evidence" is defined in *Black's Law Dictionary* as such evidence that a reasonable mind might accept as adequate to support a conclusion. At this level of the proceedings, the difference between probative evidence and substantial evidence is not dispositive. Therefore, all findings of fact in this Initial Decision are supported by reliable and probative evidence.

<sup>n1</sup> Unlike *In re Schering-Plough Corp.*, Docket 9297 (Initial Decision June 27, 2002, available at <http://www.ftc.gov/os/adjpro/d9297/020627id.pdf>), where the complaint was issued on March 30, 2001, prior to the effective date of these amendments, the Complaint in this matter was issued on October 25, 2001, after the effective

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date of the amendments.

The parties' burdens of proof are governed by Commission Rule 3.43(a), Section 556(d) of the Administrative Procedure Act ("APA"), and case law. Pursuant to Commission Rule 3.43(a), "counsel representing the Commission . . . shall have the burden of proof, but the proponent of any factual proposition shall be required to sustain the burden of proof with respect thereto." 16 C.F.R. § 3.43(a). Under the APA, "except as otherwise provided by statute, the proponent of a rule or order has the burden of proof." 5 U.S.C. § 556(d). Further, under the APA, an Administrative Law Judge may not issue an order "except on consideration of the whole record or those parts thereof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence." 5 U.S.C. § 556(d). See also *Steadman v. SEC*, 450 U.S. 91, 102 (1981) (APA establishes preponderance of the evidence standard of proof for formal administrative adjudicatory proceedings).

The Complaint challenges the Acquisition under both Section 7 of the Clayton Act and Section 5 of the FTC Act. The analytical standards for assessing legality in this context are read coextensively. *R.R. Donnelley & Sons*, 120 F.T.C. at 150 n.32; *FTC v. PPG Indus. Inc.*, 798 F.2d 1500, 1501 n.2 (D.C. Cir. 1986) (Section 5 of the FTC Act "may be assumed to be merely repetitive of [Section] 7 of the Clayton Act.").

Section 7 of the Clayton Act prohibits acquisitions, "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly." 15 U.S.C. § 18. See *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 355 (1963) ("The statutory test is whether the effect of the merger 'may be substantially to lessen competition' 'in any section of the country.'"). "Congress used the words 'may be substantially to lessen competition' to indicate that its concern was with probabilities, not certainties." *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962). Complaint Counsel need not prove that

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an anticompetitive effect is a certainty. R.R. Donnelley & Sons, 120 F.T.C. at 150 (citing *California v. American Stores Co.*, 495 U.S. 271, 284 (1990)).

The first step in analyzing a Section 7 case is to determine the "line of commerce" and the "section of the country." 15 U.S.C. § 18. In other words, the first step is to determine the relevant product and geographic markets. R.R. Donnelley & Sons, 120 F.T.C. at 151; *United States v. General Dynamics Corp.*, 415 U.S. 486, 510 (1974) ("delineation of proper geographic and product markets is a necessary precondition to assessment of the probabilities of a substantial effect on competition within them"). "Complaint Counsel bears the burden of proving a relevant market within which anticompetitive effects are likely as a result of the acquisition." R.R. Donnelley & Sons, 120 F.T.C. at 152.

The second step in analyzing a Section 7 case is to determine whether the effect of the acquisition "may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18. The analytical framework by which the government can establish probable effect has three parts, as summarized below.

First, the government has the burden of showing that the Acquisition would produce "a firm controlling an undue percentage share of the relevant market, and would result in a significant increase in the concentration of the firms in that market." *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 715 (D.C. Cir. 2001) (citing *Phila. Nat'l Bank*, 374 U.S. at 363); *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 982 (D.C. Cir. 1990). The government may establish a prima facie case of anticompetitive effect by presenting statistics showing that combining the market shares of CB&I and PDM would significantly increase concentration in the already highly concentrated United States large, field-erected LNG tank, LPG tank, LIN/LOX tank and TVC markets. See *Baker Hughes*, 908 F.2d at 983. Once this showing is made, the government establishes a presumption that the transaction will substantially lessen competition. *Phila. Nat'l Bank*, 374 U.S. at 363; *Baker Hughes*, 908 F.2d at 982 (citing *United States v. Citizens & Southern Nat'l Bank*, 422 U.S. 86,

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120-22 (1975); Heinz, 246 F.3d at 715; In re B.F. Goodrich Co., 110 F.T.C. 207, 303-05 (1988).

Second, "finding a prima facie violation of Section 7 creates a rebuttable presumption of anticompetitive effects and shifts the burden of going forward with evidence to the respondent." B.F. Goodrich Co., 110 F.T.C. at 305; Citizens & Southern Nat'l Bank, 422 U.S. at 120; United States v. Marine Bancorporation, Inc., 418 U.S. 602, 631 (1974). A finding of prima facie illegality on the basis of concentration statistics can be rebutted by a showing that "the merger is not likely to have such anticompetitive effects." In re Weyerhaeuser Co., 106 F.T.C. 172, 278 (1985) (quoting Phila. Nat'l Bank, 374 U.S. at 363).

This second step of the analysis requires that the merger be "functionally viewed, in the context of its particular industry." Brown Shoe, 370 U.S. at 321-22; Weyerhaeuser Co., 106 F.T.C. at 278 ("only a further examination of the particular market -- its structure, history and probable future -- can provide the appropriate setting for judging the probable anticompetitive effect of the merger"). Respondents may "demonstrate unique economic circumstances that undermine the predictive value of the government's statistics." FTC v. Univ. Health, Inc., 938 F.2d 1206, 1218 (11th Cir. 1991). "Nonstatistical evidence which casts doubt on the persuasive quality of the statistics to predict future anticompetitive consequences may be offered to rebut the prima facie case made out by the statistics." Kaiser Aluminum, 652 F.2d at 1341. Factors which may be considered include "ease of entry into the market, the trend of the market either toward or away from concentration, and the continuation of active price competition." *Id.*

Thus, while market share evidence is "an important starting point in merger analysis, it alone is not conclusive in determining the legality of a merger under Section 7." Weyerhaeuser Co., 106 F.T.C. at 278. See also General Dynamics Corp., 415 U.S. at 498; Baker Hughes, 908 F.2d at 992 ("The Herfindahl-Hirschman Index cannot guarantee litigation victories."); Hosp. Corp. of Am., 807 F.2d at 1386 (deciding that market share figures are not

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always decisive in a Section 7 case and that the Commission was prudent in inquiring into the probability of harm to consumers).

Third, if Respondents successfully rebut the presumption of anticompetitive effects, "the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times." *Heinz*, 246 F.3d at 715; *Baker Hughes*, 908 F.2d at 983. Cf. *Citizens & Southern Nat'l Bank*, 422 U.S. at 120; *Marine Bancorporation*, 418 U.S. at 631 (upon the government's establishment of a prima facie case under *General Dynamics*, the burden then shifts to the acquiring firm to show that the statistics do not accurately depict competitive conditions). These comparative cases do not indicate that the burden of persuasion shifts from the government, but only that a burden of going forward with the evidence shifts. *Kaiser*, 652 F.2d at 1340 and n.12.

### C. Product Markets

The proper definition of the product market is a "necessary predicate" to an examination of the competition that may be affected by a merger or acquisition. *Brown Shoe*, 370 U.S. at 335; *R.R. Donnelley & Sons*, 120 F.T.C. at 151. The relevant market is the "area of effective competition" within which the defendant operates. *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327-28 (1961). Product markets may be defined either by "the reasonable interchangeability of use or the cross-elasticity of demand." *Brown Shoe*, 370 U.S. at 325; *Coca Cola Co.*, 117 F.T.C. at 925. See also *Kaiser Aluminum*, 652 F.2d at 1330 ("the clearest indication that products should be included in the same market is if they are actually used by consumers in a readily interchangeable manner."). Complaint Counsel bears the burden of proving a relevant market, within which anticompetitive effects are likely, as a result of the acquisition. *R.R. Donnelley & Sons*, 120 F.T.C. at 152; see also 16 C.F.R. § 3.43(a); 5 U.S.C. § 556(d).

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The parties agree that the relevant product markets are large, field-erected: (1) liquefied natural gas ("LNG") storage tanks (individually, or as a component of an import terminal or an LNG peak shaving plant); (2) refrigerated liquid petroleum gas ("LPG") storage tanks; (3) liquid nitrogen, oxygen and argon ("LIN/LOX") storage tanks; and (4) large (over 20 feet in diameter) thermal vacuum chambers ("TVCs"). F. 19. Therefore, the relevant product markets for assessing the probable effects of competition are large field-erected LNG storage tanks, LPG storage tanks, LIN/LOX storage tanks, and TVCs. F. 18-45.

#### **D. Geographic Market**

The statutory language of Section 7, "any section of the country," equates to the relevant geographic market. *Marine Bancorporation*, 418 U.S. at 620-21; *In re Adventist Health Sys.*, 117 F.T.C. 224, 288 (1994). The relevant geographic market is the "area of effective competition . . . in which the seller operates, and to which the purchaser can practicably turn for supplies." *Tampa Elec. Co.*, 365 U.S. at 327. The Government has the burden of proving the relevant geographic market. *United States v. Connecticut Nat'l Bank*, 418 U.S. 656, 669 (1974); *Adventist*, 117 F.T.C. at 289.

The parties agree that the relevant geographic market in which to analyze the merger is the United States. F. 15. By definition, field-erected LNG, LPG, and LIN/LOX storage tanks, as well as TVCs, must be built "in the field" at customers' sites in the United States. F. 16. It is economically infeasible to import a field-erected storage tank from anywhere outside the United States. F. 17. Therefore, the relevant geographic market for assessing the probable effects of competition is the United States. F. 14-17.

#### **E. Effects on Competition**

The Complaint alleges violations pertaining to four product markets. Before analyzing the effects on competition in each of these markets, the standards by which probable effects are evaluated are set forth with an analysis applicable to all four



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product markets.

Section 7 is "designed to arrest in its incipiency . . . the substantial lessening of competition from the acquisition by one corporation of the whole or any part of the stock" or assets of a competing corporation. *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 589 (1957); *Univ. Health*, 938 F.2d at 1218. "Congress used the words 'may be substantially to lessen competition' to indicate that its concern was with probabilities, not certainties." *Brown Shoe*, 370 U.S. at 323. "But it is to be remembered that § 7 deals in 'probabilities,' not 'ephemeral possibilities.'" *Marine Bancorporation*, 418 U.S. at 623. "Thus, to satisfy section 7, the government must show a reasonable probability that the proposed transaction would substantially lessen competition in the future." *Univ. Health*, 938 F.2d at 1218; *FTC v. Warner Communications Inc.*, 742 F.2d 1156, 1160 (9th Cir. 1984).

The essential question is whether "the probability of such future impact exists at the time of trial." *General Dynamics*, 415 U.S. at 505; *E. I. du Pont*, 353 U.S. at 607 (economic effects of an acquisition are to be measured at the time of suit rather than at the time of acquisition). Thus, although the Clayton Act is an "incipiency" statute, post-acquisition evidence, so long as it "is such that it could not reflect deliberate manipulation by the merged companies temporarily to avoid anticompetitive activity," will be given some consideration. *Lektro-Vend Corp. v. Vendo Co.*, 660 F.2d 255, 276 (7th Cir. 1981); *Consolidated Foods*, 380 U.S. at 598. Complaint Counsel has not demonstrated that Respondents deliberately manipulated the post-acquisition evidence. Further, Complaint Counsel has relied extensively on post-acquisition evidence to argue that, since the Acquisition, CB&I has implemented price increases. Complaint Counsel's Proposed Findings of Fact ("CCPFF") at pp. 103-177. Accordingly, post-acquisition evidence is considered and evaluated.

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## **1. Prima facie case**

Assessing the likely competitive effects of the proposed transactions begins by determining the market shares of the merging firms and the level of concentration in the relevant market. *FTC v. Cardinal Health Inc.*, 12 F. Supp. 2d 34, 52 (D.D.C. 1998). The most common method for Complaint Counsel to establish a prima facie case is to show that the acquisition "would produce 'a firm controlling an undue percentage share of the relevant market, and [would] result in a significant increase in the concentration of firms in that market.'" *Univ. Health*, 938 F.2d at 1218 (quoting *Phila. Nat'l Bank*, 374 U.S. at 363). "[A] merger which significantly increases the share and concentration of firms in the relevant market is 'so inherently likely to lessen competition' that it must be considered presumptively invalid and enjoined in the absence of clear evidence to the contrary." *Cardinal Health*, 12 F. Supp. 2d at 52 (quoting *Phila. Nat'l Bank*, 374 U.S. at 363).

Complaint Counsel has established its prima facie case by showing that CB&I's acquisition of PDM's EC and Water Divisions produces a firm controlling an undue percentage share in each of the four relevant markets. Although, as described below, Complaint Counsel's HHI statistics are not sufficiently reliable, Complaint Counsel has presented reliable and probative evidence demonstrating that CB&I and PDM were the number one and two competitors in all four product markets and that no other company provided or is likely to provide effective competition. This showing establishes Complaint Counsel's prima facie case.

### **a. The Herfindahl-Hirschman Index ("HHI")**

Market concentration is often measured by the Herfindahl-Hirschman Index ("HHI"). *Heinz*, 246 F.3d at 716; *PPG*, 798 F.2d at 1503; *Univ. Health*, 938 F.2d at 1211 n.12. The Department of Justice and the FTC rely on the HHI in evaluating whether to challenge proposed horizontal mergers. United States Dep't of Justice & Federal Trade Comm'n, *Horizontal Merger Guidelines* §

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§ 1.5, 1.51 (1992), as revised (1997) ("Merger Guidelines"). "The FTC and the Department of Justice, as well as most economists, consider the measure superior to such cruder measures as the four- or eight- firm concentration ratios which merely sum up the market shares of the largest four or eight firms. PPG, 798 F.2d at 1503. See also R.R. Donnelley & Sons, 120 F.T.C. at 182 n.147 (Commission uses HHI as the most economically relevant measure of concentration). The Merger Guidelines are not binding on courts or the Commission. PPG, 798 F.2d at 1503 n.4; R.R. Donnelley & Sons, 120 F.T.C. at 151 n.36. Instead, the Merger Guidelines serve to "describe the analytical process that the Agency will employ in determining whether to challenge a horizontal merger." Merger Guidelines § 0.2.

Although market concentration is often measured by the HHI, there is no requirement that it must be. *United States v. Franklin Elec. Co., Inc.*, 130 F. Supp. 2d 1025, 1033-35 (W.D. Wisc. 2000), provides one example of a merger enjoined without a single reference to HHI. In PPG, the district court was unable to calculate an HHI for the high technology market since the market was growing rapidly, major portions of it lay in the immediate future, and market shares depended upon the success of future bids and the ultimate size of the projects for which they bid. 798 F.2d at 1505. Nevertheless, the court of appeals, without relying on the HHI for the "closest available approximation" market, concluded "the fact that there appear to be only three fully capable firms in that market indicates that the HHI will be very high." *Id.* "Even if one or two other firms were thought capable of expanding or entering, the HHI would still put the market in the highly concentrated range, and the acquisition would cause a great increase in the HHI." *Id.* Where, as in the instant case, the two largest competitors in thin product markets merge, the increase in market concentration and substantial lessening of competition are common sense conclusions.

When the HHI is utilized, the index is calculated by squaring the individual market shares of all the firms in the market and summing up the squares. *Heinz*, 246 F.3d at 716 n.9. Under the Merger Guidelines, a market with a post-merger HHI above 1800

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is considered "highly concentrated" and mergers that increase the HHI in such a market by over 50 points "potentially raise significant competitive concerns." Merger Guidelines § 1.51. Acquisitions producing an increase in the HHI of more than 100 points in highly concentrated markets raise significant competitive concerns. Merger Guidelines § 1.51. The Merger Guidelines define as "unconcentrated" a market with an HHI below 1000, as "moderately concentrated" a market with an HHI between 1000 and 1800, and as "highly concentrated" a market with an HHI over 1800. Merger Guidelines § 1.51. See also PPG, 798 F.2d at 1503. Sufficiently large HHI figures establish a prima facie case that a merger is anticompetitive. Heinz, 246 F.3d at 716; Baker Hughes, 908 F.2d at 982-83.

Complaint Counsel's economic expert, Dr. John Simpson, examined market shares from 1990 to the time of the Acquisition in early 2001 and used this eleven year time period to calculate the HHI in each of the four relevant markets. F. 69, 216-18, 273-74, 370-71. Dr. Simpson provided no valid reason for using 1990 as a starting point, other than that was the starting point of the data that had been provided to him by Complaint Counsel. F. 69, 274.

Complaint Counsel cites to Merger Guidelines § 1.4 as authority for use of the eleven year time period for calculating the HHI. "Typically, annual data are used, but where individual sales are large and infrequent so that annual data may be unrepresentative, the Agency may measure market shares over a longer period of time." Merger Guidelines § 1.4. Nowhere do the Merger Guidelines suggest that using data spanning beyond a decade is an appropriate period of time. Despite this guideline, not a single case was cited to by Complaint Counsel where the government calculated the HHI in any manner other than based on annual sales. The only case found to have calculated HHI based on more than one year of sales is Baker Hughes, discussed *infra*. Instead, Complaint Counsel argues, "evidence that high market shares are sustained over several years is regularly used in antitrust cases to assess market power." Complaint Counsel's Post Trial Brief ("CCPTB") at 14-15 (citing Heinz, 246 F.3d at 712,

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717 (in analyzing barriers to entry, the court noted that there had been no significant entries in decades, yet determined market shares based on annual sales of baby food); *Borden, Inc. v. FTC*, 674 F.2d 498, 511 (6th Cir. 1982) (determining market share over five year period to infer monopoly power; suit not brought under the Clayton Act); *Greyhound Computer Corp. v. IBM Corp.*, 559 F.2d 488, 496-97 (9th Cir. 1977) (in a Sherman Section 2 case, defendant's share of the market in 3 years over a 7 year period was evidence from which the jury could reasonably infer market power)). None of these cases support the proposition that it is appropriate to calculate the HHI based on market data spanning more than a decade.

Sales in the field-erected LNG tank, LPG tank, LIN/LOX tank and TVC markets are sporadic, and a single sale can represent a large percent of market share in any given year. See F. 65, 68, 210, 213, 269, 364. Dr. Barry Harris, Respondents' economic expert, also presented numerous challenges to Dr. Simpson's use of 1990 as the starting point. F. 70, 71, 221, 276, 373, 375. In these unusual markets, mechanical application of the HHI provides misleading results. See Merger Guidelines § 0 ("Because the specific standards set forth in the Guidelines must be applied to a broad range of possible factual circumstances, mechanical application of those standards may provide misleading answers to the economic questions raised under the antitrust laws.").

The arbitrary nature of the HHI is underscored by the fact that choosing a different date achieves a completely different result. CB&I did not build an LNG tank, LPG tank, or TVC between 1996 and the date of the Acquisition, resulting in a change of zero in the HHI in three of the four markets. F. 70, 219, 372. An acquisition resulting in zero change in the HHI would not establish a prima facie case if only HHI were relied upon. See Merger Guidelines, § 1.5 ("Mergers producing an increase in the HHI of less than 50 points, even in highly concentrated markets post-merger, are unlikely to have adverse competitive consequences."); *New York v. Kraft Gen. Foods*, 926 F. Supp. 321, 362 (S.D.N.Y. 1995). This case illustrates the fact that the

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HHI is subject to manipulation which weakens its reliability as an economic indicator.

Although Complaint Counsel places great emphasis on the HHI and the increases to the HHI, Complaint Counsel failed to demonstrate that a valid and credible HHI had been calculated in any of the relevant markets. For the reasons detailed in the following sections on each of the relevant markets, the HHI statistics alone do not conclusively establish Complaint Counsel's prima facie case.

**(i) LNG market**

Dr. Simpson testified that the post-acquisition HHI for LNG tanks is 10,000, with a change of 4,956. F. 68. Dr. Simpson's HHI calculations are of questionable value, because they are based on a period of time of over 10 years and there have been so few sales from 1990 to the Acquisition. F. 65, 69, 71. If data dating back to 1996 is used instead, CB&I had no sales over that time period and the change in the HHI based on sales in the LNG market would be zero. F. 70. Accordingly, the HHI statistics lack reliability and are insufficient to establish Complaint Counsel's prima facie case in the LNG market.

**(ii) LPG market**

Dr. Simpson testified that the post-acquisition HHI for LPG tanks is 8,380, with a change of 3,910. F. 218. Dr. Simpson's HHI calculations are suspect for two reasons. First, he included in his calculation the value of a project that was awarded to CB&I after the Acquisition. F. 216, 217. Second, because CB&I's last pre-acquisition LPG project was awarded in 1993, if data dating back to 1994 or 1996, instead of back to 1990, were used, the change in the HHI based on sales in the LPG market would be zero. F. 219. HHI calculations are not accurate in determining the concentration in the LPG market due to the extraordinarily thin market and almost nonexistent demand. F. 220. Accordingly, the HHI statistics lack reliability and are insufficient to establish Complaint Counsel's prima facie case in the LPG market.

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**(iii) LIN/LOX market**

Dr. Simpson testified that the post-acquisition HHI for LIN/LOX tanks is 5,845, with a change of 2,635. F. 273. Dr. Simpson's HHI calculations in the LIN/LOX market were based on sales from 1990 to the date of the Acquisition. F. 274. There is no principled basis for reaching back to 1990 for calculating the HHI. Unlike the other three markets, where there were only a handful of sales over the eleven year period, in the LIN/LOX market 83 projects, comprising 109 tanks, were awarded during the period from 1990 to the Acquisition. F. 269. Further, Dr. Simpson admitted that CB&I's spin off from Praxair in 1997 was a significant competitive change, a fact which could justify beginning the HHI calculation for the LIN/LOX market in 1997, after the date of that sale. F. 275. Accordingly, the HHI statistics lack reliability and are insufficient to establish Complaint Counsel's prima facie case in the LIN/LOX market.

**(iv) TVC market**

Dr. Simpson testified that the post-acquisition HHI for TVCs is 10,000, with a change of 5,000. F. 370. He arrived at this conclusion by two approaches. First, he assigned a 50-percent market share to CB&I and a 50-percent market share to PDM, based on the opinions of market participants and documents. F. 370. Second, he assigned a 49.3 percent market share to CB&I for a project that was awarded to CB&I by Spectrum Astro, but was not built. F. 371. In actuality, only one TVC was built in the 1990s and this TVC was by PDM. F. 364. The last TVC built by CB&I was in 1984. F. 365. Without the proposed Spectrum Astro project included, PDM would have 100% market share and an HHI of 10,000. The increase in the HHI would be zero. F. 372. Applying different standards results in starkly different results in this extraordinarily thin market. Accordingly, the HHI statistics lack reliability and are insufficient to establish Complaint Counsel's prima facie case in the TVC market.

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**b. Market power in bid markets**

The Supreme Court, in *General Dynamics*, held that evidence of annual sales is relevant as a prediction of future competitive strength in most markets, such as groceries or beer, since distribution systems and brand recognition are such significant factors that one may reasonably suppose that a company which has attracted a given number of sales will retain that competitive strength. 415 U.S. at 501 (referencing *United States v. Von's Grocery*, 384 U.S. 270 (1966); *United States v. Pabst Brewing Co.*, 384 U.S. 546 (1966)). However, in some markets, statistical evidence of past production may not always be the best measure of a company's ability to compete. *Id.* (upholding district court's focus on reserves of coal rather than past production, because the bulk of the coal produced was delivered under long term requirement contracts, which could not be obtained without sufficient coal reserves).

The product markets here are not like groceries or beer. Rather, the four product markets are similar to the market for hardrock hydraulic underground drilling rigs examined in *Baker Hughes*. In *Baker Hughes*, the products were assembled and made to suit each purchaser's needs and specifications. *United States v. Baker Hughes, Inc.*, 731 F. Supp. 3, 8 (D.D.C. 1990). In this case, the large field-erected tanks and TVCs are custom made to suit each purchaser's needs. See generally *supra* Part II.D. In *Baker Hughes*, customers sought bids from several suppliers and placed great emphasis upon a supplier's reputation for quality and service. 731 F. Supp. at 8. In this case, customers generally seek competitive bids from several suppliers for each of the products at issue and place great emphasis upon a supplier's reputation for quality and service. E.g., F. 166-172, 222-26, 250-52, 283, 286. *Baker Hughes* addressed a very thin product market; the overall size of the market ranged from 51 to 61 sales over a three year period. 731 F. Supp. at 9. In this case, in the two years from the Acquisition to trial, one LNG tank, one LPG tank, five LIN/LOX tanks, and zero TVCs have been sold. F. 233, 292, 407-409. Indeed, Complaint Counsel has had to reach back eleven years to



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find more than a handful of sales in three of the four markets. F. 66, 211, 364.

The district court in *Baker Hughes* held, "because of the nature of the products sold and the fact that the volume of business done is relatively small and customers' needs for new equipment are irregular, market shares in the line of commerce alone are not an accurate measure of market dominance." 731 F. Supp. at 9. As in *Baker Hughes*, here because of the nature of the products sold, the fact that the volume of business done is relatively small, and the customer's needs for new equipment are irregular, market shares in the line of commerce alone are not a conclusive measure of market dominance. Thus, other factors besides market shares are analyzed.

"In evaluating monopoly power, it is not market share that counts, but the ability to maintain market share." *United States v. Syufy Enterprises*, 903 F.2d 659, 665-66 (9th Cir. 1990) (emphasis in original). Thus, a more accurate picture of competition arises through an examination not just of the number and the value of the tank projects awarded, but of the competitive pressure each manufacturer is able to exert by bidding. See *Baker Hughes*, 731 F. Supp. at 9 (evaluating numbers of bids over last two years). This approach was used by the Court of Appeals for the Second Circuit in evaluating "the unusual market" of carrier-based aircraft. *Grumman Corp. v. LTV Corp.*, 665 F.2d 10, 12-13 (2d Cir. 1981).

In *Grumman Corp.*, the defendants did not dispute that during the past two decades the acquired and the acquiring companies had been substantial competitors. Defendants argued that there was an "insufficient basis to believe that [the acquired company would] be a competitive factor in the future." *Id.* at 12. Even though the last order for the product in one of the relevant markets had been placed two years earlier and the single domestic purchaser had no current plans to purchase the product from the acquired company, the district court concluded that the acquired company could reasonably be expected to provide competition in the relevant market. *Id.* at 12.

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The court of appeals upheld the district court's finding in Grumman, stating it reflected "an inevitable aspect of an unusual market."

[The relevant product does] not roll off assembly lines like television sets or automobiles. In a market with a single domestic purchaser, which buys intermittently, a court assessing the anti-competitive effect of a horizontal combination must consider future possibilities in assessing whether there exists a significant probability of decreased competition. Whether or not [the acquired company] will sell more [of the relevant product to the single domestic purchaser], the fact remains that it was properly found to be competing to do so. . . . The [purchaser's] rejection of the proposal [to sell a modified version of the product] does not lessen the significance of [the acquired company's] capacity and desire to make it.

Id. at 12-13.

United States v. United Tote, Inc. provides another example of a court, in analyzing an unusual market, basing its opinion not just on a review of past sales, but on an analysis of the companies' ability to constrain competition by bidding. 768 F. Supp. 1071 (D. Del. 1991). In Tote, the relevant product market lines were on-track, off-track, and inter-track totalisator systems and services. Id. at 1069. In those markets, where companies submitted bids to tracks to have their systems used, the court found it to be significant that the two merging companies submitted bids against each other on 49 of the 116 totalisator contracts for which bids were sought. Id. at 1071 (holding that even though the acquired company had never replaced the acquiring company, where the acquiring company was the incumbent, the government's statistical case accurately reflected the state of competition).

Although CB&I has not won projects in three of the four markets from 1996 to the Acquisition, to conclude that CB&I

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does not have market power "ignores the competitive effect they exert simply by being available to compete." Grumman, 665 F.2d at 14. The fact that CB&I and PDM competed against each other consistently through the bid process is more dispositive to the determination of market power than how many projects were won. Thus, in the sections that follow, CB&I's market power is demonstrated through an evaluation of which companies provided competition through bids on recent projects.

**(i) LNG market**

From 1990 to the Acquisition, nine LNG tank projects were awarded in the United States. CB&I won five of these projects and PDM won four. F. 65. For all but two of these projects, no company other than CB&I and PDM submitted bids. F. 72.

**(ii) LPG market**

From 1990 to the Acquisition, eleven LPG tank projects were awarded in the United States. CB&I won five and PDM won four. F. 210. From 1994 to the Acquisition, of the five LPG tank projects built in the United States, CB&I won zero and PDM won three. F. 210. Morse Tank and AT&V each won one. F. 210. For the last four pre-acquisition LPG tank projects for which the parties presented evidence on the companies that submitted bids, CB&I bid on all four projects and PDM bid on three of the four. F. 222-26. On two of these, CB&I and PDM were the only bidders. F. 224. Although CB&I did not win any of the last five LPG projects, both CB&I and PDM were effective competitors through bidding. See Grumman, 665 F.2d at 14.

**(iii) LIN/LOX market**

From 1990 to the Acquisition, 109 LIN/LOX tanks were awarded in the United States. F. 269. CB&I won 25 of the tanks and PDM won 44. F. 269. Graver, which went out of business in 2001 won 34 of the projects. F. 269, 270. CB&I, PDM, and Graver were competing with each other by bidding on LIN/LOX projects. F. 286-88. Because Graver is no longer in the business, it

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is no longer bidding against CB&I and no longer provides competition.

**(iv) TVC market**

From 1990 to the Acquisition, only one field-erected TVC has been built, and this TVC was built by PDM in 1996. F. 364. Both CB&I and PDM provided final pricing offers for [redacted] in 1997. F. 366 (in camera). Both CB&I and PDM submitted best and final offers for the Spectrum Astro project in 1999. F. 368. Both CB&I and PDM were asked to provide rough order of magnitude ("ROM") pricing to TRW in 1999. F. 369. [redacted] sought a sole-source procurement with PDM for its [redacted] facility. F. 367 (in camera). In all but one of these instances, CB&I and PDM were competing against each other. F. 366, 368, 369. In all but one of these instances, no other company was even asked to participate in the bidding process. F. 366-69.

**c. Acquisition of closest competitor**

Regardless of how competition is measured, the decisive issue is that CB&I bought its closest competitor which is not likely to be replaced by an equally cost-effective and qualified competitor in any of the four markets. *Infra* Part III.E.2.c. Without PDM to bid against, CB&I is no longer required to submit the lowest possible bid to win projects. F. 498. Numerous recent D.C. court cases have used this economic principle when evaluating whether to enjoin a proposed merger or acquisition. E.g., *Heinz*, 246 F.3d at 725 (finding that by buying its closest competitor, Heinz would create a "durable duopoly" that "affords both the opportunity and incentive for both firms to coordinate to increase prices"); *FTC v. Libbey, Inc.*, 211 F. Supp. 2d 34, 47 (D.D.C. 2002) (enjoining merger where there was substantial evidence that the proposed merger might effectively eliminate a competitor in the relevant market that was already highly concentrated); *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 169 (D.D.C. 2000) ("A unilateral price increase by Swedish Match is likely after the acquisition because it will eliminate one of Swedish Match's primary direct competitors."); *Cardinal Health*, 12 F. Supp. 2d at 53, 64 (By

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combining with their closest competitors to capture an 80% market share, defendants could "curb downward pricing pressure and adversely affect competition."); *FTC v. Staples Inc.*, 970 F. Supp. 1066, 1082 (D.D.C. 1997) (By eliminating its closest competitor, "this merger would allow Staples to increase prices or otherwise maintain prices at an anti-competitive level."); *FTC v. Coca-Cola Co.*, 641 F. Supp. 1128, 1139 (D.D.C. 1986) ("The stark, unvarnished truth is that the [sought to be acquired] brand has been a staunch effective competitor . . . that [the potential purchaser] has tried to stifle" and is "now seeking to buy."). See also Merger Guidelines n.21 ("A merger involving the first and second lowest-cost sellers could cause prices to rise to the constraining level of the next lowest-cost seller.").

According to the D.C. Circuit Court of Appeals in *Heinz*, "no court has ever approved a merger to duopoly." 246 F.3d at 717 (enjoining merger between the second and third largest sellers of jarred baby food where the higher priced company, Gerber, who was not a participant in the merger, had a 65% market share). In *PPG*, where there "appeared to be only three fully capable firms in [the] market," and "the proposed acquisition would leave two," the Commission's showing of market concentration was "overwhelming," and the proposed merger was enjoined. 798 F.2d at 1505-06. The circumstances in the instant case are similar to those in *Franklin Elec.*, where there were only two manufacturers of the relevant product. 130 F. Supp. 2d at 1033-35. In that case, the defendants argued that market share or percentage of sales was almost irrelevant, because the market was quite different from most consumer markets. *Id.* The court held that the combination "should be viewed" as nothing "other than a merger to monopoly that by definition will have an anticompetitive effect[.]" *Id.*

"One factor that is 'an important consideration when analyzing possible anti-competitive effects' is whether the acquisition 'would result in the elimination of a particularly aggressive competitor in a highly concentrated market . . .'" *Libbey*, 211 F. Supp. 2d at 39, 47 (enjoining a merger where, though the firm to be acquired had only seven percent of the market, it was the

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"most formidable competitor" in the relevant market) (quoting Staples, 970 F. Supp. at 1083). In Grumman, where the acquiring company and the acquired company competed against each other for every opportunity, even though neither company had a significant share of the market, the district court "was entitled to conclude that removing one competitor from this market would tend to substantially lessen competition." 665 F.2d at 15. In this case, Respondents do have a significant share of the market, so, for even stronger reasons, removing a competitor would substantially lessen competition.

As discussed in each of the product market sections below, CB&I bought its closest competitor. Prior to the Acquisition, no other still existing company challenged CB&I's market power. Without resorting to the mechanical HHI analysis, the pre-acquisition market shares controlled by CB&I and PDM and the power each exerted by bidding against the other cannot be ignored. As the evidence in this case demonstrates, lower prices for customers resulted from that pre-acquisition competition. See F. 83-87, 231, 286-91, 388-406. Even Respondents recognized at the time that they were contemplating the Acquisition that combined CB&I and PDM could achieve market dominance. F. 491-96. Accordingly, Complaint Counsel has established a presumption of illegality in all four product markets.

**(i) LNG market**

CB&I and PDM account for all of the sales of LNG tanks in the United States from 1990 to the Acquisition. F. 65. From 1990 to 2001, based on the dollar values of tank projects built, excluding cancelled projects, CB&I accounted for 45.3% and PDM accounted for 54.7% of the market. The combined market share is 100%. F. 68.

Prior to the Acquisition, Respondents were the only two competitors in the LNG market. F. 74. Respondents and industry members viewed CB&I and PDM as the only competitors for LNG tanks. F. 75-82. Customers sought to use competition between CB&I and PDM to obtain lower prices. F. 83-97.

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**(ii) LPG market**

CB&I and its two acquisitions, PDM EC and Morse, account for all but one of the sales of LPG tanks in the United States from 1990 to the time of the Acquisition. F. 210, 214, 215. Dr. Simpson calculated market shares based on sales values from 1990 to 2001 and included the post-acquisition LPG project for BASF in Port Arthur, Texas that was awarded to CB&I. F. 212. Based on Dr. Simpson's data set, PDM had a 34.5% market share, CB&I had a 56.7% market share, Morse Tank had an 8.2% market share, and AT&V had a 0.6% market share. F. 213. By Dr. Simpson's calculations, the combined CB&I and PDM market share from 1990 to the Acquisition is 91.2%. F. 213. n2 On November 30, 2001, CB&I acquired Morse Tank, eliminating the firm that had accounted for the next most substantial share of LPG sales prior to the Acquisition. F. 214.

n2 If the post-acquisition win by CB&I is excluded from the calculations, the market share totals do not vary significantly. The combined CB&I and PDM total would be 90.9%. F. 213.

Respondents viewed each other as their only competition for LPG tanks. F. 228-30. Respondents' expert, Dr. Harris, testified that prior to the Acquisition, neither CB&I nor PDM could increase prices of LPG tanks in the United States without risking losing sales to the other. F. 231.

**(iii) LIN/LOX market**

CB&I and PDM had a combined market share of 72.8% of the value of LIN/LOX awards for the time period of 1990 to the Acquisition. F. 269. Graver had a 23.3% market share, Matrix had a 2.6% market share, and AT&V had a 1.4% market share. F. 269. Graver went out of business, in 2001, and is no longer a competitor in the LIN/LOX market. F. 270.

Prior to the Acquisition, competition between CB&I and PDM

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was very aggressive. Respondents viewed each other as close competitors and in some instances dropped their prices to beat out the other or set prices that would generate "negative margins." F. 277-82. CB&I lost some projects to PDM because of PDM's "very low" pricing levels. F. 280. Prior to the Acquisition and prior to Graver's exit from the business, customers would use the vigorous competition between CB&I, PDM and Graver to obtain lower prices. F. 286-91.

**(iv) TVC market**

CB&I's acquisition of PDM EC combined the only two competitors in the market for large field-erected TVCs in the United States. F. 363. Since 1960, the only companies that have built TVCs are CB&I and PDM. F. 363.

CB&I viewed PDM as its "only competitor" for TVC projects in the United States. F. 376-78. Purchasers of TVCs viewed CB&I and PDM as the only firms with the capability to construct TVCs. F. 380-85. One customer used competition between CB&I and PDM to obtain lower pricing. F. 388-406.

**2. Respondents' rebuttal**

**a. Standards & factors**

Complaint Counsel established its prima facie case. The burden next shifts to Respondents to produce evidence that "show[s] that the market-share statistics [give] an inaccurate account of the acquisition[s] probable effect[] on competition" in the relevant markets. *Citizens & Southern Nat'l Bank*, 422 U.S. at 120; *Phila. Nat'l Bank*, 374 U.S. at 363; *United States v. Waste Mgmt., Inc.*, 743 F.2d 976, 981 (2d Cir. 1984). "The more compelling the prima facie case, the more evidence the defendant must present to rebut it successfully." *Baker Hughes*, 908 F.2d at 991. "Although the ultimate burden of persuasion always rests with the FTC, once a presumption has been established that the proposed transactions will substantially affect competition, the burden of production shifts to the Defendants to rebut the



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presumption." *Cardinal Health*, 12 F. Supp. 2d at 54 (citing *Marine Bancorporation*, 418 U.S. at 613). Respondents are not required to "clearly" disprove future anticompetitive effects, because such a requirement would impermissibly shift the ultimate burden of persuasion. *Baker Hughes*, 908 F.2d at 991.

Respondents may demonstrate unique economic circumstances that undermine the predictive value of the government's statistics. *Univ. Health*, 938 F.2d at 1218 (citing *General Dynamics*, 415 U.S. at 486). In addition to attacking the government's statistics, a respondent may present evidence on a number of factors that "are relevant in determining whether a transaction is likely to lessen competition substantially." *Baker Hughes*, 908 F.2d at 985. These factors include: ease of entry into the market, the trend of the market either toward or away from concentration, the continuation of active price competition, and evidence of customer sophistication. *Univ. Health*, 938 F.2d at 1218; *Kaiser Aluminum*, 652 F.2d at 1341; *Baker Hughes*, 908 F.2d at 986. The acquired firm's weakness is also a factor that a defendant may introduce to rebut the government's prima facie case. *Univ. Health*, 938 F.2d at 1221.

In this case, Respondents contend that the following factors sufficiently rebut the FTC's prima facie case: (1) evidence that Complaint Counsel's concentration statistics are misleading; (2) evidence of actual or potential entry or the existence of low entry barriers; (3) evidence of customer sophistication; and (4) evidence of the weakness of the merging companies. Respondents' Post Trial Brief ("RPTB") at 8-11.

**b. Statistics**

Statistics reflecting market share and concentration, while of great significance, are not conclusive indicators of anticompetitive effects. *Heinz*, 246 F.3d at 717 n.12 (citing *General Dynamics*, 415 U.S. at 498); *Brown Shoe*, 370 U.S. at 322 n.38 ("Statistics reflecting the shares of the market controlled by the industry leaders and the parties to the merger are, of course, the primary index of market power; but only a further

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examination of the particular market - its structure, history and probable future - can provide the appropriate setting for judging the probable anticompetitive effect of the merger."). "The level of market concentration . . . is only the starting point to determine the likelihood of anticompetitive effects, and many other factors affect the likelihood of collusive or unilateral anticompetitive conduct." *Adventist*, 117 F.T.C. at 307 (citing Merger Guidelines, § 2.0; *Baker Hughes*, 908 F.2d at 984, 992 ("the Herfindahl-Hirschman Index cannot guarantee litigation victories.")).

A respondent "may rebut the government's prima facie case by showing that the government's market share statistics overstate the acquired firm's ability to compete in the future and that, discounting the acquired firm's market share to take this into account, the merger would not substantially lessen competition." *Univ. Health*, 938 F.2d at 12121 "Under *General Dynamics*, a substantial existing market share is insufficient to void a merger where that share is misleading as to actual future competitive effect." *Waste Mgmt.*, 743 F.2d at 982. The Supreme Court held that, while the statistical showing proffered by the government in *General Dynamics* was sufficient to support finding an "'undue concentration' in the absence of other considerations, the question . . . is whether . . . other pertinent factors affecting the coal industry and the business of the appellees mandated a conclusion that no substantial lessening of competition occurred or was threatened by the acquisition . . . ." 415 U.S. at 498. Because of fundamental changes in the structure of the relevant market, the statistics relied on by the government in *General Dynamics* were insufficient to sustain its case. 415 U.S. at 501.

This case does not present the situation before the court in *General Dynamics* where the Supreme Court held that the market share statistics that the government used to seek divestiture of the merged firm were insufficient, because in failing to take into account the acquired firm's long-term contractual commitments (coal contracts), the statistics overestimated the acquired firm's ability to compete in the relevant market in the future. *General Dynamics*, 415 U.S. at 500-04. By contrast to *General Dynamics*, where sales made by defendants represented "the obligation to

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fulfill previously negotiated contracts at a previously fixed price" and thus did not represent the exercise of market power, sales made by CB&I and PDM represent CB&I's and PDM's continuing ability to bid for, win, and build tank projects in all four relevant markets.

Nor does this case present the situation before the court in Baker Hughes where the market shares were "volatile and shifting," where there were four domestic firms that each manufactured the relevant products, and where a contract to provide multiple rigs could catapult any one of those firms from fourth to first place. 908 F.2d at 986. As discussed above, in three of the four markets, Respondents were consistently the number one and number two competitors. In the fourth market, LIN/LOX, CB&I and PDM shared the field with Graver. Graver, however, is no longer in the business and is, thus, not able to take shares away from CB&I. *Supra* Part III.E.b. Therefore, this case does not present the situation addressed by the court in Baker Hughes where there were other competitors who were taking away sales and able to continue to take away sales from the merging companies.

As discussed in the previous section, the government's HHI statistics are not reliable and probative evidence. Nevertheless, the deficiencies in the government's HHI statistics do not undermine the evidence presented that CB&I bought its closest competitor or the evidence on CB&I's ability to compete in the future. Accordingly, Respondents have not successfully demonstrated that the government's market share statistics overstate CB&I's ability to compete the relevant markets.

**c. Actual or potential entry****Standards**

"Ease of entry is the ability of other firms to respond to collusive pricing practices by entering to compete in the market." *Cardinal Health*, 12 F. Supp. 2d at 54-55. "Even in highly concentrated markets, if there is sufficient ease of entry, enough

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firms can enter to compete with the merging firms, undercutting any of the likely anti-competitive effects of the proposed mergers." *Id.* If Respondents' evidence regarding entry shows that the Commission's market share statistics give an incorrect prediction of the Acquisition's probable effect on competition because entry into the markets would likely avert any anticompetitive effect by acting as a constraint on CB&I's prices, then Respondents have rebutted the *prima facie* case. See *Staples*, 970 F. Supp. at 1086.

In *Consolidated Foods*, the Supreme Court held that post-acquisition evidence tending to diminish the probability or impact of anticompetitive effects might be considered in a § 7 case, but that the probative value of such evidence was limited. 380 U.S. at 598. In *General Dynamics*, the Supreme Court held that post-acquisition evidence goes "directly to the question of whether future lessening of competition was probable and the District Court was fully justified in using it." 415 U.S. at 506. "Post-acquisition evidence favorable to a defendant can be an important indicator of the probability of anticompetitive effects where the evidence is such that it could not reflect deliberate manipulation by the merged companies temporarily to avoid anticompetitive activity, and could not reasonably be construed as representing less active market competition than would otherwise have occurred without the questioned acquisition." *Lektro-Vend Corp.*, 660 F.2d at 276. Accordingly, in assessing whether entry will likely avert any anticompetitive effects, post-acquisition evidence is considered.

Complaint Counsel asserts that entry must be timely (within two years); likely to be profitable at pre-merger prices; and sufficient to deter or counteract the possible anticompetitive effects of the Acquisition. CCPTB at 18 (citing *Merger Guidelines* §§ 3.1-3.4; *Coca Cola*, 117 F.T.C. at 953). Respondents assert that evidence regarding actual or potential entry rebuts a *prima facie* case and that even the mere threat of entry can rebut a *prima facie* case. RPTB at 9-10 (citing *Baker Hughes*, 908 F.2d at 981). See also *Waste Mgmt.*, 743 F.2d at 983

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("entry by potential competitors may be considered in appraising whether a merger will 'substantially lessen competition'").

### **Likelihood and timing of entry**

In *Baker Hughes*, the district court reviewed the prospects for future entry and concluded that entry was likely, particularly if the acquisition were to lead to supracompetitive pricing. 908 F.2d at 988. The government appealed this conclusion, asserting that the district court should have required defendants to show clearly that entry would be quick and effective. *Id.* at 988. The court of appeals held that the district court's factual findings amply supported its determination that future entry was likely. *Id.* at 989. Discussing *Baker Hughes*, the court in *Tote* stated, the "crucial aspect" of *Baker Hughes* was "that the leading firm's 'growth suggests that competitors not only can, but probably will, enter or expand if this acquisition leads to higher prices.'" 768 F. Supp. at 1081 (quoting *Baker Hughes*, 908 F.2d at 989). No such inference can be made in this case where the strength of Respondents, the leading firms, is not recent or attributable to any significant changes in the industry, but is grounded on long experience and a proven track record.

Despite characterizing the government's position in *Baker Hughes* that entry must be "quick and effective" as "novel and unduly onerous," the court of appeals found that "if the totality of a defendant's evidence suggests that entry will be slow and ineffective, then the district court is unlikely to find the prima facie case rebutted." *Id.* at 988 (emphasis added). Further, case law developed after *Baker Hughes* illustrates that a "quick and effective" standard for analyzing entry is no longer "novel." In *Tote*, where evidence presented at trial established that it would take 18 to 24 months to study, develop and then adequately debug a truly competitive product and where there was other evidence of factors that complicate a potential entrant's ability to design or modify the relevant product in a timely manner, defendants did not rebut the government's case. 768 F. Supp. at 1073-75. See also *Franklin Elec.*, 130 F. Supp. 2d at 1035-36 (enjoining merger where defendants had "not shown that entry is so easy that [the

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merged entity] could not sustain monopolist profits for some period of time") (emphasis added); *United States v. Calmar, Inc.*, 612 F. Supp. 1298, 1301 (D.N.J. 1985) ("If ease of entry in the market is such that the producers in the market could not long sustain an unjustified price increase, then in spite of a high degree of concentration there has not been a substantial lessening of competition.") (emphases added).

As discussed below, in all four of the relevant markets, the totality of the evidence establishes that potential and actual entry is slow and ineffective and cannot keep these markets competitive. Further, the evidence of entry in this case is not as compelling as the evidence was in *Baker Hughes* where at least two companies had entered the United States market immediately prior to the challenged acquisition and were poised for future expansion. 908 F.2d at 988-89. In *Baker Hughes*, a number of firms competing in Canada and other countries had not penetrated the United States market, but could be expected to do so if the acquisition led to higher prices. *Id.* Although, in this case, there is evidence that there are a number of firms competing worldwide, the evidence does not establish that they can be expected to enter the U.S. market and compete in a timely and effective manner.

### **Constrain pricing**

Entry "must be able to restore competitive pricing -- i.e., it must be effective in offsetting any loss of competition due to the business combination in question." *Coca Cola*, 117 F.T.C. at 953, 960 ("If new entrants cannot sufficiently expand output to prevent existing producers from raising prices, their entry will not be sufficient to prevent a cartel from raising prices."). Where the likely and timely entry is not "sufficient to offset any post-merger pricing practices," defendants' claim of entry and expansion is "insufficient to rebut the Government's prima facie case." *Cardinal Health*, 12 F. Supp. 2d at 58. Even in *Baker Hughes*, the court found potential entry would be sufficient only if it "can keep that market competitive." *Id.* at 988 (emphasis added).

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Respondents have presented evidence that other manufacturers are interested in entering the market and that customers might consider turning to these other sources. An interest of other firms in making sales is not sufficient to restore competition and prevent CB&I from exercising market power. See *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1440 (9th Cir. 1995) (If the output or capacity of the new entrant is insufficient to take significant business away from the predator, [the new entrants] are unlikely to represent a challenge to the predator's market power.") (emphasis added). Rather, the inquiry is focused on whether those firms will actually prevent an exercise of market power. See *Staples*, 970 F. Supp. at 1087-88; *Swedish Match*, 131 F. Supp. 2d at 170; *Coca-Cola*, 117 F.T.C. at 960 (Entrant must "be 'successful' in the sense of being profitable" and "sufficiently expand output to prevent existing producers from raising prices . . ."). The greater weight of evidence in this case establishes that other firms have not prevented and will not prevent CB&I from raising prices after acquiring PDM EC.

Respondents have also presented evidence of companies that have bid on recent projects. However, in most of the examples presented, the other companies' bidding has not exerted sufficient competitive pressure. In *Tote*, the defendants pointed to the example of a company that had submitted a number of bids to tracks and that could have entered the market in seven months. The court held:

despite the fact that ITS is actively bidding in the marketplace, United Tote was unable to offer even a single example of a competitor adjusting its prices in response to an ITS bid. Quite to the contrary, on one recent bid, ITS's price was almost twice that of AmTote's and 50% higher than Autotote's once the cost of buying was converted to the cost of leasing.

*Tote*, 768 F. Supp. at 1083. Thus, the court held that actual entry by ITS was not sufficient, because it would not constrain anticompetitive price increases by incumbents. *Id.* at 1082. In examples set forth below, the evidence in this case establishes

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that, as in Tote, the bids offered by smaller competitors are at higher prices than those of CB&I and thus do not constrain pricing.

**(i) LNG market**

Since the Acquisition, domestic companies partnered with foreign companies are taking steps to enter the United States LNG market. In three of the eleven new or potential LNG projects, foreign manufacturers have even submitted bids or budget pricing. However, in many of the examples presented at trial, the steps that recent or potential entrants have taken are too preliminary to challenge CB&I's market power.

The bidding stages of seven of the recently announced projects are sufficiently advanced to provide a basis for determining that other manufacturers do not constrain CB&I's exercise of market power:

In CMS Energy's planned LNG tank expansion, CB&I was awarded the contract over Skanska/Whessoe which had provided a budget price that was [redacted] than the firm negotiated price submitted by CB&I. F. 102-05 (in camera).

[redacted] F. 106-07 (in camera).

With Poten & Partners, CB&I is negotiating a sole-source contract. F. 108.

For British Petroleum's three separate projects, CB&I is negotiating sole-source contracts. F. 109-13. Testimony from BP's representative that [redacted] (Sawchuck, Tr. 6062-63, 6092 in camera) is not persuasive evidence that these other companies have entered the market.

For Dynegy's Hackberry Facility, the one post-acquisition LNG tank award that CB&I did not win,



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CB&I declined to submit a tank bid only because it did not like the conditions under which it was asked to bid. F. 89-101.

The bidding stages of the other four recently announced projects are not sufficiently advanced to provide a basis for determining that other manufacturers constrain CB&I's exercise of market power. For some of these projects, the recent or potential entrants' level of participation rises only to the level of expressing an interest or participating in preliminary meetings. Thus, the evidence presented on recent or potential entrants' attempts to enter the LNG market does not support a conclusion that recent or potential entry restrains CB&I's market power:

For Yankee Gas' Waterbury project, CB&I has submitted budgetary pricing; Skanska/Whessoe has provided preliminary design solutions, preliminary design data sheets and pricing information; and [redacted] F. 117-32 (in camera). However, Yankee Gas has not yet determined whether Skanska/Whessoe or Technigaz are qualified to bid. F. 129.

For Freeport LNG's project, which is in the early design stages and may never be built, CB&I has sent Freeport LNG a proposal to do the front end engineering and design; Black & Veatch has sent Freeport LNG a letter which indicates that it has formed an alliance with Whessoe to build LNG tanks in the Western Hemisphere; Skanska/Whessoe met with Freeport LNG to discuss contracting strategies and general tank designs and to provide Freeport LNG with marketing materials; TKK/AT&V has made presentations to Freeport LNG on the companies' capabilities and discussed contracting capabilities; and Technigaz/Zachry has approached Freeport LNG to present its alliance. F. 133-40.

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For Williams' Cove Point II project, CB&I has submitted budgetary pricing; TKK, in partnership with DYWIDAG and AT&V, has submitted budgetary pricing. F. 114-16. Testimony from [redacted] is not persuasive evidence that [redacted] has entered the market. ([redacted], Tr. 4693, (in camera)).

Calpine's Humboldt, California facility is "in the early stages of possible development;" there is only a 50% chance that the facility will be built. F. 141. Testimony from Calpine's representative that he believes that Skanska/Whessoe, Technigaz/Zachry, and TKK/AT&V are all competent builders and can build LNG tanks (Izzo, Tr. 6494-500) is not persuasive. CB&I is the only constructor with whom Calpine has had discussions about potentially building this facility. F. 142-43.

Although Respondents presented evidence that TKK/AT&V, Skanska/Whessoe, and Technigaz/Zachry have begun bidding in the U.S. LNG market and that several other manufacturers have taken steps to try to enter the U.S. LNG market, the evidence does not demonstrate that they compete with sufficient force to constrain CB&I.

Further, although Respondents assert that there is a trend toward building double or full containment tanks, and that CB&I is disadvantaged in competing for double or full containment tanks, the evidence does not demonstrate that there is a trend toward double or full containment tanks. F. 57. Respondents have not demonstrated that actual or potential entry is sufficient to challenge CB&I's market power in the LNG market.

**(ii) LPG market**

Respondents presented little evidence of recent entry in the LPG market. Respondents assert that two entrants, AT&V and Matrix, have recently begun to compete for LPG jobs, and that

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Chattanooga Boiler & Tank ("Chattanooga") is poised to enter this market. No evidence or testimony was offered to show that any foreign tank manufacturer has bid on U.S. LPG projects. F. 246. The evidence presented at trial does not demonstrate that these domestic or that foreign manufacturers can constrain CB&I's market power.

From the Acquisition to the time of trial, there has been one LPG project awarded, Port Arthur in 2001. This project was awarded to CB&I. F. 233.

The only still existing company that has built an LPG tank from 1990 to present, AT&V, lacks the capacity to constrain CB&I. Although AT&V was awarded the last pre-acquisition LPG tank project award, Deer Park, in 2000, the value of this project was a fraction of the value of the next largest tank built from 1990-2001. F. 226. AT&V also bid on the only LPG tank awarded since the Acquisition, which was won by CB&I. F. 237. Although AT&V provides some competition by bidding, the greater weight of the evidence demonstrates that AT&V cannot compete with sufficient force to constrain CB&I's market power. F. 238-40.

There is also insufficient evidence to demonstrate that Matrix, Wyatt, or Chattanooga can effectively compete. F. 241-44. Respondents did not present evidence that foreign manufacturers are poised to enter the U.S. LPG market. F. 245-49.

Therefore, Respondents have not demonstrated that actual or potential entry is sufficient to challenge CB&I's market power in the LPG market.

**(iii) LIN/LOX market**

Respondents presented evidence of recent entry by AT&V in the LIN/LOX market. Respondents assert that two other domestic manufacturers, Matrix and Chattanooga, compete in the LIN/LOX market. Respondents do not assert that foreign manufacturers are poised to enter the U.S. LIN/LOX market.

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From the Acquisition to the time of trial, there have been five LIN/LOX projects awarded. AT&V won three; CB&I won two. F. 292-93. In all three of the LIN/LOX projects that AT&V bid on and won, CB&I was also a bidder. F. 294. Respondents presented evidence that AT&V effectively competes against CB&I by bidding at lower prices than CB&I. F. 294.

However, Complaint Counsel presented evidence that AT&V cannot compete on an equal footing with CB&I in the LIN/LOX market as it lacks revenue and field capacity. F. 315. Further, some customers that have done business with AT&V have found that any initial savings are offset or exceeded by oversight costs and costs related to change orders. F. 297-98, 304-05, 314. Other customers have expressed concern with AT&V's performance and reputation. F. 318-19.

The greater weight of the evidence demonstrates that although AT&V has entered the LIN/LOX market and has won three of the five post-acquisition projects, AT&V does not provide the competitive force that PDM once did.

Matrix recently entered the LIN/LOX market, winning 4 recent pre-acquisition LIN/LOX projects. F. 320. However, Matrix has been a high bidder, and consequently non-competitive, on other recent LIN/LOX tank projects for several customers, including Air Liquide and Linde, and is viewed by some customers as not sufficiently qualified. F. 321-23. Moreover, after the sale of its subsidiary which owned the fabrication facility where Matrix fabricated LIN/LOX tanks, Matrix's capacity decreased. F. 324.

Chattanooga has never built a LIN/LOX tank and does not effectively compete in the LIN/LOX market. F. 325. LIN/LOX industry participants question Chattanooga's ability to build a LIN/LOX tank. F. 327. On one occasion when it recently bid on a LIN/LOX project, Chattanooga's price was [redacted] higher than CB&I's. F. 326 (in camera).

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Therefore, Respondents have not demonstrated that actual or potential entry is sufficient to challenge CB&I's market power in the LIN/LOX market.

**(iv) TVC market**

There is no evidence of actual or potential entry in the TVC market. In all but one of the TVC projects for which pricing was requested prior to the Acquisition, no company other than CB&I or PDM was even asked to provide pricing. F. 367-69. In the one instance where two other companies responded to the customer's request for proposals, these manufacturers were eliminated from the bidding process because the customer found them unqualified. F.366. The only company that, post-acquisition, has been asked to provide pricing on a TVC project, Howard Fabrication, was not considered by that customer to have "the technical competence nor the financial backing" necessary to award it a TVC project. F. 445. See also F. 410-11. Industry members testified that the field for manufacturing TVCs is limited to CB&I. F. 380-85. See also F. 412-14.

Therefore, Respondents have not demonstrated that actual or potential entry is sufficient to challenge CB&I's market power in the TVC market.

**d. Barriers to entry**

Determining whether there is ease of entry also entails an analysis of barriers to new firms entering the market or to existing firms expanding into new regions of the market. *Cardinal Health*, 12 F. Supp. 2d at 54 (citing *Baker Hughes*, 908 F.2d at 987). If barriers to entry are low, the threat of outside entry can significantly alter the anticompetitive effects of the merger by deterring the remaining entities from colluding or exercising market power. *Heinz*, 246 F.3d at 717 (citing *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 532-33 (1973); *Baker Hughes*, 908 F.2d at 987 ("In the absence of significant barriers, a company probably cannot maintain supracompetitive pricing for any length of time.")). Low barriers to entry enable a potential

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competitor to deter anticompetitive behavior by firms within the market simply by its ability to enter the market. *Heinz*, 246 F.3d at 717 n.13 (citing *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 581 (1967)).

Expertise in the industry, a fair amount of capital, a positive reputation, and the need to have specialized equipment are all barriers to entry. *Fruehauf Corp. v. FTC*, 603 F.2d 345, 357 (2d Cir. 1979); *Cardinal Health*, F. Supp. 2d at 58; *United States v. Blue Bell, Inc.*, 395 F. Supp. 538, 549 (M.D. Tenn. 1975). In *Kennecott Copper Corp. v. FTC*, 467 F.2d 67, 79 (10th Cir. 1972), the court found that due to the specialized nature of the industry, which required particular knowledge and highly developed equipment, the entry barriers were formidable. See also *FTC v. PPG Indus.*, 628 F. Supp. 881, 885 (D.D.C. 1986) (high entry barriers where witnesses estimated it would take from two to six years to acquire the technological expertise, assemble the trained personnel, and devise the tooling to enter the market as a credible competitor). As set forth for each of the product markets below, these barriers exist in this case.

Another barrier is that most customers already have established relationships with an existing manufacturer. Thus, to persuade those customers to conduct business with it, a new entrant would probably have to undercut the current competitors in the market by selling at lower prices in order to secure new business. *Libbey*, 211 F. Supp. 2d at 48. As set forth for each of the product markets below, this barrier exists in this case.

In some markets, "the need for reliability is so great and the consequences of new product failure so dire that, even if the competitive nature of the market deteriorated, consumers would still be reluctant to switch to new entrants." *Tote*, 768 F. Supp. at 1076 (finding proven ability to provide reliable systems and service an important factor in a racetrack's selection of a totalisator supplier to preserve the track's revenue and goodwill).

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The unwillingness of customers to use a company with an unproven track record is a barrier to entry. See *Tote*, 768 F. Supp. at 1078. As set forth for each of the product markets below, this barrier exists in this case.

Even in *Baker Hughes*, the district court noted that the following facts suggested difficulty of entry and "may handicap new entrants": products that are custom-made are not readily interchangeable or replaceable; buyers tend to return to sellers from whom they have purchased in the past; and customers typically place great importance on assurances of product quality and reliable future service. 908 F.2d at 989 n.10. As set forth for each of the product markets below, these factors exist in this case.

Many witnesses in this case, including those of Respondents, testified that to be successful in these markets, a company has to be large, have experience and know-how, have specialized equipment, and have a fair amount of capital. As set forth below, Complaint Counsel introduced evidence of high barriers to entry in all four markets. These barriers to entry make it unlikely that any potential competitor, or even a small existing competitor in the U.S., such as AT&V, will be able to replace PDM as a competitive force, by filling the capacity that PDM had or by being profitable at pre-acquisition prices at a pricing level that constrains CB&I's ability to raise prices.

**(i) LNG market**

Barriers to entry in the LNG tank market are high. LNG tank suppliers must have sufficient personnel to design, engineer and construct LNG tanks and to handle adjustments to possible schedule changes. F. 166, 169, 172. LNG suppliers must also have sufficient capacity to bond large projects. F. 175-76. Experience and reputation are extremely important in a product market, like the one for LNG tanks, where the values of the projects are so high and where there are tremendous safety considerations. F. 167-173. The evidence establishes that barriers are not low and that entry is not so easy that an existing or potential company could replace PDM in the LNG market.

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**(ii) LPG market**

Barriers to entry in the LPG market, while not as high as in the LNG or TVC markets, still exist. LPG tank suppliers must have sufficient personnel to design, engineer and construct LPG tanks and to handle adjustments to possible schedule changes. F. 250-51. Experience and reputation are important in this market. F. 252. See also F. 253. The evidence establishes that barriers are not low and that entry is not so easy that an existing or potential company could replace PDM in the LPG market.

**(iii) LIN/LOX market**

Barriers to entry in the LIN/LOX market, while also not as high as in the LNG or TVC markets, do exist. LIN/LOX manufacturers must establish the capability to perform specialized metal fabrication and must have sufficient financial capacity to conduct physical tests of materials and tank prototypes or components. F. 329-33. Experience and reputation are also important in this market. F. 328, 331, 334. The evidence establishes that barriers are not low and that entry is not so easy that an existing or potential company could replace PDM in the LIN/LOX market.

**(iv) TVC market**

Barriers to entry in the TVC market are high. No evidence or testimony was offered to show that barriers to entry are low in the large field-erected TVC market. TVC customers want experienced suppliers with knowledge, ability to fabricate in the field a stainless steel vessel, and ability to satisfy the quality requirements of leak testing and cleanliness for a TVC. F. 415-17. A new entrant would need to hire engineers with previous experience in designing TVCs, which are "truly one-of-a-kind designs for very specific applications on very technical products." F. 416. A new entrant would need to expend significant resources in developing proposals and price quotations for TVCs. F. 418. The evidence establishes that barriers are not low and that entry is



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not so easy that an existing or potential company could replace PDM in the TVC market.

**e. Customer sophistication**

"Well-established precedent and the . . . Merger Guidelines recognize that the sophistication and bargaining power of buyers play a significant role in assessing the effects of a proposed transaction." *FTC v. R.R. Donnelley & Sons Co.*, 1990 U.S. Dist. LEXIS 11361, \*10 (D.D.C. 1990). "Although the courts have not yet found that power buyers alone enable a defendant to overcome the government's presumption of anti-competitiveness, courts have found that the existence of power buyers can be considered in their evaluation of an anti-trust case, along with such other factors as the ease of entry and likely efficiencies." *Cardinal Health*, 12 F. Supp. 2d at 58. Some courts have stressed that the existence of power buyers does not necessarily mean that a merger will not result in anticompetitive effects. The court in *Tote* held that the existence of power buyers did not outweigh the potentially damaging effects of a merger on numerous smaller customers. 768 F. Supp. at 1085. Although the larger buyers were not likely to suffer the effects of a lack of competition, the court concluded that the defendants' smaller to mid-size customers without any significant bargaining power would be impermissibly harmed by the proposed merger. *Id.*

In all four of the relevant product markets, the customers purchasing the products are large companies, with sophisticated procurement processes, who generally seek to have two or more bidders for their projects. F. 254, 353-55, 471-73. However, due to the fact that, in three of the four markets, there are very few products purchased and there are confidentiality provisions, past pricing is not well known. E.g., F. 204-07. Thus, most customers do not have significant bargaining power. In the end, although evidence of the sophistication of customers in these markets was presented and has been considered, this does not rebut Complaint Counsel's prima facie case.

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### **f. Weakness of the merging companies**

The acquired firm's weakness is another factor that a defendant may introduce to rebut the government's prima facie case. *Kaiser Aluminum*, 652 F.2d at 1339; *United States v. Int'l Harvester Co.*, 564 F.2d 769, 774 (7th Cir. 1977) ("The prima facie case presented by the Government was rebutted by persuasive evidence, including [the acquired firm's] weakened financial condition."). However, such a defense is credited "only in rare cases, when the defendant makes a substantial showing that the acquired firm's weakness, which cannot be resolved by any competitive means, would cause that firm's market share to reduce to a level that would undermine the government's prima facie case." *Univ. Health*, 938 F.2d at 1221.

Facts presented at trial establish that PDM was not a weak firm. PDM was winning recent tank projects. *Supra* Part III.E.1. Moreover, PDM was a profitable company and PDM's EC Division was profitable. F. 535-45. As of July 2000, the month before CB&I and PDM signed the acquisition letter of intent, PDM EC projected earnings before interest and taxes of \$ 2 million in 2000. F. 538. Accordingly, this factor does not rebut the government's prima facie case.

### **3. Burden of persuasion**

"If the defendant successfully rebuts the presumption [of illegality], the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times." *Baker Hughes*, 908 F.2d at 983; see also *Kaiser Aluminum*, 652 F.2d at 1340 and n.12. Respondents did not successfully rebut Complaint Counsel's presumption of anticompetitiveness and thus the inquiry into whether CB&I's acquisition of PDM EC and Water Divisions violated the Clayton Act may conclude. Nevertheless, although it was not required to do so, Complaint Counsel attempted to show that anticompetitive effects have already occurred in three of the four markets. As set

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forth below, Complaint Counsel's evidence did not prove that CB&I has implemented price increases.

**a. LNG market**

**(i) Sole-source contracts**

Complaint Counsel argues that CB&I used its position as the only domestic supplier of LNG tanks to force LNG tank purchasers into sole-source arrangements. CCPTB at 37-38. The evidence establishes that three companies have entered sole-source arrangements with CB&I. F. 106-13. Complaint Counsel presented evidence that sole-source arrangements can result in higher profit margins and that one of these customers believed that CB&I was essentially its only choice. F. 111-13. Although the evidence presented at trial did not establish conclusively that the sole-source arrangements have resulted in higher prices, without competitive constraints, higher prices are probable.

**(ii) Memphis Light Gas and Water**

Complaint Counsel argues that recent prices provided for Memphis Light Gas and Water ("MLGW") represent a post-acquisition price increase. Complaint Counsel attempts to compare the competitively bid and negotiated 8% margin projected by CB&I on the 1994 MLGW project to a [redacted] margin included as part of a budget price given to MLGW in 2002. CCPTB at 6, 35 (in camera). This argument is misleading, because it is based entirely on a comparison of apples and oranges. The 1994 price was a fixed, firm price bid that was competitively bid and negotiated, while the 2002 number was a budget price. F. 83, 84, 180-82. Budget prices are preliminary in nature and are often based on broad assumptions of many unknown variables. F. 474-75, 478-79. Complaint Counsel's assertion that CB&I implemented a price increase to MLGW is not supported by sufficient evidence.

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**(iii) Cove Point I**

Complaint Counsel argues that PDM increased its price on the Cove Point expansion in September 2000 in anticipation of the Acquisition. CCPTB at 33-34. Complaint Counsel bases its argument first upon RX 127, a chart prepared by CB&I for a bid review meeting in March 2000, entitled "To Be Completed Prior to Final Proposal Submittal." CCPFF 781 (citing RX 127 at CBI-H008204). While RX 127 contains proposed pricing of [redacted] for the Cove Point project, there is no evidence in the record suggesting that this figure was actually submitted by CB&I or used as a bid for the project. RX 127 (in camera). Complaint Counsel asked no witnesses at trial about this document. Complaint Counsel asserts that PDM initially quoted a price of approximately [redacted]. CCPFF 781 (citing CX 226 at CBI-PL044978, in camera). CX 226 is a CB&I memorandum wherein an employee of CB&I speculates that PDM had provided a "budget of something like [redacted]." (CX 226 at CBI-PL044978, in camera). Based on this speculation, the CB&I employee recommended that CB&I reduce its price to [redacted]. F. 187 (in camera). Speculations made by a CB&I employee about what PDM may have provided as a budget price do not support Complaint Counsel's assertion that PDM bid [redacted]. (In camera). Complaint Counsel then asserts that PDM subsequently bid [redacted]. CCPFF 781 (citing CX 1058 at PDM-HOU 017465, in camera). CX 1058, a summary of pending LNG projects, does not establish conclusively that PDM bid [redacted] million. (CX 1058 at PDM-HOU 017465, in camera). No witnesses at trial were asked about this document.

The evidence does establish that on September 8, 2000, PDM quoted Williams a budget price of [redacted] for a 750,000 barrel tank. F. 192 (in camera). Complaint Counsel compares the September 8, 2000 budget price to the earlier figures to argue that PDM implemented a price increase in September 2000, in anticipation of the Acquisition. CCPFF 793. But because Complaint Counsel has not established that the earlier figures were budget prices or were ever submitted, Complaint Counsel's

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assertion that PDM implemented a price increase in September 8, 2000 is not supported by reliable evidence.

Next, Complaint Counsel argues that PDM increased its price on the Cove Point expansion in November 2000 in anticipation of the Acquisition. CCPTB at 33-34. Complaint Counsel bases this theory on CX 1160, [redacted]. See CCPTB at 33-34. The evidence shows that this document was created for purposes of evaluating an estimate from the estimating department in a formal bid review meeting. Decisions made at the meeting resulted in the November 2, 2000 "as submitted" price. F. 194, 195. The fact that CX 1160 shows a different price on November 2 as compared to the estimated price on November 1 is not probative, since the very nature of the meeting was to review the bid.

Complaint Counsel points to CB&I's actual post-acquisition profit margin for performing the Cove Point project and argues that the actual profit margin has increased in comparison to the March 2000 chart prepared for a bid review meeting. CCPTB at 34. However, the evidence establishes that CB&I will earn a greater than expected margin because [redacted] F. 201-03 (in camera). [redacted] F. 203 (in camera). In addition, Complaint Counsel's arguments pertaining to RX 323, a document not used at trial and CX 906, a document demonstrated by Respondents to be unreliable, are speculative and not supported by reliable evidence.

**(iv) Fairbanks**

Complaint Counsel asserts that the LNG project for Fairbanks Natural Gas, LLC in Alaska ("Fairbanks") in 2002 illustrates that, since the merger, CB&I has raised prices and increased profit margins. CCPFF 955. To support this assertion, Complaint Counsel relies on CX 307, a document that was not introduced in evidence, and on RX 407, a document for which only very limited testimony was introduced. (See Scorsone, Tr. 5331, in camera). The trial transcript is devoid of any specific information about the document including who wrote the document and when, who viewed the document and when, and what the document means.

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The conclusions Complaint Counsel draws from RX 407 are speculative. The conclusions Complaint Counsel draws from CX 307, a document not in evidence, are disregarded.

In addition, Complaint Counsel compares CB&I's budget price for Fairbanks in 2002 to PDM's budget price for BC Gas in 1996 for an LNG tank to be built in Vancouver, British Columbia and argues that the difference between these figures illustrates that CB&I implemented a price increase on the Fairbanks project. CCPFF 977. This argument fails for two reasons. First, CX 791, the document Complaint Counsel asserts represents PDM's budget estimate for the BC project, was not used at trial with any fact witness and Complaint Counsel's expert testified that he did not know how the figures listed on CX 791 were formulated. (Simpson, Tr. 5387-92). Thus, the conclusions Complaint Counsel draws from it are not reliable. Second, the differences between a 1996 budget estimate prepared by PDM for a 1.2 million gallon LNG tank located in Canada and a 2002 budget estimate prepared by CB&I for a 1.0 million gallon LNG tank located in Alaska render a comparison between the two figures meaningless. The 1996 PDM budget estimate appears to have been extrapolated from a 1993 estimate to a different client in a vastly different location. (See CX 791; Simpson Tr. 5390-93). By contrast, CB&I derived the Fairbanks estimate in 2002 using a formal budgetary exercise. (Compare RX 626 to CX 791). Further, Complaint Counsel has not shown that the costs for the BC Gas job (such as material or shipping costs) would be the same as those on the Fairbanks job located deep in interior Alaska. The Fairbanks budget price contained a very high margin figure to account for lack of information and contingencies associated with an Alaska project, such as a cold climate, short construction seasons, and burdensome labor regulations. (RX 626 at CBI 063013; Scorsone, Tr. 5004-06). Indeed, Dr. Simpson acknowledged that these factors would be relevant in any comparison of the two projects. (Simpson, Tr. 5385). Accordingly, Complaint Counsel did not present reliable evidence to support its allegation that the Fairbanks LNG project illustrates that CB&I is raising prices and increasing margins.

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**b. LPG market**

Complaint Counsel does not assert that there have been anticompetitive effects in the LPG market.

**c. LIN/LOX market**

Complaint Counsel asserts that there are three examples of CB&I implementing an 8.7% price increase to Linde and to Praxair. None of Complaint Counsel's allegations are supported by sufficient, reliable evidence.

Complaint Counsel's argument that CB&I implemented its first price increase to Linde in April 2002 is based on testimony from a fact witness' comparison of CB&I's budget price to a three year old PDM firm fixed price and his comparison to an outdated pricing model. F. 341-44. The witness admitted several deficiencies in his pricing model. F. 344. Although the witness may have believed the price was high, the opinion that the price actually increased is not reliable and is disregarded.

Complaint Counsel's argument that CB&I implemented a second price increase to Praxair in June 2002 is based on Complaint Counsel's assertion, with no cites to record evidence, that the difference in CB&I's price to Praxair and CB&I's price to Linde is only [redacted], or less than [redacted]. CCPFF 1075 (in camera). Next, Complaint Counsel hypothesizes that because CB&I's price to Linde increased by 8.7%, and because the Linde tank is similar in size to the Praxair tank, and because CB&I's price to Praxair was close to CB&I's price to Linde, then CB&I's price to Praxair must have increased 8.7%. CCPFF 1072-76. This conclusion is not supported by sufficient probative evidence. First, it is based on Complaint Counsel's theory - that is rejected in the preceding paragraph - that CB&I implemented an 8.7% price increase to Linde in April 2002. Second, because of differences in the details, such as construction schedule, location, conditions of the project site, provided by Praxair and Linde to CB&I and because of differences between the tank specifications, Complaint Counsel's comparison is speculative. F. 336-37, 345,

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347-48. Therefore, Complaint Counsel did not present reliable evidence to support its allegation that CB&I implemented an 8.7% price increase to Praxair in June 2002.

Complaint Counsel's theory of a third instance of an 8.7% price increase to Praxair in April 2002 is based on a comparison between PDM's budget price for a 500,000 gallon LOX tank in Colorado in November 2000 to CB&I's budget price for a LR-60 LIN tank in New Mexico in April 2002. CCPFF 1077-1085. CB&I's estimating staff was instructed to use PDM's price on the Colorado Springs LOX tank as a basis for determining the price for Praxair's New Mexico LIN tank. F. 350. Complaint Counsel compared these two budget prices and concluded that the difference in price amounts to an 8.7% price increase. The documents Complaint Counsel relies upon, CX 448 and CX 449, while admitted into evidence, were never used at trial with any witness. CX 448 does not provide technical specifications, including the proposed tank size. Complaint Counsel has not presented evidence that the design of the Colorado LOX tank and the New Mexico LIN tank are identical. Thus, Complaint Counsel's argument that differences in the prices is the result of an exercise of market power is not supported by reliable and probative evidence. Accordingly, the evidence does not support Complaint Counsel's allegation that CB&I implemented an 8.7% price increase to Praxair in April 2002.

**d. TVC market**

Complaint Counsel alleges that, after the letter of intent for the Acquisition was signed, CB&I and PDM colluded regarding pricing for Spectrum Astro's proposed TVC project. CCPTB at 31-32. Complaint Counsel first points to a handwritten internal note reflecting a conversation between CB&I's Chief Operating Officer and PDM's President of PDM EC calling this project "D.O.A." (CX 1705 at PDM-HOU009169). Complaint Counsel also points to an internal CB&I memorandum from a low-level salesman (Dave Lacey) to support its argument. CCPTB at 31 (citing CX 242, *in camera*). The evidence does not establish that issues of pricing, profit margins, costs or anything else related to



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this project were discussed between PDM and CB&I. (Scorsone, Tr. 4796-97, 5045-46; Scully, Tr. 1217).

Complaint Counsel alleges that, after the Acquisition, CB&I increased its price for the Spectrum Astro project. CCPTB at 32. The evidence presented does not establish this allegation. F. 423-41.

Complaint Counsel alleges that, after the Acquisition, CB&I attempted to coordinate a pricing proposal with Howard Fabrication for TRW's proposed TVC project. CCPTB at 31-32. The evidence presented does not demonstrate that anyone in CB&I's management was aware of or approved such a proposal. F. 446-51.

Complaint Counsel alleges that, after the Acquisition, CB&I increased its price on a [redacted] project. F. 454-70 (in camera). The evidence presented does not conclusively establish this allegation.

**e. Conclusion**

Complaint Counsel's evidence in support of many of its allegations of price increases implemented by CB&I after the Acquisition does not prove that CB&I has in fact increased prices. However, Complaint Counsel is not required to prove that anticompetitive effects have in fact occurred. "The Government is not required to establish with certitude that competition in fact will be substantially lessened." *Crown Zellerbach Corp. v. FTC*, 296 F.2d 800, 823 n.21 (9th Cir. 1961) (citation omitted). Because § 7 deals in "probabilities, not certainties," "the mere nonoccurrence of a substantial lessening of competition in the interval between acquisition and trial does not mean that no substantial lessening will develop thereafter . . . ." *General Dynamics*, 415 U.S. at 505 (quoting *Brown Shoe*, 370 U.S. at 323).

Complaint Counsel did prove that, prior to the Acquisition, in all four product markets, there were two primary competitors, and

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that, as a result of the Acquisition, there is now one dominant firm. A merger of the two strongest suppliers enables CB&I to increase prices up until the point where other less-strong suppliers begin to constrain it. There can be no doubt that CB&I has the ability to exercise market power as a result of its acquisition of the only other competitor that had constrained CB&I. Complaint Counsel presented reliable and probative evidence to carry its burden of persuasion that the probability of a substantial lessening of competition did exist at the time of trial.

### **F. Exiting Assets Defense**

Respondents assert an affirmative defense of "exiting assets." Respondents definitively state that "CB&I does not assert the failing firm defense, . . . which requires a showing that the acquired company is 'so depleted and the prospect of rehabilitation so remote' that it is at risk of 'the grave possibility of business failure' and that 'the company that acquires the failing company . . . is the only available purchaser.'" RPTB at 153-54 (quoting *Citizen Publ'g v. United States*, 394 U.S. 131, 138 (1969)).<sup>n3</sup> Rather, Respondents argue that the "exiting assets" defense is a viable defense to Complaint Counsel's allegations. RPTB at 152-55. Respondents acknowledge that "there has been no case since *Olin* asserting the defense until this case was tried." RPTB at 154-55 n.29.

<sup>n3</sup> The criteria for establishing a failing company are not met by PDM. F. 535-45.

Respondents claim that, absent the Acquisition, PDM would have liquidated its EC Division and that there was no potential purchaser other than CB&I. RPTB at 138-52. Under these circumstances, Respondents argue that there has been no substantial lessening of competition, because competition if CB&I had not bought PDM EC is exactly the same as competition after CB&I's acquisition of PDM EC. RPTB at 152-55.

Complaint Counsel asserts that the "exiting assets" defense is not based on any accepted law, but rather upon a 1986 law review

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article, and that the Commission has rejected this defense. Complaint Counsel's Post Trial Reply Brief ("CCPTRB") at 62. Complaint Counsel further asserts that Respondents failed to establish that CB&I was "the only available purchaser" for PDM's EC and Water Divisions, that PDM conducted an "exhaustive" search for alternative buyers, and that PDM's EC Division was actually exiting the market. CCPTRB at 63-70.

The defense presented by Respondents is similar to the one rejected in *United States v. Phillips Petroleum Co.*, 367 F. Supp. 1226, 1258 (C.D. Cal. 1973), where the court rejected the defense that since the acquired company "would have gone out of business on the West Coast anyway, the acquisition of its assets by [defendant] did not result in any anticompetitive effect in the market." *Id.* "Unless the seller objectively comes within the 'failing company' doctrine, it is irrelevant why one corporation sells its assets to another." *Id.*

The exiting assets defense, as described by a law review article, has as its "key element . . . proof that, without the merger, the assets owned by the acquired firm would shortly be leaving the market." John E. Kwoka, Jr. & Frederick R. Warren-Boulton, *Efficiencies, Failing Firms, and Alternatives to Merger: A Policy Synthesis*, 31 *Antitrust Bull.* 431, 446 (1986) (cited in *Olin Corp. v. FTC*, 986 F.2d 1295, 1307 (9th Cir. 1993)). The exiting assets defense was first presented to the Commission in *In re Olin Corp.*, 113 F.T.C. 400 (1990). In *Olin*, the ALJ characterized the exiting assets defense as a "novel policy proposal" and held that, even if the "novel 'exiting assets' doctrine" was accepted, it would not save the challenged acquisition. 113 F.T.C. at 582-84. The ALJ found that there were alternatives short of merger and that the evidence failed to show that the acquired company made an unsuccessful effort to sell its business to a competitively preferable buyer and failed to show that there were no competitively preferable acquirers. *Id.* at 583.

On appeal from the initial decision, the Commission held that the evidence in *Olin* did not establish that the selling company had made the decision to close the relevant business at issue in the

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near future (instead, the evidence showed that the selling company continued to operate the facility in the expectation that the facility could at some point be sold) and that there was no evidence that the selling company had conducted an exhaustive effort to sell the assets at issue. Olin, 113 F.T.C. at 618. Based on these factual findings, the Commission concluded "the facts would not support the description of the proposed defense, even if we adopted the defense, and we decline to do so in this case." Id.

On appeal from the Commission's decision, the Court of Appeals for the Ninth Circuit did not adopt the exiting assets defense either. Rather, it characterized the defense as "novel," stated that the Commission had indicated that it was not inclined to recognize this defense, and held that the "burden of proof is undoubtedly on Olin to establish any such defense." 986 F.2d at 1307 (emphasis added).

A finding that the assets would not be exiting the relevant market "shortly" is sufficient to sustain a ruling that CB&I did not establish an "exiting assets" defense. See Olin, 986 F.2d at 1307 (The Ninth Circuit did not need to determine whether or not less anticompetitive alternatives to the merger existed.). In Olin, the respondent had not demonstrated that assets would be exiting the market shortly where: (1) the evidence did not establish that the selling company had made the decision to close the business in the near future; and (2) there was no evidence that the selling company had conducted an exhaustive effort to sell the relevant assets to any companies other than respondent. Olin, 113 F.T.C. at 618 (emphasis added).

To the extent that an exiting assets defense is legally recognizable, the facts presented in the instant case do not support the proposed defense. First, Respondents did not establish that PDM would have closed the business in the near future. Second, Respondents did not establish that PDM had conducted an exhaustive effort to sell the EC Division to any company other than CB&I.

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Because Olin is the only case law found specifically addressing an exiting assets defense, cases analyzing failing company or failing division defenses are utilized. Cases analyzing a failing company defense hold that intent to leave the market is not sufficient to establish the defense. E.g., Phillips Petroleum, 367 F. Supp. at 1260 (subjective statements of management intention or desire by management to exit the business does not satisfy the defense); Warner Communications, 742 F.2d at 1165 ("a company's stated intention to leave the market or its financial weakness does not in itself justify a merger"); Blue Bell, 395 F. Supp. at 550 (company's intention to divest itself of a certain division is immaterial).

Respondents' argument that PDM intended to leave the market is not supported by the evidence presented at trial. Mr. Scorsone, the former President of PDM EC, testified that if the EC Division had not been sold, it would not have gone out of business, and that it would be profitable in the future. F. 548. Mr. Byers, former V.P. of Finance for PDM, testified that before making any recommendation to liquidate the PDM EC Division, his fiduciary duties would have required him to investigate to assure himself that there was no alternative purchaser for either PDM or PDM EC willing to pay more than the liquidation value of the business. F. 549. PDM's investment banker, Tanner & Company ("Tanner"), would also have attempted to find alternative purchasers prior to recommending liquidation. F. 550. PDM's President, William McKee, stated that if the CB&I transaction fell through, PDM would have continued its efforts to sell the PDM EC and PDM Water Divisions by seeking other purchasers. F. 551. Finally, PDM's Board of Directors never took up the issue of liquidating the PDM EC Division. F. 552.

Thus, the evidence does not establish that PDM had made the decision to close the business in the near future. Respondents' defense may be rejected on this basis. Citizen Publ'g, 394 U.S. at 136 (rejecting defense where there was "no indication that the owners of the Citizen were contemplating a liquidation").

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In addition, Respondents did not present sufficient evidence to demonstrate that PDM conducted an exhaustive effort to sell the package of assets sold to CB&I. Respondents have not made a "clear showing" that PDM "undertook a well conceived and thorough canvas of the industry such as to ferret out viable alternative partners." *United States v. Pabst Brewing Co.*, 296 F. Supp. 994, 1002 (E.D. Wis. 1969) (defendant had burden of proving that it had made every reasonable effort to explore alternative possibilities).

Tanner assembled a preliminary list of potential buyers, including 18 steel companies, 15 engineering and construction companies, and 4 financial buyers. F. 528. This list was presented to the PDM Board on June 1, 2000. F. 528. Among the companies identified by Tanner as potential acquirers of PDM EC were Fluor, Jacobs Engineering, Foster Wheeler, and Morrison Knudsen. F. 529. However, to Mr. Byers' knowledge, none of these companies were contacted about acquiring PDM. F. 529. Tanner never contacted any foreign firms regarding the purchase of PDM EC. F. 530.

In July of 2000, PDM announced that it would sell the company. F. 525. Tanner prepared an offering memorandum for the sale of the PDM EC Division. F. 517. This offering memorandum was sent to only one company -- CB&I. F. 517. By the time the offering memorandum was completed, negotiations between CB&I and PDM were at a point "that it didn't make sense to send it out to other people." F. 518.

These efforts in no way rise to the level sufficient to sustain the proposed defense. For example, in *California v. Sutter Health Sys.*, the defendant's efforts to seek offers from other potential purchasers satisfied an element of a failing company defense where defendant proved that it had conducted a three-year "extensive good faith search for purchasers" in which it "formulated a detailed and thorough proposal process and sought out numerous potential partners." 130 F. Supp. 2d 1109, 1136 (N.D. Cal. 2001). One "expression of interest" came only after the defendant "repeatedly contacted" the potential buyer who

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"failed to make any offer in response to these inquiries." *Id.* Further, the efforts taken by PDM were even less exhaustive than those found to be insufficient in *FTC v. Harbour Group Invs.*, 1990 U.S. Dist. LEXIS 15542, \*12-13 (D.D.C. Nov. 19, 1990), where the efforts made by the investment banker did not comport with its normal exhaustive search; where the offering materials were minimal, containing a brief two page executive summary with financial information and product brochures attached; and the search consisted of minimal exploratory phone calls, with little follow-up or attention by the brokers who were responsible for the search.

Financial buyers, who would have maintained PDM as an independent on-going entity, were available and had been recommended by Goldman Sachs and by Tanner as alternative buyers. F. 526. Matrix, then the third-largest United States tank constructor, made efforts to buy PDM EC. F. 531. Tanner's fairness opinion, dated February 7, 2001, noted that if CB&I's acquisition of PDM EC and Water Divisions fell through, there were other potential buyers with the interest and adequate resources to purchase PDM EC. F. 532.

Because Respondents have not presented sufficient evidence to demonstrate that PDM had made the decision to close the business in the near future and that PDM had conducted an exhaustive effort to sell the assets sold to CB&I, Respondents have not demonstrated that the assets would be exiting the market shortly. Thus, to the extent that exiting assets is a viable defense, Respondents have not met their burden of establishing it.

### **G. Summary of Liability**

Count I of the Complaint charges that "the effect of the Acquisition may be substantially to lessen competition or tend to create a monopoly in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45." Count II of the Complaint charges that "CB&I and PDM, through the Acquisition and the Acquisition agreement described in Paragraph 8 [of the Complaint], have engaged in

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unfair methods of competition in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45." Complaint Counsel has presented reliable and probative evidence to support Counts I and II of the Complaint.

## **H. Remedy**

### **1. Standard**

Complaint Counsel has established that the acquisition of PDM's Water and EC Divisions by CB&I may substantially lessen competition in the relevant markets and, thus, has established that Respondents violated Section 7 of the Clayton Act. Pursuant to Section 11(b) of the Clayton Act:

If upon such hearing the Commission . . . shall be of the opinion that any of the provisions of [Section 7] have been or are being violated, it shall . . . issue and cause to be served on such person an order requiring such person to cease and desist from such violations, and divest itself of the . . . assets, held . . . in the manner and within the time fixed by said order." 15 U.S.C. § 21(b) (emphasis added).

Through Section 11 of the Clayton Act, Congress expressly directed the FTC to issue orders requiring that a violator of § 7 divest itself of the assets held in violation of the Clayton Act. *Am. Stores*, 495 U.S. at 284-85 and n.11; *FTC v. Western Meat Co.*, 272 U.S. 554, 559 (1926) (Commission has a duty to issue an order directing that a violator of § 7 "cease and desist therefrom and divest itself of what it had no right to hold.").

Under both the text of the Clayton Act and Supreme Court precedent, divestiture is the usual and proper remedy where a violation of § 7 has been found. *E.I. du Pont*, 366 U.S. at 329 ("The very words of § 7 suggest that an undoing of the acquisition is a natural remedy."); *Ford Motor Co. v. United States*, 405 U.S. 562, 573 (1972) ("Complete divestiture is particularly appropriate where asset or stock acquisitions violate



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the antitrust laws."); *Am. Stores*, 495 U.S. at 285 n.11 (A person who is allowed to continue holding ownership over stock or assets that created a Section 7 violation would be engaging in a perpetual violation, thus divestiture is the only effective remedy.). See also *United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 662 (1964) (directing the district court to order divestiture without delay). "Of the very few litigated § 7 cases which have been reported, most decreed divestiture as a matter of course." *E.I. du Pont*, 366 U.S. at 330.

Respondents argue that Complaint Counsel's proposed remedy is not appropriate because Complaint Counsel has not met a burden of presenting evidence relating to the effectiveness of the proposed remedy. RPTB at 158-59 (relying principally on *United States v. Microsoft*, 253 F.3d 34, 46 (D.C. Cir. 2001)). In *Microsoft*, a case brought under the Sherman Act, the Court of Appeals for the D.C. Circuit reversed the district court order of remedy based in large part on the district court's failure to take evidence concerning remedy. See *id.* at 103. However, as the *Microsoft* Court recognized, merger cases are different from monopolization cases:

By and large, cases upon which plaintiffs rely in arguing for the split of *Microsoft* have involved the dissolution of entities formed by mergers and acquisitions. On the contrary, the Supreme Court has clarified that divestiture "has traditionally been the remedy for Sherman Act violations whose heart is intercorporate combination and control," and that "complete divestiture is particularly appropriate where asset or stock acquisitions violate the antitrust laws."

*Microsoft*, 253 F.3d at 105 (citations omitted) (emphasis added). Thus, *Microsoft* is distinguishable and does not impose on Complaint Counsel the burden of presenting evidence related to the effectiveness of Complaint Counsel's proposed remedy for this violation of the Clayton Act.

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To the contrary, "it is well settled that once the Government has successfully borne the considerable burden of establishing a violation of law, all doubts as to the remedy are to be resolved in its favor." *E.I. du Pont*, 366 U.S. at 334. In a merger case, "absent clear proof, which is generally likely to come only at the compliance stage when a good faith effort to divest has been made, the presumption should be that an acquired competitive entity can be viably restored to its preacquisition status." *In re RSR Corp.*, 88 F.T.C. 800, 894 (1976), *aff'd* 602 F.2d 1317 (9th Cir. 1979).

Consistent with the Commission's "duty" to order divestiture, *Am. Stores*, 495 U.S. at 285 n.11, the Commission has held that "the burden rests with the respondent to demonstrate that a remedy other than full divestiture would adequately redress any violation which is found." *In re Fruehauf Corp.*, 90 F.T.C. 891, 892 n.1 (1977). In *In re Diamond Alkali Co.*, after stating that the most appropriate remedy to redress a Section 7 violation is "generally divestiture," the Commission held, "exceptions to the general rule can be reasonably invoked . . . only when the proof of their probable efficacy is clear and convincing." 72 F.T.C. 700, 742 (1967).

In the absence of proof to the contrary the assumption of this Commission must be that "only divestiture can reasonably be expected to restore competition and make the affected markets whole again." Moreover, if an order of divestiture appears to the Commission to be in all likelihood the most effective available remedy, the Commission need not justify its order beforehand by showing that it will unquestionably restore competition.

*Id.* (citation omitted).

The Commission has ordered divestiture of integrated assets in consummated merger cases numerous times where violations of the Clayton Act have been found. E.g., *Olin*, 113 F.T.C. at 619; *In re Crown Zellerbach Corp.*, 54 F.T.C. 769, 808 (1957), *aff'd*,

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296 F.2d 800 (9th Cir. 1961); *In re Ekco Prods. Co.*, 65 F.T.C. 1163, 1228-29 (1964), *aff'd* 347 F.2d 745 (7th Cir. 1965). In this case, Respondents have not presented compelling arguments or sufficient evidence to depart from the usual remedy of divestiture.

## **2. Divestiture is the appropriate remedy**

"In section 7 cases, the principal purpose of relief is to restore competition to the state in which it existed prior to, and would have continued to exist but for, the illegal merger." *In re B.F. Goodrich*, 110 F.T.C. at 345. The foremost function of divestiture is "the liquidation of the illegally acquired market power." *United States v. Greater Buffalo Press, Inc.*, 402 U.S. 549, 556 (1971) (citing *Schine Chain Theatres v. United States*, 334 U.S. 110, 127-29 (1948)). Divestiture is limited to assets that were purchased in the illegal acquisition. *Reynolds Metals Co. v. FTC*, 309 F.2d 223, 230-31 (D.C. Cir. 1962); *Luria Bros. & Co. v. FTC*, 389 F.2d 847, 865 (3rd Cir. 1968) (An order can only be directed at assets obtained by the buyer "as a result of the illegal acquisition.").

Complaint Counsel, relying on *Ford*, 405 U.S. at 573 and n.8, urges additional equitable relief to create a viable entity that operates independently of CB&I. Nowhere does *Ford* refer to the use of such relief to increase the competitiveness of the marketplace beyond the level existing prior to the merger. Further, *Ford* concerned the equitable powers of a district court. *Id.* Specific provisions of Complaint Counsel's proposed order that are designed to force CB&I to give up any after acquired assets or to do more than "restore competition to the state in which it existed prior to . . . the illegal merger[.]" *B.F. Goodrich*, 110 F.T.C. at 345, are rejected.

The record in this case includes evidence on the structure, composition, and competitive viability of PDM and CB&I premerger, the PDM assets and personnel acquired by CB&I, and the disposition of those assets and personnel. F. 545-65. Upon consideration of the entire record in this case, divestiture is hereby ordered.

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### **a. Complete divestiture**

To "ensure that the package of assets divested is sufficient to give its acquirer a real chance at competitive success," the Commission may order broad divestiture. *Olin*, 113 F.T.C. at 619-20. In *Olin*, the Commission ordered the respondent to divest a facility that manufactured the relevant product, isocyanurate (ISOS) and a product outside the relevant market, cyanuric acid (CA). The ISOS and CA facilities were located at the same plant. The respondent in *Olin* failed to introduce evidence that the facilities were separate, stand-alone operations, rather than integrated facilities that share common facilities of power, emission control, receiving and shipping, and other functions. *Id.* Because both facilities were intertwined, both were ordered to be divested. *Id.*

In the instant case, the evidence clearly establishes that PDM's EC and Water Divisions are closely interrelated. F. 566-72. The same personnel, equipment, and fabrication facilities are generally used in the construction of the products of both groups. F. 566-69. The dispositive point is that the assets of both divisions were acquired together by CB&I. F. 554-65. PDM did not find it practical or value optimizing to split the EC and Water Divisions when it evaluated the best course of action for the assets prior to the Acquisition. F. 570-72. Although only the products made by the EC Division are within the affected lines of commerce, the Water Division must be divested along with the EC Division.

### **3. Relief**

The record in this case includes evidence on the assets CB&I acquired from PDM. F. 554-65. The evidence establishes that CB&I acquired intellectual property, technology and know-how and other intangible assets related to the relevant products from PDM. F. 564-65. Evidence also establishes that CB&I acquired a number of outstanding contracts from PDM. F. 563.

Upon consideration of the entire record, relief designed to restore competition as it existed prior to the Acquisition is hereby

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ordered. The attached Order, discussed below, is designed to remedy the anticompetitive effects arising from the Acquisition.

Paragraph II.A.1 orders CB&I to divest all assets, title, properties, interest, rights and privileges purchased from PDM in the Acquisition. CB&I is also ordered to divest all assets that have been purchased by CB&I to replace or maintain assets purchased in the Acquisition. See *B.F. Goodrich*, 110 F.T.C. at 344 (ordering divestiture of all additions and improvements); *Ekco*, 65 F.T.C. at 1228-29 (ordering assets acquired, together with all additions thereto and replacements therefore to be divested).

Paragraphs II.A.2-4 order CB&I to divest all intellectual property or rights to such intellectual property as were purchased by CB&I from PDM in the Acquisition. See *Ekco*, 347 F.2d at 754 (intellectual property subject to divestiture when acquired in contravention of Section 7). Any rights that CB&I acquired to the PDM name shall also be divested. See *Ford*, 405 U.S. at 574.

Paragraphs II.A.5-6 order CB&I to divest all contracts formerly held by PDM and obtained by CB&I in the Acquisition that have not been fully performed. A lag-time provision of 180 days, after the Order becomes final, is included for construction contracts. Complaint Counsel's proposed order sought the divestiture of "45% of the total combined dollar value of CB&I's Tank Business Customer Contracts." Complaint Counsel's Proposed Order ("CCPO") at II.C.3. Such requested relief would require the divestiture of assets not obtained in the Acquisition. This is not appropriate. *Luria Bros.*, 389 F.2d at 865; *Reynolds Metals*, 309 F.2d at 231 ("no basis for ordering divestiture of after acquired properties"). Accordingly, the Order does not require CB&I to divest a portion of its backlog of work or customer contracts entered into by CB&I post-acquisition.

Paragraph II.B. of the Order requires that "if at all possible, irrespective of loss suffered by CB&I, the divested assets shall be sold as a viable going concern that will enhance competition in the relevant markets." For bonding purposes, to be a viable competitor in the LNG market, a company must have a substantial

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revenue base. F. 586-90. Therefore, to comply with the Order, the Acquirer, if at all possible, must possess the necessary revenue base to actively compete in the LNG market.

The divestiture sale shall be conducted in "good faith," Paragraph II.D., and CB&I is ordered to maintain the assets to be divested, Paragraph V. In conjunction, these provisions prohibit CB&I from disclosing or making available any proprietary information regarding the divested assets to any person, except as is necessary to effect the sale.

Complaint Counsel also sought to require CB&I to transfer 45% of its total full time employees to the Acquirer. CCPO at II.F. Although educated, experienced, and knowledgeable employees are required to build the relevant products, F. 582-85, unlike other necessary assets, such as tools, building supplies, and mechanical equipment, employees are not owned by the company for which they work. Furthermore, Complaint Counsel has cited no authority supporting the proposition that at-will employees are assets that may be divested. Accordingly, this proposed measure is not included in the Order. The Order does, at Paragraph IV, preclude CB&I from granting incentives to its employees or enforcing any non-compete clauses in its employees' contracts in order to prevent its employees from transferring to the Acquiring company.

Paragraph VII orders a divestiture trustee. Complaint Counsel sought both a "monitor trustee," CCPO at V, whose responsibility would be to ensure that Respondents comply with the terms of the Order; and a "divestiture trustee," CCPO at VI, who would be appointed to accomplish the divestiture, in the event that CB&I fails to divest in the manner and time required by the Order. Complaint Counsel has failed to cite any litigated case where a monitor trustee has been ordered. Although monitor trustees have been used recently to monitor compliance with divestiture agreements where respondents have entered into consent decrees with the FTC, e.g., *Solvay*, 2002 FTC LEXIS 34, \*47 (2002), *America Online, Inc.*, 2001 FTC LEXIS 44, \*37 (2001), this is not persuasive. *E.I. du Pont*, 366 U.S. at 330 n.12 ("the

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circumstances surrounding . . . negotiated [consent decrees] are so different that they cannot be persuasively cited in a litigation context"). A contingent divestiture trustee is ordered; a monitor trustee is not.

Complaint Counsel sought to require CB&I to provide technical assistance and administrative services to the Acquirer. CCPO at II.I-J. Requiring technical assistance and administrative services may provide an opportunity for anticompetitive behavior. In addition, Complaint Counsel did not demonstrate that technical assistance or administrative services are not available from a source other than CB&I. These assets were not expressly acquired by CB&I in the Acquisition. (See CX 328). Therefore, the Order does not require this relief.

Complaint Counsel did not seek to prohibit Respondents from future acquisitions of all or any part of the stock or assets of, or any interest in, any producer of the relevant products. Therefore, such a prohibition is not included in the Order.

**IV. SUMMARY OF CONCLUSIONS OF LAW**

1. The Federal Trade Commission ("FTC") has jurisdiction over the subject matter of this proceeding and over Respondents Chicago Bridge & Iron Company, N.V., Chicago Bridge and Iron Company, and Pitt-Des Moines, Inc. ("PDM"), pursuant to Section 5 of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 45, and Sections 7 and 11 of the Clayton Act, 15 U.S.C. §§ 18, 21(b).

2. Chicago Bridge & Iron Company N.V., and Chicago Bridge & Iron Company, a corporation (collectively, "CB&I") is a corporation, as "corporation" is defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44.

3. Respondents were engaged in commerce, as "commerce" is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12, and affected commerce, as "commerce" is defined in Section 4 of the FTC Act, as amended, 15 U.S.C. § 44.

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4. On or about February 7, 2001, CB&I acquired PDM's Water and Engineered Construction ("EC") Divisions, ("the Acquisition"). The Acquisition is a transaction subject to Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the FTC Act, 15 U.S.C. § 45.

5. Section 7 of the Clayton Act prohibits any acquisition of stock or assets "where in any line of commerce . . . in any section of the country, the effect of such acquisition may be substantially to lessen competition or to tend to create a monopoly." 15 U.S.C. § 18.

6. Section 7 of the Clayton Act is designed to arrest in its incipency the substantial lessening of competition from the acquisition by one corporation of the assets of a competing corporation. Section 7 does not require proof from Complaint Counsel that a merger has caused higher prices in the affected market. To satisfy Section 7, Complaint Counsel need only show a reasonable probability that the proposed transaction would substantially lessen competition in the future.

7. The appropriate lines of commerce within which to evaluate the probable competitive effects of the Acquisition are: large, field-erected: (1) liquefied natural gas ("LNG") storage tanks (individually, or as a component of an import terminal or a LNG peak shaving plant); (2) refrigerated liquid petroleum gas ("LPG") storage tanks; (3) liquid nitrogen, oxygen and argon ("LIN/LOX") storage tanks; and (4) large (over 20 feet in diameter) thermal vacuum chambers ("TVCs").

8. The appropriate section of the country within which to evaluate the probable competitive effects of the Acquisition is the United States.

9. The government has the burden of showing that the Acquisition would produce a firm controlling an undue percentage share of the relevant markets and would result in a significant increase in the concentration of the firms in those markets. A merger which significantly increases the share and



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concentration of firms in the relevant markets is so inherently likely to lessen competition that it is considered presumptively invalid.

10. Complaint Counsel established its prima facie case by showing that the Acquisition produces a firm controlling an undue percentage share in each of the four relevant markets. Complaint Counsel established that CB&I and PDM were the number one and two competitors in all four product markets and that no other company provides effective competition.

11. Finding a prima facie violation of Section 7 creates a rebuttable presumption of anticompetitive effects and shifts the burden of going forward with evidence to Respondents. Respondents have the burden of producing evidence that shows that the market share statistics supporting the prima facie case give an inaccurate account of the Acquisition's probable effects on competition.

12. Respondents have not demonstrated that the market share statistics give an inaccurate prediction of the Acquisition's probable effects on competition.

13. Respondents may rebut the prima facie case by demonstrating that entry by other firms would likely avert the Acquisition's probable effects on competition by acting as a constraint on CB&I's exercise of market power. Respondents may rebut the prima facie case by demonstrating that barriers to entry are so low that the threat of entry can significantly alter the anticompetitive effects of the merger by deterring the remaining entities from exercising market power.

14. Respondents have not demonstrated that actual or potential entrants constrain CB&I's exercise of market power. Due to high barriers, entry by new manufacturers or the expansion of existing manufacturers is not likely to avert the anticompetitive effects of the Acquisition in the relevant markets.

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15. Respondents have not produced any significant evidence rebutting the presumption of a violation of Section 7 of the Clayton Act.

16. Because Respondents did not produce evidence sufficient to rebut the presumption of a violation of Section 7 of the Clayton Act, the burden of producing further evidence of anticompetitive effects did not shift to Complaint Counsel.

17. Respondents have presented an exiting assets defense. To the extent that an exiting assets defense is a valid defense, Respondents have not demonstrated that PDM EC's assets would have left the market in the near future or that PDM had conducted an exhaustive effort to sell the EC Division to a company other than CB&I.

18. The Acquisition is likely to increase CB&I's ability to raise prices unilaterally in the relevant markets because the Acquisition eliminates competition from PDM, CB&I's closest competitor. The Acquisition is a merger involving the first and second lowest-cost sellers which could cause prices to rise to the constraining level of the next lowest-cost seller.

19. The Acquisition violates Section 7 of the Clayton Act because "the effect of such acquisition may be substantially to lessen competition or to tend to create a monopoly." 15 U.S.C. § 18. The Acquisition also constitutes an unfair method of competition in or affecting commerce in violation of Section 5 of the FTC Act. 15 U.S.C. § 45.

20. Complaint Counsel met its burden of proof in support of Count I and Count II of the Complaint.

21. Divestiture is the proper remedy.

22. Complete divestiture of all assets acquired in the Acquisition is required to restore competition as it existed prior to the Acquisition.

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23. Relief designed to restore competition as it existed prior to the Acquisition is appropriate.

24. The Order entered hereinafter is necessary and appropriate to remedy the violations of law found to exist.

**ORDER****I.**

**IT IS HEREBY ORDERED** that for the purposes of this Order, the following definitions shall apply:

A. "Acquirer" means an entity approved by the Commission who purchases the assets divested, pursuant to this Order.

B. "Acquisition" means the transaction consummated on February 7, 2001, whereby CB&I purchased PDM's Water and Engineered Construction ("EC") Divisions.

C. "CB&I" means Chicago Bridge & Iron Company N.V. and Chicago Bridge & Iron Company, individually and collectively.

D. "Chicago Bridge & Iron Company N.V." means Chicago Bridge & Iron Company, N.V.; its directors, officers, employees, agents and representatives, predecessors, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by Chicago Bridge & Iron Company N.V.; and the respective directors, officers, employees, agents and representatives, successors, and assigns of each.

E. "Chicago Bridge & Iron Company" means Chicago Bridge & Iron Company; its directors, officers, employees, agents and representatives, predecessors, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by Chicago Bridge & Iron Company; and the respective directors, officers, employees, agents and representatives, successors, and assigns of each.

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F. "Commission" means Federal Trade Commission.

G. "Divestiture Trustee" means a person, with experience and expertise in acquisitions and divestitures, appointed by the Commission to effect the divestiture requirements of this Order.

H. "PDM" means Pitt-Des Moines, Inc.; its directors, officers, employees, agents and representatives, predecessors, successors, and assigns; its subsidiaries, divisions, groups, and affiliates controlled by Pitt-Des Moines, Inc.; and the respective directors, officers, employees, agents and representatives, successors, and assigns of each.

**II.**

**IT IS FURTHER ORDERED** that:

A. No later than one hundred and eighty (180) days from the date that this Order becomes final, CB&I shall completely divest all assets, title, properties, interest, rights and privileges, of whatever nature, purchased from PDM in the Acquisition. This divestiture shall be complete and shall include, but is not limited to, all buildings, machinery, equipment, raw material reserves, inventory, customer lists, trade names, trademarks, patents, and any other assets, of whatever description, that were acquired by CB&I from PDM in the Acquisition.

1. Complete divestiture shall include any assets that have been purchased by CB&I to replace or maintain assets purchased in the Acquisition.

2. Complete divestiture shall include any intellectual property or any rights to intellectual property as were purchased by CB&I from PDM in the Acquisition. Any rights acquired by CB&I to the "Pitt-Des Moines," "PDM," "Pitt-Des Moines EC," "PDM EC," "Pitt-Des Moines Water," and "PDM Water" names or any other variation of these names shall be divested.

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3. Complete divestiture shall include a worldwide, royalty-free, perpetual, irrevokable, transferable, sublicensable, non-exclusive license to all intellectual property that was (1) created in part by former PDM employees who became employed by CB&I as a result of the Acquisition or (2) was premised in part upon intellectual property formerly owned by PDM and transferred to CB&I in the Acquisition.

4. Complete divestiture shall include a worldwide, royalty-free, perpetual, irrevokable license to any intellectual property owned by CB&I that would block Acquirer's legal use of the intellectual property that shall be required to be licensed to Acquirer, pursuant to Paragraph II.A.3 of this Order.

5. Complete divestiture shall include the assignment of all construction contracts formerly held by PDM and obtained by CB&I in the Acquisition that have not been fully performed by CB&I one hundred and eighty (180) days after this Order becomes final. Acquirer shall compensate CB&I in quantum meruit for any work completed under these contracts by CB&I prior to assignment. If a third party's consent must be obtained to assign any of these contracts, CB&I must use all available means, in good faith, to obtain such consent.

6. Complete divestiture shall include all non-construction contracts formerly held by PDM and obtained by CB&I in the Acquisition that have either not been fully performed by CB&I or that have not yet expired. These contracts include, but are not limited to, sales representative agreements, cooperation agreements, license agreements, partnership agreements, term employment contracts, and leases. If a third party's consent must be obtained to assign any of these contracts, CB&I must use all

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available means, in good faith, to obtain such consent.

B. If at all possible, irrespective of loss suffered by CB&I, the divested assets shall be sold as a viable going concern that will enhance competition in the relevant markets.

C. Prior to the execution of the divestiture sale, a full accounting of all assets purchased in the Acquisition shall be provided to the Commission. The accounting shall disclose the approximate value, both at the time of the Acquisition and at the time that this Order becomes final; the current location; and the current condition of all of the assets purchased in the Acquisition. In the event that an asset is no longer in the possession of CB&I, any consideration received for the sale of such an asset shall be disclosed.

D. The divestiture sale shall be conducted in good faith, at no minimum price, and in compliance with the laws of the United States. The Acquirer, a divestiture agreement, and the manner of the sale must be approved by the Commission prior to the execution of the divestiture sale. The divestiture agreement shall not vary from or contradict, or be interpreted to vary from or contradict, the terms of this Order.

E. The divested assets shall not be sold or transferred, directly or indirectly, to any entity that at the time that this Order becomes final is a substantial stockholder, officer, director, employee, agent of, or otherwise directly or indirectly connected with or under the control or influence of CB&I.

**III.**

**IT IS FURTHER ORDERED** that CB&I shall comply with all terms of the divestiture agreement to be approved by the Commission, pursuant to Paragraph II.D of this Order. The divestiture agreement shall be deemed incorporated by reference into this Order, and any failure by CB&I to comply with the terms of the divestiture agreement shall constitute a failure to comply

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with this Order.

#### IV.

**IT IS FURTHER ORDERED** that CB&I shall, from the date that this Order becomes final and extending for a period of two (2) years after the divestiture required by Paragraph II.A of this Order is completed: (1) not offer or provide any incentive to any employee of CB&I to decline employment with the Acquirer; (2) waive any non-compete clauses in CB&I employees' contracts that would prevent such employees from seeking employment with the Acquirer.

#### V.

**IT IS FURTHER ORDERED** that from the date that this Order becomes final, until such time as the divestiture required by Paragraph II.A of this Order is completed, CB&I shall take all measures necessary to maintain all assets ordered to be divested in their accounted for condition and to prevent any further deterioration, except normal wear and tear, so as to not impair the assets' operating viability, marketability, or confidentiality, if applicable.

#### VI.

**IT IS FURTHER ORDERED** that:

A. CB&I shall, within sixty (60) days from the date that this Order becomes final and every sixty (60) days thereafter, for one (1) year from the date that the divestiture required by Paragraph II.A of this Order is completed, submit in writing to the Commission a verified compliance report. Each report shall set forth, in detail, the manner and form in which CB&I intends to comply, is complying, or has complied with each of the requirements of this Order.

B. CB&I shall include in the compliance reports, among other relevant information requested by the Commission, a description

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of all substantive contracts or negotiations relating to the divestiture, both oral and written; the identity of all potential Acquirers; copies of all written communications (including email) to and from such entities regarding the divestiture; internal documents and communications relating to the divestiture; and a statement that the provisions of this Order have been and are being fully complied with.

**VII.**

**IT IS FURTHER ORDERED** that:

A. If CB&I has not fully complied with Section II.A of this Order within one hundred and eighty (180) days of this Order becoming final, the Commission may, at its discretion and at any time thereafter, appoint a Divestiture Trustee to fulfill the requirements of Paragraph II.A. This provision by no means hinders either the Commission or the U.S. Attorney General from seeking civil penalties or a court-appointed trustee for any violation of this Order by CB&I.

B. If a Divestiture Trustee is appointed, that Divestiture Trustee shall have the following powers, duties, authority, and responsibilities:

1. Subject to the prior approval of the Commission, the Divestiture Trustee shall have the exclusive authority to effect the divestiture, in accordance with the requirements of this Order, for which the Divestiture Trustee has been appointed.
2. Within ten (10) days of the Divestiture Trustee's appointment, CB&I shall grant the Divestiture Trustee, with the prior approval of the Commission, all of the rights and powers necessary to effect the divestiture for which the Divestiture Trustee has been appointed.



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3. The Divestiture Trustee shall have twelve (12) months, from the date that the Commission approves the grant of rights and powers, to complete the divestiture in accordance with this Order. This temporal duration may be extended for good cause or extenuating circumstances with the consent of the Commission.

4. CB&I shall provide the Divestiture Trustee with full and complete access to personnel, books, records, facilities, or any other information that is related to the assets ordered to be divested. CB&I shall cooperate with the Divestiture Trustee in good faith and comply with any reasonable requests for the production of additional relevant information. Should CB&I delay or hinder the Divestiture Trustee, the duration of time lost due to the delay or hindrance shall be credited to the twelve-month temporal deadline for completion of the divestiture.

5. Best efforts shall be used by the Divestiture Trustee to negotiate the most favorable price and terms available for the assets being divested; but at the same time, the Divestiture Trustee shall seek to submit the proposed sales contracts to the Commission as promptly as possible at no minimum price. If the Divestiture Trustee receives good faith offers from more than one eligible potential Acquirer, and if the Commission approves more than one of these entities, the Divestiture Trustee shall divest the assets to the Acquirer that is selected by CB&I from those approved by the Commission. However, if CB&I does not respond within five (5) business days to the Commission's request for such a selection, the Divestiture Trustee shall have complete discretion in choosing the Acquirer from those entities approved by the Commission.

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6. The Divestiture Trustee shall serve without bond or other security, at the cost and expense of CB&I, on such reasonable and customary terms and conditions as the Commission may set. The Divestiture Trustee shall have the authority to employ, at the cost and expense of CB&I, such consultants, accountants, attorneys, investment bankers, business brokers, appraisers, and other representatives and assistants as are necessary to carry out the Divestiture Trustee's duties and responsibilities. The Divestiture Trustee shall account for all consideration derived from the sale and all expenses incurred. Upon approval by the Commission of the Divestiture Trustee's accounting, all remaining fees and expenses shall be paid and the remainder of the consideration shall be distributed at the discretion of CB&I. Following the final distribution, the Divestiture Trustee's power and authority shall be terminated.

7. CB&I shall indemnify and hold the Divestiture Trustee harmless against any losses, claims, damages, liabilities, or expenses arising out of or in connection with the performances of the Divestiture Trustee's duties. This indemnification shall include all reasonable fees for counsel and other expenses incurred in connection with the preparation for or defense of any claim, whether or not resulting in any liability, except to the extent that such liabilities, losses, damages, claims, or expenses result from gross negligence or willful misconduct by the Divestiture Trustee. This indemnification shall be inclusive of all agents of or entities retained by the Divestiture Trustee, pursuant to Paragraph VII.B.6 of this Order.

8. The Commission may appoint a substitute in the event that the Divestiture Trustee fails to perform in a diligent manner, acts with gross negligence, or engages in willful misconduct.

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9. The Divestiture Trustee shall have no obligation or authority to operate or maintain the assets ordered to be divested.

10. The Divestiture Trustee shall report to the Commission, in writing, every sixty (60) days to inform it of the Divestiture Trustee's efforts to complete the ordered divestiture.

C. The Commission may, at the request of the Divestiture Trustee, issue such additional orders or directions, within the scope of this Order, as may be necessary or appropriate to further the completion of the divestiture.

### VIII.

**IT IS FURTHER ORDERED** that CB&I shall provide a copy of this Order to each of CB&I's officers, employees, or agents possessing managerial responsibility relating to any of the provisions contained in this Order, no later than ten (10) days after the date that this Order becomes final.

### IX.

**IT IS FURTHER ORDERED** that CB&I shall notify the Commission at least thirty (30) days prior to any proposed change in the corporate structure or financial condition of CB&I that could affect compliance with the requirements of this Order, including, but not limited to, dissolution, assignment, sale, merger, sale or dissolution of subsidiaries, or bankruptcy.

### X.

**IT IS FURTHER ORDERED** that, for the purpose of determining or securing compliance with this Order, subject to any legally recognized privilege, and upon written request with reasonable notice, CB&I shall permit any authorized agent of the Commission:

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A. Access, during office hours and in the presence of counsel, to all relevant facilities and documents. Such documents that may be inspected and copied include, but are not limited to, non-privileged books, ledgers, accounts, and correspondence memoranda that are in the possession of or under the control of CB&I and relate to any matter contained in this Order.

B. Access to interview CB&I's officers, directors, or employees who may possess information relevant to any matter contained in this Order. Counsel may be present for such interviews.