PUBLIC

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION
WASHINGTON D.C.

In the Matter of UNION OIL COMPANY OF CALIFORNIA, a corporation.	Docket No. 9305

RESPONDENT'S TRIAL BRIEF

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TABLE OF CONTENTS

Page

Page

Page

Page

Page

Page

TABLE OF AUTHORITIES

FEDERAL CASES:

<u>STATE CASES:</u>

FEDERAL STATUTES:

STATE STATUTES:

OTHER AUTHORITIES:

Respondent Union Oil Company of California ("Unocal"), in compliance with Your Honor's Scheduling Order, submits this Trial Brief for consideration.

I. <u>INTRODUCTION</u>

The gravamen of Complaint Counsel's case against Unocal is fraud. The Complaint pleads each of the well-recognized elements of fraud, and in fact, fraud is the *only* theory of exclusionary conduct alleged. Moreover, in its July 7 order, the Commission made it clear that to avoid *Noerr* immunity, Complaint Counsel must prove knowing, intentional and material fraud with respect to "sharply defined facts." Absent proof that Unocal intentionally made material misrepresentations to CARB and the refiners—and that these groups reasonably and detrimentally relied upon such misrepresentations—Complaint Counsel cannot establish that Unocal is liable for violations of Section 5 of the FTC Act.

As will be discussed below, there are many other elements of a Section 5 violation that Complaint Counsel will need to prove in addition to fraud, and Complaint Counsel's proof of each of these elements fails as well. Unocal has a number of strong defenses that Complaint Counsel cannot rebut. But the starkest defect in Complaint Counsel's case is that there is no evidence to support a finding of fraud.

The Complaint alleges that Unocal committed fraud by saying that emissions test data was "non-proprietary" and was "in the public domain." The evidence at trial will show that these statements were true when made and remain absolutely true today. The Complaint alleges that Unocal created a false and misleading impression that it had no patent applications, but the evidence will show that no one could reasonably interpret Unocal's statements about its data this way, and that in fact no one did so. The Complaint alleges that Unocal intended for CARB to adopt regulations that overlapped its pending patent claims and that Unocal caused CARB to do so. But the evidence will show that Unocal strongly opposed CARB's regulations and that CARB had determined that the key property at issue—T50—was "critical" to regulate months before CARB became aware of Unocal's research. And finally, the Complaint alleges that CARB has not changed its regulations to avoid Unocal's patent because it is "locked in" by reason of the refiners' investments made for CARB's Phase 2 regulations. But the evidence will show that the reason CARB did not even consider Unocal's patent when it issued its new Phase 3 regulations is because it considered Unocal's patent to be "in flux" and invalid even after Unocal had won a verdict of infringement in which the court rejected an invalidity defense.

Complaint Counsel's response to this devastating evidence is to run. Despite their oft-repeated invective that Unocal has "lied," Complaint Counsel's pretrial brief tells a story of retreat. Complaint Counsel run from their own allegations by denying repeatedly that they need to prove fraud. They run from the evidence by making bold assertions with no record citations. And they run from the most basic requirement that they must show Unocal's statements harmed California consumers by claiming such causation should be inferred. They give short shrift to the Commission's July 7 *Noerr* opinion requiring knowing and deliberate fraud—and they completely ignore Judge McGuire's recent initial decision in the *Rambus* matter.

In the brief that follows, Unocal provides a summary of the most powerful evidence that will be established at trial and a discussion of the law Unocal believes most relevant to the issues before this Court. For all the reasons that follow, Unocal submits that the Complaint should be dismissed.

II. QUESTIONS FROM THE COURT

The Court specifically asked that the parties address certain questions in their trial briefs. We have set forth below succinct answers to those questions, together with a reference to a more in-depth discussion of these questions in the body of the trial brief.

(1) What is the proper standard of proof to apply in a case where fraud is alleged?

Whether common law fraud needs to be proved by clear and convincing evidence or by a preponderance of the evidence varies from jurisdiction to jurisdiction. But Unocal submits that where, as here, fraud is alleged in connection with the alleged unlawful enforcement of a patent, and where *Noerr* immunity is at stake, the clear and convincing evidentiary standard should apply. Clear and convincing evidence is required to establish antitrust claims based on allegations that the patentee committed fraud upon the patent office. *Walker Process Equip., Inc. v. Food Mach. and Chem. Corp.*, 382 U.S. 172, 177 (1965). Clear and convincing evidence is also required when a litigant is threatened with losing its patent rights based upon allegations that it has violated the antitrust laws through sham patent litigation. *Handgards, Inc. v. Ethicon, Inc.*, 601 F.2d. 986, 996 (9th Cir. 1979).

Complaint Counsel correctly note that the general burden of proof under the Administrative Procedure Act is preponderance of the evidence, and that this is the standard typically employed in Commission proceedings. In the recent *Rambus* decision, Judge McGuire applied the preponderance of the evidence standard, *In re Rambus, Inc.*, No. 9302, slip op. at 242 (FTC Feb. 23, 2004), although he left open the question of whether the remedy sought—denying a patentee the ability to enforce its patents—required the heightened standard of clear and convincing evidence. *Rambus,* slip op. at 242-43. Given the remedies sought here, the allegations of deliberate fraud and the potential for chilling of governmental speech, Unocal believes that this is a case where an exception to the general rule should apply. Unocal's arguments and discussions of the issue are set forth more fully at pp. 56-61, *infra*.

(2) Whether an omission constitutes a misrepresentation or a deliberate misrepresentation?

An omission constitutes a misrepresentation only where there is a duty to speak and a party remains silent in the face of that duty. *Kovich v. Paseo Del Mar Homeowners' Ass'n*, 48 Cal. Rptr. 2d 758, 760 (Cal. Ct. App. 1996) ("The general rule for liability for nondisclosure is that even if material facts are known to one party and not the other, failure to disclose those facts is not actionable fraud unless there is some fiduciary or confidential relationship giving rise to a duty to disclose."). Section 5 liability will not be premised upon a failure to disclose unless the duty to disclose is "clear and unambiguous." *Rambus*, slip op. at 259.

If the duty to disclose is in any way uncertain, then a failure to disclose also cannot constitute a *deliberate* misrepresentation, since as a matter of law there can be no deceptive intent when the disclosure obligation was unclear. *OddzOn Prods., Inc. v. Just Toys, Inc.*, 122 F.3d 1396, 1404 (Fed. Cir. 1997).

Unocal presents a more detailed legal and factual analysis of these issues at pp. 69-92, *infra*.

(3) What is the authority of an administrative agency and of a federal district court to order the remedy sought by the government, to expressly include any and all case law regarding the authority to order a party to cease and desist its enforcement of valid patents based on misconduct other than misconduct before the United States Patent and Trademark Office?

Unocal is not aware of any authority by which the Federal Trade Commission, or any other administrative agency, can order the remedies sought by the Complaint. Although disguised as a "cease and desist" order, the remedy is in reality a punitive measure which seeks to enjoin Unocal from enforcing its five reformulated gasoline patents in California and which presumably also seeks to prevent Unocal from collecting the more than $280 million to which it is entitled under a judgment from the federal District Court in California. The authority to seek restitution—if the FTC has such authority—must stem from a civil action in district court. 15 U.S.C. § 53(b). But this case was brought as an administrative proceeding under Section 5 of the FTC Act. Thus, any proposed relief must not operate as a penalty, disgorgement, forfeiture or punitive measure. *See FTC v. Ruberoid Co.*, 343 U.S. 470, 473 (1952) ("Orders of the Federal Trade Commission are not intended to impose criminal punishment or exact compensatory damages for past acts, but to prevent illegal practices in the future.").

Unocal is not aware of any reported, precedential decisions in which the FTC has issued an order preventing a respondent from enforcing its patents against those who infringe them, much less a precedential decision in which the FTC has issued an order preventing the enforcement of valid patents for conduct other than conduct before the PTO. Although the Complaints in *Rambus* and *Dell* sought such relief, Judge McGuire determined that Rambus had not violated Section 5 of the Act, and *Dell* was settled by a consent order, which has no precedential value. The only court of which Unocal is aware that has directly addressed the Commission's authority on this point is the Sixth Circuit in *American Cyanamid,* which explicitly stated "nor do we hold that the Commission could order compulsory licensing without payment of reasonable royalties." *Am. Cyanamid Co. v. FTC*, 363 F.2d 757, 772 (6th Cir. 1966). At pp. 186-197, *infra*, Unocal discusses in more detail the many reasons why the Commission does not have the authority to order the remedies set forth in the Complaint.

Complaint Counsel cite to no authority (other than the non-precedential consent order in *Dell*) in which the Commission has ordered relief similar to that sought in this Complaint. *See* Compl. Counsel's Pretrial Br. at 78-79. The opinion in *In re Roberts Co.*, 56 F.T.C. 1569 (1960), cited by Complaint Counsel at page 78, does not support the relief sought in this matter. There, the Commission ordered the respondent to cease threatening patent infringement litigation against competitors *who were not infringing. Id.* at 1610-11. The Commission in *Roberts* carefully noted the need to strike a balance that preserves the reward of the inventor as much as is possible when ordering relief against a patent holder. *Id.*[1]

Your Honor also asked the parties to address whether federal district courts have the authority to order the relief requested by the Complaint. In general, there are certain legal theories (other than inequitable conduct or fraud on the PTO) which allow a court to deny a patentee the right to enforce its patents against individual parties to the litigation. *See* Compl. Counsel's Pretrial Br. at 80-82. For example, as a defense to claims of patent infringement, infringers can raise theories such as patent misuse,[2] equitable estoppel,[3] and implied license.[4] But none of these theories provides any

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1 Complaint Counsel's citation to the July 7 opinion of the Commission (Compl. Counsel's Pretrial Br. at 78) is similarly unpersuasive, since the Commission was only addressing the *Noerr* and jurisdiction issues before it, and thus never ruled upon the specific remedies sought and whether they were reasonable related to the alleged harm.

2 *E.g., United States Gypsum Co. v. Nat'l Gypsum Co.*, 352 U.S. 457, 494-495, 1 L.Ed.2d 465, 77 S. Ct. 490 (1957) (courts will not aid a patent owner who has misused its patents until the effects of such misuse have been purged).

3 *E.g., A.C. Aukerman Co. v. R.L. Chaides Constr. Co.,* 960 F.2d 1020, 1041-42 (Fed. Cir. 1992) (discussion of equitable estoppel and laches defenses).

4 *E.g., Wang Labs, Inc. v. Mitsubishi Elec. Am., Inc.*, 103 F. 3d 1571, 1580 (Fed. Cir. 1997) (discussion of implied license defense).

support for Complaint Counsel's claims in this action. And, in fact, all these defenses *were* raised by the six major refiners in California in their litigation against Unocal and all were abandoned by them by trial. *Union Oil Co. v. Chevron USA, Inc.*, 34 F. Supp. 2d 1222, 1224 (C.D. Ca. 1998). The allegations by the refiner defendants in that action were remarkably similar to the allegations of Complaint Counsel in this case. *Id.* ("Defendants asserted the defenses of equitable estoppel, implied license, and unclean hands, alleging generally that Unocal had lulled CARB and the defendants into believing that Unocal did not intend to enforce its patent rights."). The Court ultimately sanctioned the defendants for the vexatious manner in which they litigated these defenses and then abandoned them. *Id.* Given principles of *res judicata*, no federal District Court could, in another action between Unocal and any of those six refining defendants, order the relief the Complaint seeks in this action.

(4) A list of all disputed issues alleged in the Complaint that have been litigated in any other court or forum and the current status thereof.

- The Complaint alleges that the CARB Phase 2 proceedings were quasi-adjudicative. Compl. ¶ 26. The Supreme Court of California has held that CARB's adoption of air quality regulations is a quasi-legislative action. *Western States Petroleum Ass'n v. Superior Ct. of L.A. County,* 9 Cal. 4th 559, 566-67 (Cal. 1995). That matter has been litigated to its conclusion.
- The Complaint alleges that Unocal's management approved the filing of a patent application "that sprang from the 5/14 project," referring to research emissions testing approved on May 14, 1990. Compl.¶¶ 29, 30. The federal District Court for the Central District of California held that the conception

date for Unocal's invention was March 30, 1990—before the 5/14 research was conducted. *Union Oil Co. of Cal. v. Atlantic Richfield Co.*, No. CV-95-2379, slip. op. at 15 (C.D. Cal. Aug. 31, 1998) (Phase III: Memorandum of Decision Setting Forth the Court's Factual Findings and Conclusions of Law) (establishing a conception date of March 30, 1990).

- The Complaint alleges Unocal's invention was "purportedly" a novel discovery. Compl. ¶ 30. The District Court for the Central District of California held that Unocal's '393 patent was not invalid for lack of novelty. *Union Oil Co. of Cal v. Atlantic Richfield Co.*, No. CV-95-2379, 1998 U.S. Dist. LEXIS 22847, at **8-9 (C.D. Cal. Mar. 6, 1998). This holding was affirmed by the Federal Circuit. *Union Oil Co. of Cal. v. Atlantic Richfield Co.*, 208 F.3d 989, 996 (Fed. Cir. 2000). The Supreme Court has denied certiorari in this matter. These issues have thus been conclusively resolved.
- The Complaint alleges that Unocal amended its patent claims in March 1992 to ensure that the patent claims more closely matched the regulations. Compl. ¶ 60. The jury determined that Unocal's patent was not invalid by reason of derivation. *See Union Oil Co. of Cal. v. Chevron USA, Inc.,* 34 F. Supp. 2d 1222, 1224 (C.D. Cal. 1998) ("[D]efendants asserted a new "derivation" argument, the gist of which was that Unocal had copied the invention from CARB. No competent evidence was introduced in support of that argument and the jury did not find the patent invalid on that basis.") In addition, the federal district court held that there was substantial evidence to

support the jury's verdict that the inventors had possession of the claimed subject matter by December 1990 when they filed the patent application and that the patent was not invalid for lack of a written description. *Union Oil Co. of Cal.*, 1998 U.S. Dist. LEXIS 22847, **12-14. This holding was affirmed by the Federal Circuit. *Union Oil Co. of Cal.*, 208 F.3d at 999 ("In sum, the record shows that the inventors possessed the claimed invention at the time of filing . . . ."). Because the Supreme Court has denied certiorari in this matter, these issues have thus been conclusively resolved.

- In its Notice of Contemplated Relief, the Complaint states the Commission may order Unocal to cease and desist all efforts to prosecute any infringement actions based upon gasoline sold in California. Compl. ¶ 17. This would be in direct contravention to a judgement of the federal District Court for the Central District of California, which ordered that:

> With respect to infringement from August 1, 1996 to the date of final judgment this Court orders that an accounting for defendants' oil production take place in order to determine the number of gallons of infringing motor gasoline, to be then multiplied by the royalty rate of 5.75¢ per gallon, prejudgment interest at the rate of 8.24%, compounded quarterly, such accounting to be stayed during the pendency of an appeal in this matter.

Union Oil Co. of Cal. v. Atlantic Richfield Co., No. CV-95-2379, slip op. at ¶14 (C.D. Cal. September 28, 1998) (Order Granting Plaintiff's Rule 59(e) Motion; Granting and Staying Request for Accounting and Denying Plaintiff's *Ex Parte* Application for Magistrate Judge Designation.)

> After the refiners' unsuccessful appeal, Unocal performed an accounting pursuant to this order, and moved the Court for an award of damages totaling $209 million for infringement of the '393 patent for the period from August 1, 1996 through September 30, 2000, and pre-judgment interest of $71 million through December 17, 2001. The Court has administratively placed Unocal's request for an accounting action on hold pending the patent's re-examination proceedings before the PTO. An in-court status conference has been scheduled by the Court for November 29, 2004.

In addition, Unocal would like to briefly respond to Complaint Counsel's characterization of their list of seven disputed issues litigated in other tribunals. Compl. Counsel's Pretrial Br. at 67-71. In large part, Unocal's response to these allegations has been fully briefed as part of Unocal's Response to Complaint Counsel's Motion in Limine on judicial estoppel issues. *See* Response to Complaint Counsel's Motion in Limine Requesting Judicial Estoppel (Oct. 24, 2003).

With respect to issues relating to whether refiners could blend around the '393 patent, the conclusions Unocal's experts drew in the patent litigation were based upon the information produced in discovery by the refiner defendants for the first five months of CARB production—from March through July 1996. Unocal's economic expert, Professor David Teece, explicitly stated in that litigation that if the refiners would provide him with information showing refinery-specific blend-around costs, he would incorporate it in his analysis. After Unocal won the trial at which Professor Teece testified and the Court of Appeals for the Federal Circuit affirmed the outcome, the refiners went back to the district court and presented for the first time new evidence that they had withheld in the original litigation. That new evidence indicated that the refiners could easily blend around the '393 patent. In this litigation, discovery has shown that the refiners can blend around the '393 patent at little to no cost. Just as he said he would do in the patent case, Professor Teece has thus incorporated this evidence into his analysis in this case. Moreover, the issues in the two cases are distinct. In the patent case, Professor Teece was performing a hypothetical negotiation analysis for purposes of determining infringement damages. In this case, he is looking at market power allegations in an antitrust context.

As noted in Unocal's response to Complaint Counsel's motion *in limine*, "lock in" was never litigated in the '393 trial, nor was the amount of royalties that would be passed through to consumers. And although Professor Teece testified that the hypothetical negotiators would have concluded that CARB would not want to change its regulations[5] the issue of whether CARB *could* change its regulations was not litigated.

III. <u>BACKGROUND</u>

The deception alleged by Complaint Counsel is based on a theory that Unocal pushed CARB to include a particular property of gasoline, known as the T50 distillation point, in its regulations. Compl. ¶¶ 2a, 36, 43, 37, 44, 45, 78a. (The distillation point of gasoline is a measurement of the temperature at which a particular percentage of the gasoline has vaporized. Thus, T10 refers to the 10% distillation point, T50 refers to the 50% distillation point and so on.) According to Complaint Counsel, Unocal wanted CARB to require a specific T50 parameter in its regulation so that gasoline made under the regulations would be covered by future Unocal patents. Compl. ¶¶ 5 ("patent

[5] With hindsight, this proved to be an accurate, though unremarkable, conclusion, since nine years have passed since the theoretical hypothetical negotiation and CARB has not elected to change its regulations so that refiners could have more flexibility to avoid Unocal's patent.

ambush"), 76, 78. Complaint Counsel maintain that without Unocal's input, CARB would have remained "blissfully ignorant" of the effects of T50 and not regulated it. Complaint Counsel's Opposition to Unocal's Motion to Compel Amended Interrogatory Responses at 2.

As shown below, the record evidence reveals that there is no dispute as to whether reducing T50 reduces emissions. In fact, CARB's own statistical analysis shows that T50 is one of the largest, if not the single largest, driver of reducing emissions of hydrocarbon pollution. Simeroth Dep. (CARB), 7/9/03, at 185:12-17. Moreover, the evidence shows that CARB became interested in regulating T50 before it ever met with Unocal and that CARB justified, and continues to justify, regulating T50 on studies other than Unocal's research. Finally, the evidence shows that CARB, facing a huge pollution problem, became convinced, and remains convinced that a T50 requirement is needed in its regulations in order to enforce and make certain that emissions reductions occur.

A. <u>The Air Pollution Problem</u>

In 1989 Californians were confronted with serious air pollution caused in significant part by vehicles using gasoline and diesel fuel in their internal combustion engines. The problem was so severe that policymakers were engaged in a serious debate whether motor gasoline (with its already existing infrastructure for production, distribution and use in vehicles) should be replaced with an alternative, expensive fuel like methanol (which would require a new infrastructure for production, distribution and use by vehicles). *E.g.*, Jessup IH Dep. (Unocal), 1/25/02, at 8:6-9:13.

One of California's agencies, the California Air Resources Board, was charged with the responsibility of adopting regulations which would achieve the maximum reductions in pollution caused by vehicular sources as quickly as possible. CAL. HEALTH & SAFETY CODE § 43018(a) (requiring CARB "to achieve the maximum degree of emission reduction possible from vehicular and other mobile sources . . . at the earliest possible date"). At the same time, the Environmental Protection Agency of the United States ("EPA") was charged with mandating its own plan for California to reduce air pollution in the event that California did not timely develop an acceptable plan to do so. *See* Pedersen Rpt. at 6. Thus, California was under both state and federal mandates to achieve drastic emissions reductions.

Facing regulators motivated to regulate, the refining industry and automobile manufacturers came together to jointly conduct research into how gasoline emissions could be reduced for the express purpose of influencing potential regulations at state and national levels. RX 226 at U0003028-29. This research project became known as the Air Quality Improvement Research Program ("Auto/Oil"). This group proposed testing certain aspects of gasoline composition and physical characteristics to determine whether it was feasible to modify gasoline properties to reduce gasoline emissions. By written agreement, and in accordance with antitrust guidelines on such industry collaborations, its members acknowledged that the work done by and paid for by the group jointly could not be patented and that the joint work would not remain confidential. At the same time, members were free to conduct research independently of the program and to maintain for themselves whatever benefits that research yielded. RX 226 at U0003040-41.

This freedom to engage in independent research is highly relevant to this case because of a decision made by the Auto/Oil group regarding the scope of its research. The group decided to examine only four characteristics of gasoline within narrow ranges of variability for each aspect examined. Jessup IH Dep. (Unocal), 1/25/02, at 73:14-75:4; Croudace IH Dep. (Unocal), 2/20/02, at 54:14-56:15; 58:12-59:17. As a result, Unocal undertook the research that yielded the patents that are at the heart of this litigation.

B. <u>The Unocal Study</u>

Two scientists at Unocal, Drs. Peter Jessup and Michael Croudace, had proposed to industry that a broader, more comprehensive design be used. Jessup IH Dep. (Unocal), 1/25/02, at 73:12-75:5; Croudace IH Dep. (Unocal), 2/20/02, at 54:14-55:5; RX 760 at U0095462-63. The proposed design contemplated many other prospects for potential change in gasoline and in addition proposed widely varying ranges within each property or characteristic. *Id.* The Unocal scientists' proposal was rejected. *Id.*

Convinced that Auto/Oil was being motivated by politics more than science and hoping to find true scientific rational as a basis for regulatory action, the inventors conducted their own study. CX 142; *see also* RX 760; Croudace IH Dep. (Unocal), 2/20/02, at 58:23-59:11. Their research led to many new discoveries, including a dramatic new understanding of which physical properties and compositional characteristics affected exhaust emissions for particular pollutants, and importantly, which ones did not. *E.g.*, RX 761. The scientists, using their expertise, conducted a statistical analysis of the experimental data. Based on the results of that analysis, the scientists developed equations (using the various properties of motor gasoline they had identified as having an effect on emissions) which could predict the amount of individual pollutants coming from the exhaust emissions of an automobile. *Id.* at UNO 013-0345-52. Again, using their expertise, the scientists developed and defined new and novel ranges of compositions of gasoline which would simultaneously reduce all three criteria pollutants.

Jessup and Croudace then approached their management with some of their conclusions and were granted additional confirmation funding on May 14, 1990. CX 176; Croudace IH Dep. (Unocal), 2/20/02, at 102:7-102:10 ("The 5/14 project is the—is actually a date, and it's the date at which we got approval to go forward with our ten-car fleet"). Jessup and Croudace verified their results in a ten-car study, which yielded similar but slightly different results. RX 11 at CARB10004442, 10004449-50; Croudace IH Dep. (Unocal), 2/20/02, at 164:4-19 (stating that "there was an additional variable [, aromatics,] that we found to be pertinent").

C. <u>The Patent Application Process</u>

By July of 1990, the scientists had drafted an internal invention disclosure document describing just some of the aspects of their invention, in accord with company policy. RX 761. The disclosure went through the usual course of being reviewed by a "conception committee" and was sent to Unocal's patent group with instructions to file an application for a patent. *See* Jessup Dep. (Unocal), 6/11/03, at 139:25-140:7. Unocal's chief patent counsel decided to handle the application himself and would file the application on December 13, 1990. RX 852 at UFTC 004615; *see also Union Oil Co. of Cal. v. Atlantic Richfield Co.*, 208 F.3d 989, 993 (Fed. Cir. 2000).

The patent application itself claimed compositions of unleaded fuel, suitable for combustion in an automotive engine, having certain defined ranges for commonly understood measurement tools: paraffin volume percentage, olefin volume percentage, Reid vapor pressure, octane number, and distillation points for 10%, 50% and 90% (referred to as T10, T50 and T90, respectively). RX 852 at UFTC004622-71. The application was later separated into later filed applications (referred to as continuation applications) claiming methods of refining, distribution and combustion of gasolines with certain defined ranges. As is common practice, the prosecuting attorney amended the claims throughout the course of the application in order to simplify issues for the examiner in light of publications or other documents made of record in the proceeding. RX 852 at UFTC004774-809. In February 1994, the Patent and Trademark Office ("PTO") issued to Unocal the '393 patent.

Complaint ¶ 9; Answer ¶ 9. The PTO continued its evaluation of Unocal's continuing applications through 2000 when it issued the fifth patent arising from Unocal's application. Answer ¶ 15.

D. <u>The Inventors' Desire for Publication and Credit for Their Discoveries</u>

Having made what they considered to be truly significant discoveries, Croudace and Jessup were anxious to have their discoveries published and/or put to use and to receive credit for their work. On November 27, 1990, Croudace wrote his manager, Wayne Miller, and told him that *it is inevitable* that other studies to be conducted in the immediate future would uncover for CARB two of the key variables to reducing emissions—including T50—and that CARB would then regulate these variables in their Phase 2 regulations. RX 764 at U0001818. Referencing others' previous or future studies, Croudace told Miller that if Unocal intended to use its results to its advantage in the marketplace and/or to influence CARB that "we have to use our information now." *Id.* Although Complaint Counsel have attempted to portray this memorandum as evidence of intent to use the information to induce CARB to adopt a T50 specification, it is evident from the face of the memorandum that "influencing CARB" did not, and could not, mean trying to convince CARB to include a T50 specification in its regulations, as Croudace acknowledged that *it was inevitable* that this would occur without Unocal's input. *Id.*

Croudace and Jessup peppered their superiors with various memorada or presentations in which they raised various justifications for telling others about or otherwise using parts of their discoveries. For example, in a memorandum dated December 11, 1990, the scientists argued for an opportunity to go to Auto/Oil and present an alternative analysis of Unocal data which would suggest that a mathematical construct of T50, T90 and T10 (known to the industry as a Driveability Index ("DI")) was a key variable to reduce emissions and not just the T90 parameter that Auto/Oil was investigating. CX 3005 at U0001830. This option, they argued, would "leave the door open" for Unocal to use its research results and license gasoline formulations to other oil companies. *Id.* The scientists also argued that allowing publication of research results could allow Unocal to avoid expensive equivalency testing with the EPA or that publishing could make their CEO a hero in the oil industry by showing scientifically that emissions from gasoline could be reduced.

The scientists also argued that because their work showed low olefins reduced emissions that Unocal could benefit from a regulation which recognized this fact since one of its refineries did not produce olefins. Attempting to generate interest, Jessup and Croudace spoke of $114 million in royalties per year. *Id.* Jessup and Croudace have both admitted in their depositions that this dollar figure was "totally off the wall" and "pulled out of the air" to try and get management's attention for their work as neither has any expertise in licensing. Jessup IH Dep. (Unocal), 1/25/02, at 36:18-38:11; Croudace IH Dep. (Unocal), 2/20/02, at 271:19-273:1. In any event, the request to make such a DI presentation to Auto/Oil was not approved by management and did not go forward.

Persistent in the attempt to receive credit for their work and to show management that it should not cut scientists from Unocal's budget, the two scientists created a poster-board showing a billion dollar figure at some point in 1991, although the date has never been specifically determined. CX 2. From time to time, Unocal had "in-house" presentations for their management where various poster-boards were set up to give management an idea of what various projects the scientists had been working on at their science and technology building. Jessup IH Dep. (Unocal), 1/25/02, at 91:5-94:18; Jessup Dep. (Unocal), 6/11/03, at 85:19-86:6. Again the testimony reflects that this poster-board was an attempt to get management's attention to the importance of having research work conducted. Jessup IH Dep. (Unocal), 1/25/02, at 94:24-95:13, 96:2-96:10. As the scientists both recognized, it was not their decision to make for Unocal as to how the research would be used or whether it would be used to advocate for or against any regulations.

Complaint Counsel attempt to use the memoranda from the inventors to cast aspersions on the motives of Unocal. But the executives at Unocal with decisional authority, including those who managed the process of interacting with CARB regarding the Phase 2 regulations, not only rejected the inventors' recommendations, but lobbied for a policy that is the diametric opposite of that ascribed to the company by Complaint Counsel.

E. Unocal's Decision to Advocate for a Pure Predictive Model

Unocal management opposed any regulations by CARB, arguing that a program to remove older and higher polluting cars from highways would be less expensive and more effective. *E.g.*, Beach IH Dep. (Unocal), 1/23/02, at 41:13-43:2. But part of what caused Unocal management to oppose the specific regulations being discussed by CARB was the mandate that oxygenates be included in motor gasoline, which, in the context of California, meant an oxygenate known chemically as MTBE. Stegemeier Dep. (Unocal), 6/5/03, at 43:1-7; RX 756. From a competitive standpoint, Unocal had no means of producing MTBE which would necessarily mean having to either build expensive facilities for such production or having to buy it on the market at a disadvantageous cost. Lamb IH Dep. (Unocal), 1/16/02, at 28:11-29:3. Coupled with that concern was the fact that the regulations being discussed were estimated to cost hundreds of millions of dollars for reconfiguration of Unocal's refineries.

What Unocal's research revealed was that MTBE, contrary to what its largest producer ARCO was espousing, did *not* have an effect on emissions from modern technology cars. Instead, Unocal's research showed that the effects commonly attributed to MTBE were coming from a depressed T50 distillation point. Lamb IH Dep. (Unocal), 1/16/02, at 29:4-13. Since the inclusion of MTBE typically lowers the T50 in a gasoline, the true effects of T50 were being masked by those who assumed it was MTBE itself which had the emissions effects. *Id.* Moreover, since Unocal's research showed that there were multiple ways, and not just one recipe, to reduce emissions from gasolines, there was no need to mandate specific minimum or maximum limitations on individual fuel parameters as CARB was suggesting would be done.

Thus, instead of advocating for any specific limitations on individual properties, Unocal management decided instead to advocate before CARB for the adoption of what Unocal dubbed a "pure" predictive model—a performance based regulation without limits on specific motor gasoline properties. Such a model would have not required any specific gasoline composition to be made to comply with the regulations. Rather, CARB would set the emissions reductions required and leave to the refiners how to achieve the reductions. Lamb IH Dep. (Unocal), 1/16/02, at 39:2-42:11; Beach IH Dep. (Unocal), 1/23/02, at 41:16-43:2, 62:6-63:22; Beach Dep. (Unocal), 6/19/03, at 23:3-25:4.

The underlying decision by Unocal to advocate for such a pure predictive model is reflected in several memoranda authored by Dennis Lamb of Unocal, who headed Unocal's fuel issues team. On October 2, 1990 Lamb set out a background of arguments that had been previously made by others as to how Unocal might use the information from the 5/14 project, including the suggestion that an effort be made to have the specifications adopted by EPA and CARB reflect the 5/14 conclusions. RX 151 at U0101212. Lamb argued against that suggestion, instead recommending that Unocal continue to argue for performance standards and against formula regulations. RX 151 at U0101212; see also Beach IH Dep. (Unocal), 1/23/02, at 134:20-136:12. Lamb further recommended that the 5/14 findings be kept secret as a potential alternative for complying with any regulations that might be passed (often referred to as a certification alternative). Lamb's recommendation was adopted by Unocal management on October 16, 1990. Lamb IH Dep., 1/16/02, at 44:25-46:13, 156:13-157:18.

On February 18, 1991, Lamb described the adopted strategy in a memorandum to Roger Beach:

- Advocate unrestricted (pure) equivalency provisions in CARB Phase II regulations.

- Focus on keeping oxygen levels unrestricted in CARB regulations.

RX 765.

By May 10, 1991, Lamb had contacted CARB and requested a meeting in the future between CARB and Unocal, although he had not told CARB the purpose of the meeting. CX 240 at U0077008. On that date Lamb internally described what he envisioned the meeting's purpose to be:

> The purpose of the meeting should be to convince CARB staff *that predictive equations or vehicle testing in particular should not include unnecessary minimums or maximums on fuel parameters* (*e.g.* oxygen). Including such factors as minimum 2% oxygenate could be less cost-effective. *If performance standards are met or exceeded the fuel parameters should be allowed to float to represent the individually optimized refinery.*

Id. (emphasis added).

Consistent with Unocal's findings that it was T50—and not the oxygenate MTBE—which had an effect on emissions, Lamb listed as a second priority "to convince CARB of the importance of T50." *Id.* The reason Unocal wanted to convince CARB of T50's importance, however, was not because Unocal wanted to see to T50 included as a parameter in the regulations. Lamb IH Dep. (Unocal), 1/16/2002, at 199:9-201:22 ("the basic purpose is in its context with a predictive model and the oxygen standard. And the ability to have flexibility within the model, and particularly for the oxygen standard, depended upon a good understanding of T50."); *see also* Beach IH Dep. (Unocal), 1/23/02, at 62:06-63:22 ("[W]e did not want them to adopt T50 in any way, shape or form, we wanted them to use a predictive model to predict the results of exhaust emissions and leave all the parameters out of this thing."). Unocal adopted this approach with some hesitation. The company felt that it was taking a calculated risk in sharing its T50 results with CARB and that its efforts could backfire and be used by CARB to justify the type of regulation that Unocal in fact opposed. Beach IH Dep. (Unocal), 1/23/02, at 61:1-62:5 ("It was a risk we were taking that showing them that data they might fall in love with T50."). During the Phase 2 rulemaking proceeding later that year, Unocal publicly opposed CARB's proposal to regulate T50, and argued that such a specification was unnecessary. RX 10 at CARB10000315.

F. <u>CARB's Development of Phase 2 Regulations</u>

By the beginning of 1991, CARB staff was involved in developing proposals for regulations, referred to as Phase 2 regulations, that aimed to reduce emissions by mandating the reformulation of gasoline by mandating that certain properties of gasoline have certain rigid limitations. An "internal use only" CARB memorandum, dated January 30, 1991, detailed CARB's potential list of properties to regulate, including "distillation temperature distribution." RX 267 at CARB 0010105. CARB anticipated that a study known as ARB/WSPA/GM[6] would produce justification for a regulation on distillation characteristics in time for a September 1991 regulatory proposal. *Id.*

At least five months before Unocal engaged in any petitioning of CARB regarding its Phase 2 regulations, CARB had already concluded that "*it is critical for the purposes of the study [a proposed pre-regulation study] and regulation to have lower T50.*" RX 113 (emphasis added).

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[6] WSPA is Western States Petroleum Association.

CARB also sought and received information about the importance of T50 in reducing hydrocarbon emissions from other sources before becoming aware of Unocal's research. For example, in April 1991, CARB staff attended a meeting with Toyota, where the auto manufacturer lobbied CARB as to the importance of T50 in reducing emissions. Venturini Dep. (CARB), 5/13/03, at 169:22-170:10; 174:15-175:15; RX 19; *see also* Fletcher Dep.(CARB), 7/8/03, at 132:10-135:1. Thus, CARB was focused on T50 as an important specification before Unocal ever met with CARB during the Phase 2 process.

[redacted] 180; Courtis Dep. (CARB), 8/28/03, at 200:11-201:1 (testifying that by June 7, 1991, CARB was interested in potentially regulating T50 based on information received from Toyota and driveability information). This focus led the CARB staff to inquire [redacted] because CARB was interested in regulating T50. RX 180; Fletcher Dep. (CARB), 7/8/03, at 162:1-163:6.[7]

G. Unocal's Communications with CARB Staff

On June 20, 1991—several weeks after CARB's meeting with ARCO—Unocal met with CARB staff to discuss Unocal's research studies. The meeting itself, as well as the presentation slides prepared by Unocal for that meeting, were understood by CARB to be confidential. RX 24.

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7 [redacted]

A separate "ACTION STEPS" slide shows Unocal's advocacy in bullet point form, reflecting the three things Unocal desired:

- "AVOID RULES OVERLAP" meaning that Unocal did not want to have to comply with potentially conflicting rules promulgated separately by the Federal EPA as well as from California;
- "ADOPT PREDICTIVE MODEL"; and
- "AVOID RFG O2 MANDATE" by allowing the model to work.

RX 24.

These action steps reflect precisely the decisions Unocal management had made for advocating regulatory change. This proposed course of action rebuts completely the suggestion by Complaint Counsel that Unocal's desire from this meeting was to convince CARB to regulate T50 as a parameter. Importantly, Unocal was not attempting to identify for CARB what recipes or compositions of gasoline CARB should regulate. Such an approach would have been antithetical to the predictive model approach whose benefit was not identifying any single composition of gasoline as a regulatory requirement. Croudace IH Dep. (Unocal), 2/21/02, at 243:15-244:11 (stating that during the June 20, 1991 meeting, "we didn't want to level any focus on any one parameter or two parameters, because that is exactly what we're trying to eliminate"); *see also id.* at 242:5-243:7. To the contrary, Unocal identified in a separate slide a fuel with higher limits than CARB was then publicly proposing as an example of how rigid fuel limits were not necessary. RX 24 at 037.

Although no one seems to recall who made the request, CARB staff evidently asked Unocal by July 1, 1991, to disclose the equations which Unocal had referenced in its presentation. RX 2. By letter dated July 1, 1991, Unocal's Mike Kulakowski, writing for Dennis Lamb, confidentially enclosed the equations. *Id.* In this letter, Kulakowski stated that if CARB were to pursue a meaningful dialogue on a predictive model approach to Phase 2 gasoline, Unocal would consider making the equations and supporting data public as required to assist in the development of a predictive model. *Id.*

In addition to seeking Unocal's equations, CARB also subsequently asked Unocal to provide the raw emission data from Unocal's 10-car study. Although CARB's request is not documented, records show that Unocal sent CARB a disk with such data, dated July 25, 1991. Chan Dep. (CARB), 8/29/02, at 9:2-7; Boyd Dep. (CARB), 8/22/03, at 193:23-194:8. The disk was received by CARB by August 2, 1991, because CARB copied the data into its computer base on that date. RX 121, RX 124; Cleary Dep. (CARB), 8/7/03, at 83:17-84:3. At the time CARB received the disk, Unocal had not yet released the confidentiality of this data.[8]

H. <u>CARB's Development of a Draft T50 Specification</u>

No later than July 21, 1991, (*before* receiving Unocal's data) CARB staff prepared two internal drafts of proposed Phase 2 regulations, one of which specified a T50 value of 190° F and the other of 200° F. RX 198 (190° F); RX 184 (200° F); *see also* Boyd Dep., 8/22/03, at 217:19-218:13 (testifying that CARB staff recognized and internally discussed ARCO's EC-X formulation as establishing a foundation for the Phase 2 regulations). [redacted]

[8] Although a file containing the data was allegedly created on August 2, 1991, at the Teale Data Center, there is no documented evidence that CARB ever accessed or considered the data before the conclusion of rulemaking. Attorney Goldman for the State of California represented that CARB had no proof or documentation that indicated that anyone accessed the data from August through October 1991. Chan Dep. (CARB), 8/29/03, at 26:3-26:18.

On August 1, 1991, before CARB had permission to make public use of any of Unocal's research data,[9] CARB published a draft of its proposed regulation that specified a T50 value of 200°. RX 184. [redacted]

CARB continued to modify its regulations in response to ARCO's direction on particular specifications and particularly T50. [redacted]

As proposed, the regulations were viewed by the industry as embracing ARCO's EC-X formulation. RX 504. The California Air Resources Board ultimately ended up passing regulations that were substantially similar to the properties of ARCO's EC-X gasoline. ARCO's EC-X gasoline met all of the Phase 2 specifications with the exception of the oxygenate requirement. RX 330; Boyd Dep. (CARB), 8/22/03, at 241:24-243:12. Adoption of the Phase 2 regulations was seen by the industry as a victory for ARCO. RX 503 at 008. Former CARB executive officer Jim Boyd and staffer John Courtis acknowledged that they were cognizant of criticism that they had simply endorsed ARCO's formulation, which according to Mr. Boyd was the "type of criticism one seeks

[9] Without the right to use Unocal's data publicly, CARB had no ability to base a regulation on that data or otherwise rely on it. Simeroth Dep. (CARB), 7/9/03, at 145:25-148:8; Boyd Dep. (CARB), 8/22/03, at 230:11-236:13; Venturini Dep. (CARB), 5/13/03, at 29:15-18.

to avoid if you want to remain in existence." Boyd Dep. (CARB), 8/22/03, at 217:19-218:13; Courtis Dep. (CARB), 8/28/03, at 113:22-228:19.

I. Unocal Agrees to Lift the Confidentiality of its Data in Response to CARB's Announcement That it Would Consider a Predictive Model

In its August 1 draft regulation, CARB had announced that it would consider adopting a predictive model. RX 184 at CARB10003064-65 (§ 2265) (Certified Gasoline Formulations Resulting in Equivalent Emission Reductions Based on a Predictive Model)). In doing so, it indicated: "The ARB intends to develop predictive models based on past and current vehicle emissions testing programs. The ARB is interested in obtaining any information or data that should be considered in developing the models."

Unocal's internal fuels issues team met on August 22, 1991 to discuss CARB's proposal. RX 155 at U0083539. At the meeting, the team discussed concerns with CARB's proposal and the need for a predictive model that was truly flexible. *Id.* To ensure that the model was as well-founded as possible, Unocal decided to waive its rights to the confidentiality of its data so that CARB could use it in the development of the model. *Id.* Unocal documented this decision in minutes of this meeting, noting:

> Unocal wants to make sure that CARB understands that the proposed form of the predictive model does not truly give the industry "flexibility" in the certification process . . . In order to insure that the predictive model is as well-founded as possible, Unocal will send CARB a waiver to release the 514 Project emissions data. . .
>
> One Unocal-specific example of why we want a full term predictive model is so that refineries such as SFR are able to take advantage of their ability to produce at lower sulfur and olefin levels than competition.
>
> CARB is interested in having a predictive model workshop in the near future. Unocal will notify CARB that it will waive its rights to the confidentiality of the 514 Project data.

RX 155.

Shortly after this internal meeting, on August 27, 1991, Unocal's Denny Lamb sent a letter to CARB's Executive Officer, James Boyd. RX 3. After indicating that the subject of the letter concerns the "PUBLIC AVAILABILITY OF UNOCAL RESEARCH *DATA*," Lamb wrote:

> On June 20, 1991, certain Unocal representatives met with Peter Venturini and other members of his staff. During that meeting, we presented the results of three phases in Unocal's Vehicle/Fuels testing program. We subsequently made the data base available to the staff and agreed to make the data public if necessary in the development of a predictive model for use in the certification of reformulated gasoline.
>
> The staff has now proposed to develop such a predictive model and requested that we make the data public.
>
> 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.

Id. (emphasis added).

What should be self-evident from this letter is that the *data* referred to in the last paragraph of the letter is the *data base* specifically identified in the letter as having previously been made available to CARB staff.

A contemporaneous memorandum prepared by Mr. Lamb on August 28, 1991, the day after Mr. Lamb sent his letter to CARB demonstrates Unocal's intent to release confidentiality of Unocal's data for use in the predictive model. In that memorandum, Mr. Lamb stated:

> CARB has advanced from agreeing to "consider" a predictive model to proposing that a model be included as a certification alternative along with a recipe fuel and vehicle testing.
>
> CARB has not yet developed a specific proposal to define the model but Unocal has been invited to participate in a workshop for that purpose. We have agreed to make

> our 5/14 data public in order for CARB to use it at the workshop and in technical justification for the model. . . .
>
> At this point in time all activity is concentrated with CARB staff with the next step the actual development of a useful model.

RX 157.

J. What CARB Staff Said about the Letter under Oath in 1996

In depositions in 1996, CARB staffers were uniform in their interpretation of this letter. All simply spoke of the confidentiality of data being lifted, so that it could be used in the development of a predictive model, refusing to agree the letter meant anything more. No one testified that they understood the letter to represent a statement by Unocal that it was waiving its patent rights.

CARB staff person Peter Venturini testified as follows:

> A. This letter refreshes my— my memory that around August 27 Unocal agreed to release the data.
>
> Q. Okay. And what did you understand was the permission that Unocal was giving you at that time?
>
> [Objection noted]
>
> A: Well I can just reiterate the letter indicates *that they're releasing the data to be publicly available because we have proposed to develop a predictive model* . . .
>
> Q. And did you understand that CARB could use the information to promulgate regulations that included a T50 specification? . . .
>
> A. That's—*I can't infer that from reading the letter and I don't have a recollection of that specifically.*

Venturini 1996 Dep. (CARB), 6/18/96, at 136:23-138:7 (emphasis added); *see also* Venturini Dep. (CARB), 5/13/03, at 115:6-116:20.

James Boyd (the CARB representative to whom the underlying letter was addressed, although the letter was sent to Dean Simeroth):

A. I don't recall the letter. Undoubtedly I saw it, but I don't—I no longer recall it. And like I said, in the context of debates back and forth among who will and who will not make data and formulations public, I think this—I just received it in that context if—if certainly I'm unlikely—undoubtedly I probably saw this, but I frankly don't recall that far back.

Q. . . . Does this by chance refresh your recollection with regard to any particular information that came to your attention about Unocal and their position on releasing information or not releasing information?

A. No, I don't recall anything specific. I don't remember anything unique to Unocal.

Q. Do you recall any information about Unocal having granted some permission to the California Air Resources Board with regard to its submissions to California Air Resources Board?

[Objection noted]

A. Again I don't recall anything unique to Unocal.

Boyd 1996 Dep. (CARB), 6/19/96, at 45:24-46-20.

Dean Simeroth (the CARB representative who received the letter):

Q: And you understood that through this Exhibit 656 Unocal was making its data previously which had been marked confidential, it was now making it public?

[Objection noted]

A. *Reading the letter, it would indicate or indicates that they were making the previously submitted data available.*

Simeroth 1996 Dep. (CARB), 6/20/96, at 56:21-57:3

Bob Fletcher, a CARB staff person testified as follows at pages 203-204:

A. I don't recall who asked Unocal to make the data non-confidential. I can't remember whether I did or—or one of my staff did or Dean did or Peter did, *but we did ask Unocal to make the data available so that we could include it in the predictive model* and felt that it was a data set that was very important in the development of the—the predictive model, which again at that point was—was still considered as part of the Phase 2 regulation. So in order—I think it's consistent with what I said earlier, that *we were getting the data, we were evaluating it, and it wasn't until a certain point in time that we needed to consolidate it in with the other data. In order to do that, we had to make it nonconfidential. If they would have kept it as confidential data, we would not have been able to include it into the—the mega-data base of all the vehicle tests.*

. . .

Q. Other than what you've described for me, were there discussions within CARB about this letter?

A. I don't recall. My—my sense was that they had done what we wanted them to do and that was that.

Fletcher 1996 Dep. (CARB), 6/17/96, at 203:20-204:23.

The suggestion, then, that the letter somehow misrepresented the status of Unocal's patent rights is not supported by the deposition testimony of any of the witnesses deposed in the previous litigation. Curiously, these same witnesses now attempt to assert that they believed the word "non-proprietary" was a representation of non-ownership in anything that Unocal presented to them, including data, presentation slides and equations and any intellectual property rights Unocal might have relating to its inventions.

K. Unocal's Other Publication of its Research

Consistent with its belief that CARB would hold a workshop and assemble data from many studies in order to develop a predictive model, Unocal made a presentation to the Auto/Oil group in September of 1991. The slides used in this presentation were very similar to the slides shown to

CARB but also included the equations developed from the company's ten-car study.[10] Jessup IH Dep. (Unocal), 1/25/02, at 124:17-125:3.

An antitrust lawyer present for the Auto/Oil group, David Meyer, wrote in his minutes from that meeting the following: "Mr. Jessup explained that the data from Unocal's research has been provided to CARB and is in the public domain." RX 231 at RPC 00036. Dr. Jessup has testified that he does not believe he used the words "public domain" in his presentation. Jessup IH Dep (Unocal)., 1/25/02, at 125:4-12. Asked in 1996 whether these were Dr. Jessup's actual words and whether they meant anything other than accessible to the public, attorney Meyer responded:

> Q. Do you have any other independent recollection of Peter Jessup's comments on that topic?
>
> A. Well, as I sit here today, *I have no specific recollection of precisely what he said to me that led me to author that sentence.*
>
> Q. Would you look at the last phrase in that sentence where it says "in the public domain."
>
> A. All right.
>
> Q. What do you understand that phrase to be referring to?
>
> A. Well, my understanding as I sit here today of what that phrase is intended to refer to is my understanding that by virtue of the fact that Unocal's research had been provided to CARB that research, *that data was available to any interest—any interested party who may want to access the data.*

Meyer Dep. (Auto/Oil Attorney), 7/23/96, at 23:1-5, 24:16-25:2 (emphasis added).

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[10] The Society of Automotive Engineers published in 1992 an article written by Unocal discussing the one-car, ten-car and thirteen-car studies, together with the equations and coefficients from those studies. RX 771. Such publication, after filing of a patent application, does not in any way affect the patentability of the claims of the application. Linck Rpt. at 10. It is not uncommon to publish research findings after the filing of a patent application without making reference to whether an application has or has not been filed. *Id.* CARB staff reviewed the article and took no action whatsoever based on it. Cleary Dep. (CARB), 8/7/03, at 36:2-41:17, 166:5-167:1.

Consistent then with what Unocal had told CARB staff, Unocal's *data* was being made publicly available for others to study, analyze or include with others' data for analysis.

L. <u>CARB Staff Proposes its Phase 2 Regulations</u>

CARB staff formally proposed a set of regulations in October of 1991 in the form of a lengthy Staff Report and accompanying Technical Support Document ("TSD"). RX 52; RX 5. Through these documents, CARB articulated the need for its regulations, as proposed, based on state and federal statutory mandates, the amount of pollutants it estimated would be removed as a result of the regulations and through an analysis of cost-effectiveness.

1. <u>Statutory mandates</u>

In its justification for the regulations, CARB pointed out that motor vehicle fuel emissions are a significant source of the criteria pollutants carbon monoxide, volatile organic compounds and oxides of nitrogen and that many areas in California exceed the state and federal standards for criteria pollutants. RX 5 at CARB0000706. The Staff Report emphasizes that CARB "needs to take action to reduce further emissions from motor vehicles to improve air quality and to fulfill statutory requirements." RX 52 at 008. Further, the report acknowledged that "the California Clean Air Act requires the ARB to achieve the maximum degree of emission reductions possible from vehicular and other mobile sources in order to attain the state ambient air quality standards at the earliest practicable date." *Id.* The report further set out the EPA requirements under the Federal Clean Air Act which required specific reductions in volatile organic compounds by 1995 and even further reductions by the year 2000. *Id.* at 009.[11]

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[11] Environmental regulation expert Bill Pedersen, former Deputy General Counsel of the EPA, explains at length in his report the lack of any alternatives to CARB for achieving the (continued...)

2. **Emissions reductions**

In estimating the amount of reductions of emissions to be achieved for purposes of the cost-effectiveness analysis, CARB used no information that came from Unocal. CARB instead used two methodologies using regression equations developed by Auto/Oil and ARCO EC-X fuels. Chan Dep. (CARB), 8/29/03, at 46:2-56:16; RX 5 at CARB0000758-64.

3. **Cost-effectiveness calculation**

Although Complaint Counsel may argue that cost considerations were of paramount importance to CARB, the record shows that CARB did not place great priority in the methodology of how it would examine costs. For example, throughout the rulemaking process, CARB staff publicly explained that it would conduct its *own* cost analysis using a linear program methodology to be developed by Bechtel Corporation. *E.g.*, RX 167 at WSPA-FTC0007362; Aguila Dep. (CARB), 7/24/03, at 30:17-31:16, 88:10-89:18; Fletcher Dep. (CARB), 7/8/03, at 67:9-15. Completion of this model, however, was not accomplished before the October 4, 1991 staff proposal of the regulations and would never be completed. RX 52 at 071; Aguila Dep. (CARB), 7/24/03, at 81:23-83:1.

CARB ended up justifying its cost analysis *not* on the basis of Bechtel's LP model but on the voluntary submission of cost information from just a few refiners. CARB staffer Jim Aguila, who was responsible for the cost-effectiveness work, testified that a general request went out late in the process asking refiners for their expected costs. Aguila Dep. (CARB), 7/24/03, at 51:11-52:19,

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[11] (...continued)
reductions in emissions needed. *See generally* Pedersen Rpt.

53:1-54:18, 89:20-91:12. Out of thirty refineries, only six responded with any information.[12] Simeroth Dep. (CARB), 7/9/03, at 234:23-235:12. Out of those six, only two provided the estimated cost information for capital investments and operating expenses. Aguila Dep. (CARB), 7/24/03, at 164:25-165:10; RX 52 at 071. Yet CARB continued to state in its October proposal that the Linear Program cost methodology would be finished in time for the Board hearing. RX 52 at 079. It never was completed. Instead, CARB used the two refiners' information to estimate operating costs and then extrapolated costs for the rest of the industry.

That cost-effectiveness calculation estimated that it would cost $8,000 to $12,000 per ton of pollution removed. RX 5 at CARB0000841. CARB used as a comparison in its Technical Support Document ("TSD") other adopted regulations which included upper cost bounds up to $32,000 per ton. RX 5 at CARB0000853. The reason for setting out the cost of previous regulations is made evident by CARB's Cost-Effectiveness Guidance document, a document specifically referenced in the TSD. RX 195. In that guidance document, it is emphasized that any amount lower than the upper cost bound of a previously adopted regulation is deemed cost-effective.[13] RX 195 at CARB-FTC 0039612.

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12 [redacted]

13 Using this same methodology, if one were to assume for simplicity that Unocal would charge a royalty of two cents per gallon on 100% of CARB summer-time gasoline (which is actually higher than what Unocal is willing to license for), adding such an amount to CARB's analysis would yield a range of $9,200 to $13,200. Such a range does not change the cost-effectiveness determination since this amount is still well below the upper cost bound of $32,000 used in the TSD. Courtis Dep. (CARB), 8/28/03, at 56:17-58:19.

4. Support for parameters regulated

Also, included in the Technical Support Document was a discussion of the impact of gasoline properties on emissions. While Complaint Counsel argue that Unocal's research was the basis for CARB's regulation on T50, the Technical Support Document in fact takes a broader view of the various studies which justified regulating T90 and T50. For example, CARB had previously considered regulating distillation properties not by their individual T50 and T90 limits, but through the drivability equation, which itself is a mathematical product of T10, T50 and T90. *E.g.*, RX 184 at CARB10003057. Although CARB decided to not regulate distillation in this fashion [redacted] CARB still justified its regulations on T50 and T90 through reference to studies looking into the effects of Driveability Index. RX 73; RX 5 at CARB000724-32.

In the Technical Support Document, staff pointed out that the GM/WSPA/ARB study looked at the effects on emissions of a lower vapor pressure and DI and concluded that the results were similar to the results from Auto/Oil, Unocal and ARCO studies "if one considers that DI reductions in this study are achieved solely through reductions in T50 and T90." RX 5 at CARB0000720. CARB further found that the results of this study "could also be looked at as representing the combined effects of T50 and T90 on exhaust emissions." *Id.* CARB concluded that lowering DI and RVP together will decrease exhaust emissions, citing to the GM/WSPA/ARB study as well as Chevron's work. *Id.* at CARB0000720, 726.

The agency's staff then discussed the impact on changing T50 on emissions. RX 5 at CARB 0000727-32. Citing first to Toyota and then to Unocal work, staff stated that their proposed regulation of 210° F would result in small decreases in pollutants since their baseline gasoline had an average value of 212° F. Staff declined to lower the T50 further under the belief that doing so would affect the volatility of the front end of gasoline. *Id.* Staff used two graphs from the Unocal June 20, 1991, presentation and listed Unocal's ten-car equations in its appendix.

Staff then discussed its support for T90, oxygenate, sulfur, aromatics and olefins citing almost exclusively to ARCO, Auto/Oil and Chevron studies. RX 5 at CARB 0000732-744. No explanation was given as to why staff rejected findings by Unocal on T10, aromatics, oxygenate, octane or paraffin effects.

M. <u>The November 1991 CARB Hearing</u>

CARB held its public hearing to adopt the Phase 2 regulations beginning on November 21, 1991, with the hearing being transcribed. RX 60. The actual proposal to the Board was not what had been sent out in early October, but was a modified version, as shown on page CARB00001698 of RX 60. The Board proposed its own modification at the hearing and adopted a more stringent and what was said to be more costly regulation than the modified version shown on RX 60. However, CARB no longer has any worksheets showing how it calculated the tradeoffs between cost and emissions reductions that served as the basis for the regulation as adopted. Venturini Dep. (CARB), 5/15/03, at 561:22-564:16. [redacted] remained identical in the two proposals and in what was adopted. RX 338.

At the hearing itself, ARCO was the first company to speak, other than staff who explained the proposal. ARCO spoke in favor of the regulations and stated that they mandated fuel specifications that were essentially identical to its EC-X gasoline. *E.g.*, RX 60 at CARB0001184-89. Unocal, which had already sent formal comments to the Board opposing the regulations on the grounds that they were not cost-effective, argued at the hearing for a loosening of the parameters and, in fact, indicated that the T50 specification was not necessary. *Id.* at CARB0001444 ("We don't see the spec for T50 as necessary"). ARCO, on the other hand, urged that CARB adopt strict regulations, specifically arguing that the T50 limitation not be relaxed. RX 10 at CARB0000317. Again, Unocal argued that a predictive model alternative to the regulations was preferable because of flexibility in comparison to rigid fuel specifications. In fact, Unocal argued and would continue to argue for a delay in the regulations until a predictive model was developed and adopted.

Despite having an understanding that companies could be sensitive to antitrust laws in sharing cost information (Sharpless Dep. (CARB), 8/6/03, at 165:21-166:9), the Chairwoman asked several companies during the public hearing to state their expected cost of production of RFG 2. Some answered. Unocal's Mr. Lamb declined to answer the question, stating that Unocal did not have a cost figure to provide. Lamb IH Dep. (Unocal), 1/16/02, at 72:4-25.

Another speaker at this Board hearing was Robert Cunningham of the consulting firm of Turner Mason, who had been hired by WSPA to make a presentation to CARB.[14] RX 60 at CARB0001250. Cunningham told CARB that its regulations were not cost-effective, suggested that relaxation of specifications take place and further said that the T50 specification should be dropped entirely, since there was no known way to control it. RX 60 at CARB00001273. [redacted]

The Board passed the regulation with only one negative vote. RX 60 at CARB0001649-50. It later adopted a Board resolution, which is the only document approved by the Board as to its

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[14] Cunningham was an expert witness for the major refiners during the 1997 trial, whose firm has received millions of dollars to opine at trial and in continuing reexamination proceedings in the PTO that Unocal's patents are invalid.

reasons for adoption. RX 189; Sharpless Dep. (CARB), 8/6/03, at 139:23-140:21. The Board did not adopt a predictive model as part of its regulation. Staff did indicate that a predictive model would be developed in short order. RX 189 at CARB0000254-255. However, language of the regulation adopted provided that any predictive model adopted would have to comply with the cap limits in the 1991 regulations.

Following the Board's adoption of the regulations, Unocal again wrote the Board indicating that the Board's adoption of a regulation which provided that the cap limits would have to be met for any predictive model which would later be approved threatened the viability of the predictive model as an option. RX 42. Unocal also complained of delay in adoption of a predictive model and continued to do so up until the time that a predictive model was adopted in 1994. *E.g.*, RX 39 at CARB0003235-36; CX 575 at U 0069224-25; RX 42 at CARB0004779-82. The Board made no changes as a result of Unocal's letter.

N. <u>Final Statement of Reasons</u>

Almost a year after the Board had adopted the 1991 regulations, CARB staff published its Final Statement of Reasons ("FSR"). RX 10. The regulations were then approved by the Office of Administrative Law as a regular rulemaking, which under the applicable statute, distinguishes such rulemaking as quasi-legislative and not quasi-adjudicative. The FSR is not a Board approved document, but is drafted by staff and its lawyers. Boyd Dep. (CARB), 8/22/03, at 120:3-9.

In the FSR, staff responded to comments made during the formal rulemaking as well as those within the comment period following the rulemaking on many different topics. Included in the comments were criticisms from industry, including Unocal, as to various parts of the regulations. Some of the pertinent portions include CARB's rejection of the alternative of simply following the

EPA reformulated gasoline restrictions. RX 10 at CARB0000449. CARB staff additionally justified why the regulations were necessary in order to meet federal and state statutory mandates and why the regulations were cost-effective. Specifically, the FSR indicated that the regulation would remain cost-effective even if its cost were *raised by* 25%. RX 10 at CARB0000456 ("even if the cost-effectiveness of Phase 2 RFG is changed by 25% as suggested by Unocal, the Phase 2 RFG cost-effectiveness would still be comparable to recently adopted regulations.") CARB also justified the individual parameters regulated. With respect to T50, staff states that Unocal's study formed the basis for the specification, but in response to other comments, cites to Toyota and specifically to Auto/Oil for the numerical limitations of 210° F for T50. RX 10 at CARB0000344, CARB0000315-16; *see also* Boyd Dep. (CARB), 8/22/03, at 220:2-226:2.

The FSR also documented the support by ARCO for the regulations and ARCO's specific urging that the T50 specification not be relaxed. RX 10 at CARB0000317.

O. Unocal's '393 Patent Issues

Unocal's '393 patent issued in February of 1994 with more than 150 claims. RX 793. Other competitors became aware of the patent but said nothing to CARB during CARB's June 1994 adoption of a predictive model. *E.g.*, [redacted]

Unocal, which had an additional application pending, sought outside legal assistance for the next ten months on issues relating to the patent and continue to prosecute its pending application. [redacted]

[redacted]

[redacted]

[redacted]

Unocal later disclaimed all but 41 claims of the patent. The claims of the '393 patent are composition claims of motor gasoline, claiming ranges of such gasolines through descriptions of the gasolines, vapor pressure, T90, T50, and T10 distillation points, paraffin and olefin volume percentage by hydrocarbon content and octane number. RX 793.

Unocal announced in January 1995 that it had received the '393 patent and intended to come out publicly with a licensing plan. CX 599. On February 17, 1995, CARB's executive officer, Jim Boyd, wrote to Unocal requesting a meeting. RX 47. There was no suggestion whatsoever that Unocal had defrauded CARB, or that Unocal had somehow represented it did not have or would not enforce patent rights because of the 1991 letter written by Unocal to Boyd. *Id.* Rather, CARB wanted a meeting to discuss Unocal's marketing plans, the extent of the 155 claims and their impact on CARB's regulations.

The meeting occurred on March 17, 1995. By letter dated April 13, 1995, Boyd wrote to Unocal. RX 50. Again, no suggestion was made by Boyd that Unocal had defrauded CARB or had made any representation as to ownership rights or patent rights in the 1991 letter to Boyd. Rather, Boyd sought assurance that Unocal did not intend to assert patent infringement in connection with a test program that CARB was conducting using some 450,000 gallons of summer gasoline. *Id.* Unocal gave assurance to CARB that it would not do so, while noting that its forbearance was for the stated test fuel amount because Unocal would seek licensing in the future. RX 49.

Rather than allow Unocal to roll out a licensing plan, ARCO, Chevron, Exxon, Mobil, Shell and Texaco sued Unocal in mid-April 1995. *Union Oil Co. of Cal. v. Chevron USA, Inc.,* 34 F. Supp. 2d 1222, 1224 (C.D. Cal. 1998). The suit alleged that Unocal's patent was invalid based, among other things, upon anticipation, obviousness, lack of written description, failure to disclose best mode and lack of enablement. The refiners also asserted patent misuse under the antitrust laws, inequitable conduct, implied license, unclean hands, and estoppel in arguing for unenforceability. During discovery, refiners also attempted to argue through an expert that the patent lacked utility in that the equations developed from the research were invalid. Prior to trial, the declaratory judgment action was dismissed for failure of the refiners to show that they had an objective basis to fear of imminent suit by Unocal for infringement, as opposed to the licensing plan which Unocal had announced it would roll out by the end of April 1995.

In 1996, refiners secretly sought to involve the FTC in an investigation into Unocal's patents. That attempt was rejected. Also in 1996, following depositions of CARB representatives, refiners secretly attempted to persuade CARB to join the lawsuit filed against Unocal. Kenny Dep. (CARB), 5/15/03, at 104:23-107:16. CARB's former executive officer Michael Kenny contacted the governor of California for authority to do so but was rejected, for reasons which CARB has refused to disclose based upon deliberative process privilege.

P. <u>The '393 Trial</u>

The trial involving the '393 patent occurred from July to December 1997. As described by the district court in its reported opinion, refiners had asserted that CARB and refiners had been lulled by Unocal into believing patent rights would not be enforced. The court was about to grant summary judgment to Unocal on such theories but did not, given refiners assurance that evidence would be produced at trial to justify that allegation. *Union Oil,* 34 F. Supp. 2d at 1224. At trial, however, refiners abandoned this argument. *Id.* Refiners instead argued that Unocal had derived or stolen the invention from CARB, and specifically represented that CARB staff person Peter Venturini would provide the factual basis for the derivation argument. *Id.* But Venturini's testimony did not provide such evidence and, as a result, the judge and jury rejected the derivation defense and all other defenses raised. *Id.*

The court and jury also found infringement of the claims of the patent, having first been given the claim construction by the court as to the manner in which the claims had to be construed. Specifically, the court found that simply matching the numerical measurements of a composition with the numerical limitations of the claims of the patent was not evidence that the claim covered such a composition. *Atlantic Richfield Co. v. Union Oil Co. of Cal.*, No. CV-95-2379 (C.D. Cal. May 19, 1997) (Memorandum of Decision Granting in Part and Denying in Part Plaintiff's Motion for Summary Judgment for Construction of the '393 Patent as a Matter of Law and for Lack of Novelty). More specifically, the court found that each claim of the '393 patent had limitations other than the numerical limitations expressed—namely that the composition had to be what is commonly referred to as motor gasoline, a standard automotive gasoline composition. *Id.* Given that instruction, the jury found that refiners, on average, had infringed the patent 29 percent of the time over the five-month period examined in 1996, although each refiner's individual infringement rate differed markedly. The court then entered judgment pursuant to 28 U.S.C. § 1292(c)(2) under which a judgment is final except for the accounting that must take place after appeal for the additional infringement that has occurred. *Union Oil Co. of Cal. v. Atlantic Richfield Co.*, No. CV-95-2379 (C.D. Cal. Sept. 28, 1998) (Judgment Pursuant to 28 U.S.C. § 1292(c)(2)).

That verdict and claim construction was upheld on appeal, with *certiorari* rejected by the United States Supreme Court in 2001. *Union Oil Co. of Cal. v. Atlantic Richfield Co.*, 208 F.3d 989 (Fed. Cir. 2000), *cert. denied*, 531 U.S. 1183 (2001). [redacted] refiners sought to convince the court to not apply the damage award of 5.75 cents per infringing gallon to the accounting stage. The court rejected the refiners' argument on grounds that refiners have produced no legitimate justification for not having made this factual argument at an appropriate time prior to trial.

The refiners subsequently filed multiple requests for reexamination of the '393 and the later filed '126 patent in the Patent and Trademark Office contending that the patents are invalid, using essentially the identical arguments and documents previously rejected by the judiciary. The original request for reexamination was denied by the PTO examiner, but that decision was reversed by appeal to the Commissioner. Presently, the examiner has issued preliminary rejections on all of the claims of the '393 and one of Unocal's later RFG patents, the '126 patents (see Section Q, below). The accounting action has been administratively placed on hold pending the PTO matter, with an in-court status conference scheduled by the Court for November 29, 2004.

Q. Unocal's Other Four Patents

Unocal eventually obtained four other patents issue based upon the original specification, although those patents would not issue until the years 1997- 2000. Although each of the claims of every patent requires a particular range of a combination of properties of gasoline, as well as the additional limitation of the gasoline constituting a standard automotive gasoline, the vast majority of the claims contain even further limitations. None of these further limitations have been construed by any court.

1. **<u>‘567 Patent</u>**

Issued January, 14, 1997, this patent has 40 claims, none of them composition claims, directed to methods of operation of an automotive vehicle with a particular engine and converter yielding a reduced amount of identified criteria pollutants in comparison to an identified baseline fuel.

2. **<u>‘866 Patent</u>**

Issued August 5, 1997, this patent has 58 claims, none of them composition claims, directed to a method of operation of an automotive vehicle with a particular engine and converter yielding a reduced amount of identified criteria pollutants in comparison to an identified baseline fuel, as well as methods of delivery, supply and use of identified ranges of combinations of motor gasoline.

3. **<u>‘126 Patent</u>**

Issued November 17, 1998, this patent has 40 composition claims and 26 method claims directed to the method of blending hydrocarbon streams to produce given minimum quantities of motor gasoline as well as delivery of gasoline to particular locations or facilities.

4. **<u>‘521 Patent</u>**

Issued February 29, 2000, this patent has 58 process claims directed to processes of blending gasoline of particular combinations and ranges using mathematical equations to predict particular criteria pollutants as a function of an identified parameter(s).

IV. <u>TO PREVAIL, COMPLAINT COUNSEL MUST ESTABLISH ALL THE ELEMENTS OF MONOPOLIZATION OR ATTEMPTED MONOPOLIZATION</u>

Complaint Counsel have alleged five counts against Unocal. *See* Compl. ¶¶ 99-103. The First Count alleges that Unocal has violated Section 5 of the FTC Act by wrongfully obtaining monopoly power in the technology market for the production and supply of CARB-compliant "summer-time" gasoline to be sold in California (¶ 99). The Second and Third Counts allege that Unocal has attempted to monopolize two markets: the technology market for the production and supply of CARB-compliant "summer-time" gasoline to be sold in California (¶ 100), and the downstream goods market for CARB-compliant "summer-time" gasoline to be sold in California (¶ 101). The final two counts of the Complaint—at ¶¶ 102 and 103—are based upon the same factual allegations as the monopolization and attempted monopolization claims and purport to state a generic "unfair competition" claim under Section 5 of the FTC Act.

A. <u>Section 5 of the FTC Act Is No Broader than the Sherman Act</u>

Preliminarily, your Honor should reject Complaint Counsel's attempt to argue that Counts 4 and 5 are broader than, or create liability apart from, the monopolization and attempted monopolization claims set forth in Counts 1, 2 and 3. *See* Compl. Counsel's Pretrial Br. at 9-10. The Commission has specifically rejected past attempts such as this to "expand the reach of the prohibition against attempted monopolization in the Sherman Act by condemning less offensive conduct under the purview of the Federal Trade Commission Act." *In re General Foods Corp.*, 103 F.T.C. 204, 364-66 (1984).

While the FTC theoretically has the authority under Section 5 to define and proscribe unfair competitive practices outside the scope of the antitrust laws, important limitations imposed by the

Supreme Court—together with the FTC's own reluctance to exercise the powers granted under Section 5—compel the dismissal of Counts 4 and 5 in this action. These Counts, which rely upon the exact same factual allegations as Counts 1, 2, and 3, cannot be the basis for extending the FTC's authority under Section 5.

In case after case, and in a variety of contexts, the FTC and federal courts have declined to extend Section 5 beyond the scope of the antitrust laws. *See E.I. du Pont de Nemours & Co. v. FTC,* 729 F.2d 128, 138-40 (2d Cir. 1984) (rejecting attempt to extend Section 5 beyond the scope of established Sherman Act § 1 caselaw); *General Foods*, 103 F.T.C. at 364-66 (declining to extend Section 5 in the context of alleged Sherman Act § 2 violations); *In re Grand Union Co.,* 102 F.T.C. 812 (1983) (dismissing Section 5 claim that was based on claim that acquisition that did not violate Section 7 of the Clayton Act might nonetheless violate Section 5); *see also FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1501 n.2 (D.C. Cir. 1986) (reading Section 5 as "merely repetitive of § 7 of the Clayton Act"); *In re Chicago Bridge & Iron Co.*, No. 9300, slip op. at 84 (FTC June 18, 2003) (initial decision) (citing cases and ruling that separate Clayton Act Section 7 claim and Section 5 claim challenging acquisition "are read coextensively"); *In re R.R. Donnelly & Sons Co.*, 120 F.T.C. 36, 150 n.32 (1995) ("[T]he analytical standards for assessing liability [under both Section 7 of the Clayton Act and Section 5 of the FTC Act] are read coextensively.").

The Commission has explained its reluctance to allow the enforcement of Section 5 in the monopolization context outside the judicially-delineated boundaries of the Sherman Act:

> While Section 5 may empower the Commission to pursue those activities which offend the 'basic policies' of the antitrust laws, we do not believe that power should be used to reshape those policies when they have been clearly expressed and circumscribed. Senator Cummins, a principal sponsor of the Act, explained the words, 'unfair competition,' to his colleagues as follows:

> It will be the duty of the Commission to apply those words in the sense precisely as it is now the duty of the court to apply the words 'undue restraint of trade' in the sense in which we commonly understand that phrase. 51 Cong. Rec. 13048 (1914).

> The record in this case does not offer a rationale for using the Federal Trade Commission Act to graft an extension onto Section 2 of the Sherman Act.

General Foods, 103 F.T.C. at 365.

Counts 4 and 5 in this case contain the same flaws that proved to be fatal in the above-cited cases. These two Counts refer to the same subject matter already addressed in the monopolization and attempted monopolization claims. Moreover, Complaint Counsel have articulated no appropriate or distinct standards for assessing these final two claims, and the claims appear to be based on little more than some undefined "antitrust policy." The Court should dismiss these amorphous claims and require that Complaint Counsel prove their monopolization and attempted monopolization claims under the well-established standards already developed under the Sherman Act.

B. Unocal Cannot Commit an Antitrust Violation by Lawfully Exercising its Patent Rights

The good faith enforcement of a properly procured patent constitutes a legitimate anticompetitive intent beyond the purview of the antitrust laws or Section 5 of the FTC Act. *See E.I. du Pont de Nemours & Co. v. Berkley and Co., Inc.*, 620 F.2d 1247, 1273-74 (8th Cir. 1980). By law, a patent grants its owner the lawful right to exclude others. *See* 35 U.S.C. §§ 271(a) (defining infringement), 283 (providing injunctive relief for infringement); *Dawson Chem. Co. v. Rohm and Haas Co.,* 448 U.S. 176, 215 (1980) ("[T]he essence of a patent grant is the right to exclude others from profiting by the patented invention."). This exclusionary right is granted to allow the patentee to exploit whatever degree of market power it might gain thereby as an incentive to induce investment in innovation and the public disclosure of inventions. *Valley Drug Co. v. Geneva Pharms., Inc.*, 344 F.3d 1294, 1304 (11th Cir. 2003) (citing *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 150-51 (1989); *United States v. Studiengesellschaft Kohle, m.b.H.*, 670 F.2d 1122, 1127 (D.C. Cir. 1981)). A patentee may exercise its right to exclude others by requiring users to enter into license agreements and by bringing suit against infringers unconstrained by and immune from the reach of the antitrust laws. *Cf. Walker Process Equip., Inc. v. Food Mach. and Chem. Corp.*, 382 U.S. 172, 177 (1965) (A patent "is an exception to the general rule against monopolies and to the right to access to a free and open market." (citation omitted)).

The Federal Circuit has held that the exercise of a patent holder's rights can serve as the basis for antitrust liability in only very limited circumstances, none of which is applicable here: "In the absence of any indication of illegal tying, fraud in the Patent and Trademark Office, or sham litigation, the patent holder may enforce the statutory right to exclude others from making, using or selling the claimed invention free from liability under the antitrust laws." *In re Indep. Serv. Orgs. Antitrust Litig.*, 203 F.3d 1322, 1327 (Fed. Cir. 2000) ("*ISO*"). Although the court recognized that "[i]ntellectual property rights do not confer a privilege to violate the antitrust laws," it reasoned that "it is also correct that the antitrust laws do not negate the patentee's right to exclude others from patent property." *Id.* at 1325 (quoting *Intergraph Corp. v. Intel Corp.*, 195 F.3d 1346, 1362 (Fed. Cir. 1999)). Similarly, the Court of Appeals for the Second Circuit held that "where a patent has been lawfully acquired, subsequent conduct permissible under the patent laws cannot trigger any liability under the antitrust laws." *SCM Corp. v. Xerox Corp.*, 645 F.2d 1195, 1206 (2d Cir. 1981).

There is no question that Unocal acquired its RFG patents lawfully and that its challenged conduct is lawful under the patent laws. There is no allegation in this case that Unocal has engaged in illegal tying, fraud on the PTO, or sham litigation. These facts serve as an absolute bar to Complaint Counsel's challenge of Unocal's exercise of its lawful rights under its patents. Relying on the Federal Circuit's *ISO* decision, the United States District Court for the Northern District of California dismissed an action alleging a patent "ambush" based on the complaint's failure to satisfy the *ISO* test. In *Townshend v. Rockwell Int'l Corp.*, No. C 99-0400, 2000 U.S. Dist. LEXIS 5070, at **22-23 (N.D. Cal. Mar. 28, 2000), the court held that an antitrust claim based on an alleged misrepresentation by a patent holder to a standard-setting organization regarding the terms under which it would license its patents to manufacturers of standard-compliant products could not go forward in light of *ISO*. Rejecting a challenge to the licensing terms offered by 3Com Corporation to the counterclaimant, the court held: "Given that a patent holder is permitted under the antitrust laws to completely exclude others from practicing his or her technology, the Court finds that 3Com's submission of proposed licensing terms with which it was willing to license does not state a violation of the antitrust laws." *Townshend*, 2000 U.S. Dist. LEXIS 5070, at *23.

Townshend is directly on point in the current case, in which case Complaint Counsel seek to establish liability based on the license terms that Unocal is seeking for the use of its technology. Indeed, under Complaint Counsel's theory, both the basis for Unocal's alleged monopoly power and the wrongfulness of its conduct are established by its attempt to collect a royalty that is greater than zero. Like 3Com in *Townshend*, Unocal has the lawful right to exclude others from practicing its RFG technology, and the fact that it is seeking to be compensated for the use of its technology by offering to license it cannot serve as the basis for an antitrust violation.

C. **To Establish Their Monopolization and Attempted Monopolization Claims, Complaint Counsel Will Need to Establish Each Element of These Violations**

To prevail on the monopolization claim pled in Count 1, Complaint Counsel must prove "two elements: (1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *United States v. Grinnell Corp.*, 384 U.S. 563, 570-571 (1966); *United States v. Microsoft Corp.*, 253 F.3d 34, 50 (D.C. Cir. 2001); *accord Image Technical Servs., Inc. v. Eastman Kodak Co.*, 125 F.3d 1195, 1202 (9th Cir. 1997). To prove their attempted monopolization claims in Counts 2 and 3, Complaint Counsel must establish: (1) a specific intent to monopolize, (2) anticompetitive conduct in furtherance of that intent, and (3) a dangerous probability of successful monopolization. *Spectrum Sports v. McQuillan*, 506 U.S. 447, 456 (1993); *General Foods*, 103 F.T.C. at 341; *In re E.I. du Pont de Nemours & Co.*, 96 F.T.C. 653, 725 (1980).

1. **To establish that Unocal engaged in exclusionary conduct Complaint Counsel will need to prove each of the elements of fraud**

A critical element of any monopolization offense is proof of anticompetitive or exclusionary conduct. The importance of this element lies in the fact that the antitrust laws are loath to condemn mere monopoly. *See, e.g., United States v. Aluminum Co. of Am.,* 148 F.2d 416, 429-30 (2d Cir. 1945) ("[S]ize does not determine guilt; . . . there must be some 'exclusion' of competitors; . . . the growth must be something else than 'natural' or 'normal'; . . . there must be a 'wrongful intent,' or some other specific intent; or . . . some 'unduly' coercive means must be used."). The exclusionary conduct necessary to prove an unlawful monopolization is defined as "behavior . . . other than competition on the merits—or other than restraints reasonably 'necessary' to competition on the merits—that reasonably appear capable of making a significant contribution to creating or maintaining monopoly power." III PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 651, at 83-84 (2d ed. 2002). Significantly, the antitrust laws seek to encourage rather than punish acts of a pure competitive nature. Thus:

> [A]ggressive but non predatory pricing, higher output, improved product quality, energetic market penetration, successful research and development, cost-reducing innovations, and the like are welcomed under the Sherman Act. They are therefore not to be considered 'exclusionary' for § 2 purposes even though they tend to exclude rivals and may even create a monopoly.

Id. ¶ 651c, at 78-79.

In its July 7 opinion, the Commission noted that, according to the Complaint, the proximate cause of the alleged competitive harm was Unocal's *enforcement* of its patent rights. *In re Union Oil Co. of Cal.*, No. 9305, slip op. at 44 (FTC July 7, 2004) (emphasis supplied). The Federal Circuit has held that the question whether conduct in "enforcing a patent is sufficient to strip a patentee of its immunity from the antitrust laws is to be decided as a question of Federal Circuit law." *Nobelpharma AB v. Implant Innovations, Inc.,* 141 F.3d 1059, 1068 (Fed. Cir. 1998); *Unitherm Food Sys., Inc. v. Swift-Eckich, Inc.*, 375 F.3d 1341, 1355 (Fed. Cir. 2004) ("Federal Circuit law governs all antitrust claims premised on the abuse of a patent right."). Under Federal Circuit law, this requires a showing of each of the elements of fraud: "(1) a representation of a material fact, (2) the falsity of that representation, (3) the intent to deceive or, at least, a state of mind so reckless as to the consequences that it is held to be the equivalent of intent (scienter), (4) a justifiable reliance upon the misrepresentation by the party deceived which induces him to act thereon, and (5) injury to the party deceived as a result of his reliance on the misrepresentation." *Nobelpharma*, 141 F.3d at 1069-70.

In this action, as Complaint Counsel themselves have stated, the alleged competitive harm is "analogous to the harm alleged in *Walker Process*—the private enforcement of monopoly power established by fraud." Complaint Counsel's Opposition to Unocal's Motion for Dismissal of the Complaint Based Upon Immunity Under *Noerr-Pennington* at 5 (Apr. 21, 2003). And thus, as required by *Walker Process* and its progeny, Complaint Counsel have pled—and must prove—each of the elements of intentional fraud. For example, in ¶¶ 3, 77, 78, 81 and 85 they allege that Unocal made "knowing and willful misrepresentations" to CARB, Auto/Oil and WSPA and that these statements were "materially false." *See also* ¶¶ 2a-c, 3, 48, 58, 76, 78, 81. Complaint Counsel further allege that CARB, Auto/Oil and WSPA "reasonably relied" upon Unocal statements (*see, e.g.,* ¶¶ 5, 80, 90); that Unocal's misrepresentations "caused" CARB to adopt regulations that substantially overlapped with Unocal's patent claims (*see, e.g.,* ¶¶ 45, 76); and that "but for" Unocal's fraud CARB would not have adopted RFG regulations that substantially overlapped with Unocal's patent claims and/or that the terms upon which Unocal could have enforced its patents would have been substantially different (*see, e.g.,* ¶¶ 5, 80, 90). At trial, Complaint Counsel bear the burden of proving each of these allegations.

Moreover, as the Commission's *Noerr* opinion makes clear, because Complaint Counsel are challenging Unocal's speech to a governmental agency, they must establish that Unocal made a deliberate, knowing and willful misrepresentation with respect to a clear and sharply defined fact, and that such fraud was material to the outcome of the government proceeding. *In re Union Oil Co. of Cal.*, No. 9305, slip op. at 36, 42-43 (FTC Jul. 7, 2004).

In their pretrial brief, despite their constant use of the phrase "lies," Complaint Counsel repeatedly attempt to run from their obligation to establish each of the elements of knowing, willful fraud. *See, e.g.*, Compl. Counsel's Pretrial Br. at 11-12, 56-58.[15] But even if this case were not brought in the context of the alleged enforcement of a fraudulently obtained patent monopoly, and even if Complaint Counsel did not need to establish deliberate, material fraud under the Commission's *Noerr* opinion, Complaint Counsel would still have to demonstrate the impropriety of Unocal's representations with reference to well-established fraud principles. Complaint Counsel's case may be essentially distilled into one of misleading representations to CARB and others.

> To determine the impropriety of a representation implicates the usual tort issues with respect to nondisclosure (when is there a duty to speak?), the distinction between fact and opinion, the knowledge or due care of the speaker, the actual degree of reliance by those allegedly deceived, and the reasonableness of any such reliance.

IIIA PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 782b, at 273 (2d ed. 2002).

Thus, even in non-patent Sherman Act cases in which the alleged exclusionary conduct involves misrepresentations, courts have held that elements such as falsity, materiality and reasonable reliance must be established. *See, e.g., Nat'l Ass'n of Pharm. Mfrs. v. Ayerst Labs.*, 850 F.2d 904, 916 (2d Cir. 1988) (monopolization case based on deceptive advertising requires "proof that the representations were [1] clearly false, [2] clearly material, [3] clearly likely to induce reasonable reliance, [4] made to buyers without knowledge of the subject matter . . ."); *Am. Prof'l Testing Serv., Inc. v. Harcourt Brace Jovanovich Legal & Prof'l Publ'g, Inc.*, 108 F.3d 1147, 1152 (9th Cir. 1997) (citing *Nat'l Ass'n of Pharm. Mfrs.* for same list of elements); *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 288 n.41 (2d Cir. 1979) (Section 2 claim not allowed where plaintiff could produce no evidence that significant numbers of plaintiff's products would have been purchased but for the alleged misrepresentation).

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[15] It is not at all clear from their brief what Complaint Counsel believe they *do* need to prove—only that they do not seem to want to meet their burden to prove fraud.

Even in a case that does *not* implicate *Noerr* principles, it would be incongruous to premise antitrust liability on conduct that cannot be condemned under the very same theory phrased in common law terms. If anything, the antitrust laws are directed at a narrower set of conduct than common law, and most violations of common law obligations cannot support an antitrust violation. In this action, where *Noerr* has been raised as a defense, Complaint Counsel must prove each element of fraud to establish exclusionary conduct.

2. **Complaint Counsel will also need to define a relevant market and prove that Unocal has monopoly power in that market or a dangerous probability of achieving such power**

In either a monopolization or an attempted monopolization action, Complaint Counsel must establish for the Court the boundaries of the relevant markets. *See Walker Process*, 382 U.S. at 177 ("Without a definition of [the relevant] market there is no way to measure [defendant's] ability to lessen or destroy competition."). A market is properly defined only if it includes all products that are "reasonably interchangeable by consumers for the same purpose." *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 395 (1956). Courts consistently look to reasonable interchangeability as the primary indicator of a product market. *See United States v. Cont'l Can Co.*, 378 U.S. 441, 453-58 (1964); *FTC v. R.R. Donnelly & Sons Co.*, No. 90-1619, 1990, U.S. Dist. LEXIS 11361, at **5-12 (D.D.C. Aug 27, 1990).

Technology relevant markets are defined and analyzed in a manner similar to goods relevant markets. Technology markets comprise the intellectual property at issue "and its close substitutes—that is, the technologies or goods that are close enough substitutes significantly to constrain the exercise of market power with respect to the intellectual property that is licensed." *Antitrust Guidelines for the Licensing of Intellectual Property* § 3.2.2.

Once a market is defined, Complaint Counsel will have to demonstrate that Unocal has monopoly power in that market (for its monopolization claim) or a dangerous probability of achievement of such power (for its attempted monopolization claims). *See Cost Mgmt. Servs., Inc. v. Wash. Natural Gas Co.*, 99 F.3d 937, 949-50 & n.15 (9th Cir. 1996). Monopoly power has been defined by the Supreme Court as "the power to control prices or exclude competition." *United States v. E. I. du Pont de Nemours & Co.*, 351 U.S. at 391. A firm has monopoly power when "it can profitably raise prices substantially above the competitive level." *Microsoft*, 253 F.3d at 51. A party cannot monopolize a market in which it does not participate. *Official Airline Guides, Inc. v. FTC*, 630 F.2d 920, 926 (2d Cir. 1980).

The burden of proof in establishing a properly defined relevant market for antitrust purposes is on the plaintiff. *R.C. Dick Geothermal Corp. v. Thermogenics, Inc.*, 890 F.2d 139, 143 (9th Cir. 1989); *Brokerage Concepts, Inc. v. U.S. Healthcare, Inc.*, 140 F.3d 494, 513 (3rd Cir. 1998) ("The burden is on the plaintiff to define both components [geographic and product] of the relevant market."). Likewise, Complaint Counsel have the burden to establish that Unocal has monopoly power or a dangerous probability of achieving such power. *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 381 (1956) ("The burden of proof, of course, was upon the Government to establish monopoly.").

3. <u>Finally, Complaint Counsel will need to establish that Unocal's actions have an "anticompetitive effect"</u>

To be condemned as exclusionary, a monopolist's actions must have an "anticompetitive effect." *Microsoft*, 253 F.3d at 46. This means that the actions must harm the competitive process and thereby harm consumers. *Id.* "The [Sherman Act] directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself." *Spectrum Sports,* 506 U.S. at 458.

The plaintiff has the burden of demonstrating that the alleged monopolist's conduct has the requisite anticompetitive effect. *See generally Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 225-26 (1993). Just as a plaintiff in a private action must prove antitrust injury (that is, that its injury is the type that the antitrust laws were designed to forestall), so too must the Government demonstrate that the alleged monopolist's conduct harmed competition, not just a competitor. *Microsoft*, 253 F.3d at 59 (citing *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 487-88 (1977)); *see also E.I. du Pont de Nemours & Co. v. FTC*, 729 F.2d 128, 141 (2d Cir. 1984) (challenged practice can only be found to be unfair method of competition under § 5 of the FTC Act if Complaint Counsel can establish a clear nexus between the challenged conduct and the substantial lessening of competition); Timothy J. Muris, *The FTC and the Law of Monopolization,* 67 ANTITRUST L.J. 693, 697-98 (2000) ("The particular exclusionary act in question itself must make the requisite 'significant contribution' to the monopoly.").

V. <u>COMPLAINT COUNSEL MUST ESTABLISH THE ELEMENTS OF THEIR CLAIMS THROUGH CLEAR AND CONVINCING EVIDENCE</u>

Unocal proposes that the heightened evidentiary standard, clear and convincing evidence, should be applied to this case. Typically, the standard of proof is preponderance of the evidence. *E.g.*, 16 C.F.R. § 3.43(a) ("[c]ounsel representing the Commission . . . shall have the burden of proof"); *In re Adventist Health System/West*, 117 F.T.C. 224, 297 (1994) (establishing burden to be "preponderance of the evidence").[16] But Administrative Law Judges have left open the possibility

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[16] Complaint Counsel cite several sources to establish that the general burden is (continued...)

that a heightened standard of proof should apply in appropriate cases. *See, e.g., In re Trans Union Corp.*, No. D-9255, 1998 FTC LEXIS 88, at **116-17 (July 31, 1998) (applying preponderance standard, but noting that clear and convincing burden should be applied where the Court considers that a particular type of claim should be disfavored on public policy grounds); *In re Rambus Inc.*, No. 9302, slip op. at (FTC Feb. 23, 2004) (initial decision).

This is such a case, not only because it implicates Unocal's rights to enforce its patents, but also because Complaint Counsel's theories require proof of willful, deliberate fraud, and because Complaint Counsel's allegations have the potential to chill First Amendment speech.

First, Unocal has a firmly established patent right—granted by the Patent & Trademark Office and upheld by the federal courts of law—that will be effectively invalidated in California by the proposed remedy. Courts require proof by clear and convincing evidence in antitrust cases based on allegations that a patentee wrongfully attempted to enforce its patents. *Handgards, Inc. v. Ethicon, Inc.*, 601 F.2d. 986, 996 (9th Cir. 1979) (A standard of proof "commensurate with the statutory presumption of patent validity" is required); *see also CVD, Inc. v. Raytheon Co.*, 769 F.2d 842, 850 (1st Cir. 1985) ("The requirement of clear and convincing evidence is intended to prevent a frustration of the patent laws. It also ensures the free access to the courts by allowing honest patentees to protect their patents without undue risk of incurring liability for asserting their rights.")

Second, the Complaint alleges fraud, and courts often require that fraud be proved by clear and convincing evidence, especially where patent rights are implicated. Cases similar to *Walker*

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[16] (...continued)
preponderance of the evidence. This is an accurate description of the general rule, but *Walker Process* and *Handgards* provide exceptions to the rule, and those exceptions should apply in this case.

Process require clear and convincing evidence to prove fraud necessary to find that a patentee's conduct before the PTO is exclusionary conduct under the antitrust laws. *Nobelpharma AB v. Implant Innovations, Inc.,* 141 F.3d 1059, 1070-71 (Fed. Cir. 1998) (a patentee is not liable under antitrust laws unless fraud can be shown by clear and convincing evidence); *see also SSIH Equip. S.A. v. ITC,* 718 F.2d 365, 380-81 (Fed. Cir. 1983) (additional comments of Nies, J.) (quoting *Addington v. Texas,* 441 U.S. 418, 423-25 (1979)) ("[t]he interests at stake in [fraud] cases are deemed to be more substantial than mere loss of money and some jurisdictions accordingly reduce the risk to the defendant of having his reputation tarnished erroneously by increasing the plaintiff's burden of proof"); *Inquiry Into Three Mile Island Unit 2 Leak Rate Data Falsification,* 25 N.R.C. 671, 690 (1987) (explaining that an agency finding of dishonesty or fraud can result in "severe reputational injury," which can support the higher standard of proof).

Complaint Counsel attempt to limit *Handgards* to cases in which the alleged defendant engages in "one or more infringement actions initiated in bad faith," Compl. Counsel's Pretrial Br. at 16-17 (citing *Handgards*, 601 F.2d at 996),[17] but it makes no sense to limit *Handgards* in this way. Instead, *Handgards*, was concerned more broadly with creating barriers, which "are necessary to provide reasonable protection for the honest patentee," 601 F.2d at 996, when it is charged with conduct sufficient for antitrust law to strip away its rights granted by the Patent & Trademark Office.[18] This is consistent with the use of clear and convincing evidence to revoke other

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[17] Interestingly, Complaint Counsel's interpretation would provide *less protection to a patentee that won its infringement case*—such as Unocal—than one that engaged in a losing and potentially bad-faith litigation.

[18] *See also Golan v. Pingel Enter., Inc.*, 310 F.3d 1360, 1371 (Fed. Cir. 2002) (requiring clear and convincing evidence that patentee engaged in bad faith in attempting to enforce (continued...)

government-issued benefits. *See Sea Island Broad. Corp. of S.C. v. FCC*, 627 F.2d 240, 244 (D.C. Cir. 1980) ("we stand with the view that revocation of an FCC license is governed, at the agency level, by the 'clear and convincing' standard of proof") (citing *Collins Security Corp. v. S.E.C.*, 562 F.2d 820, 825 (D.C. Cir. 1977)).

Finally, the "fraud" allegedly committed by Unocal was undeniably done in the context of Unocal's efforts to lobby CARB. Because Complaint Counsel are arguing that Unocal should be required to forfeit valuable assets (worth at least several hundred million dollars, *see infra* at pp. 189-191 as a result of Unocal's conduct during its exercise of its First Amendment right to petition, then at a very minimum Complaint Counsel should be required to prove such illegal conduct by clear and convincing evidence.

Indeed, given the potential chilling effect of a finding of antitrust liability based upon efforts to seek redress from the government, some courts have held that exceptions to *Noerr* immunity must be shown by clear and convincing evidence. *See, e.g., MCI Communication Corp. v. Am. Tel. & Tel. Co.*, 708 F.2d 1081, 1155-56 (7th Cir. 1983) (approving jury instructions, in the context of communication tariffs, that required the jury to find sham exception to *Noerr* by clear and convincing evidence); *see also Christianson v. Colt Indus. Operating Corp.*, 766 F. Supp 670, 683 (C.D. Ill. 1991) (applying the clear and convincing standard to sham litigation exception); *Illinois*

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[18] (...continued)
an expired patent); *Loctite Corp. v. Ultraseal Ltd.*, 781 F.2d 861, 876-77 (Fed. Cir. 1985) (rejecting the preponderance of the evidence standard and affirming use of clear and convincing standard for an antitrust claim grounded in patent misuse vis-à-vis bad faith litigation), *overruled on other grounds by Nobelpharma*, 141 F.3d at 1067; *Lockformer Co. v. PPG Indus., Inc.*, 264 F. Supp. 2d 622, 627 (E.D. Ill. 2003) (adopting clear and convincing standard for patent misuse claim); *Conceptual Eng'g Assocs., Inc. v. Aelectronic Bonding, Inc.*, 714 F. Supp. 1262, 1266-67 (D.R.I. 1989) (requiring clear and convincing evidence of patent misuse for antitrust violation).

ex rel. Hartigan v. Panhandle E. Pipe Line Co., 730 F. Supp. 826, 937-939 (C.D. Ill. 1990) (same holding for intervention before the FERC); *cf. Kottle v. Northwest Kidney Centers*, 146 F.3d 1056, 1059 (9th Cir. 1998) (holding that the heightened pleading standard applies when alleging an exception to *Noerr* based on fraud: "when a plaintiff seeks damages . . . for conduct which is *prima facie* protected by the First Amendment, the danger that the mere pendency of the action will chill the exercise of First Amendment rights requires more specific allegations than would otherwise be required") (quoting *Franchise Realty Interstate Corp. v. San Francisco Local Joint Exec. Bd. of Culinary Workers*, 542 F.2d 1076, 1083 (9th Cir. 1976)). *Contra Litton Sys., Inc. v. Am. Tel. & Tel. Co.*, 700 F.2d 785, 813-814 (2d Cir. 1983).

In the recent *Rambus* decision, Judge McGuire applied the preponderance of the evidence standard, rather than the clear and convincing evidence standard which Rambus had argued was appropriate. *In re Rambus, Inc.*, No. 9302, slip. op. at 242 (FTC Feb. 23, 2004). On this point, the *Rambus* case is distinguishable in several respects. First, the *Rambus* Complaint did not allege conduct involving "knowing and willful" fraud. Here, obviously the Complaint not only alleges such knowing and willful fraud, but also, under the Commission's July 7 opinion, Complaint Counsel must prove "deliberate, knowing and willful" fraud to vitiate Unocal's *Noerr* protection. *In re Union Oil Co. of Cal.*, No. 9305, slip op. at 16-17 (FTC July 7, 2004). Second, Judge McGuire specifically left open the issue of whether the remedy sought in *Rambus*—denying Rambus the right to enforce its patents—required the heightened standard of proof. *Rambus*, slip op. at 242-43. For all the reasons set forth above, Unocal submits that it does.

Ultimately, however, Unocal does not believe that the standard of proof chosen will be dispositive in this case because Complaint Counsel have no reliable evidence which would justify a finding against Unocal under a preponderance of the evidence standard, much less under a clear and convincing evidence standard.

VI. UNOCAL DID NOT ENGAGE IN EXCLUSIONARY CONDUCT

A. Unocal Has Not Engaged in Fraud Against Either CARB or the Other California Refiners

1. Unocal made no affirmative misrepresentations

a. Unocal made no false statement to CARB

On August 27, 1991, in response to a request from CARB, Unocal made public the emissions data from its ten-car study. On that date, Unocal's Denny Lamb wrote to James Boyd of CARB. The top of the letter states that it is regarding "PUBLIC AVAILABILITY OF UNOCAL RESEARCH DATA." RX 3. In the body of the letter, Lamb states:

> On June 20, 1991, certain Unocal representatives met with Peter Venturini and other members of his staff. During that meeting, we presented the results of three phases in Unocal's Vehicle/Fuels testing program. We subsequently made *the data base* available to the staff and agreed to make *the data public* if necessary in the development of a predictive model for use in the certification of reformulated gasoline.
>
> The staff has now proposed to develop such a predictive model and requested that we make *the data public.*
>
> 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.*

RX 3 (emphasis added).

This letter serves as the centerpiece of Complaint Counsel's affirmative misrepresentation claim. But everything that Unocal stated in this letter was and remains absolutely true. Unocal made a presentation to CARB on June 21, 1999—just as the letter states. It subsequently provided CARB with a data base containing its emissions testing data—again, just as the letter states. Unocal told CARB that it would consider making its data public if it was necessary for the development of CARB's predictive model. CARB then announced that it was going to consider a predictive model, and asked Unocal to make its data public. And—just as the letter states—in response to this request, Unocal agreed to make its data public and available to anyone who asked.

To support their claim of willful and intentional fraud, Complaint Counsel allege this 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." Compl. ¶ 42. But the letter itself says nothing about any inventions. It does not speak to competitive advantage, royalties, licenses, patents, or patent applications. Just as the letter's topic sentence heralds, each line of this letter speaks to one topic and one topic only: the "PUBLIC AVAILABILITY OF UNOCAL RESEARCH DATA." RX 3.

To read into Unocal's August 27, 1991 letter a representation that Unocal did not have any patent applications on file, or that Unocal would never seek licensing revenues from any patents that it might some day receive, is to give the letter a tortured interpretation that is belied not only by the explicit language of the letter but also by the context in which these statements were made and by the interpretations the author and the recipients themselves placed on this letter.

What should be self-evident from this letter is that the "data" which Unocal is making publicly available in the third paragraph is the "data base" specifically referred in the second paragraph of the letter as having previously been made available to CARB staff. Near the end of discovery in this action, after repeated requests from Unocal, CARB finally admitted that they had the data base referred to in the August 1991 letter. *See* RX 327 (producing "the original diskette containing the data base referred to in Dennis Lamb's August 27, 1991 letter"). The diskette produced by CARB contains raw data showing the amount of exhaust emissions generated by 15 different test fuels when run in 10 different cars.[19] That's all.

Unocal agreed to make this data public so that it could be incorporated into a larger data base that CARB would need to compile in order to develop a predictive model. And that's exactly what CARB did with this data base—it combined Unocal's data with the results of many other industry tests to create a large data set.[20] From that "mega-data base" CARB then eliminated certain outlier data points, and then used its own statisticians to create a complex mathematical model showing the relationships between various fuel properties and different types of emissions. *See* Cleary Dep. (CARB), 8/7/03, at 11:4-10. CARB adopted the Phase 2 "predictive model" in June of 1994.[21] RX 54 at 005.

Significantly, in August 1991, neither CARB nor Unocal understood Unocal's August 27 letter to mean anything other than what it plainly states—that Unocal was agreeing to make its data base public. Unocal's own contemporaneous internal memorandum—prepared on August 28, 1991—shows that Lamb believed he had agreed to make the "data public in order for CARB to use it at a workshop [on a possible predictive model] and in technical justification for the model." RX 157; *see also* RX 155. Likewise, CARB staff members (to the extent they had any recollection

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[19] In other words, this raw data shows that when Unocal tested a particular fuel in a particular car, it measured a particular amount of exhaust emissions.

[20] Unocal's data constitutes approximately 10% of the data in the Phase 2 predictive model. Cleary Dep. (CARB), 8/7/03, at 167:2-24; RX 53 at 150-51.

[21] CARB adopted a new predictive model in June 1999. Most of the gasoline in California today is made under this Phase 3 predictive model.

of the letter) testified that they understood the letter to be a release of the confidentiality of Unocal's data. *See, e.g.,* Fletcher 1996 Dep. (CARB), 6/17/96, at 203:14-204:12 ("we did ask Unocal to make the data available so that we could include it in the predictive model and felt that it was a data set that was very important in the development of the—the predictive model . . . we needed to consolidate [Unocal's data] in with the other data. In order to do that, we had to make it nonconfidential. If they would have kept it as confidential data, we would not have been able to include it into the—the mega-data base of all the vehicle tests."); Venturini 1996 Dep. (CARB), 6/18/96, at 137:7-17 ("the letter indicates that they're releasing the data to be publicly available because we have proposed to develop a predictive model"); Simeroth 1996 Dep. (CARB), 6/20/96, at 56:21-57:3 ("the letter . . . indicates that they were making the previously submitted data available").

Moreover, *no one* understood that the letter was a statement by Unocal that it had no pending patent applications or that it was dedicating any inventions covered by such patent applications to the public. In 1991, CARB never even considered patent rights, much less made such an inference from Lamb's short, plainly worded letter. Venturini Dep. (CARB), 5/13/03, at 69:19-22 (Venturini did not think the letter had to do with patent rights); Fletcher 1996 Dep. (CARB), 6/17/96, at 204:24-205:14.

To reach their tortured explanation of Mr. Lamb's letter, Complaint Counsel have alleged that Lamb's statement that Unocal "now considers this data to be non-proprietary" is a representation that Unocal had no ownership rights in its pending patent application. This argument is fatally flawed for a number of reasons, the first of which is the fact that the letter says nothing about inventions or patent rights but speaks only to raw emissions data. By the explicit terms of the letter, Unocal was agreeing to make its diskette "available to CARB, environmental interest groups, other members of the petroleum industry, and the general public upon request." The letter cannot possibly be read to say that Unocal was somehow agreeing to provide the public with anything other than this tangible disk containing raw emissions data. Thus, if the word "non-proprietary" is read as a relinquishment of ownership, it can only apply to Unocal's agreement to make its data diskette available to anyone who requested it and not as a relinquishment of some yet-to-be granted patent rights on an invention of new gasoline compositions that Unocal had never discussed with CARB.

But, more fundamentally, Complaint Counsel's argument ignores the common usage of the term "proprietary" as one simply synonymous with "confidential." Mr. Lamb, the author of the letter, has testified that all he meant to convey by the use of the term "non-proprietary" is that the data was no longer considered confidential. Likewise, the recipient of the letter, James Boyd, does not even recall receiving the letter, but admitted in testimony that he is aware that people use the term "proprietary" as a synonym for "confidential." Moreover, the record in this case is replete with examples of instances in which members of the oil industry have used the word "proprietary" to mean "confidential."[22] [redacted]; *see also* Boyd Dep. (CARB), 8/22/03, at 209:21-213:9.

And importantly, CARB's reaction in 1995 when it learned of Unocal's patent and licensing plans is very telling. If Unocal truly had misled CARB into believing that it did not have any (or

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22 [redacted]

would not enforce any) intellectual property rights, then surely some one would have said something to Unocal in 1995 when Unocal issued a press release announcing that it had received a patent and intended to license. But no CARB board member, staff member or any other California government representative accused Unocal of lying to CARB. No one told Unocal that they believed Unocal had waived its rights to enforce its patent by telling CARB years earlier that certain of its emissions data were "non-proprietary." Even CARB's internal documents from this time period do not accuse Unocal of misleading CARB.

Instead, the record shows that after Unocal announced that it had a patent in late January 1995, CARB's Executive Officer James Boyd wrote to Unocal, inviting Unocal to meet with CARB to discuss its marketing plans and the extent of the patent's claims. RX 47. Shortly thereafter, Unocal representatives met separately with CARB staff, CARB Chairman John Dunlap and with California Governor Pete Wilson. During their meeting with Unocal, CARB staff expressed concern whether there would be an adequate supply of gasoline, and Unocal assured CARB that Unocal would not do anything to upset CARB's plans for the Phase 2 rollout, which was scheduled for the spring of 1996. Beach IH Dep. (Unocal), 1/23/02, at 82:19-83:24. CARB also raised the subject of CARB's Phase 2 test program, which was scheduled for the following summer, and which would require 600,000 gallons of summer-time Phase 2 fuel. Explaining that it was in Unocal's interest, as well as CARB's, to ensure a smooth and successful implementation of the Phase 2 regulations in 1996, CARB asked Unocal to agree not to raise any patent infringement issues regarding this summer test fuel. RX 50. Unocal agreed that it would not assert any patent infringement claims in conjunction with this test program. RX 49.

Like its meeting with CARB, Unocal's meeting with California Governor Wilson also went very well. As it had with CARB, Unocal assured the Governor that Unocal would not do anything to upset the rollout of Phase 2 gasoline. Beach Dep. (Unocal), 6/19/03, at 63:13-64:16. During this meeting, Governor Wilson spoke highly of the U.S. patent system's ability to promote innovation; Wilson wished Unocal luck; and then the Unocal representatives had their pictures taken with Wilson. *Id.*

Internally, CARB's Jim Ryden authored a memo in March 1995 looking at the background leading up to Unocal's patent announcement and discussing the issues this announcement presented for CARB. RX 62. The memo does not state or even imply that Unocal ever did anything to mislead CARB. *Id.* And although it notes that one option might be for Unocal to place its patented formulations in the public domain, it does not state or imply—as Complaint Counsel now allege—that Unocal *had already done so* by sending its August 27, 1991 letter to CARB. *Id.*

Also in March 1995, Unocal's Terry Larson spoke with CARB Chairman John Dunlap at a reception in Dunlap's honor. RX 840. Dunlap never once accused Unocal of lying to CARB. Instead, he told Larson that he was impressed that Unocal's 76 Products President had taken time to brief him on the patent issues and spoke of the hard work Unocal had done to maintain good regulatory relationships with CARB. *Id.* He did express a concern to Larson that Unocal should brief him personally first—rather than CARB staff—when significant events occur. Far from seeing any erosion of Unocal's long-standing relationship with CARB as a result of the patent announcement, Larson reported that he believed Unocal had a golden opportunity to provide Dunlap with further briefings and further develop the relationship. *Id.*

Even in the midst of the patent litigation between Unocal and the refiners in 1996, several key CARB staff and board members would not say that they were deceived by Unocal. For example, Chairwoman Jan Sharpless was asked whether Unocal's conduct misled her. She replied:

> . . . I'm not naive. I do recognize that—that companies take positions but also hedge their futures with other plans, business plans, in the event that certain circumstances might occur. I think it was clear that the reformulated proposal was a proposal that was gaining in acceptance by many stakeholders and that the event that it would become a reality was becoming clearer and clearer. So no, I'm not necessarily surprised, even though Unocal was strongly opposed to it, that they may have taken other actions.

Sharpless 1996 Dep. (CARB), 6/20/96, at 44:14-45:3. Ms. Sharpless would not say she was deceived by Unocal, only "disappointed." *Id.* at 45:4-11.

Likewise, Dean Simeroth, CARB's Chief of Criteria Pollutants Branch, was asked if he was deceived by Unocal. He replied that he did not personally feel deceived and that deceived was not a word he would use. Simeroth 1996 Dep. (CARB), 6/21/96, 220:19-221:1. He was then asked:

> Q. Put aside the issue of whether you think it happened intentionally or not or whether they had an obligation to disclose it or not. What I want to know is: Do you think that Unocal's conduct in the course of Phase 2 served to mislead you?
>
> [Objections and attorney colloquy omitted]
>
> A. The technical data provided to us by Unocal, to my knowledge at this point in time, was correct. The comments they provided to us on the other aspects of the regulatory development, my feeling is they were consistent with what we were hearing from the other companies. As I would not use the word "deceive," I would not use the word "misled."

Id. at 222:14-223:9. Simeroth also testified that while he was surprised that Unocal had received a patent, he was not surprised that Unocal had not told CARB about its pending application:

> I can't say that we're routinely informed by companies when they apply for patents. The surprise was more that they had applied and had been granted one than the fact that they . . . had not told us that they were applying.

Id. at 206:12-20.

b. Unocal made no misrepresentations to Auto/Oil or WSPA

Shortly after its letter to CARB, Unocal gave a slide presentation of some of its research results to Auto/Oil. Complaint Counsel's fraud claim with respect to Auto/Oil centers on a statement in the minutes from Auto/Oil's September 1991 meeting, written by an antitrust lawyer for the group: "Mr. Jessup explained that the data from Unocal's research has been provided to CARB and is in the public domain." RX 231 at RPC00036. Although Dr. Jessup does not believe he used the phrase "public domain," there is nonetheless nothing false about this statement. As the lawyer who wrote the statement testified: "Well, my understanding as I sit here today of what that phrase is intended to refer to is my understanding that by virtue of the fact that Unocal's research had been provided to CARB that research, *that data was available to any interest—any interested party who may want to access the data.*" Meyer 1996 Dep. (Auto/Oil), 7/23/96, at 24:19-25:2 (emphasis added). As noted above, it was and remains true that Unocal's data was publicly available to any person who requested it.

2. Unocal made no fraudulent omissions

Just as Unocal made no affirmative misrepresentations, Unocal also made no actionable fraudulent omission that could serve as the basis for liability under Section 5 of the FTC Act. There can be no Section 5 antitrust violation based upon a failure to disclose absent proof of a "clear and unambiguous" duty to disclose. *In re Rambus Inc.*, No. 9302, slip op. at 259 (FTC Feb. 23, 2004).

Indeed, courts have long recognized that antitrust rules generally, and specifically liability under Section 5, must be based upon clearly defined rules. *Int'l Distribution Ctrs., Inc. v. Walsh Trucking Co., Inc.*, 812 F.2d 786, 796 n.8 (2d Cir. 1987) ("A major concern underlying antitrust jurisprudence lies in the fear of mistakenly attaching antitrust liability to conduct that in reality is the competitive activity the Sherman Act seeks to protect."); *Westman Comm'n Co. v. Hobart Int'l, Inc.*, 796 F.2d 1216, 1220 (10th Cir. 1986) ("if the antitrust laws applicable to vertical dealings are uncertain, or inefficient, they are likely to have a chilling effect on beneficial, procompetitive market interaction"); *E.I. du Pont de Nemours,* 729 F.2d at 139 (in a Section 5 action, "[t]he Commission owes a duty to define the conditions under which conduct claimed to facility price uniformity would be unfair so that businesses will have an inkling as to what they can lawfully do rather than be left in a state of complete unpredictability"); *Rambus*, slip. op. at 259 ("[W]here rules are ambiguous or indefinite, businesses are unfairly left to speculate whether their conduct will expose them to potential antitrust liability.").

Well-established fraud principles recognize that a failure to disclose can give rise to fraud liability only where there is a clear duty to disclose (and assuming that all other elements of fraud are met). Such a duty can arise where there is a relationship between the parties, such as a confidential or fiduciary duty that gives rise to such an obligation. "Ordinarily, failure to disclose material facts known only to one party is not actionable fraud unless there is a fiduciary or confidential relationship imposing a duty to disclose." *Kruse v. Bank of Am.*, 248 Cal. Rptr. 217, 225 (Cal. App. 1988); *Wilkins v. Nat'l Broad. Co.*, 84 Cal. Rptr. 2d 329, 338 (Cal. Ct. App. 1999); *Kovich v. Paseo Del Mar Homeowners' Ass'n,* 48 Cal. Rptr. 2d 758, 760 (Cal. App. 1996) ("The general rule for liability for nondisclosure is that even if material facts are known to one party and not the other, failure to disclose those facts is not actionable fraud unless there is some fiduciary or confidential relationship giving rise to a duty to disclose").

When the relationship between the parties is one of joint participants in a standard setting proceeding, both the Federal Circuit (which was addressing common law fraud) and Judge McGuire (who was addressing Section 5 liability) held that absent a clear policy delineating what intellectual property must be disclosed, there can be no liability for nondisclosure sufficient to give rise to either fraud or antitrust violations. *Rambus Inc. v. Infineon Techs. AG*, 318 F.3d 1081, 1102 (Fed. Cir. 2003) ("A policy that does not define clearly what, when, how and to whom the members must disclose does not provide a firm basis for the disclosure duty necessary for a fraud verdict."). *Rambus*, slip op. at 260 ("any duties Respondent may have had towards other JEDEC members were so unclear and ambiguous that they cannot form the basis for finding liability in this case")

Here Complaint Counsel will be unable to establish that Unocal was under any duty to disclose to either CARB, Auto/Oil or WSPA that it had filed a patent application on certain discoveries arising from its RFG research.

a. <u>Complaint Counsel can show no confidential or fiduciary relationship giving rise to a disclosure duty</u>

(1) <u>Unocal's relationship with CARB did not give rise to a duty to disclose</u>

Here, CARB was a regulatory body engaged in the process of determining regulations that would have the force and effect of law. Unocal was a company that would be subject to the proposed regulations and actually opposed CARB's proposal. There was no confidential, fiduciary or any other kind of relationship between CARB and Unocal that created a duty to disclose pending patent applications.

Unlike some private standard-setting bodies, CARB has no regulation requiring rulemaking participants to disclose patent applications. Boyd Dep. (CARB), 8/22/03, at 251:17-252:07. By law, CARB cannot have or attempt to enforce any unwritten policies. *Id.* at 251:6-16; RX 332 at 006 (§ 11347.5(a)). Indeed, CARB has never asked anyone in any rulemaking to disclose the existence of patents or patent applications. 2d RFA Responses at Rsp. 11. Even today, CARB does not ask those who comment upon its proposed regulations whether they have any patent application that may relate to those regulations. Venturini Dep. (CARB), 5/13/03, at 145:23-148:22.

Moreover, none of the major refiners in California have disclosed the presence of a patent application to CARB in the context of its RFG rulemakings. [redacted]

There are a number of reasons why companies such as Unocal have policies that pending patent applications should be kept confidential. For example, one primary reason for confidentiality is to allow the applicant to retain the confidential trade secret value of the invention if for some reason the invention is determined not to be patentable. Linck Rpt. at 9. Other business reasons for a policy of maintaining confidentiality include avoiding the potential for provoking an interference with the application. *Id.* According to the unrebutted testimony of Unocal's patent expert Nancy

Linck: "premature disclosure of the existence of a patent application is almost certain to be to the commercial disadvantage of the applicant in that it could disclose potential legitimate trade secrets," or spawn potential litigation at a time "when the scope of patent coverage is highly uncertain." Linck Rpt. at 9.

Thus, at the time of CARB's Phase 2 rulemaking, the PTO was required by law to keep confidential both the contents of pending patent applications and the fact that an application had been made.[23] 35 U.S.C. § 122 (1991). As the Federal Circuit has observed: "[t]he integrity of the patent system is maintained in part by inventors' understanding that their patent applications will remain secret until either the patents issue or the applications are otherwise published by the PTO." *Eagle Comtronics, Inc. v. Arrow Comm. Labs., Inc.*, 305 F.3d 1303, 1314 (Fed. Cir. 2002), *reh'g granted in part on other grounds*, Nos. 01-1544 & 1591, 2002 U.S. App. LEXIS 22717 (Fed. Cir. Nov. 1, 2002). CARB itself has recognized that Unocal was "permitted under federal patent laws" to keep confidential its pending patent application, as well its subsequent amendments. RX 203 at CARB-FTC0037559.

Not only did CARB have no formal policy or regulation requiring the disclosure of pending patent applications (or any other sort of intellectual property rights), but individuals from CARB have testified that they would not have expected individual companies to come forward with such information. For example, in his 1996 deposition, Dean Simeroth acknowledged: "I wouldn't necessarily have expected them to bring that to us. It's a decision the companies have to make, what information they want to share with us." Simeroth Dep. (CARB), 7/9/03, at 233:15-234:5. Likewise, the lack of any duty to disclose confidential information such as pending patent

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[23] Today, these are generally kept confidential for 18 months following the application.

applications is confirmed by CARB Chairwoman Sharpless's 1996 testimony that "[i]t's been my experience that those who go through a [regulated] proceeding don't—are not always forthcoming with all of the information that affects their industry, bar none." Sharpless 1996 Dep. (CARB), 6/20/96, at 32:11-22. Ms. Sharpless testified that CARB understood that refiners who participated in its rulemaking would not share with it information that "they did not want [CARB] to have," and would only provide CARB with "information that best represents their interests." Sharpless Dep. (CARB), 8/6/03, at 167:18-25.[24] This testimony establishes that far from the type of special confidential or fiduciary relationship which by law may create a duty to disclose, the relationship between regulator and regulated is adversarial in nature and creates no expectations of disclosure.

(2) Unocal had no relationship with Auto/Oil or WSPA that gave rise to a duty to disclose its pending patent application

Unocal was a direct competitor of most of the other members of Auto/Oil and WSPA. There was no "fiduciary" or other relationship between the members of these groups that would have required Unocal to divulge highly confidential information regarding its patent application or

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[24] Indeed, as the United States Supreme Court has recognized in *Noerr*, it is those with a personal interest in the proposed law that are most likely to have a strong motivation to communicate with their government:

> Indeed, it is quite probably people with just such a hope of personal advantage who provide much of the information upon which governments must act. A construction of the Sherman Act that would disqualify people from taking a public position on matters in which they are financially interested would thus deprive the government of a valuable source of information and, at the same time, deprive the people of their right to petition in the very instances in which that right may be of the most importance to them.

E. R.R. Presidents Conferences v. Noerr Motor Freight, Inc., 365 U.S. 127, 139 (1961).

potential royalty plans to its competitors. In fact, just the opposite was true—both organizations had explicit guidelines that prohibited such discussions.

(a) <u>**Unocal had no duty to disclose its patent application to WSPA**</u>

With respect to WSPA, the Complaint alleges no specific misrepresentations made by Unocal, but rather that Unocal created "a materially false and misleading impression" that it did not have any intellectual property rights associated with its emissions research results. Compl. ¶ 86. According to the Complaint, this alleged "deceptive conduct" constituted a breach of Unocal's "fiduciary duties" to the other members of WSPA, and "violated the integrity of WSPA's procedures and subverted WSPA's process of providing accurate data and information to CARB." Compl. ¶ 89. The Complaint alleges that Unocal's conduct was deceptive because Unocal failed to disclose to WSPA "that it had pending patent rights, that its patent claims overlapped with the proposed RFG regulations, and that Unocal intended to charge royalties." Compl. ¶ 88.

But Complaint Counsel will be unable to show that Unocal had any such duty to disclose to WSPA members the existence of (much less the content of) Unocal's pending patent application, or any duty to disclose any royalty plans. First, as a matter of law, there is no such fiduciary duty among the competitors who belong to a trade association. WSPA's counsel and its corporate designee under Rule 3.33 (c) have stated WSPA is not aware of any fiduciary relationship existing between and among WSPA and its members. *See* RX 674 at 6; [redacted] *see also* RX 673 at ¶ 4 ("WSPA does not possess or have custody or control of any documents evidencing any fiduciary relationships between or among WSPA members. Nor has it possessed or had custody or control of any such documents in the past."). Indeed, in *Rambus Inc.*

v. Infineon Techs. AG, 318 F.3d 1081 (Fed. Cir. 2003), *cert denied*, 124 S. Ct. 227 (2003), the Federal Circuit rejected a duty of disclosure arising from an alleged fiduciary duty between members of trade association:

> Rambus and Infineon are competitors. There is no basis for finding that Rambus and Infineon shared a fiduciary relationship solely by virtue of their JEDEC membership. Indeed, the implications of holding that mere membership forms a fiduciary duty among all JEDEC members could be substantial and raise serious antitrust concerns.

Id. at 1096.

In analogous settings, courts have looked askance upon arguments that companies owe a duty to their competitors to disclose information about their internal innovations. *See Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 282 (2d Cir. 1979). There, the plaintiff proposed that Kodak had a limited duty to disclose certain information to Kodak's competitors. *Id.* In rejecting such a duty, the Second Circuit noted the uncertainties surrounding such a proposed duty, and the chilling effect it would have upon innovation:

> [I]t is difficult to comprehend how a major corporation, accustomed though it is to making business decisions with antitrust considerations in mind, could possess the omniscience to anticipate all the instances in which a jury might one day in the future retrospectively conclude that predisclosure was warranted. . . . These inherent uncertainties would have an inevitable chilling effect on innovation.

Id.; see also United States v. Nat'l Lead Co., 332 U.S. 319, 359 (1947) (rejecting government's attempt to require antitrust defendants to provide at a reasonable fee information about manufacturing processes and methods because such effort would "reduce the competitive value of the independent research of the parties" and "discourage rather than encourage competitive research").

As the Supreme Court recently noted in *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*:

> Compelling . . . firms to share the source of their advantage is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities. Enforced sharing also requires antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing—a role for which they are ill-suited. Moreover, compelling negotiation between competitors may facilitate the supreme evil of antitrust: collusion.

540 U.S. 398, 124 S. Ct. 872, 879 (2004)

Here, not only is there no fiduciary duty that might require the disclosure of patent applications, but under WSPA's antitrust guidelines, WSPA members were *prohibited* from discussing with one another information relating to pricing, supply, cost, business strategies, and any other competitively sensitive information—including patents. [redacted]

RX 670 at WSPA00007, (WSPA antitrust policies prohibited discussion of "past, present or future prices or any aspect of such prices . . . information relating to the costs that members have incurred or expect to incur or any aspect of those costs . . . Discussion or exchange of other information that may be competitively sensitive should also be scrupulously avoided"); *id.* at WSPA00009 ("Do not discuss . . . members' or competitors' business plans or marketing strategies [and] other competitively sensitive types of information."). [redacted]

[redacted]

As noted above, Unocal, like many other companies, considered its pending patent application to be competitively sensitive and had a policy of not disclosing such information. Beach IH Dep. (Unocal), 1/23/02, at 54:8-13, 59:16-22; Jessup IH Dep. (Unocal), 1/25/02, at 150:3-14; Wirzbicki IH Dep. (Unocal), 8/7/02, at 209:1-210:19. Moreover, any plans relating to potentially charging royalties would be a future business plan relating to pricing—the very sort of information that WSPA's policies said members should not discuss. Given the undisputed evidence that there is no fiduciary duty between members of a trade association such as WSPA, as well as the undisputed evidence that WSPA members were directed not to discuss with one another competitively sensitive business plans or any aspect of pricing or costs, there is no basis upon which to find that Unocal had any duty to disclose anything related to its pending patent application.

Just as there is no evidence of any fiduciary relationship giving rise to a duty to disclose, so too is there no evidence that Unocal violated any processes or procedures of WSPA. [redacted]

The only specific WSPA procedures that the Complaint alleges were violated by Unocal relate to a cost study that WSPA commissioned in 1991. *See* Compl. ¶¶ 56, 57, 87, 80. According to the Complaint, this cost study, which estimated the costs of the proposed regulations on a cents-per-gallon basis, "could have incorporated costs associated with potential royalties flowing from Unocal's pending patent rights." Compl. ¶ 57.

Presumably, Complaint Counsel's allegations are based on the affidavit Turner Mason's Robert Cunningham sent to the FTC in 2001, [redacted]

But Cunningham's deposition testimony in this case demonstrates conclusively that there is no basis upon which to infer that Unocal had *any* duty to inform Cunningham of some potential royalties from some unknown future license agreement on a patent (or patents) which had not yet issued.

[redacted]

[redacted]

[redacted]

Moreover, Cunningham did not survey individual companies on their individual understandings relating to gasoline prices and costs, and he underscored this point in his comments to CARB at the hearing: "There was no survey made, because of antitrust considerations on individual companies' data." RX 60 at CARB0001261-62.

Of course in 1991, when Cunningham was preparing the WSPA report, Unocal did not know whether a patent would ever issue. It did not know what the scope of any issued claims would be, or what the CARB regulations would be. It had no way of ascertaining what value, if any, some yet-to-be issued patent would have to the industry, whether anyone would license, and what amount or form any such licensing fees would take. Had Unocal perfect prescience in 1991, it would have foreseen that the industry would greet Unocal's ultimate licensing efforts with a lawsuit challenging the patent's validity, and that ten years after the first patent issued (and was subsequently upheld by the Federal Circuit), every major refiner in California would still refuse to pay any license fees to Unocal.

(b) <u>Unocal had no duty to disclose its patent application to Auto/Oil</u>

Auto/Oil was a joint research program of fourteen major oil companies and three auto manufacturers under the National Cooperative Research Act. RX 226 at U0003027. Complaint Counsel's allegations with respect to Auto/Oil are similar to their allegations relating to WSPA; namely that Unocal breached its "fiduciary duties" to Auto/Oil members and "violated" and "subverted" its processes and procedures. Compl. ¶ 84. But like WSPA, Auto/Oil members were competitors with one another. By law, there were no such "fiduciary" duties that would have obligated Unocal to disclose its confidential information to its competitors. *See Rambus Inc. v. Infineon Techs. AG*, 318 F.3d 1081, 1096 n.7 (Fed. Cir. 2003).

Moreover, the obligations of the Auto/Oil members are set forth in a written agreement. *See* RX 226. This Agreement makes it clear that Unocal had the right to pursue independent research in the area of reformulated gasoline and *that it had no obligation to disclose the fact that such independent research was undertaken or the nature or results thereof.* RX 226 at U0003040 (¶ 6(B)).

In addition, just as WSPA antitrust policies prohibited members from discussing their competitively sensitive business plans, so too did the Auto/Oil Agreement. *See* RX 226 at U0003034 (¶ 3(A)) ("No Member will utilize the Program for . . . [e]xchanging of information among competitors relating to cost, sales, profitability, prices, marketing, or distribution of any product, process, or service that is not reasonably required to conduct the research and development that is the purpose of such venture.").

Thus there is nothing in the contractual relationship between Unocal and the other Auto/Oil members upon which any sort of duty could be inferred to disclose to others the existence of its pending patent application, the contents of such an application or any internal discussions Unocal may have had regarding royalties.

In addition to arguing that the statement attributed to Unocal at an Auto/Oil meeting (that its data was in the "public domain") is fraudulent, the Complaint also alleges that because Unocal made a presentation of some of its research to Auto/Oil, that everything Unocal did with respect to RFG became the "work of the Program" as set forth in ¶ 2(E) of the Agreement. Compl. ¶¶ 52-53; *see*

RX 226 at U0003033. This provision of the Auto/Oil Agreement states that no patent applications will be prosecuted on the basis of "work of the Program." *Id.* Hence Complaint Counsel wants to argue that Unocal's continued pursuit of its patent application violated the Auto/Oil agreement.

This argument is specious at best. First, not only does the Agreement make it clear that members can engage in their own independent research on RFG, but it also states that if a member chooses to engage in independent research *"the project shall not be deemed to be undertaken by the Program."* RX 226 at U0003041 (¶ 6(B)) (emphasis added).

There is nothing in the Agreement that creates an exception for independent research results which are disclosed to Auto/Oil members.[25] Indeed, the Agreement implicitly contemplates that independent research will be disclosed to Auto/Oil members and goes on to state explicitly that if a member engages in independent research:

> (ii) neither the Program nor the other Members shall have any rights or obligations relating thereto by reason of this Agreement; (iii) the Member undertaking such project shall not be credited by the Program with any expenditures or research time relating to such project; (iv) the other Members shall not have any rights to participate in such project by reason of this Agreement; and (v) the Research

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[25] The right of companies to pursue independent research was contemplated from the inception of the research program. *See* RX 134 at MEYER 00007 (discussing formation of research program, and stating that the discussions among competitors should "emphasize the development of additional information or technology but are not to prevent other research from being conducted or in any way impede the development of other technology on fuels."); [redacted]"). The language in what became Paragraph 6(b) was strengthened further at the request of Mobil who wanted "to make sure that nothing in the agreement would intrude upon intellectual property rights that Mobil might otherwise have or might otherwise develop." RX 138 at MEYER00015.

> Planning Task Force shall not have any right to review or approve any contracts relating to such Project.

Id.

If, as Complaint Counsel argues, the disclosure of "independent research" converts such research into the "work of the Program," then the above provisions would be nonsensical since none of these would come into play unless the independent work were disclosed to the Program. For example, there could be no question about whether the Program should pay for the independent work (subsection (iii)), whether other Members would have a right to participate in the project (subsection (iv)), or whether the Auto/Oil Research Planning Task Force should have the right to review or approve contracts relating to the project (subsection (v)) unless Members of the Auto/Oil program knew about the independent research project.

In contrast to "independent research," which was conducted, approved, and paid for by an individual member, "work of the Program" was directed, conducted, paid for and published by the Auto/Oil Program. *See* RX 226 at U0003035 (¶ 4(A)) ("The Program will be managed by the Research Planning Task Force"); U0003037 (¶ 4(C)) ("No Member of the Program shall enter into any contract on behalf of the Program . . . except with the approval of the Research Planning Task Force"); U0003038-39 (¶¶ 5(A), (B) and (C)) (describing members obligations "to contribute such funds as may be necessary to develop and complete all research approved by the Research Planning Task Force"); U0003040 (¶ 6(A)) ("all of the research and testing to be carried out in the Phase I Program will be disclosed in the final report").

There is no question but that the Unocal RFG work was "independent research" belonging to Unocal. It was designed, conducted, and paid for by Unocal. No Auto/Oil funds were used, no direction was provided by Auto/Oil, and none of Unocal's work was disclosed in the final reports of Phases 1 and 2 of the Auto Oil Program. RX 424; [redacted] Even though Unocal's first patent issued in 1994, no one from Auto/Oil ever alleged that Unocal's intellectual property was the "work" of the Auto/Oil Program until Complaint Counsel brought this action in 2003.[26] This is a made-up argument with no merit.

The independent research provision of the Auto/Oil Agreement is susceptible to only one reasonable construction—one that preserves the rights of an Auto/Oil member to conduct independent research and to retain its rights in the results of its work whether or not it discusses the work with the other members of the Program. The clearly delineated rights in the Auto/Oil Agreement set forth the complete agreement between the parties. There is no legal or factual basis upon which this Court could find that Unocal had a duty to disclose its competitively sensitive information regarding its patent application or potential royalty plans to its competitors in the Auto/Oil Program.

b. <u>Unocal's truthful statements were not misleading and did not give rise to a duty to disclose its pending patent applications</u>

In addition to fraud stemming from an affirmative misrepresentation or an omission, the law generally recognizes a third category of fraud: that is when "(1) the defendant makes representations but does not disclose facts which materially qualify the facts disclosed, or which render his disclosure likely to mislead; (2) the facts are known or accessible only to defendant, and defendant knows they are not known to or reasonably discoverable by the plaintiff; (3) the defendant actively

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26 [redacted]

conceals discovery from the plaintiff." *Warner Constr. Corp. v. City of Los Angeles,* 466 P.2d 996, 1001 (Cal. 1970) (footnotes omitted). But even in these circumstances, a relationship between the parties that justifies a duty to disclose must exist. *See Wilkins v. Nat'l Broad. Co.*, 84 Cal. Rptr. 2d 329, 338-39 (Cal. Ct. App. 1999) ("[e]ach of the other three circumstances in which nondisclosure may be actionable presupposes the existence of some other relationship between the plaintiff and defendant in which a duty to disclose can arise").

A party who voluntarily makes disclosures (in the absence of a duty to do so) must speak truthfully. That is, a party may not engage in "half-truths"; if it speaks, its statements must be true without qualification. *Paulsell v. Cohen,* No. CV-00-1175, 2002 U.S. Dist. LEXIS 20386, at *71 (D. Or. May 22, 2002) ("[A] representation in the nature of a 'half-truth,' plus concealment of the remaining truth, may constitute fraud.") (internal quotation marks and citations omitted). Just because a party speaks on a topic, however, does not mean that it must disclose every facet of the subject it discusses. *See Miller v. Champion Enters., Inc.*, 346 F.3d 660, 682 (6th Cir. 2003) ("Just because defendants issued a press release and held a conference call to discuss their second quarter earnings does not mean that they chose to speak on any situation that could possibly affect their financial condition."); *Backman v. Polaroid Corp.*, 910 F.2d 10, 16 (1st Cir. 1990) (requirement that disclosures be "complete and accurate . . . does not mean that by revealing one fact about a product, one must reveal all others that, too, would be interesting, market-wise, but means only such others, if any, that are needed so that what was revealed would not be so incomplete as to mislead.") (internal quotation marks and citation omitted). The extent to which a representation is misleading and, therefore, imposes a duty of disclosure, is a question of fact. *Meade v. Cedarapids, Inc.*, 164 F.3d 1218, 1221-22 (9th Cir. 1999).

c. Unocal's statements regarding the public availability of its data are not misleading

Complaint Counsel have alleged that the statements that Unocal purportedly made regarding its data (that it was "non-proprietary" and in the "public domain") are misleading *because* Unocal did not disclose that it had a pending patent application or that it would charge royalties should a patent ever issue. *See, e.g.,* Compl. ¶ 2(a).

None of these allegations constitute the sort of misleading half-truths that are actionable fraud. First, as noted above, Unocal had no special relationship with CARB, Auto/Oil or WSPA that would create such a duty. Second, also as noted above, neither the statement that Unocal's data was "nonproprietary," nor the statement that the data was in the "public domain" were in any way false or inaccurate. And, finally, neither statement was "incomplete" because there is no expectation that the disclosure of data relating to a research project creates some duty to disclose that a company has filed for a patent application on any invention relating to that research.

As the evidence at trial will show, it is common for researchers to do as Unocal did here and disclose their data in public forums or in literature without any indication as to whether a patent application is pending or will be filed. Linck Rpt. at 8-9. In fact, other refiners have done precisely that. [redacted]

[redacted]

In other words, the public disclosure of data or research results says nothing—one way or another—about whether or not the researcher has applied for a patent on any inventions relating to that research. Thus, there is nothing misleading about a truthful statement that data has been made publicly available. Significantly, as noted above at pp. 63-65, no one from CARB understood Unocal's statement to mean anything other than that the data base was now public and could be incorporated into the mega data base CARB was compiling.

Moreover, nothing in Unocal's advocacy efforts created a duty to disclose its patent application because Unocal never disclosed to CARB, Auto/Oil or WSPA any of the inventions set forth in the claims of its patent. Hence, even if the word "data" were read to mean something other than the raw data which Unocal had provided to CARB on a diskette in late July 1991 (which it should not be), it could not possibly be read so broad as to include patent claims which Unocal never shared with anyone other than the PTO. It is crystal clear from both the August 27, 1991 letter (RX 3), and from the Auto/Oil September 1991 minutes (RX 231), that the data referred to as "non-proprietary" and "in the public domain" is data that has previously been shared with CARB. *See* RX 3 ("We subsequently made *the data base* available to the staff and agreed to make *the data public* if necessary in the development of a predictive model for use in the certification of reformulated gasoline.") ; RX 231 ("Mr. Jessup explained that *the data from Unocal's research has been provided to CARB* and is in the public domain.") (emphasis added).

The entire context of Unocal's communication with CARB demonstrates that there was nothing misleading about Unocal's August 27, 1991 letter. In June 1991, Unocal met with CARB to persuade CARB staff: (1) to adopt a predictive model; and (2) not to mandate MTBE since it had only an indirect impact on emissions. RX 24. During this meeting, Unocal confidentially disclosed to CARB some of the results of its research which Unocal believed were important to it on these points. The slides which Unocal confidentially shared with CARB at that meeting included information about its experimental design, the fuels it used in some of its tests, the properties which Unocal's research showed had an effect on emissions and the directions those properties should be adjusted to lower emissions. *Id.* In that meeting Unocal told CARB that its research showed that it was possible to predict emissions from fuel properties (hence a predictive model was viable) and that other properties—not MTBE—had a direct effect on emissions (hence MTBE should not be regulated). Lamb IH Dep. (Unocal), 1/16/02, at 34:17-35:21; RX 24 at 006-013.

After their June meeting, in response to a request from CARB, Unocal sent to CARB on July 1, 1991, the equations it derived from its ten-car test and asked CARB to treat these as confidential. RX 2. Later that same month, in response to another request by CARB, Unocal sent to CARB the diskette containing the raw emissions data that it measured and recorded from its ten-car test. RX 3. CARB also understood that this data was to be treated confidentially. Boyd Dep. (CARB), 8/22/03, at 146:19-147:9. CARB then requested that Unocal lift the confidentiality of the data base only (not the equations or the slides), and on August 27, 1991 Denny Lamb of Unocal agreed to do just that. RX 3; RX 155, RX 157.

In September 1991 Unocal shared its ten-car data base with a WSPA committee that was trying to develop a predictive model. Also in September 1991, Unocal gave a slide presentation to

Auto/Oil, containing many of the slides it had presented to CARB in June, as well as slides showing the ten-car equations.

At no point in time during the development of the Phase 2 regulations did Unocal ever disclose to Auto/Oil, WSPA or CARB the combination of properties and their ranges for the compositions of motor gasoline claimed in the patents. Indeed, the trial in the district court established that the claims of the '393 patent were conceived based upon Unocal's one-car study. *Union Oil Co. of Cal. v. Atlantic Richfield Co.*, No. CV-95-2379, slip op. at 15 (C.D. Cal. Aug. 31, 1998) (Phase III: Memorandum of Decision Setting Forth the Court's Factual Findings and Conclusions of Law) (establishing a conception date of March 30, 1990). The equations for the one-car study were not part of Unocal's presentation to CARB or Auto/Oil.

Moreover, no duty to disclose can be implied from Unocal's advocacy efforts, because Unocal never urged CARB to mandate any specific fuel composition, much less one of its yet-to-be patented fuel compositions. In fact, Unocal was arguing strongly *against* the mandate of specific fuel compositions, seeking instead a regulation that would allow refiners to use a "pure predictive model" to make low emissions gasoline. Hence there was nothing in Unocal's advocacy efforts, the material it disclosed, or any of its statements regarding the public availability of its data which were in any way incomplete, inaccurate or misleading.

d. <u>**Unocal's statements regarding the cost-effectiveness and flexibility of the predictive model are not misleading**</u>

The Complaint also alleges that it was misleading for Unocal to speak to the cost-effectiveness and flexibility of the predictive model without disclosing that it had a patent application and might some day charge royalties. Compl. ¶ 2(b). For many reasons, this allegation does not constitute a misleading half-truth that could give rise to actionable fraud claim.

First, Unocal specifically supported a predictive model because it would allow Unocal refineries more flexibility in reducing emissions and complying with the regulations. *E.g.*, RX 60 at CARB0001419-21 (Lamb); Beach IH Dep. (Unocal), 1/23/02, at 41:16-43:2; 46:25-47:13; 62:6-23; Courtis Dep. (CARB), 8/28/03, at 126:17-127:5. Both CARB and others in the refining industry shared Unocal's opinion that predictive model would be cost-effective and flexible. Hence this statement cannot possibly be considered false. *See* RX 54 at 007 (internal page 3), 022 (internal page 18) (CARB document stating that the purpose of the regulatory amendments incorporating the predictive model was "to provide additional flexibility to gasoline producers . . ." and concluding that "the California predictive model will reduce production costs and minimize the potential for supply disruptions"); *see also* RX 53 at 053 (internal page 48) ("proposed predictive model is expected to lower producers' and gasoline suppliers' costs to comply with the Phase 2 RFG regulations"); Boyd Dep. (CARB), 8/22/03, at 177:15-179:4, 221:12-22 (predictive model provided cost savings and flexibility to refiners); Kenny Dep. (CARB), 5/15/03, at 100:11-101:18 (even with knowledge of Unocal's patents, CARB believes the predictive model "provides greater flexibility" to refiners). [redacted]

Second, comments with respect to "cost-effectiveness" and "flexibility" are broad opinion statements. A statement of opinion is not an actionable fact statement that could be construed as a "half-truth" which gives rise to a duty to disclose. *See Paulsell,* 2002 U.S. Dist. LEXIS 20386, at **66-67.

Finally, the mere fact that Unocal gave accurate statements as to its opinion regarding the cost-effectiveness and flexibility of a predictive model cannot be read to give rise to a duty to disclose any or all information Unocal had regarding potential refinery costs. Neither CARB nor any of the stakeholders in the Phase 2 rulemakings understood that companies who chose to petition CARB had a duty to volunteer any and all information that CARB might later claim is relevant to its cost-effectiveness determination.

Just as there is no rule or regulation requiring companies to disclose patents or patent applications, there is also no rule requiring companies to volunteer information that CARB might consider relevant to the costs of the regulation. Boyd Dep. (CARB), 8/22/03 at 251:6-16; RX 332 at 006 (§ 11347.5(a)). Few companies, in fact, responded to CARB's requests for information regarding costs and those few that did were not completely forthcoming with information CARB sought.

For example, when CARB asked at its August 1991 workshop for information regarding prospective costs of compliance with the Phase 2 regulations, only six out of thirty California refineries provided information. Aguila Dep. (CARB), 7/24/03, at 54:24-56:19; Simeroth Dep. (CARB) at 234:23-235:12; *see also* RX 10 at CARB0000351 (stating that "[t]he staff requested data from all refineries in California, but only six refineries provided data"). Of those six, only two provided the types of information that CARB sought. Aguila Dep. (CARB), 7/24/03, at 164:25-165:10. [redacted]

[redacted]

Like most California refiners, Unocal never provided CARB with any cost data for the cost-effectiveness analysis for the Phase 2 regulations. RX 10 at CARB0000394. Given that Unocal never submitted any cost data, it could not have submitted cost information that was misleading or incomplete.

3. <u>Unocal did not intend to mislead CARB, Auto/Oil or WSPA</u>

The Commission's July 7 opinion emphasized that cases recognizing a misrepresentation exception to *Noerr* all require that any such misrepresentation be made with deliberate intent. *Union Oil*, slip op. at 36; *see Whelan v. Abell,* 48 F.3d 1247, 1254 (D.C. Cir. 1995) ("We see no reason to believe that the right to petition includes a right to file *deliberately false* complaints.") (emphasis added); *Clipper Exxpress v. Rocky Mountain Motor Tariff Bureau, Inc.*, 690 F.2d 1240, 1261-62 (9th Cir. 1982) (finding no First Amendment protection when false statements are furnished to the government "with predatory intent" in a "deliberate attempt to mislead"); *Potters Medical Center v. City Hosp. Ass'n,* 800 F.2d 568, 580 (6th Cir. 1986) (finding exception to *Noerr* for "*knowing and willful* submission of false facts to a government agency") (emphasis added).

And, of course, intent is an element of both a monopolization case and an attempted monopolization case, although the requisite intent is greater for an attempted monopolization case. "While the completed offense of monopolization under § 2 demands only a general intent to do the act . . . a specific intent to destroy competition or build monopoly is essential to guilt for the mere attempt. . . ." *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 626 (1953). In *Rambus*, Judge McGuire noted that when the exclusionary conduct is based upon an allegation that the Respondent intentionally sought to mislead, then to establish a Section 5 violation, Complaint Counsel must prove an intent to mislead or deceive. *See Rambus,* slip op. at 297 (citing *MCI Communications Corp. v. Am. Tel. & Tel. Co.,* 708 F.2d 1081, 1129 (7th Cir. 1983) (holding that a representation about products must be "knowingly false or misleading before it can amount to an exclusionary practice").

And, finally, intent to deceive is a necessary component of both common law fraud and *Walker Process* fraud. *Kangaroos U.S.A. v. Caldor, Inc.*, 778 F.2d 1571, 1573 (Fed. Cir. 1985) (citing *J.P. Stevens & Co., Inc. v. Lex Tex Ltd., Inc.*, 747 F.2d 1553, 1559 (Fed. Cir. 1984). This element of fraud requires intent to induce "the particular action taken by the hearer." *Carlson v. Murphy*, 8 Cal. App. 2d 607, 611 (Cal. App. 1935) (citation omitted); *see Walker Process*, 382 U.S. at 177 (construed in *Union Oil* slip op. at 36, as requiring knowingly and willfully misrepresenting facts).

Complaint Counsel will be unable to establish that Unocal intended to mislead CARB into adopting regulations that "substantially overlapped with Unocal's concealed patent claims." Compl. ¶ 5. Unocal intended no such thing. As noted above, unlike others such as ARCO—who argued that CARB should mandate certain formulations of gasoline with specific properties—Unocal never advocated to CARB any specific set of formulations, much less formulations that fell within any of its patent claims. Indeed, the only hypothetical fuel example set forth in the slides which Unocal showed to CARB does not even fall within the ranges in Unocal's patent claims, nor was Unocal advocating that CARB adopt this (or any other) mandatory set of fuel specifications. RX 24 at 0037.

Rather, the evidence conclusively shows that Unocal never even attempted to persuade CARB to adopt regulations that "overlapped" with any of its patent claims because *it did not want CARB to mandate specific fuel properties*. Concern for how the proposed regulations would affect the company's refining operations predominated the company's Phase 2 CARB advocacy strategy. Lamb IH Dep. (Unocal), 1/16/02, at 84:14-86:12; 39:2-44:1. So at the June 1991 meeting, Unocal hoped to persuade CARB on two points that had a direct effect on Unocal's refineries: (1) Unocal wanted CARB to adopt a predictive model; and (2) Unocal wanted CARB to reject an oxygenate mandate. RX 24.

What Unocal hoped to accomplish in this meeting is set forth on the cover page of the presentation that Unocal confidentially provided to CARB on June 20, 1991. RX 24. Two of the "actions steps" on this page are:

- ADOPT PREDICTIVE MODEL
  - PRACTICAL
  - COST EFFECTIVE
  - ENFORCEABLE
- AVOID RFG 02 MANDATE
  - ALLOW MODEL TO WORK

- ADDITIONAL NOX CONTROL

RX 24.

In this meeting, Unocal discussed some of its research with CARB in an attempt to persuade CARB on these two points. For example, Unocal's research showed that Unocal believed it was possible to use mathematical equations containing the properties of a gasoline fuel to predict what the exhaust emissions of that particular fuel would be. Unocal told CARB that developing such a mathematical model would enable CARB to achieve whatever emissions goals it wanted while at the same time allow refineries the option to vary the properties of gasoline according to their own specific refinery needs.

Although CARB did not adopt a predictive model as part of its 1991 regulations (as Unocal had sought), CARB did adopt such a model in June 1994. The model CARB adopted still contained specific caps on property limits, in direct contravention to Unocal's arguments supporting a "pure" predictive model with no property caps. *See* RX 33; RX 159 at WSPA-FTC0004946; RX 33 at CARB0001747. Nevertheless, the predictive model as adopted by CARB provides refiners with the flexibility to avoid making gasolines that match the numerical property limitations of many Unocal patent claims. Stellman Rpt. at 16. A pure predictive model such as that sought by Unocal would have provided refiners with even greater latitude to avoid matching the property limitations of Unocal patent claims. *Id.* Unocal was still arguing for the adoption of a pure predictive model in 1994, after the '393 patent issued. RX 159.

The next bullet point from the June 20, 1991 presentation—AVOID RFG O2 MANDATE—refers to Unocal's desire that CARB not require refiners to add oxygenate to their gasoline. RX 24, Lamb IH Dep. (Unocal), 1/16/02, at 34:17-35:21. Unlike some refiners such as

ARCO, Unocal did not have a ready source of oxygenate such as MTBE. In addition, Unocal's research had shown that the effects commonly attributed to MTBE were coming from a depressed T50 distillation point. Lamb IH Dep. (Unocal), 1/16/02, at 29:4-13. Since the inclusion of MTBE typically lowers the T50 in a gasoline, the true effects of T50 were being masked by those who assumed it was MTBE itself which had the emissions effects. *Id.* By emphasizing these research results to CARB, Unocal hoped to convince CARB not only to base its regulations on good science, but also to avoid specific mandates such as an oxygenate requirement, which would be difficult and costly for Unocal's refineries to meet. Lamb IH Dep. (Unocal), 1/16/02, at 28:11-293.

Unocal continued to oppose a minimum oxygenate requirement at the November 1991 Board hearing. *See* RX 10 at CARB0000308-09, CARB0000341 (comments 45-47, 128). Because MTBE depresses the T50 of gasoline, eliminating the MTBE from gasoline will raise its T50 (all other things being equal). Stellman Rpt. at 16. Gasolines with increased T50 are more likely to avoid the numerical limitations in some of Unocal's patent claims. *Id.*

In fact, time and again, Unocal argued to CARB not to adopt specific limitations on gasoline properties, even though such limitations would have created "overlap" with the property limitations in Unocal's patent claims. For example, Unocal argued *against* CARB's adoption of a T50 specification, even though a number of Unocal's patent claims contain a T50 limitation. *See* Sharpless Dep. (CARB), 8/6/03, at 98:17-99:5; RX 10 at CARB0000315 (comment 63); Stellman Rpt. at 16. Had CARB not included a T50 specification—as Unocal argued—refiners would have had greater ability to avoid making gasolines which match some of the property limitations of Unocal's patent. Stellman Rpt. at 16. Unocal also questioned CARB's rationale for its proposed olefin specification, argued that there was no support for its proposed aromatics regulation, and argued for more flexibility and a higher cap in the proposed RVP regulation. *See* RX 10 at CARB0000299-300, CARB0000338-40 (comments 23, 25, 122-125). Had CARB done as Unocal advocated in these areas, refiners would have had additional flexibility to avoid the numerical property limitations in Unocal's patent claims. Stellman Rpt. at 16-17.

Even after the 1991 CARB Board Meeting, Unocal continued to argue against the CARB regulations, telling CARB that the regulations were not necessary and seeking a postponement of their starting date. For example, in a January 1994 meeting with CARB's chairperson, Unocal specifically argued that "RFG2 is not needed in California to achieve air quality standards." RX 200. As CARB's Dean Simeroth recalled, "[Unocal's] whole actions through this time period was that they did not like the RFG2 regulations." Simeroth Dep. (CARB), 7/9/03, at 158:22-159:10; *see also, e.g.,* RX 39 at CARB0003235-36; CX 575 at U069224-25; RX 42 at CARB0004779-82 (Unocal reiterated its request for delay of the CARB regulations in June 1992, again in August of 1992, and again in September 1992).

Unocal's opposition of the regulations before CARB is also consistent with what Unocal was espousing to WSPA during work on the predictive model during 1994. Even after the '393 patent issued, Unocal's Peter Jessup continued to advocate an unbounded, pure predictive model. *See* RX 159 at WSPA-FTC0004946 (Unocal's 5/19/94 presentation to the WSPA predictive model working group, concluding: "no caps on fuel properties are necessary").

Again, Unocal consistently advocated for regulations that were in the best interests of its refineries and *against* regulations that might increase the value of its patents. Because Unocal intended CARB to take a course of action that was diametrically opposed to the one that CARB adopted, Complaint Counsel cannot meet their burden of establishing the intentional fraud necessary to prove the Section 5 violations pled in the Complaint.

Nor can Complaint Counsel establish that Unocal intended to deceive CARB, Auto/Oil or WSPA by failing to tell any of these groups about its patent application. If a duty to disclose is in any way unclear or ambiguous, a failure to disclose cannot as a matter of law constitute acting "with deceptive intent." *OddzOn Prods., Inc. v. Just Toys, Inc.*, 122 F.3d 1396, 1404 (Fed. Cir. 1997).

Here Unocal employees never thought of disclosing its patent application because Unocal—like other companies—had a longstanding policy of not disclosing the existence of patent applications to anyone outside the company. *E.g.*, Beach IP Dep. (Unocal), 1/23/02, at 54:8-13, 59:16-22; Jessup IH Dep. (Unocal) 1/25/02, at 150:3-14; [redacted] CARB was well aware of this general industry practice. Simeroth Dep. (CARB), 7/9/03, at 45:18-21; 233:15-234:5. And, most significantly, no one from CARB ever asked Unocal whether it had any patent applications, and no one from CARB ever told Unocal that patents, much less patent applications, would play any role in CARB's deliberations.

With respect to WSPA and Auto/Oil, Unocal itself had internal policies that prohibited it from discussing competitively sensitive information (such as patent applications) with its competitors. Auto/Oil and WSPA had similar policies, and these policies were vigorously enforced. Since the only "duty" that Unocal could possibly have understood was a duty *not* to disclose, as a matter of law, it did not act the requisite "deceptive intent" when it failed to disclose its patent application to CARB, WSPA and Auto/Oil.

4. **Unocal's alleged misrepresentations were not material**

Fraud requires that the alleged misstatements of fact be material. *E.g.*, *Charpentier v. Los Angeles Rams Football Co.*, 89 Cal. Rptr. 2d 115, 123 (Cal. Ct. App. 1999); *City of Atascadero v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 80 Cal. Rptr. 2d 329, 354 (Cal. Ct. App. 1999); *see also Fish v. Richfield Oil Corp.*, 178 F. Supp. 750, 756 (S.D. Cal. 1959) ("There can be no fraud unless the representation relates to a material matter.") (footnote omitted). A representation is not material unless a reasonable person would want to consider the fact in determining whether to enter the transaction in question. *E.g., Roberts v. Lomanto*, 5 Cal. Rptr. 3d 866, 876 (Cal. Ct. App. 2003) ("The test of materiality is objective: whether a reasonable person in the principals's position would have acted differently had he known the undisclosed facts."); *Charpentier*, 89 Cal. Rptr. 2d at 123 (A matter is material if "a reasonable person would attach importance to its existence or nonexistence in determining his choice of action in the transaction in question.") (citation omitted); *see also United States v. Ciba-Geigy Corp.,* 508 F. Supp. 1157, 1170 (D.N.J. 1979) (stating, in the context of *Walker Process* fraud: "A misrepresentation is material if the patent would not have issued 'but for' the omission.").

The central allegation of the Complaint is that Unocal failed to tell CARB and its competitor refiners that it had a patent application on file. But even had CARB been aware that Unocal had filed a patent application, this fact would not have provided CARB with any of the information CARB would have needed to evaluate an alternative regulatory strategy. Likewise, had Unocal informed the other refiners of its patent application, they would have had none of the information necessary to determine whether to reconfigure their refineries differently. For example, an analysis of the potential cost impact to the industry and/or consumers could not have even begun without answers to the following questions, none of which were capable of being evaluated in 1991:

(1) Would one or more patents subsequently issue from Unocal's 1990 patent application?

Unocal's application could only have a potential future impact on industry costs if Unocal actually received a patent. A significant percentage of patent applications do not result in issued patents. Moreover, the patent prosecution process can take a significant amount of time, and a party often will not know for many years whether or not it will receive a patent on its invention. Here, Unocal filed its patent application in 1990. It did not receive its first patent based on this application until 1994; it then went on to receive subsequent patents based upon this original 1990 application in 1997, 1998 and 2000.

(2) If a patent were to issue, what compositions of gasoline would it claim?

The Complaint does not allege that Unocal had any duty to tell CARB or the refiners the contents of its application; only that it had an application and intended to assert its "proprietary rights" should a patent issue. Compl. ¶¶ 2a, 2b, 48, 78. Had Unocal simply told CARB and/or the refiners that it had an application (but not divulged its contents), they would have had *no* information upon which to determine if some alternative regulatory strategy or refinery configuration was preferable. And even if Unocal had shown CARB or the refiners the contents of its patent application, there would have been no way to know in 1991 what the claims of any subsequently issued patent would cover. Indeed, it is not unusual for the PTO to narrow the scope of the patentee's original application. Here, for example, the 151 claims originally allowed for the '393 patent were more narrow than those originally sought by Unocal. Moreover, the owner of the patent also has the right to decide not to pursue all the claims allowed by the PTO. And, in fact, Unocal elected to disclaim a large number of the original claims allowed by the PTO, and the final '393 patent issued in 1994 with just 41 claims. In 1991, neither CARB nor Unocal nor the refiners could have known which claims, if any, might ultimately be allowed, or which claims, if any, Unocal would chose to pursue. In fact, just before the CARB vote in 1991, all of Unocal's pending claims were disallowed by the PTO. RX 852 at UFTC004810 (November 14, 1991 rejection of all pending claims).

In addition, a single patent application is often broken apart into several applications, each of which then proceeds on its own patent prosecution path—should the inventor chose to pursue any of these continuing applications. (Patent applications are also frequently abandoned.) Continuing applications include "continuations"—a second application for the same invention claimed in a prior application, filed before the first application is either abandoned or patented—and "divisional" applications—a later application for an independent or distinct invention disclosing only subject matter that was disclosed in an earlier or parent application.

Here, Unocal's original patent application, filed in December 1990, ultimately gave rise to four patents, in addition to the '393. Two of these additional patents issued in 1997, one in 1998 and the final in 2000, a *decade* after the first application was filed. No one could have known in 1991 the prosecution path Unocal's 1990 patent application would take, what patents and claims Unocal might chose to pursue in the future based upon Jessup and Croudace's original invention, nor which claims the PTO would subsequently allow.

(3) What would the overlap be between the compositions of gasoline covered by CARB's regulations and the compositions covered by Unocal's subsequently issued patents?

In other words, what percentage of potential CARB-compliant gasoline would infringe? This question would be crucial to a determination of the ultimate cost impact of any Unocal patent and any evaluation of an alternative regulation or an alternative refinery configuration. If, for example, a small percentage of the gasoline manufactured infringes, the cost impact to the refiners and the ultimate consumer (regardless of the amount of the royalty) would be de minimus. And, in fact, the evidence at trial will show that refiners have been able to avoid infringing the '393 patent at minimal cost and that very little of the gasoline produced in California within the past several years falls within the '393 patent claims.

(4) What would the cost to avoid infringement be?

To assess the potential economic impact of Unocal's yet-to-be issued patents under any proposed regulatory strategy, it would have been essential for CARB to have an estimate of what it would cost refiners to avoid infringement. Likewise, to determine if an alternative refinery configuration was feasible and preferable, refiners would have needed to know (among other things) the cost to avoid infringement. These factors would have been impossible to determine in 1991. Not only did no one know what the scope of Unocal's patent (if any) would be or what the scope of the ultimate regulations would be, but refiners would not have known what the potential avoidance costs would be under potential alternative refinery configurations.

(5) Would CARB and the industry have believed Unocal's patents to be valid?

No one will have to pay license fees or incur costs to avoid a patent that is not valid. CARB would have had no way of knowing in 1991 whether any potential patents granted to Unocal would have been viewed as valid by the industry, or subsequently upheld as valid by a court. [redacted] It simply was not material to their decision-making. Even today—after the '393 patent has been upheld as valid by the Federal Circuit —the major California refiners claim that Unocal's four additional patents are not valid.

(6) What licensing fees would Unocal and the refiners ultimately agree upon?

The scope and nature of any licensing agreement between Unocal and the other refiners—and the amount of any royalty—would necessarily depend upon whether refiners viewed Unocal's patents as valid, what Unocal's patent claims covered, the demand for the compositions covered by Unocal's patent, and the costs to avoid infringement. In 1991, no one could have known what any of these factors might have been many years later.

Unocal did not even begin to discuss licensing its patent until January 1995, when Unocal issued a press release announcing that it had received the '393 patent and that it anticipated having a licensing program ready to offer other refiners by the end of April 1995. Before Unocal could even propose such a program, California's six major refiners brought a declaratory judgment action seeking a declaration that Unocal's patent was invalid. It wasn't until many years later, in 2000, that Unocal finally announced a licensing program for its patent portfolio. [redacted]

5. **Neither CARB nor the refiners relied upon Unocal's omission**

Materiality is an objective standard which focuses upon whether a reasonable person would have found the withheld information significant to the transaction. *Roberts*, 5 Cal. Rptr. 3d at 876; *Charpentier*, 89 Cal. Rptr. 2d at 123. In contrast, the element of reliance is a subjective standard that focuses on whether the allegedly defrauded party would have made the same decision but for the misrepresentation or omission. *E.g.*, *City of Atascadero*, 80 Cal. Rptr. 2d at 354-55 ("It is essential, however, that the person complaining of fraud actually have relied on the alleged fraud, and suffered damages as a result."); *see also*, *e.g.*, *Whiteley v. Philip Morris, Inc.*, 11 Cal. Rptr. 3d 807, 842-43 (Cal. Ct. App. 2004) ("Actual reliance occurs when a misrepresentation is an immediate cause of a plaintiff's conduct, which alters his legal relations, and when, absent such representation, he would not in all reasonable probability, have entered into the contract or other transaction.") (citations omitted); *Acosta v. Synthetic Indus., Inc.*, 106 Cal. Rptr. 2d 361, 377 (Cal. Ct. App. 2001) ("In order to maintain a cause of action for fraud or one based on alleged misrepresentations, facts establishing actual reliance must be pleaded."); *Gawara v. United States Brass Corp.*, 74 Cal. Rptr. 2d 663, 666 n.8 (Cal. Ct. App. 1998) (recognizing settled law requiring a showing of actual reliance); *Orient Handel v. United States Fid. & Guar. Co.*, 237 Cal. Rptr. 667, 672 (Cal. Ct. App. 1987) ("In order, however, to plead and prove a fraud cause of action, '[it] must [also] be shown that the plaintiff *actually relied* upon the misrepresentation.'") (citing 4 WITKIN SUMMARY OF CALIFORNIA LAW, TORTS § 446, p. 2732 (8th ed. 1974)).[27]

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[27] Like common law fraud, defenses to patent infringement claims, such as implied license and equitable estoppel, also require detrimental reliance. As the Federal Circuit explained, equitable estoppel requires that the "accused infringer must show that, in fact, it substantially relied on the misleading conduct of the patentee in connection with taking some action." *A.C. Aukerman* (continued...)

To fall within any fraud exception to the *Noerr* doctrine, as recognized by the Commission in its July 7 order, the challenged representation must be one which was actually material and relied upon by the governmental body at issue. *See Balt. Scrap Corp. v. David J. Joseph Co.*, 237 F.3d 394, 402 (4th Cir. 2001) ("If a judgment is not procured by fraud or deceit, it cannot fall within any fraud exception to *Noerr-Pennington.*"); *Cheminor Drugs v. Ethyl Corp.*, 168 F.3d 119, 123-24 (3d Cir. 1999) (alleged frauds that "do not infect the core" of a case will receive *Noerr-Pennington* immunity because regardless of the alleged fraud, the outcome would have been the same); *Kottle v. Northwest Kidney Ctrs.*, 146 F.3d 1056, 1063 (9th Cir. 1998) (To survive 12(b)(6) motion and overcome *Noerr* immunity, allegations must demonstrate that the defendant "so misrepresented the truth to the Department that the entire CON proceeding was deprived of its legitimacy.")

Here, the evidence overwhelming shows that neither CARB nor the refiners relied Unocal's omission, thus—regardless of the alleged "fraud," the outcome would be the same.

a. <u>CARB would not have made a different regulatory choice had Unocal told of its patent application</u>

(1) <u>CARB does not consider or ask about intellectual property right in forming its regulations</u>

CARB has consistently revealed an indifference to information regarding the existence of intellectual property rights that bear on its regulations. During its lengthy Phase 2 rulemaking process, CARB *never* asked about patents, much less patent applications. And, unlike some private

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[27] (...continued)
Co. v. R.L. Chaides Constr. Co., 960 F.2d 1020, 1042-43 (Fed. Cir. 1992). Detrimental reliance is likewise critical under an implied license theory. *Stickle v. Heublein, Inc.*, 716 F.2d 1550, 1559 (Fed. Cir. 1983) ("[A]n implied license cannot arise out of the unilateral expectations or even reasonable hopes of one party. One must have been led to take action by the conduct of the other party.")

standard-setting bodies, CARB has never had any regulation requiring that those communicating with CARB disclose patent applications. 2d RFA Responses at Rsp. 11. Moreover, by law CARB was not permitted to have informal, unwritten policies. Boyd Dep. (CARB), 8/22/03, at 251:6-16; RX 332 at 006 (§ 1347.5(a)). In other words, there can be no CARB policy regarding patents other than a written policy, and no written policy exists.

In fact, other companies—like Unocal—did not disclose to CARB that they had filed patent applications on inventions relating to reformulated gasoline. [redacted] nor did CARB ever ask about patents or patent applications. *Id.* at 36:03-36:21; 2d RFA Responses at Rsps. 8, 12.

[redacted]

[redacted]

Even after learning about Unocal's patent in 1994, CARB never asked Unocal to disclose any additional applications. And most significantly, CARB did not consider Unocal's patent during its Phase 3 ruling making in 2000 because the patent was "still in a state of flux" and "we believed that there were concerns with the validity of the patent." Venturini Dep. (CARB), 5/14/03, at 402:17- 403:15.

Moreover, CARB has never had a practice of refusing to issue regulations that might impact the use of patented technology. In 1989—when CARB was considering the adoption of Phase 1 regulations addressing gasoline additives—Unocal informed CARB of a "patent-pending" additive that it believed would meet the proposed regulations. CX 131; Croudace Dep. (Unocal), 6/12/03, at 19:25-20:2; RX 165 at CARB-FTC0060533. CARB sought no additional information from Unocal regarding this pending patent, and went on to enact its regulation without conducting any further inquiry or analysis of Unocal's patent application. 2d RFA Responses at Rsp. 10; Simeroth Dep. (CARB), 7/9/03, at 20:25-21:16. The response to Unocal's "patent-pending" additive was not unusual; during his tenure as CARB's executive director, James Boyd testified that he never gave a directive that patented technologies could not be used in CARB's regulations.[28]

In sum, there is simply no viable evidence to show that CARB ever asked about patent applications or ever based any of its regulatory decisions upon the existence (or lack thereof) of

28 [redacted]

intellectual property rights. In 2000, even after Unocal was granted additional patents and after the Federal Circuit had upheld the validity of Unocal's first patent, CARB elected not to consider Unocal's patent in its Phase 3 rulemaking. There is certainly no reason to believe that in 1991 had Unocal told of a *pending* application, that CARB would have made a different regulatory choice in its Phase 2 rulemaking.

(2) Unocal's failure to disclose its patent application did not affect CARB's cost-effectiveness analysis

(a) The Phase 2 regulations are still "cost-effective," even assuming CARB had perfect foresight into Unocal future

It is not surprising that CARB was indifferent to the disclosure of intellectual property rights, given the way in which it determined cost-effectiveness and the role this cost-effectiveness determination played in its Phase 2 rulemaking.

The "cost-effectiveness study" conducted by CARB was done pursuant to a "Cost-Effectiveness Guidance" document produced by CARB under the California Clean Air Act. RX 195 (September 1990). CARB calculated "cost-effectiveness by calculating the dollars per ton of pollutants reduced." RX 195 at CARB-FTC0039611. That rate was then compared to the rate of other recently adopted or proposed measures. "A measure is deemed cost-effective if it reduces emissions at a cost comparable to other measures, again, on a per ton basis." *Id.* at 0039611.

CARB assigned the task of conducting the cost-effectiveness analysis to a junior engineer, James Aguila, who had no formal training in accounting and who had never performed a complicated cost analysis before. Aguila Dep. (CARB), 7/24/03, at 7:21-8:1,14:1-15:14;

15:20-16:5. The only guidance provided to Mr. Aguila was a copy of RX 195, the September 1990 "Cost-Effectiveness Guidance" document. *Id.* at 16:10-18:6.

To assist in this analysis, CARB asked the refiners to voluntarily provide information regarding their estimated production costs for RFG. Aguila Dep. (CARB), 7/24/03, at 53:1-54:18; 89:20-91:12. CARB never asked the refiners to provide any information about revenues or potential revenues related to compliance with the proposed RFG regulations, nor did it ask refiners to provide information about *other* refiners' costs. *Id.* at 134:8-135:14. In response to its request for voluntary cost information, CARB received information from only six refiners of the thirty California refiners. Simeroth Dep. (CARB), 7/9/03, at 234:23-235:12. Of these six, only *two* refiners provided information about capital and operating costs. Aguila Dep. (CARB), 7/24/03, at 164:25-165:10; RX 52 at 071. Unocal, like many other refiners, did not furnish any cost information to CARB. Beach IH Dep. (Unocal), 1/23/02, at 54:8-13, 59:16-22.

The two refiners who did provide operating cost information to CARB estimated that their operating costs would be 25% and 40% of their capital costs, respectively. Aguila Dep. (CARB), 7/24/03, at 203:20-206:9. To determine the predicted operating costs necessary for CARB's cost-effectiveness determination, Mr. Aguila then took the percentage estimates from these two refiners (25% and 40%) and chose to use 50%, in an effort to include a "factor of safety" and derive a "conservative estimate." *Id.* at 162:13-163:2, 203:20-206:9.

Using this 50% factor, CARB estimated that the high-end costs per ton for its Phase 2 regulations was $11,000 per ton of emissions reductions. RX 10 at CARB0000360. To determine whether this cost was "cost-effective" (as defined in its guidance document, RX 195), CARB then compared this $11,000 estimate with the "going rate" for cost-effectiveness—the upper cost bound for measures recently adopted or proposed for adoption. RX 195 at CARB-FTC0039612. So long as the estimate for the Phase 2 regulations was at or lower than the upper cost bound, the Phase 2 regulations were deemed to be cost-effective. *Id.* The upper cost bound cited by CARB staff in the Technical Support document was $32,000 per ton. RX 10 at CARB0000360, 391-392; Sharpless Dep. (CARB), 8/6/03, at 206:1-5. At the November 21, 1991 Board hearing, CARB staff member Bob Fletcher stated that there was an even higher upper cost bound of $50,000 per ton. RX 60 at CARB0001357. Since Mr. Aguila's $11,000 per ton estimate was below these high end costs, the regulations were deemed to be cost-effective.

In 1991, no one would have had any ability to predict what effect, if any, Unocal's patent application could have on these cost estimates. [redacted]

[redacted] the upper cost bounds of other measures CARB was discussing ($32,000 and $50,000), but in 1991 CARB staff specifically considered what impact a [redacted] increase would have upon their estimates and determined that such an increase "doesn't have a significant impact of the cost-effectiveness" of the regulation. RX 60 at CARB0001097. Moreover, in 1991, when CARB was faced with an argument by Unocal that the regulations were likely to be considerably more costly than CARB had projected, CARB stated that even with a 25% increase in the cost, the regulations would still be cost-effective. RX 10 at CARB 0000456 ("even if the cost-effectiveness of Phase 2 RFG is changed by 25% as suggested by Unocal, the Phase 2 RFG cost-effectiveness would still be comparable to recently enacted regulations").

(b) <u>Cost effect did not play a dominant role in CARB's decision making</u>

Although CARB performed a "cost-effectiveness" analysis as set forth above, this analysis was not one of the predominant factors in CARB's Phase 2 rulemaking. CARB's own cost-effectiveness guidelines dictate that CARB's consideration of cost-effectiveness should be neither the sole, nor the dominant, criterion for decision making. RX 195 at CARB-FTC0039609. Rather, CARB's "primary mandate was to achieve the state air quality standards by the earliest practicable date . . . ." *Id.*

As noted above, CARB did not do a rigorous analysis, but rather assigned the task to an inexperienced junior engineer who performed his cost study by rounding up estimates from two of California's 30 refiners. CARB had in fact planned on performing a more scientific study of costs through the use of a linear programing model, but abandoned this approach because of time constraints. Fletcher Dep. (CARB), 7/8/03, at 81:17-82:4. Additionally, Mr. Aguila did no serious analysis of the effect of the regulation on consumers; rather, he simply added the "fuel penalty" to the estimate of the operating costs to the refiners. Aguila Dep. (CARB), 7/24/03, at 187:25-188:6.

In a number of instances during its Phase 2 rulemaking, CARB subordinated cost-effectiveness concerns in favor of other values—such as higher emissions benefits. For example, WSPA had proposed a regulation that it believed would prove 80% of the emissions benefit, for 50% of the cost of the original CARB proposal. RX 60 at CARB0001235. CARB rejected this WSPA's proposal, and rejected as well a "middle ground" compromise proposed by CARB staff which would have provided 90% of the benefits of the original staff proposal at 70% of the costs.[29] RX 60 at CARB0001184. CARB's rejection of these less costly measures was in line with its cost-effectiveness guidelines, which advised that it is appropriate to "adopt measures that are less cost-effective on a dollars per ton basis if the potential emission reductions are greater." RX 195 at CARB-FTC0039620. And in its Final Statement of Reasons for Rulemaking, CARB explicitly noted that it was not required to adopt measures in order of their cost-effectiveness, but rather could look to other factors such as emissions benefits, federal and state mandates, potential safety issues and enforceability. RX 10 at CARB0000379; *see also* RX 195 at CARB-FTC0039621 (There is no obligation "to adopt or implement control measures in rank order of cost-effectiveness . . . the California Clean Air Act mandates consideration of several different factors and places an emphasis on expeditious attainment.").

(3) **Complaint Counsel have identified no alternative regulations that CARB would have adopted but for Unocal omissions**

To prove that CARB relied upon Unocal's omission, Complaint Counsel must establish that but for this omission, CARB would not have adopted alternative regulations that "substantially

[29] CARB also rejected other cost-effective measures such as a pure predictive model and a vehicle-scrapping program.

overlapped with Unocal's . . . patent claims." Compl. ¶¶ 5, 45, 80. But Complaint Counsel have proffered no evidence of any of the alternative regulations which they claim CARB would have adopted had it been aware of Unocal's patent application. The only alternative which CARB claims it would have adopted—simply choosing not to regulate—is a choice that was not viable and which would have imposed far greater burdens and costs upon California industry and consumers.

(a) <u>CARB's representative now claims that if CARB had known of Unocal's patent application in 1992, CARB would not have adopted *any* Phase 2 regulations</u>

According to CARB's designated 3.33(c) witness, if Unocal had told CARB that it had filed a pending patent application in 1991, CARB would not have adopted any Phase 2 regulations for reformulated gasoline. Venturini Dep. (CARB), 5/14/03, at 503:11-19. Mr. Venturini claims that it would not have mattered what the potential infringement rate would be, what the costs to avoid infringement would be or whether or not Unocal would license or what the licensing fee would be. *Id.* at 518:7-520:19. Although Complaint Counsel claimed in interrogatory responses that there were a number of alternative regulations that CARB would have pursued (such as more tightly regulating certain parameters and eliminating the regulation of others), Mr. Venturini testified that CARB would not have pursued any of these options. *Compare* Complaint Counsel's Response and Objections to Respondent's Second Set of Interrogatories at 3 *with id.* at 532:6-534:25. Rather, Mr. Venturini claims that CARB would simply have done nothing and that the EPA gasoline regulations would then apply. *Id.* at 534: 22-25.

(b) <u>CARB's recent post hoc claim is not credible</u>

CARB's recent claim, as set forth in Mr. Venturini's testimony, is not believable for many reasons. First, when he was deposed in 1996, Mr. Venturini was asked whether knowing that Unocal had a patent application would have been relevant to CARB's ultimate consideration of the Phase 2 specifications. Venturini 1996 Dep. (CARB), 6/18/96, at 145:9-24. *He replied that he would have to speculate to answer the question*, but that he felt comfortable saying that it was information that he and his staff would have considered. *Id.* In contrast, in his 2003 deposition, Mr. Venturini knew for a fact that CARB not only would have considered this information, but would have concluded that a pending patent application meant they would have needed to abort the entire Phase 2 program.

Second, as noted above, CARB has never before aborted a regulatory program simply because of the presence of a pending patent application. In 1989, Unocal disclosed that it had a patent pending on an additive that would meet Phase 1 requirements; CARB went on to enact its regulation without any inquiry or analysis of Unocal's patent application. 2d RFA Responses at Rsp. 10; Simeroth Dep. (CARB), 7/9/03, at 20:25-21:16. There is no basis to presume that CARB's behavior two years later would have been so different that it would have shut down an entire rulemaking.

Third, Mr. Venturini's current testimony that California would simply have followed the EPA regulations is nonsensical, since CARB would have had no assurances that gasoline made under the EPA regulations would not also overlap with some then-future patent claims Unocal might be granted.

(c) **<u>If CARB had adopted no Phase 2 regulations, CARB would have failed to meet its state and federal clean air mandates</u>**

Finally, the Phase 2 regulations were essential to CARB's ability to meet its state and federal mandates, and simply defaulting to the EPA regulations would have left California with enormous emissions reductions that it would have had to make up elsewhere in order to meet its State Implementation Plan ("SIP"). No responsible regulatory body would have made this choice.[30]

The federal Clean Air Act requires that the EPA set "National Ambient Air Quality Standards" to specify maximum allowable levels of various air pollutants. Once the EPA sets these standards, then all states with pollution levels exceeding those requirements must adopt State Implementation Plans ("SIPs") on a prescribed schedule. Pedersen Rpt. at 5-6. If a state does not adopt an adequate SIP on a timely basis, then the EPA is required to promulgate and implement a Federal Implementation Plan ("FIP") to correct the deficiencies. *Id.* Like the federal Act, California's own Clean Air Act also mandated very substantial reductions in ozone forming compounds at the earliest practical date. RX 10 at CARB0000322-23, CARB0000363. Throughout the early 1990s, California was putting together its SIP and attempting to meet both state requirements and increasingly stringent federal Clean Air Act requirements. *See* Pedersen Rpt. at 6.

The Phase 2 RFG regulations were an integral part of the SIP which California submitted and which the EPA ultimately approved. RX 62; Pedersen Rpt. at 4; *see also* Kenny Dep. (CARB), 5/15/03, at 53:5-15 (Phase 2 regulations were a "huge" part of the SIP in terms of predicted

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[30] Indeed, even if one were to assume that Mr. Venturini's current testimony on behalf of CARB is correct, and that CARB did in fact rely upon Unocal's omission, the reliance described by Mr. Venturini was in no way justifiable. Justifiable reliance is an element of common law fraud, as well as an element of the fraud essential to establish an antitrust claim against a patent holder. *See Unitherm Food Sys., Inc. v. Swift-Eckrich, Inc.*, 375 F.3d 1341, 1358 (Fed. Cir. 2004).

emissions reductions); RX 331 at 25 ("[T]the SIP doesn't work without California cleaner burning gasoline."). CARB considered the Phase 2 regulations to be "a necessary component" for attainment of pollutant standards. RX 189 at CARB0000251. In fact, in adopting the Phase 2 regulations, CARB believed that no other measure could provide the "dramatic emissions benefits" of Phase 2 RFG. RX 10 at CARB0000380.

Even with the Phase 2 regulations, however, the emissions reductions in the 1994 SIP were barely adequate to support EPA approval. Pedersen Rpt. at 5; Kenny Dep. at 46:3-7 ("[T]he SIP was kind of getting us by the skin of our teeth."). If California had adopted different regulations with meaningfully less substantial emissions abatement than those in 1994, chances of EPA approval of that SIP would have been "significantly reduced." Pedersen Rpt. at 5.

(d) <u>Using the EPA reformulated gasoline regulations would have threatened the implementation of the costly and unacceptable federal implementation plan</u>

As noted above, Mr. Venturini now claims that CARB would have used the EPA regulations for reformulated gasoline,[31] had it known of Unocal's patent. The EPA regulations, however, provide only about half the clean air benefits of the CARB Phase 2 regulations. RX 202 at 004. In fact, during the Phase 2 rulemaking, CARB squarely rejected the suggestion that the State simply adopt the EPA reformulated gasoline requirements, finding that this proposal "is not realistic because the California Clean Air Act mandates very substantial reductions in ozone forming compounds at the earliest practicable date. The emissions reductions resulting from the federal

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[31] Under the 1990 Amendments to the federal Clean Air Act, the EPA issued reformulated gasoline regulations. The federal regulation preempted all inconsistent state regulations, but allowed regulations—such as California's—which are more stringent. Pedersen Rpt. at 7-9.

reformulated gasoline do not achieve the same emission reductions as staff's proposal." RX 10 at CARB0000363. CARB concluded: "Implementation of only the federal gasoline standards would leave the State far short of obtaining the emissions reductions needed to meet either the federal or state ambient air quality standards. The result would be far greater likelihood of sanctions on transportation funds and new source growth, and an imposition of a greater burden on California industries to reduce emissions." *Id.* at CARB0000449.

If CARB had in fact adopted only the EPA reformulated regulations, it would not have been able to meet the requirements of its SIP, absent some other unknown and undefined set of stringent controls. Pedersen Rpt. at 16-17. As CARB staff member Jim Ryden wrote in 1995 after learning of Unocal's patent:

> [T]he ARB could rescind its Phase 2 RFG regulations. However, the clean fuel regulations are an integral part of the State Implementation Plan designed to achieve clean air for all Californians. Unfortunately this approach would result in California not achieving our clean air goals and cause renewed legal challenges from U.S. EPA for failing to abide by our State Implementation Plan.

RX 62 at CARB0010092. Indeed, California's failure to promulgate an appropriate SIP would have triggered an immediate FIP promulgation by the federal government. Pedersen Rpt. at 18.[32]

But the FIP which the EPA had developed for California was wholly undesirable and unacceptable to the state. Indeed, then-Governor Pete Wilson told CARB that the implementation of the FIP would be "irresponsible and devastating." RX 201. A study performed by the Governor's office called the FIP "infeasible and unaffordable" and found that it would cost the state at least $8.4 billion in direct costs, $17.2 billion in output and 165,000 in jobs. RX 334 at 001.

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[32] In addition, California would have faced other consequences as well, including sanctions and tightened control requirements. *Id.* at 19-20, *see also* Kenny Dep. (CARB), 5/15/03, at 54:1-10.

CARB staff member Dean Simeroth recalled that the FIP called for "highly unpopular" measures "that went way beyond any that had been in our consideration for both stationary, transportation, planning and other categories . . . ." Simeroth Dep. (CARB), 7/9/03, at 163: 13-18; 164: 3-9. And CARB's Reza Mahdavi, who worked on the Governor's economic study, recalled that the FIP was twice as expensive as the SIP. Mahdavi Dep. (CARB), 7/25/03, at 59:14- 60:23.

CARB viewed its Phase 2 regulations as an essential part of meeting its state and federal mandates for cleaner air. There is no basis to believe that CARB would have abrogated its responsibility to the state legislature and jeopardized its state implementation plan by refusing to adopt any Phase 2 regulations, thus threatening the institution of the unacceptable, "infeasible and unaffordable" federal implementation plan.

(4) **CARB's ex post behavior shows it would have done nothing different ex ante, even had it known of a pending patent**

Complaint Counsel's claim that CARB would have done something different in 1991, had it learned of Unocal's patent *application*, is not credible in light of CARB's behavior once it learned that Unocal had been granted an actual *patent*. Significantly, in the nine years since Unocal announced that it had a patent, CARB has made no effort to change its regulations based upon Unocal's intellectual property. Despite the refiners' requests for changes that they claimed would make it easier to avoid Unocal's patents, CARB made no such changes in it Phase 2 regulations. And in 1999, when CARB adopted its Phase 3 regulations, CARB did not even consider Unocal's intellectual property during its rulemaking process.

Unocal announced its patent and licensing plans in January 1995. The record shows that CARB never gave any serious consideration to rescinding its regulations, or to changing them in some way to make it easier for refiners to avoid infringement. Indeed, in his March 1995 memorandum exploring CARB's options, Jim Ryden rejected the notion of rescinding the regulations, given their importance to California's SIP. RX 62 at CARB 0010092 ("this approach would result in California not achieving our clean air goals . . . "). Ryden also explored two other options, noting that Unocal could place its patented RFG formulations in the public domain, but pointing out that "[t]he downside of this approach would be to deprive the financially strapped Unocal of a lucrative revenue source. It is unlikely that Unocal would embrace this suggestion unless the corporation was faced with a formidable and very costly legal assault on the RFG patent by its competitors." *Id.*[33] Mr. Ryden's memorandum concluded with the suggestion that a final approach would be for Unocal to establish its licensing fees low enough to make patent challenges uneconomical by the other oil companies: "The California consumer would also benefit from this approach, since low RFG patent licensing fees would result in only a small increase in pump price." *Id.*

After CARB met with Unocal in early 1995, CARB chairman John Dunlap told Unocal's Terry Larson that, while other oil companies had been contacting him to express concerns with the patent and to pressure him about the Phase 2 requirements, he believed "the issue is up to company lawyers to solve rather than develop a regulatory solution." RX 840.[34]

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33 But Ryden *never* stated—as Complaint counsel now claim—that Unocal had already placed its patents in the public domain by reason of its August 27, 1991 letter.

34 Unocal's Larson also reported that Dunlap had asked that in the future, Unocal brief him personally before contacting CARB staff. *Id.* Additionally, Larson reports that Dunlap told him that Unocal had worked hard to maintain good regulatory relationships and that he supported Unocal's efforts in that area. *Id.*

And indeed, in the intervening years, CARB has consistently refused to alter the regulations, despite the refiners' repeated requests that it do so. For example, in early 1998—after Unocal had won the jury trial on its patent case, and after the jury had awarded 5.75 cents per gallon for past damages to Unocal—[redacted]520 at [redacted]

Id. He noted:

> [redacted]

[redacted] (emphasis added).

[redacted]

[redacted]

35 California was contemplating banning MTBE—then the most commonly used oxygenate in Phase 2 gasoline. The ban of MTBE was part of the Phase 3 regulations which CARB ultimately passed in December 1999.

[redacted]

CARB adopted its Phase 3 regulations in December 1999. Unocal patents were not discussed in any of the public workshops on the Phase 3 regulations. Kulakowski Dep. (Unocal/Texaco), 6/26/03, at 130:21-131:7. Nor was there any discussion of Unocal's patents in the Phase 3 public hearing. And neither the Final Statement of Reasons for Phase 3, or any of the economic studies performed on Phase 3 even mention the Unocal patents, much less analyze their potential effect on the cost-effectiveness of the regulation. *See* RX 64. Indeed, Peter Venturini, the 3.33(c) witness whom CARB designated to speak on this issue, testified that CARB did not consider Unocal's patent in its Phase 3 regulations because it was still in "flux." Venturini Dep. (CARB), 5/14/03, at 402:17- 403:15.

Even after the Phase 3 regulations were adopted, refiners continued to ask CARB to make changes in the new Phase 3 regulations to make it easier for refiners to avoid the numerical claim limitations in the Unocal patents. [redacted] Despite the refiners' arguments that such a change would provide them with additional flexibility in dealing with the Unocal patent without increasing emissions, CARB has not made any such changes. And, although CARB did make certain changes in its Phase 3 regulations and in the Phase 3 predictive model, [redacted] The fact that CARB has not changed the regulations in the nine years since it has known of Unocal's intellectual property rights is fatal to Complaint Counsel's claim that but for Unocal's alleged fraud, CARB would have enacted different regulations.

In recognition of this fatal flaw, Complaint Counsel have alleged that CARB cannot now change its regulations to provide sufficient flexibility for refiners to avoid Unocal's patent claims (Compl. ¶ 94) because CARB is "locked in" to its Phase 2 regulations (Compl. ¶ 6).[36] In interrogatory answers, Complaint Counsel explained that CARB has not changed its regulations because (1) refiners are locked into their capital investments and refinery modifications, and (2) because California legislative activity has foreclosed CARB from modifying—on its own—regulations related to reformulated gasoline. Complaint Counsel's Response and Objections to Respondent's Second Set of Interrogatories at 3-5.

The overwhelming evidence at the hearing, however, will show that CARB could change the regulations without incurring any increased costs and that CARB has elected to maintain its regulations for reasons that are wholly unrelated to any supposed "lock-in." Indeed, as CARB's 3.33(c) witness testified, CARB *did not even consider* Unocal's patents when it adopted its Phase 3 regulations and thus could never have found any patent-avoiding option foreclosed because of an alleged "lock-in." Rather, the reason given by Mr. Venturini for CARB's failure to consider the Unocal patents when it adopted its Phase 3 regulations was because CARB believed the patents to be invalid and in a state of flux—not because CARB believed that it was "locked-in" to the current regulation by virtue of the investments the refiners made to comply with the Phase 2 regulations. Moreover, the evidence is clear that the refiners did not consider themselves "locked-in" to the

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[36] Complaint Counsel's allegations of lock-in are addressed in more detail at pp. 166-76, *supra*.

[redacted] RX 180 at CARB-FTC0058831; [redacted]; *see also* Boyd Dep. (CARB), 8/22/03, at 217:19-218:13 (testifying that CARB staff recognized and internally discussed ARCO's EC-X formulation as establishing a foundation for the Phase 2 regulations).

Thus, by the time Unocal finally met with CARB on June 20, 1991, CARB had already discussed T50 with [redacted] And CARB had already determined, many months earlier, that T50 was "critical" for its Phase 2 regulations.

Although CARB later publicly justified its T50 regulation upon Unocal's work (as well as the work of others), discovery in this action has shown that CARB *did not use* Unocal's data in the development of its T50 specification. CARB first prepared draft regulations containing a T50 specification on July 21, 1991. *See* RX 198 at CARB-FTC0030878 (190°) and RX 184 at CARB10003057 (200°). CARB staff received the disk containing data from one of Unocal's studies some time *after* July 25, 1991. RX 327; *see also* RX 121 (letter from W. Thomas Jennings to Bethany D. Krueger, dated 8/4/03, at 1-2). Thus, both sets of draft regulations were prepared *before* CARB received this emissions research data base from Unocal.

Moreover, Unocal did not make this data base public until August 27, 1991. RX 3. Simeroth testified that absent a right to use the data publicly, CARB would not have based a regulation on that data or otherwise relied upon it. Simeroth Dep. (CARB), 7/9/03, at 145:25-148:8. Three weeks before CARB had permission to make public use of any of Unocal's research data, CARB published a draft of its proposed regulation that specified a T50 value of 200° F. RX 184 at CARB10003057. [redacted]

Even after CARB received permission to use Unocal's data base, there is no evidence that CARB ever used it to develop its T50 specification. Rather, the evidence shows that CARB continued to modify its regulations in response to ARCO's direction. [redacted]

In November 1991, CARB adopted final regulations that were substantially similar to the properties of ARCO's EC-X gasoline. RX 330; Boyd Dep. (CARB), 8/22/03, at 241:24-243:12). Not surprisingly, the refining industry reported that CARB had embraced ARCO's EC-X formulation. RX 504. [redacted]

[redacted]

[redacted]

In contrast to ARCO, Unocal had lobbied *against* the proposed regulations, submitting numerous comments in opposition to the draft regulations in CARB staff's October 1992 Final

Statement of Reasons and testifying against the proposed regulations at the hearing. *See, e.g.*, RX 10 at CARB0000299-300, 308-309, 338-40, 404 (listing just some of Unocal's numerous comments). In particular, Unocal argued *against* the inclusion of a T50 specification. *Id.* at CARB0000315 (comment 63) ("we don't see the specification for T50 as necessary").

In conclusion, the evidence demonstrates that Unocal did not cause CARB to adopt a T50 specification. Rather, before its meeting with Unocal, CARB had already been told of T50's emissions benefits and had determined that regulating this property was critical. Moreover, CARB did not use Unocal's data base in setting the T50 specification, but rather relied upon ARCO's EC-X specifications. And unlike others who lobbied for the inclusion of T50, Unocal unequivocally argued against regulating T50.

c. Auto/Oil and WSPA members did not rely on Unocal's conduct

The Complaint alleges three ways in which the members of Auto/Oil and WSPA purportedly relied upon Unocal's alleged fraud. First, the Complaint alleges that but for Unocal's fraud, WSPA and Auto/Oil participants would have advocated that CARB adopt regulations that minimized or avoid infringement. Compl. ¶ 90(a). Second, the Complaint alleges that refiners would have advocated that CARB negotiate license terms substantially different than Unocal was later able to obtain. *Id.* ¶ 90(b). Finally, the Complaint alleges that but for Unocal's fraud, refiners would have been able to incorporate knowledge of Unocal's pending patent rights in their capital investment and refinery reconfiguration decisions to avoid and/or minimize potential infringement. *Id.* ¶ 90(c).

With respect to the first two allegations (¶¶ 90(a) and (b)), there is no factual support for either proposition. To have advocated that CARB adopt regulations that minimized or avoided infringement, the refiners and CARB would have had to have been aware of the scope of Unocal's yet-to-be issued patents—something that even Unocal did not know. *See* pp. 99-103 *infra.* Moreover, Complaint Counsel have not alleged any theory of fraud which requires Unocal to have disclosed the contents of its patent application to CARB or to its competitors. Without ever seeing the application (much less knowing the actual scope of the issued patents), there is no basis upon which the refiners would have been able to advocate for "regulations that minimized or avoided infringement."

And the refiners' real-world behavior shows that, with the exception of ARCO, the other major refiners already lobbied *against* the regulations—all to no avail. Moreover, [redacted]

And even if CARB had the ability to foretell Unocal's patent claims years before such patents issued, as noted above, Complaint Counsel has come forth with no evidence to suggest that CARB would have issued different regulations so that refiners could avoid infringement of Unocal's patents. *See* pp. 118-124, *infra.*

Complaint Counsel's second claim in Paragraph 90(b)—that the refiners would have advocated that CARB negotiate license terms substantially different than Unocal was later able to obtain—also has no merit whatsoever, since there is no evidence that the refiners would ever have advocated that CARB negotiate license terms, much less that CARB would ever have attempted such a negotiation. [redacted] And when the refiners all learned of the patent in 1994, none approached Unocal for a license. Rather, once Unocal announced that it was putting together a licensing program, all the major refiners in California sued Unocal, declaring that the patent was invalid. And finally, CARB's 3.33(c) designee testified that if CARB had known that Unocal had a pending patent application, CARB would not have negotiated a license but rather there would have been no Phase 2 regulations. Venturini Dep. (CARB), 5/14/03, at 510:6-18.

The Complaint's final allegation with respect to the refiners' alleged reliance is that the refiners "would have been able to incorporate knowledge of Unocal's pending patent rights in their capital investment and refinery reconfiguration decisions to avoid and/or minimize potential infringement." Compl. ¶ 90(c). But there are major problems with this allegation as well.

First, as noted above, there is no allegation (nor could there be) that Unocal ever had a duty to describe its pending patent claims to its competitors in the refining industry. Although the Complaint alleges that Unocal misled refiners by not disclosing "that Unocal intended to assert its proprietary interests (as manifested in pending patent claims)" (Compl. ¶ 2), even if Unocal *had* disclosed that it had filed a patent application and intended someday to assert any claims that might issue from such an application, the refiners would not have known the contents of the application, what claims were sought, what claims would someday issue, and what claims Unocal might disclaim. Thus, not only was it not possible for Unocal to know what patent claims would ultimately issue (and which Unocal would ultimately pursue), but even if Unocal had known this, it had no duty to share this information with its competitors. Without knowing the claims of Unocal's yet to be issued patents, there would have been nothing that the refiners could have done to change the configuration of their refineries—even had they so desired. [redacted] *see also* Griffin Rpt. at 58.

Second, corporate representatives from each of the major refiners testified that had they known that Unocal had a patent application [redacted]

Complaint Counsel's experts do not address this testimony, and indeed, it seems highly dubious, given the questionable economics of such a decision, as well as the real world behavior of the refiners once they learned of Unocal's *issued* patent. [redacted] Even if this were a realistic but for scenario (which it is not), it is certainly not a preferable one.

Third, the refiners' actual behavior upon learning of Unocal's *issued* patent in 1994 is very telling. All claimed that the patent was invalid,[37] and [redacted]

37 [redacted]

[redacted] Given this behavior in light of an issued patent, it is not credible to suggest that the refiners would have done anything differently with mere knowledge that an application had been filed.

In an attempt to rebut this devastating conclusion, Complaint Counsel allege that refiners cannot produce significant volumes of non-infringing CARB gasoline today without incurring substantial additional costs, but that had they known of Unocal's claims before making their Phase 2 investments, they would have been able to have configured their refineries in such a way as to minimize or avoid infringement. Compl. ¶¶ 90(c), 93. But Complaint Counsel have no evidence that, even with perfect foresight of all the claims that would issue to Unocal from 1994 to 2000, the refiners would have made changes to their refineries in the early 1990s to avoid Unocal's patents, nor can they establish that any such changes cannot be made today.

[redacted]

[redacted]

Presumably Complaint Counsel will attempt to proffer evidence of a refiner lock-in through the testimony of one of their refining experts, Michael Sarna. [redacted]

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[38] Like Complaint Counsel's other refining expert, Blake Eskew, Mr. Sarna did no infringement analysis, but rather looked only to whether the gasolines matched some of the limitations of Unocal's patents.

[redacted] Mr. Sarna's opinions are irrelevant to the issues for this Court.

B. <u>Complaint Counsel May Not Proceed on a Breach of Contract Theory</u>

Although it is clear from their brief that Complaint Counsel do not believe they need to prove underlying fraud to establish exclusionary conduct, it is not clear from their brief what, if anything, they believe they do need to prove. Despite the fact that Complaint Counsel have not pled breach of contract—and do not appear to be arguing such—their economic expert witness, Professor Carl Shapiro—does rely upon an unsupported contract-like theory, which was not pled in the Complaint, as the key assumption underpinning of his analysis. [redacted]

Professor Shapiro's testimony is discussed further at pp. 141-156. But any attempt by Complaint Counsel at trial to establish a violation of Section 5 based on theory that was not pled in the Complaint—such as breach of contract—must be rejected because it would violate FTC Rule 3.15(a)(1). Moreover, such a theory is neither factually nor legally viable.

To prove a violation based on any theory not pled, Complaint Counsel must file a motion to amend, as required by 16 C.F.R. § 3.15(a)(1):

> [A] motion for amendment of a complaint or notice may be allowed by the Administrative Law Judge only if the amendment is reasonably within the scope of

> the original complaint or notice. Motions for other amendments of complaints or notices shall be certified to the Commission.

Id.; *In re Kellogg Co.*, 99 F.T.C. 8, 22-23 (1982) (holding that Complaint Counsel violated section 3.15(a)(1) by seeking relief under theory that was not pled in the Complaint without filing motion for amendment first and where no order of amendment had issued). Moreover, the law is well settled that claims based on theories that are not pled in the complaint do not fall "reasonably within the scope of the original complaint"; thus, the ALJ may not grant such amendments. *See, e.g., In re Beatrice Foods Co.*, 101 F.T.C. 733, 825 (1983) (holding that "no potential competition theory of liability was pled in the complaint and that it is therefore inappropriate to consider evidence under this theory"); *In re Standard Camera Corp.*, 63 F.T.C. 1238, 1267 (1963) (holding that amendment to substitute word altering underlying theory of complaint "was not reasonably within the scope of . . . the original complaint and therefore was beyond the power of the hearing examiner to authorize").[39]

Additionally, there is no factual or legal basis to premise Section 5 liability upon a breach of contract theory in this case. First, the evidence clearly shows that neither Unocal nor CARB believed there to be any such contact. The "formation of a contract requires a bargain in which there is a manifestation of mutual assent to the exchange and a consideration." RESTATEMENT SECOND OF CONTRACTS § 17 (1981); *see also* CAL. CIV. CODE § 1550 (2004). "Manifestation of mutual assent . . . requires that each party either make a promise or begin . . . a performance." RESTATEMENT SECOND OF CONTRACTS § 18 (1981); *see also* CAL. CIV. CODE § 1565 (2004). For

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[39] The ALJ may order only amendments that clarify allegations of the Complaint or that merely add examples of practices already challenged. *In re Champion Home Builders Co.*, 99 F.T.C. 397 (1982); *In re Crush Int'l Ltd.*, 80 F.T.C. 1023, 1024 (1972) (stating that ALJ has no authority to amend "except to the extent that his ruling deal with matters of procedure rather than substance").

"consideration," a performance or return promise must be "bargained for"—that is, sought by the promisor in exchange for the promise and given by the promisee in exchange for that promise. *Restatement (Second) of Contracts* § 71 (1981); *see also* CAL. CIV. CODE § 1605 (2004).

Here, not a single witness has testified that Unocal intended to convey, or that CARB understood Unocal to be conveying, a "zero royalty" offer in any of Unocal's communications with CARB in 1991. The August 27 letter does not speak to patents or "technology" but only the *data base* of emissions data on a computer disk which Unocal had previously sent to CARB on a confidential basis.

CARB did not believe Unocal's August 27, 1991 letter offered a royalty free patent license. CARB's 3.33(c) witness Peter Venturini testified that when he received this letter in 1991, the thought did not occur to him that the letter had anything to do with patent rights. Venturini Dep., (CARB), 5/13/03, at 69:7-22. Bob Fletcher, another CARB staff member testified that CARB had asked Unocal to release the confidentiality of its data so it could be included in "the mega-data base of all the vehicle tests" that CARB was compiling in the development of the predictive model. Fletcher Dep. (CARB), 7/8/03, at 203:21-204:13. And in 1995, when Unocal announced that it had received a patent on new compositions of gasoline, CARB's Executive Director, Jim Boyd, sought a limited license from Unocal for CARB's upcoming test program, asking Unocal not to raise any patent infringement issues with respect to CARB's summer test fuel. RX 50. No such request would have been necessary had CARB believed that it already had accepted a "royalty-free offer" back in 1991. Absent any evidence of mutual assent regarding a patent license for a zero royalty, there is no support for any such breach of contract theory. It is nothing more than a post-hoc creation with no evidentiary basis.

Second, even had a breach of contract claim been pled, and even if there were facts to support such a claim (which there clearly are not), such an underlying allegation would not support Section 5 liability. Breach of contract presents "a claim that rarely, if ever, would implicate antitrust laws." *Apperson v. Fleet Carrier Corp.*, 879 F.2d 1344, 1352 (6th Cir. 1989); *cf. In re Microsoft Corp. Antitrust Litig.*, 274 F. Supp. 2d 747, 750 (D. Md. 2003) (refusing to read term "unlawful" in California Unfair Competition Law "to include any breach of contract under the common law").

In *Apperson*, the Sixth Circuit held that plaintiff union members lacked standing to pursue an antitrust claim under the Sherman Act because plaintiffs' alleged injuries were in the nature of breach of contract damages. 879 F.2d at 1352. In so holding, the Sixth Circuit reasoned:

> The essential flaw in Plaintiffs' argument, in our view, is that their alleged injuries are in the "nature" of contract damages, not those arising from an antitrust violation. The theory underlying this antitrust complaint is premised entirely on a showing that [Defendant] breached its Contract with [Plaintiffs], thus causing [Plaintiffs'] alleged losses, which appears to be a classic breach of contract action.

Id. at 1352. The court also described as "dubious" even the idea that a breach of contract might be "parlayed . . . . into a mechanism to destroy competition." *Id.* at 1351.

VII. COMPLAINT COUNSEL CANNOT ESTABLISH THAT UNOCAL POSSESSES, OR IS DANGEROUSLY LIKELY TO ATTAIN, MONOPOLY POWER

To prevail on their monopolization claim, Complaint Counsel must show that Unocal possesses monopoly power in a relevant market. *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966). Monopoly power is "the power to control prices or exclude competition" within a relevant market. *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 391 (1956). Complaint Counsel's attempted monopolization claim requires proof of a dangerous probability that

Unocal will monopolize a relevant market. *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 455 (1993). Complaint Counsel are unable to meet their burden on both the monopolization and attempted monopolization claims.

A. <u>The Gasoline Market Claims Fail Because Unocal Is Not a Participant in the Alleged Market</u>

As will be discussed more fully below, the existence of monopoly power or dangerous probability that it will be attained must be established by first defining a relevant market and then establishing the power of a firm to exclude competition within that market or threat that it would do so imminently. In this case, however, the allegations regarding one of the alleged relevant markets can be disposed of without a detailed discussion of the contours of the relevant market. This is the alleged market for CARB-compliant "summer-time" RFG produced and supplied for sale in California. Compl. ¶ 75. Unocal exited this alleged relevant market in 1997 when it sold its West Coast refining and marketing operations to Tosco Corporation. *Id.* ¶ 13. Consequently, even if Complaint Counsel establish the existence of the alleged gasoline market, Unocal cannot monopolize or dangerously threaten to do so.

It is black letter law that a company cannot monopolize or attempt to monopolize a market in which it does not compete. As the Court of Appeals for the Eleventh Circuit made clear in *Spanish Broad. Sys. of Fla. v. Clear Channel Communications,* where a defendant "does not participate" in the alleged relevant market, it "cannot attempt to monopolize that market." 376 F.3d 1065, 1075 (11th Cir. 2004); *see also Aquatherm Indus., Inc. v. Fla. Power & Light Co.*, 145 F.3d 1258, 1261 (11th Cir. 1998) (failure to allege that defendant competes in relevant market fatal to monopolization complaint); *Goodloe v. Nat'l Wholesale Co.*, No. 03-C-7176, 2004 U.S. Dist.

LEXIS 13630, at **14-15 (N.D. Ill. July 16, 2004) (impossible for defendants to monopolize a market in which they do not participate); *Fieldturf, Inc. v. S.W. Recreational Indus., Inc.*, 235 F. Supp. 2d 708, 721 (E.D. Ky. 2002) ("a firm cannot monopolize a market in which it does not compete"), *vacated in part on other grounds*, 357 F.3d 1266 (Fed. Cir. 2004); *Moecker v. Honeywell Int'l, Inc.*, 144 F. Supp. 2d 1291, 1309 (M.D. Fla. 2001) (same).[40] This issue has also been decided in the context of an attempt by the FTC to hold a firm liable for anticompetitive effects in a market in which it did not compete. *See Official Airline Guides, Inc. v. FTC*, 630 F.2d 920, 927 (2d Cir. 1980).

Complaint Counsel's gasoline market allegations are also contrary to the Justice Department-Federal Trade Commission *Antitrust Guidelines for the Licensing of Intellectual Property* (1995), *available at* http://www.usdoj.gov/atr/public/guidelines/ipguide.pdf. Under the Guidelines, market shares in goods markets, such as the alleged California RFG market, are measured in the same manner under section of the agencies' Horizontal Merger Guidelines. *Id.* § 3.2.1. Under that section, in turn, market shares are assigned "based on the total sales or capacity currently devoted to the relevant market together with that which likely would be devoted to the relevant market in response to a 'small but significant and nontransitory' price increase." *Horizontal Merger Guidelines* § 1.41 (1992), *available at* http://www.usdoj.gov/atr/public/guidelines/hmg.pdf. Under this approach, Unocal's share of the gasoline market is zero, and not the fanciful 100% share that Complaint Counsel would assign it.

40 Even when Unocal was a participant in the California gasoline market many years ago, it had a relatively small share—approximately 15 percent of the market. This market share is far too small for "monopoly power" or for showing a "dangerous probability of success" of achieving such power. Teece Rpt. ¶ 172.

Wholly apart from the legal authority, Complaint Counsel will not be able to show that Unocal has monopolized the alleged market for CARB "summer-time" RFG because their economic expert does not support this claim. Professor Shapiro's expert report does not assert that Unocal has either monopolized this market or has any prospects of doing so.

B. Complaint Counsel Will Be Unable to Prove That Unocal Has Monopoly Power or Has a Dangerous Probability of Achieving Such Power Even in the Technology Market Described by Their Expert

Complaint Counsel have no evidence that Unocal possesses or dangerously threatens to possess monopoly power in the market defined by their economic expert. Complaint Counsel's evidence fails for at least three reasons. First, their claim of monopoly power relies on the report of an expert who conducted no analysis of the structure of the market and Unocal's power within it and based his opinion, instead, on the assumed wrongfulness of Unocal's *conduct*. Second, Complaint Counsel cannot show that Unocal possesses monopoly power through a standard structural analysis because they have no evidence of Unocal's market share. Third, Complaint Counsel's allegations of monopoly power are dependent on the existence of a "lock-in" that cannot be proved.

1. Complaint Counsel's attempt to prove monopoly power based on an assumption of wrongful conduct is contrary to the requirements of monopolization law

a. Complaint Counsel conflate the exclusionary conduct and monopoly power elements of the monopolization offense

As in most antitrust cases, Complaint Counsel seek to prove its monopoly power allegations through the testimony of an economic expert.[41] But, unlike in most antitrust cases, they seek to do

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41 [redacted]

so without evidence of market structure. They base the claim of monopoly power merely on the assertion that Unocal made and violated a binding promise to give away its patents. In other words, Complaint Counsel's evidence of monopoly power is the same as their evidence of exclusionary conduct. The case law, however, makes clear that monopolization may not be established solely by evidence of exclusionary conduct and requires a separate showing that a firm "actually monopolizes or dangerously threatens to do so." *Spectrum Sports*, 506 U.S. at 459.

[redacted]

The most common way of proving the existence of monopoly power is through evidence "pertaining to the structure of the market." *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1434 (9th Cir. 1995). To establish the existence of monopoly power through structural evidence, an antitrust claimant must "(1) define the relevant market, (2) show that the defendant owns a dominant share of that market, and (3) show that there are significant barriers to entry and show that existing competitors lack the capacity to increase their output in the short run." *Id.*

In limited circumstances, monopoly power may be established through "evidence of restricted output and supracompetitive prices. . . ." *Id.* "Because such direct proof is only rarely available, courts more typically examine market structure in search of circumstantial evidence of monopoly power." *United States v. Microsoft Corp.*, 253 F.3d 34, 51 (D.C. Cir. 2001). Direct evidence must be particularly rigorous, moreover, given the ease with which it can be asserted that a particular price exceeds the competitive level. Rigorous proof entails the use of techniques such as the estimation of the residual demand curve facing a firm. *See* IIIA PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 801a, at 319 (2d ed. 2002). Even so, in monopolization cases, courts tend to rely exclusively on structural evidence. *Id.* ¶ 801b, at 322; *see also Republic Tobacco Co. v. Atlantic Trading Co., Inc.*, Nos. 04-1098 & 1202, 2004 U.S. App. LEXIS 18470, at **46-50 (7th Cir. Sept. 1, 2004). Indeed, Complaint Counsel do not cite a single case in which the "direct method" was used to sustain a finding of monopolization.

Moreover, even the "direct proof" method does not allow an antitrust claimant to dispense with evidence of market structure. Rather, "if a plaintiff can show the rough contours of a relevant market, and show that the defendant commands a substantial share of the market, then direct evidence of anticompetitive effects can establish the defendant's market power—in lieu of the usual showing of a precisely defined relevant market and a monopoly market share." *Republic Tobacco*, 2004 U.S. App. LEXIS 18470, at *49 (footnote omitted); *see also Forsyth v. Humana, Inc.*, 114 F.3d 1467, 1475-76 (9th Cir. 1997) (rejecting attempt to use "direct proof of market power" based on evidence that defendant charged higher prices than its competitors).

Professor Shapiro's assessment of monopoly power does not rely on any rigorous tool of economic analysis and does not present reliable evidence that Unocal "commands a substantial share of the market. . . ." *Republic Tobacco*, 2004 U.S. App. LEXIS 18470, at *49. Nor does it present any evidence of reduced output. [redacted] This approach, even if its factual predicate could be supported, improperly conflates exclusionary conduct and monopoly power and seeks to establish monopoly power based on wrongful conduct, an approach that the Supreme Court rejected in *Spectrum Sports*.[42]

b. <u>Complaint Counsel cannot establish that the competitive royalty level is zero</u>

Even if Unocal had promised to license its intellectual property for nothing, which it did not, this fact would not prove that it has the ability to charge a price above the competitive level. Indeed, there will be no evidence that Unocal is able to charge *any* price for its patents for any consequential amount of CARB summer-time RFG. Moreover, it is clear that the magnitude of the infringement that was the [redacted]

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[42] The plaintiff in *Spectrum Sports* attempted to establish a dangerous probability that monopoly power would be attained based on the allegedly wrongful conduct. It is even further outside established legal norms to attempt to establish the existence of monopoly power itself based on allegedly wrongful conduct.

[redacted] A claim that Unocal has monopoly power based on this jury award cannot be reconciled with the evidence.[43]

[redacted] also cannot be reconciled with evidence that Unocal is charging nearly the same royalty rate for the use of its technology outside California as it is charging in California. Given that there is no claim that Unocal has a monopoly outside California or that Unocal has misrepresented to regulators outside California, [redacted] This is the only persuasive evidence on the competitive rate.

c. **<u>Complaint Counsel cannot establish that Unocal agreed to give away its intellectual property on a royalty-free basis</u>**

The factual predicate for Professor Shapiro's analysis of monopoly power lacks any evidentiary basis. The entire determination of monopoly power rests on the assumption that [redacted] But Unocal's August 1991 letter to CARB says nothing about patents, inventions, or even "technology." Instead, it refers expressly to a *data base* of emissions data on a computer disk that Unocal had previously provided to CARB on a confidential basis. RX 3. *All* the competent evidence in the record shows that by this letter, Unocal intended to lift the confidentiality of this disk, so that CARB could incorporate the data on the disk into the larger data base it was developing to support a predictive model. Any contrary interpretation is belied by the language of the letter, by Unocal's contemporaneous memoranda regarding its intent, and by CARB's own statements and conduct.

43 Professor Shapiro did not analyze the technologies implemented to avoid Unocal's patents as part of the relevant technology market.

To summarize the evidence regarding CARB's understanding of the letter, CARB has taken the position that the letter referred to "a diskette containing the data base" that Unocal had provided to that government agency (RX 327). James Boyd, the CARB Executive Director to whom Unocal addressed the letter, testified that he did not recall "anything unique to Unocal" based on this letter. Boyd Dep. (CARB), 8/22/03, at 184:6-186:2. A few years after receiving the letter, Mr. Boyd asked Unocal for a very limited royalty-free license (or covenant not to sue) in connection with an emissions test program that CARB conducted in 1995. RX 50. This request cannot be reconciled with the preexistence of a royalty-free license. It is, however, entirely consistent with Mr. Boyd's recollection that the letter did not have any unique attribute that distinguished it from communications from other refiners to CARB.

Just as significantly, CARB's Rule 3.33(c) witness, Peter Venturini, testified that when he received Unocal's letter in 1991, it did not occur to him that the letter had anything to do with patent rights. Venturini Dep. (CARB), 5/13/03, at 69:7-22. In fact, as noted at pp. 28-30, *infra*, each CARB witness who testified in 1996 and recalled the letter understood the letter to release the confidentiality designation attached to Unocal's data so that CARB could incorporate the data into a mega-data base of vehicle tests it was assembling in its development of a predictive model.

The claim that Unocal possesses monopoly power based on the alleged "zero royalty" license grant thus cannot stand. The assumption that underlies it is both legally insufficient to establish monopoly power and contrary to the evidence.

2. <u>"Matching" or "coverage" rate is not a valid proxy for market share</u>

Complaint Counsel's experts rely heavily on the value of a so-called "coverage" or "matching" rate between Unocal's patent claims and CARB summer-time RFG produced by major California refiners.[44] [redacted] This approach is inherently unreliable, as it ignores claims limitations in Unocal's patents that have not been construed by the courts and which the California refiners construe as placing virtually all California RFG outside the patents' reach. It also completely disregards alternative technologies that could be brought to bear to avoid the patents in the event that the patents were construed as reaching the refiners' gasoline.

To establish monopoly power, all technologies and goods that compete with Unocal's patented technology must be examined.[45] Once these technologies and goods are identified, Unocal's share of the relevant market must be determined. As a matter of law, a share below two-thirds of the market is insufficient to establish monopolization of a market. *See Colo. Interstate Gas Co. v. Natural Gas Pipeline Co.*, 885 F.2d 683, 694 n.18 (10th Cir. 1989) ("courts generally require a minimum market share of between 70% to 80%"); *Holleb & Co. v. Produce Terminal Cold Storage Co.*, 532 F.2d 29, 33 (7th Cir. 1976) (60% insufficient); *Fineman v. Armstrong World Indus., Inc.*, 980 F.2d 171, 201-02 (3d Cir. 1992) (55% insufficient); *Blue Cross & Blue Shield*

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[44] The term that Complaint Counsel's experts use, "coverage rate," falsely suggests that the rate represents the percentage of gasolines "covered" by Unocal's patents. In fact, the "coverage" rate represents no such thing.

[45] The relevant technology market must include both competing technologies and competing goods because "the owner of a process for producing a particular good may be constrained in its conduct with respect to that process not only by other processes for making that good, but also by other goods that compete with the downstream good and by the processes used to produce those other goods." U.S. Federal Trade Commission and Department of Justice, *Antitrust Guidelines for the Licensing of Intellectual Property* ¶ 3.2.2, n.18 & Example 2.

United of Wisc. v. Marshfield Clinic, 65 F.3d 1406, 1411 (7th Cir. 1995) (50% insufficient); *Twin City Sportservice, Inc. v. Charles O. Finley & Co.*, 512 F.2d 1264, 1274 (9th Cir. 1975) (50% insufficient).[46]

The "consistency check" based on so-called "coverage rates" fails to satisfy the case law standards as it is based on a measure that cannot plausibly serve as a proxy for market share. That measure captures neither the percentage of RFG subject to Unocal's patents nor the share attributable to alternative technologies for complying with CARB's regulations.

a. **<u>The "matching" or "coverage" rate analysis proffered by Complaint Counsel does not show that Unocal had market power</u>**

There is no way to establish Unocal's market share without determining (1) the percentage of CARB summer-time RFG that infringe Unocal's patents (which necessarily requires the Court to construe the claims of the four patents which have never been litigated), (2) the alternate technologies are used to produce the non-infringing gasolines that account for the remainder of the market, and (3) the substitutability of the alternatives for Unocal's patents. Because California refiners are neither paying for the use of Unocal's patents nor making significant efforts to avoid

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[46] Moreover, market share alone is not sufficient to state a claim. "Monopolization or threatened monopolization requires something more, which may include 'the strength of competition, probable development of the industry, the barriers to entry, the nature of the anti-competitive conduct, and the elasticity of consumer demand.'" *Crossroads Cogeneration Corp. v. Orange & Rockland Utils., Inc.*, 159 F.3d 129, 141 (3d Cir. 1998) (quoting *Barr Labs, Inc. v. Abbott Labs.*, 978 F.2d 98, 112 (3d Cir. 1992)); *see Am. Prof'l Testing Serv. v. Harcourt Brace Jovanovich Legal & Prof'l Publ'g*, 108 F.3d 1147, 1154 (9th Cir. 1997) ("neither monopoly power nor a dangerous probability of achieving monopoly power can exist absent evidence of barriers to new entry or expansion"). Indeed, even a 100% market share cannot support a finding of monopolization in the absence of entry barriers. *See United States v. Syufy Enter.*, 903 F.2d 659 (9th Cir. 1990).

Unocal's patents,[47] even a proper infringement analysis, standing alone, will not reveal the alternative technologies that are reasonably interchangeable with the technologies claimed by Unocal's patents. Rather, it is necessary to examine the technologies that would be used to avoid Unocal's patents if California's refiners faced the choice of either paying Unocal royalties or investing to avoid the patent, as is the case with the '393 patent. [redacted]

(1) <u>Complaint Counsel have no evidence of infringement</u>

Unocal owns five patents related to reformulated gasoline. Each of the patents claims certain gasoline compositions based on the numerical values of specific gasoline properties. The claims limitations in these patents, however, require more to prove infringement than simply matching numerical property limitations of specific patent claims. Many claims require the use of particular processes or methods. Consequently, although each of Unocal's process and method claims is directed to a specific composition of gasoline, simply making, using or selling gasolines

47 [redacted]

that meet the numerical property limitations of these claims does not constitute infringement. Stellman Rpt. at 11.

Unocal's "right to exclude" under the patents extends only to those compositions, processes, and methods that are proved to actually infringe. A patentee's rights are highly circumscribed by the claims of the patent, which must be read in light of the specification and the patent prosecution history. *See Burke, Inc. v. Bruno Ind. Living Aids, Inc.*, 183 F.3d 1334, 1340 (Fed. Cir. 1999) (patent claim "provides the metes and bounds of the right which the patent confers on the patentee to exclude others from making, using or selling the protected invention") (citation omitted). Proof of infringement requires first construing each asserted claim in light of the patent specification and prosecution history and then comparing the claim, as construed, to the accused device (or process). *See Tate Access Floors, Inc. v. Interface Architectural Res., Inc.*, 279 F.3d 1357, 1365 (Fed. Cir. 2002). To prove infringement, each and every limitation of the claim must be present in the accused device, method, or process. *Id.*; *see also Southwall Techs., Inc. v. Cardinal IG Co.*, 54 F.3d 1570, 1575 (Fed. Cir. 1995).

Complaint Counsel have made no attempt to prove that any of the gasoline infringes Unocal's patents. [redacted]

[redacted] refiners answered these questions, they would have had to testify that the infringement rate is close to zero. [redacted] Since nearly all of CARB summer-time RFG is now made with ethanol, very little, if any, would infringe under this view, even if the gasoline met all numerical property limitations and thus "matched" [redacted]

[48] Unocal vehemently disputes this theory that gasolines with ethanol do not infringe its patents. But it is Complaint Counsel's burden here to prove market power; they cannot complete abrogate this responsibility to offer any evidence of infringement, especially when their own fact witnesses refuse to answer these questions under oath, and when Complaint Counsel know that these same witnesses have denied infringement in other litigation under theories such as the ethanol theory.

Complaint Counsel argue that they do not need to show infringement because [redacted] *Cf. Zenith Radio Corp. v. Hazeltine Research,* 395 U.S. 100, 138 (1969) (royalty structure may be set for convenience of parties). [redacted]

In short, an analysis which is based on the extent to which California gasolines match the numerical property limitations of Unocal's patents but which ignores all other claims limitations is meaningless. Unocal would not be permitted to argue in an action for infringement that the refiners infringed its patents because their gasolines met some but not all of the claims limitations in its patents. Complaint Counsel likewise should not be permitted to argue that "matching" is a substitute for infringement.

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[49] If a licensee were to stop paying royalties, Unocal's right to recover against the licensee would have to be based on breach of contract and would be limited by the contract; Unocal would have no right to recover for patent *infringement* based solely on a showing that the licensee's gasolines fell within the agreed upon means for calculating a license fee under a license agreement.

(2) Counsel's "matching" percent is meaningless because the major refiners are not paying for Unocal's technology

There is another significant reason why Dr. Eskew's matching analysis is not a valid proxy for infringement, let alone Unocal's market power. Even if this matching percentage could show the extent to which refiners have used Unocal technology to produce CARB-complaint gasoline, simply analyzing the amount of infringing gasoline made by refiners that are *not paying for that technology* reveals little about whether and to what extent the refiners would elect to use Unocal's technology if they were required to pay the competitive price for the technology.

The proper measure of Unocal's share of the technology market is the usage of Unocal's technology that is paid for or would be made if the refiners were paying for it. Teece Rpt. ¶ 218. It is an elementary economic principle that demand at a price of zero is not representative of what demand would be at a positive price. This economic truth is not merely of theoretical interest. [redacted]

'393 Tr. Trans. at 2587.[50] Significantly, none of the major California refiners has licensed Unocal's patents.

Complaint Counsel are asking this Court to presume that there are no substitute technologies *solely* based on the "matching rate" analysis. [redacted] Although Complaint Counsel will proffer the testimony of a refining expert for the proposition that California refiners cannot maintain their current production of CARB-compliant gasoline and *avoid* Unocal's patents, that expert, Michael Sarna, did not analyze any of the substitute technologies that would enable the

50 [redacted]

refiners to reduce their "matching" of Unocal's patents, let alone the costs and benefits of such technology.[51] Stellman Rpt. at 27-29; Teece Rpt. at ¶¶ 209-215.

(3) <u>CARB is not "locked in" to the current CARB regulations</u>

Complaint Counsel claim that a "regulatory lock-in" reinforces Unocal's alleged monopoly power by preventing CARB from changing its regulations to enable refiners to avoid Unocal's patents. Recognizing that no meaningful monopoly power may exist if it may be defeated readily by a CARB regulatory change or by refiner actions, the Complaint alleges that CARB is locked into its regulations. Compl. ¶¶ 6, 94. [redacted]

Because Complaint Counsel cannot prove the existence of monopoly power even without reference to the lock-in issue, the existence of a lock-in is ultimately irrelevant to the determination of monopoly power in this case. If monopoly power does not exist, no amount of lock-in can give it life. But the evidence will also show that there is no lock-in. There is no evidence that CARB is unable to change its regulations to allow refiners to avoid the numerical properties of Unocal's patents. The evidence will show that CARB has never cared enough about Unocal's patents to take any actions to avoid them. Moreover, as further discussed at pp. 166-176, *supra*. Complaint Counsel lack *any* evidence to establish lock-in as properly defined by [redacted]

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[51] Like Mr. Eskew, Mr. Sarna conducted no infringement analysis but rather based his opinion solely upon whether or not gasolines "match" certain limitations (but not others) in Unocal's patent claims.

[redacted] Instead, the evidence overwhelmingly shows that the no regulatory option that was more cost-effective than the current regulations, taking Unocal's patents into account, ceased to be available to CARB at any time after the promulgation of its Phase 2 RFG regulations.

VIII. COMPLAINT COUNSEL HAVE FAILED TO PROVE THAT UNOCAL'S CONDUCT CAUSED ANY ANTICOMPETITIVE EFFECTS

A. Complaint Counsel Must Prove That Unocal's Challenged Conduct Caused an Anticompetitive Effect

To establish a monopolization or attempted monopolization claim, an antitrust claimant must establish a causal link between the challenged conduct and the attainment or maintenance of monopoly power or the dangerous threat that it would be attained. The prohibition against monopolization or attempts to monopolize is directed "against conduct which unfairly tends to destroy competition itself." *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 458 (1993). This legal standard "is plainly not met by inquiring only whether the defendant has engaged in 'unfair' or 'predatory' tactics." *Id.* at 459. Indeed, "[e]ven an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws." *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 225 (1993); *see also Nynex Corp. v. Discon, Inc.*, 525 U.S. 128, 137 (1998). Accordingly, monopolizing conduct must "cause or threaten harm to consumers from lower market output, higher prices, reduced innovation, or some other indicator of diminished competitiveness." III PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 651d, at 79 (2d ed. 2002).

Consequently, "to be condemned as exclusionary, a monopolist's act must have an 'anticompetitive effect.' That is, it must harm the competitive *process* and thereby harm consumers." *United States v. Microsoft Corp.*, 253 F.3d 34, 58 (D.C. Cir. 2001) (emphasis in original). An evaluation of allegedly exclusionary conduct must "consider its impact on consumers and whether it has impaired competition in an unnecessarily restrictive way." *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 605 (1985). Monopolization requires proof that the defendant "willfully acquired or maintained its power, thereby causing unreasonable 'exclusionary' or 'anticompetitive' effects." *Trans Sport, Inc. v. Starter Sportswear, Inc.*, 964 F.2d 186, 188 (2d Cir. 1992); *see also Ass'n for Intercollegiate Athletics for Women v. NCAA*, 735 F.2d 577, 584 (D.C. Cir. 1984) ("[P]laintiff must demonstrate that the defendant in fact acquired monopoly power as a result of unlawful conduct."). Similarly, in an attempted monopolization case, "a violation will only be found where there is a causal link between the anticompetitive behavior and the dangerous probability of success." *Ashkanazy v. I. Rokeach & Sons, Inc.*, 757 F. Supp. 1527, 1540 (N.D. Ill. 1991). In short, "showing a link between the exclusionary conduct and the monopoly requires a determination of the impact of the conduct on competition." Timothy J. Muris, *The FTC and the Law of Monopolization*, 67 ANTITRUST L.J. 693, 697 (2000).

Judge McGuire's holding in *Rambus* makes clear that the causal link between the alleged exclusionary conduct and competitive harm or dangerous threat must also be established in the context of FTC cases alleging monopolization or attempted monopolization. *In re Rambus Inc.*, No. 9302, slip op. at 300-02 (FTC Feb. 23, 2004) (Initial Decision). The same need to establish a causal link also applies to actions for unfair methods of competition in violation of Section 5 of the FTC Act. *Id.* at 309-10; *see also E.I. du Pont de Nemours & Co. v. FTC*, 729 F.2d 128, 141 (2d Cir. 1984) (requiring a "causal connection between the challenged practices and market prices"). The Commission has made clear that Section 2 monopolization standards apply to cases brought under

Section 5 of the FTC Act, as Section 5 may not be used to reshape the policies of the Sherman Act "when they have been clearly expressed and circumscribed." *In re General Foods Corp.*, 103 F.T.C. 204, 365 (1984).

B. Complaint Counsel Must Prove That the Alleged Harm to Consumers Would Not Have Occurred but for the Alleged Misconduct

"[T]he plaintiff, on whom the burden of proof of course rests, must demonstrate that the monopolist's conduct indeed has the requisite anticompetitive effect." *Microsoft*, 253 F.3d at 58-59; *see also Rambus*, slip op. at 311. In the context of a claim of misrepresentations involving patents, the antitrust claimant must establish that the alleged competitive harm would not have occurred but for the alleged misconduct. But-for causation evidence is essential to show that the conduct had an adverse impact on the market. Absent proof of such causal link, what remains is merely proof of "unfair" conduct, which *Spectrum Sports* underscores is insufficient to sustain a monopolization or attempted monopolization case.

Accordingly, every antitrust tribunal to examine allegations of misrepresentations regarding patent rights to a standard-setting organization has imposed this causation requirement.[52] The antitrust claimant must establish "a causal link between the standard setting conduct and the adoption of a standard that infringed the wrongdoer's patent." *Rambus,* slip op. at 301; *see also Townshend v. Rockwell Int'l Corp.*, No. C 99-0400, 2000 U.S. Dist. Lexis 5070, at *33 (N.D. Cal. Mar. 28, 2000) (rejecting monopolization claim where plaintiff had "not asserted that the [standard

[52] CARB, of course, is a government regulatory agency that operates in the political environment and not a standard-setting organization. Petitioning of a government agency is subject to *Noerr* protection that is not accorded to participation in standard-setting organizations. These cases are nevertheless instructive, as there is no basis for imposing a lesser causation requirement in the context of petitioning conduct than in the case of misrepresentations to an organization to which a participant owes a fiduciary duty.

setting organization] could have adopted a V.90 standard which did not encompass [defendant's] technology"); *In re Dell Computer Corp.*, 121 F.T.C. 616, 624 n.2 (1996) (knowledge of Dell patent would have led standards body to choose "an equally effective, non-proprietary standard"); 2 HERBERT HOVENKAMP, MARK G. JANIS, & MARK A. LEMLEY, IP AND ANTITRUST § 35.5, at 35-41 (2003 ed.) ("failure to disclose the existence of a patent to a standard-setting organization will not affect the competitive marketplace if the standard setting organization would have approved the standard even if it had known about the patent").

The law in the area of *Walker Process* fraud, to which Complaint Counsel have likened Unocal's conduct in arguing against application of the *Noerr* doctrine, also makes it clear that the inquiry must extend beyond the wrongfulness of the challenged conduct to its impact on competition. *Walker Process* fraud requires "a clear showing of reliance, i.e., that the patent would not have issued but for the misrepresentation or omission." *Nobelpharma AB v. Implant Innovations, Inc.*, 141 F.3d 1059, 1071 (Fed. Cir. 1998). Where the patent would have issued even if the challenged misconduct had not occurred, "the patentee would receive no exclusionary rights to which he was not legally entitled under the patent laws. Hence, no basis exists for a charge of illegal monopolization or attempt to monopolize." *E.I. du Pont de Nemours & Co. v. Berkley and Co., Inc.,* 620 F.2d 1247, 1274 (8th Cir. 1980).

The rationale for these holdings goes beyond the *Walker Process* context. It is grounded in the need to show that the allegedly exclusionary conduct created avoidable consumer harm. Judge Posner explained this in rejecting a claim that a patent applicant stole an invention that properly belonged to the plaintiff:

> If the invention is patentable, it does not matter from an antitrust standpoint what skullduggery the defendant may have used to get the patent issued or transferred to him. The power over price that patent rights confer is lawful, and is no greater than it otherwise would be just because the person exercising the rights is not the one entitled by law to do so.

Brunswick Corp. v. Riegel Textile Corp., 752 F.2d 261, 265 (7th Cir. 1984).

As *Brunswick* shows, it is not enough to show merely that the antitrust defendant engaged in improper conduct. Rather, the antitrust claimant must show that the challenged conduct harmed consumers in that the defendant's "power over price" was "greater than it otherwise would be" if the wrongful conduct had not occurred. *Id.* In the *Walker Process* context, this entails proof that a patent that confers monopoly power would not have issued but for the fraud. And in the context of alleged misrepresentations to a standard-setting body, this principle entails a showing that a competitively preferable standard would have been chosen in place of the actual standard had the alleged misconduct not occurred. *See Dell*, 121 F.T.C. at 624 n.2. Consistent with the case law, Judge McGuire determined in *Rambus* that Complaint Counsel must prove that, absent the alleged misrepresentation, the standard setting body could have or would have chosen a different standard that did not implicate Rambus's patents. *Rambus*, slip op. at 310. Incredibly, Complaint Counsel do not even acknowledge Judge McGuire's holding on this issue.

Complaint Counsel go far beyond ignoring Judge McGuire's controlling decision. They ignore the entire body of case law on causation, arguing that "there need not be detailed proof of the world as it would have existed 'but for' deception, for such a requirement would eviscerate the ban on exclusionary monopolization [sic] and allow monopolists to profit by their wrongdoing." Compl. Counsel's Pretrial Br. at 7. This claim, of course, is contrary not just to *Rambus,* but also to the entire body of monopolization law. The Supreme Court has emphasized that "it is wrong categorically to condemn" as antitrust violations even tortious practices that *"could anticompetitively create or sustain a monopoly*" without examining their actual impact on competition. *Nynex*, 525 U.S. at 137 (quoting III PHILLIP E. AREEDA, & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 651d, at 80 (1996)) (emphasis added, internal quotations omitted). That is why the Court requires proof of the challenged conduct's "impact on consumers." *Aspen Skiing*, 472 U.S. at 605.

In recognition of the weight of this authority, the Complaint in this case repeatedly alleges that but for the alleged fraud, CARB would not have adopted regulations that "overlap" Unocal's patents and refiners would have taken measures to avoid those patents. Compl. ¶¶ 5, 80, 89. The complaint also alleges that Unocal's conduct "harm[ed] consumers in the downstream product market for 'summer-time' reformulated gasoline in California." *Id.* ¶ 5. Allegations of harm to California consumers pervade the entire Complaint. *See id.* ¶¶ 1, 7, 89, 93, 96, 97, 102, 103. The Complaint also repeatedly alleges that the asserted harms would have been avoided had Unocal disclosed its patent application. *Id.* ¶¶ 89, 90. Neither the Complaint's "but for" allegations nor its allegations of harm that would have been avoided can be proved without evidence of but for causation. Unless CARB could have chosen an equally effective regulatory solution that did not implicate Unocal's patents, there can be no consumer harm. Complaint Counsel have no evidence of any such regulatory alternative and no means of proving the Complaint's allegations. Their only recourse, as evidenced by their Pretrial Brief, is to evade the Complaint's allegations entirely and attempt to dispense with any need to prove causation on the eve of trial.

C. *Microsoft* Does Not Change the Requirement That Complaint Counsel must Prove Causation Arising from Unocal's Alleged Conduct

Complaint Counsel's attempt to recast *United States v. Microsoft* as obviating the need to prove a causal link between the challenged conduct and consumer harm has no foundation. This is the same misreading of the *Microsoft* decision that Complaint Counsel proffered and Judge McGuire rejected in *Rambus*. The *Microsoft* court by no means eliminated the causation requirement. To the contrary, it required that an antitrust plaintiff "demonstrate that the monopolist's conduct indeed has the requisite anticompetitive effect." *Microsoft*, 253 F.3d at 58. The court merely stated that the requisite causal link between conduct and effect may be established without proof that a competitive alternative that a monopolist had eliminated through exclusionary conduct would have prevailed in the marketplace absent that conduct. *Id.* at 79. It did not, however, dispense with the proof that a competitive alternative even existed, which is what Complaint Counsel seek to do in this case.

The *Microsoft* court addressed causation in the context of Microsoft's assertion that the elimination of nascent competitors was insufficient to establish competitive harm without further evidence that the competitors would have matured into full-fledged competitive threats. The court rejected this position, stating that the relevant questions are "(1) whether as a general matter the exclusion of nascent threats is the type of conduct that is reasonably capable of contributing significantly to a defendant's continued monopoly power and (2) whether Java and Navigator reasonably constituted nascent threats at the time Microsoft engaged in the anticompetitive conduct at issue." *Microsoft*, 253 F.3d at 79. The court explained that this approach was needed to prevent monopolists from having complete freedom to squash all nascent threats, as a nascent threat by definition is not a full-fledged competitive threat. Its approach required proof that the nascent threats existed and had been eviscerated by the monopolist's conduct. In other words, the court required proof that the monopolist's conduct prevented outcomes that were competitively preferable to those that actually occurred. The court emphasized that there were "ample findings that both Navigator and Java showed potential as middleware platform threats." *Id.*

In this case, the analogous proof to that required by the *Microsoft* court would be proof that, but for the alleged fraud, CARB likely would have adopted a different regulatory scheme that is competitively superior to regulations that CARB adopted and to those that it is currently able to adopt. In other words, the proof would be that Unocal's conduct defeated a regulatory alternative that would have been competitively preferable. This is the equivalent to Microsoft's elimination of nascent competitors that threatened to undermine its monopoly. Complaint Counsel, however, seek to avoid even the proof that a nascent threat existed and has been eliminated by Unocal's alleged conduct.

Had Unocal's conduct actually eliminated a competitive alternative, *Microsoft* counsels that Complaint Counsel should get the benefit of the doubt if there were a close question whether any particular alternative would have been competitively superior (i.e., more cost-effective). *Microsoft* rejected the need to prove that the nascent threats would have matured into successful rivals; it was enough to show that they had that potential. But Complaint Counsel do not proffer a foregone regulatory alternative that had the potential to be more cost-effective than the current regulations, taking Unocal's patents into account. *Microsoft* in no way endorses this complete failure of proof. It expressly requires proof of foregone competitive alternatives.

Alternative outcomes that are significantly costlier than the Phase 2 RFG regulations, taking Unocal's patents into account, cannot be viewed as having been even nascent threats. And refinery configurations that refiners clearly would not have adopted had they known that Unocal had applied for a patent similarly cannot be deemed to have been even nascent threats. They would not have been adopted, and consumers would be worse off if they had been adopted. Even if Unocal's conduct is somehow deemed to have been wrongful, there are no regulatory outcomes that are more procompetitive than the present state of affairs that Unocal's conduct allegedly eliminated.

Having failed to identify any such outcome comporting with the allegations of the Complaint, Complaint Counsel's only recourse is to claim that *Microsoft* allows them to prove the mere possibility of competitive harm. But this position simply cannot be reconciled with the Supreme Court's instruction in *Nynex* that "it is wrong categorically to condemn" as antitrust violations even tortious practices simply because they "*could* anticompetitively create or sustain a monopoly." *Nynex*, 525 U.S. at 137 (emphasis added).[53]

Finally, Complaint Counsel's mistaken reading of *Microsoft* does not even have the virtue of raising a new issue in this forum. In *Rambus*, Complaint Counsel similarly attempted to use *Microsoft* to evade the need to prove causation. Judge McGuire properly gave this argument short shrift. As his opinion explains, "while . . . the government *proved* that Microsoft's conduct had the alleged effect on Netscape, Complaint Counsel, in this case, want to *infer* that first step of causation (i.e., that JEDEC would have adopted a different standard)." *Rambus*, slip op. at 310 (emphasis in original). Complaint Counsel do not even acknowledge Judge McGuire's analysis in *Rambus*. As in *Rambus*, Complaint Counsel here seek to avoid the essential first step in the causation analysis and simply *assume* that Unocal's conduct caused CARB to adopt the Phase 2 RFG regulations. That is exactly the fallacy that Judge McGuire rejected in *Rambus* and that should be rejected here.

[53] This does not suggest that tortious conduct must go unremedied. The essential point in the Supreme Court's jurisprudence is that the antitrust laws uniquely protect *competition*, and the absence of anticompetitive effects makes them an unsuitable vehicle to redress conduct that is wrongful under some other standard.

D. Complaint Counsel Have Failed to Prove That Unocal's Challenged Conduct Caused an Anticompetitive Effect

Complaint Counsel will not be able to prove that Unocal's alleged misconduct caused an anticompetitive effect. There will be no evidence that CARB even plausibly would have adopted a competitively superior regulation but for the alleged fraud. And there will be no evidence that, but for the alleged fraud, the refiners would have invested in refinery configurations that would have produced an outcome that is competitively superior to the current state of affairs. Complaint Counsel's economic expert did not examine whether, and does not assert that, CARB could (let alone would) have adopted any regulatory scheme that is more cost-effective than the current one, taking Unocal's patents into accounts. And he did not examine whether, and does not assert that, the refiners might have invested in patent-avoiding refinery configurations that they can no longer pursue today.

The uncontroverted evidence will show that the sole alternative regulation proffered by Complaint Counsel's expert would have imposed costs that are significantly greater than the maximum royalties that Unocal could collect if its patents are valid and infringed and refiners agree to negotiate with it in good faith. The uncontroverted evidence will also show that California refiners could not have done anything to avoid the Unocal patents had they had perfect foresight of the patents and Unocal's royalty arrangement at the time of the Phase 2 rulemaking that they could not do after they learned about the patents. In other words, had the alleged misconduct not occurred (1) CARB would have adopted either the same regulations or alternative regulations that would have been less cost-effective than the current regulation, taking Unocal's patents into account, and (2) refiners would have made the same investment decisions that they actually made, or (if their testimony is to be credited) investment decisions that would have been far more harmful to California consumers.

IX. NEITHER CARB NOR THE REFINERS ARE LOCKED-IN

Complaint Counsel's inability to establish causation is exacerbated by their inability to prove another critical element of their case. Complaint Counsel cannot prove the existence of lock-in affecting either CARB or the refiners. No lock-in exists and no credible evidence of any lock-in will be presented at the hearing.

The claim of lock-in is central to Complaint Counsel's case for several reasons. First, if CARB is not locked into its current regulations and can assist California refiners in avoiding Unocal's patents, Unocal cannot have monopoly power even if the other elements of such power otherwise could be established. Second, absent lock-in, CARB's failure to offer refiners relief from Unocal's patents with knowledge of the patents is highly probative of what CARB would have done with the same knowledge before enacting its regulations. Third, CARB's ability to relieve refiners from any alleged "overlap" with Unocal's patents breaks the link in causation between Unocal's allegedly wrongful conduct and any claimed competitive harm. The same reasons also apply to the so-called refiner lock-in, which is the asserted inability of the California refiners to avoid Unocal's patents within the framework of the current regulations.

The lock-in claim in this case fails for a number of reasons. First, Complaint Counsel cannot show that CARB or the refiners are foreclosed today from adopting any competitively superior option that they could have adopted but for the alleged fraud.[54] The concept of lock-in

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54 [redacted]

involves the loss of options. As Professors Areeda and Hovenkamp observe, "[o]ne is 'locked-in' by an earlier choice that narrows one's later options." X PHILLIP E. AREEDA, HERBERT HOVENKAMP & EINAR ELHAUGE, ANTITRUST LAW ¶ 1740c, at 123 (2d ed. 2004). Similarly, [redacted]

> [redacted]

[redacted] The evidence will show that no such lock-in exists in this case.

Second, Complaint Counsel have no proof of another important element of lock-in. Lock-in is a phenomenon involving switching costs. As Judge McGuire stated in *Rambus*, lock-in entails "a situation where switching costs prohibit consumers from changing to another product or technology." *In re Rambus Inc.*, No. 9302, slip op. at 326 (FTC Feb. 23, 2004). Complaint Counsel will not be able to establish that switching costs prevent CARB from adopting regulations that ease refiners' avoidance of Unocal's patents or refiners from avoiding Unocal's patents within the current regulations. Their economic expert performed no analysis of any switching costs. *See* Shapiro Rpt. Third, the so-called "regulatory lock-in" claim will fail for the additional reason that CARB has rejected proposals from refiners to amend its regulations to ease patent avoidance while avoiding increased pollution. The evidence will show that the reason for CARB's failure to change its regulations to facilitate patent avoidance is not an inability to do so but, rather, a mixture of apathy and a conviction that Unocal's patents are invalid.

A. Complaint Counsel Cannot Establish the Existence of Competitively Superior Options That Are No Longer Available to CARB and the Refiners

To establish lock-in, Complaint Counsel will need to prove the existence of forgone options that are competitively superior to those that exist today. For regulatory lock-in, Complaint Counsel must prove that, absent the alleged misrepresentations, CARB would have adopted regulations that would have provided more cost-effective emissions abatement than the current regulations, taking Unocal's royalties into account, and that it cannot adopt such regulations today. For refiner lock-in, Complaint Counsel must prove that, absent the alleged misrepresentations, refiners would have adopted refinery configurations that enable regulatory compliance more cost-effectively than current configurations, taking Unocal's royalties into account, and that they cannot adopt these alternative configurations today.

No such proof will be forthcoming. Complaint Counsel expressly disclaim the necessity of offering proof that CARB's or the refiners' options became, [redacted] This is because they have no such proof. Their economic expert did not investigate whether any superior option that CARB or the refiners might plausibly have adopted had Unocal not made the alleged misrepresentation subsequently ceased to be available. Unocal's economic experts did examine this question and will offer unrebutted testimony that no option that is superior to the current regulatory scheme in terms of cost-effectiveness, taking Unocal's patents into account, has ceased to be available. Options that do not exist today also did not exist at the time of the rulemaking; options that existed at the time of the rulemaking remain available today. This is fatal to the lock-in claim.

A fundamental problem with Complaint Counsel's regulatory lock-in claim is their inability to proffer a single regulatory option that CARB might have considered at the time of the alleged fraud that would have been more cost-effective than the regulations that CARB actually adopted, taking Unocal's royalties into account. Their expert will not testify that any option that is superior in terms of cost-effectiveness to the current state of affairs was available to CARB in 1991 but subsequently became unavailable. Asked to rank the cost-effectiveness of the various regulatory options, including the current regulations with Unocal's royalties, [redacted]

In spite of the absence of evidence that this option was even plausible in terms of its relative cost-effectiveness, [redacted] Professor Shapiro did not analyze whether consumers would be better off if CARB had followed this path or whether it was even conceivable for CARB to do so. Without this analysis, it is impossible to say that CARB's [redacted] to what they were in 1991.

It is clear that consumers would have been, and would remain today, considerably worse off if this path had been chosen by CARB. William Pedersen, Unocal's expert on environmental enforcement, will testify that adoption of the Phase 2 regulations was essential in order to satisfy California's obligations under the State Implementation Plan (SIP) with which it was required to comply under the federal Clean Air Act. *See* Pedersen Rpt. *passim*; Pedersen Dep. (Expert), 10/15/03, at 88:17-89:22. The essentiality of the Phase 2 regulations to the SIP will also be acknowledged by senior CARB Officials. *See, e.g.*, Kenny Dep. (CARB), 05/15/03, at 53:5-15 (Phase 2 regulations represented a "huge" part of the SIP in terms of predicted emissions reductions, accounting for 300 tons of avoided emissions per day). Absent compliance with the SIP, the EPA would have been required to impose on California a costly and burdensome Federal Implementation Plan (FIP), which then-Governor Pete Wilson had described as "irresponsible and devastating." RX 201 at 001; Pedersen Rpt. at 13-15.

A study by the California Governor's Office of Planning and Research determined that the FIP would have imposed costs of more than $24 billion on the Los Angeles area alone. RX 334 at 001; Griffin Rpt. at 28. The measure was also projected to lead to the loss of 165,000 jobs and increase the unemployment rate by 0.5% to 1.7%. RX 334 at 001. [redacted] As Unocal's expert, Professor James Griffin, observed:

> [T]he data on the costs of achieving alternative emission reductions through the control measures identified in the FIP suggest that these costs would have been much higher—by at least an order of magnitude—than the potential cost of Unocal royalties if Unocal's patents were determined to be valid and infringed by California refiners.

Griffin Rpt. at 29. Professor Shapiro did not dispute any of this analysis.

Moreover, CARB's Final Statement of Reasons for the Phase 2 rulemaking dismissed as "not realistic" the proposal that the State simply adopt the EPA reformulated gasoline requirements. RX 10 at CARB0000363. In that same documents, CARB concluded:

> Implementation of only the federal gasoline standards would leave the state far short of obtaining the emissions reductions needed to meet the [sic] either the federal or state ambient air quality standards. The result would be a far greater likelihood of sanctions on transportation funds and new source growth, and an imposition of a greater burden onto other California industries to reduce emissions.

Id. at CARB0000449.

The evidence thus shows that CARB's options today are neither [redacted] compared to the so-called EPA option. The options have not been reduced because the EPA option could not realistically have been adopted by CARB.[55] And the options have not been made less attractive because the EPA option would have imposed considerably greater costs on California consumers than the current regulations with Unocal's patents. [redacted] Similarly, he was unable to testify that the EPA option was the next-best alternative that would have been available to CARB in 1991. *Id.* at 115:15-24.

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[55] Complaint Counsel make much of the fact that Unocal advocated to CARB that it adopt the EPA option, missing the salient point that acceptance of Unocal's position would have obviated the harm that Unocal is alleged to have inflicted through deliberate deception. In any event, CARB's strenuous rejection of the suggestion, based on concerns about "sanctions on transportation funds and new source growth, and an imposition of a greater burden onto other California industries to reduce emissions" (RX 10 at CARB0000449) shows that it is highly improbable that CARB would have adopted that option had it been aware of Unocal's patent application.

Given the uncontested evidence that the EPA option would have imposed far greater costs on California consumers than the current regulations, with Unocal's patent royalties, no regulatory lock-in can be established. Nor can refiner lock-in be established. As an initial matter, Professor Shapiro's report addresses only regulatory lock-in, and Complaint Counsel thus will not have support from their economic expert for any claim of refiner [redacted]

[redacted] Complaint Counsel will not dispute this analysis. [redacted]

56 [redacted]

57 [redacted]

[redacted] And, indeed, the refiners could not have modified their refineries to avoid the Unocal patents had Unocal disclosed the fact that it had a pending patent application related to RFG without disclosing the contents of the application. Thus, no refiner can testify that a superior option that would have been available to it absent the alleged misrepresentation is no longer available. Moreover, had the refiners truly done what many of them claim they would have done upon learning of the Unocal patent application—[redacted] price of gasoline in the State of California would have been much higher than it is today. Teece Rpt. ¶ 291.

B. Complaint Counsel Also Cannot Establish a Lock-in Because There Is No Evidence of Switching Costs That Create a Lock

Complaint Counsel's counsel analysis of lock-in is at odds with another fundamental aspect of lock-in analysis. For lock-in to exist, switching costs must prevent the affected party from changing to another product or technology. Lock-in exists, as the Supreme Court observed in *Eastman Kodak Co. v. Image Technical Services, Inc.*, where "the cost of switching is high." 504 U.S. 451, 476 (1992); *see also Brokerage Concepts, Inc. v. U.S. Healthcare, Inc.*, 140 F.3d 494, 515 (3d Cir. 1998); *In re Rambus Inc.*, slip op. at 326. As Professor Shapiro observed in his book INFORMATION RULES, "[s]witching costs measure the extent of a customer's lock-in to a given

58 [redacted] goes without saying that a valid inquiry requires the same question to be asked for both the *ex post* and *ex ante* periods. *See* Teece Rpt. ¶¶ 250-52.

supplier." CARL SHAPIRO & HAL R. VARIAN, INFORMATION RULES 111 (1999); *see also id.* at 104 ("When the costs of switching from one brand of technology to another are substantial, users face *lock-in.*"). Complaint Counsel's economic expert, however, did not examine switching costs to support his lock-in analysis. [redacted]

[redacted] But the critical issue for purposes of lock-in [redacted] as Judge McGuire determined, what switching costs must be incurred—what must be spent prospectively—to avoid the patent. *In re Rambus Inc.*, slip op. at 327-28. If a regulatory change can take place, for example, at little or no cost, it makes eminently good sense to adopt it regardless of what sunk costs were incurred.

Complaint Counsel will present no evidence that compares the costs associated with regulatory amendments to facilitate greater avoidance of Unocal's patents to the refiner benefits from such regulations. Nor will Complaint Counsel present evidence that compares the cost of refinery modifications to avoid the patents within the current regulatory scheme to the refiner benefits from making such modifications. Complaint Counsel thus will not be able to meet their burden of showing that switching costs create a lock-in, even without regard to whether the alternatives in question would have been adopted by CARB and the refiners in the absence of the alleged fraud.

C. Complaint Counsel Also Cannot Establish Regulatory Lock-In Because CARB Never Tried to Assist Refiners in Avoiding Unocal's Patents

Complaint Counsel also cannot establish regulatory lock-in because there is no evidence that CARB ever seriously considered any regulatory options to facilitate patent avoidance even though such options existed. Refiners took note of CARB's indifference to the Unocal patents in spite of its professed concern about them. [redacted] Accordingly, in spite of refiners' pleas to CARB to modify the regulations to ease the avoidance of Unocal's patents, and proposals for doing so without increasing pollution, CARB refused to amend its regulations. [redacted] CARB reportedly believed that the Unocal royalty was [redacted] Courtis Dep. (CARB), 8/28/03, at 108:10-09:12.[59]

In 2000, two years after a district court sustained a jury verdict of infringement on Unocal's '393 patent and five years after CARB learned about Unocal's intellectual property, CARB declined to take Unocal's patents into account in amending its RFG regulations. Even after the judicial ruling, CARB viewed the '393 patent as being "still . . . in a state of flux" and "believed that there were concerns with the validity of the patent." Venturini Dep. (CARB), 5/14/03, at 402:25-403:15. Even the denial of the refiners' motion for judgment as a matter of law following a jury verdict in favor of Unocal did not persuade CARB to take Unocal's patents seriously.

[59] The only "royalty" in effect at the time was the damage award in the '393 infringement case, which is significantly greater than the royalty under which Unocal has offered to license its patents. Thus, Unocal's licensing is even more difficult to distinguish from the noise of normal price fluctuations than the damages award that produced CARB's indifference.

The evidence will show that CARB did not amend its regulations because it did not care enough about the patents to do so and believed in any event that the patents would be invalidated. Its failure to act cannot be explained by an alleged inability to make regulatory changes by reason of a lock-in. No CARB witness will be able to testify that CARB seriously attempted to amend its regulations to ease patent avoidance. No CARB witness will be able to identify specific switching costs that prevent CARB from adopting alternative regulations.[60]

X. <u>UNOCAL HAD LEGITIMATE BUSINESS JUSTIFICATIONS FOR ITS CONDUCT</u>

Unocal did not engage in any improper conduct under the antitrust laws because the core conduct which the Complaint alleges to be exclusionary was in fact done pursuant to legitimate business justifications.

As noted above, to prove monopolization, Complaint Counsel has to demonstrate that Unocal's conduct was exclusionary within the meaning of the antitrust laws. Under the antitrust laws, exclusionary conduct is "behavior that not only (1) tends to impair the opportunities of rivals, but also (2) either does not further competition on the merits or does so in an unnecessarily restrictive way." *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 605 (1985). The key factor courts look to in assessing whether the conduct is or is not competition on the merits is the proffered business justification for the act. *Stearns Airport Equip. Co. v. FMC Corp.*, 170 F.3d 518, 522 (5th Cir. 1999). A legitimate business justification is practically any conduct that has a rational business purpose. *Id.* at 523 ("Generally, a finding of exclusionary conduct requires some

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60 [redacted]

sign that the monopolist engaged in behavior that—examined without reference to its effects on competitors—is economically irrational.").

Legitimate competitive behavior includes a company's efforts to enhance efficiency, reduce costs, enforce intellectual property, and maximize profits. *See, e.g., In re E.I. du Pont de Nemours & Co.*, 96 F.T.C. 653, 738 (1980) (To determine whether conduct has legitimate business justification, courts look to a variety of criteria such as whether the behavior amounted to ordinary marketing practices, whether it was profitable or economically rational or whether it resulted in improved product performance). When there is a business justification, the challenged conduct is not exclusionary even if "one reason for [defendant's conduct] was to disadvantage the competition." *Universal Analytics, Inc. v. MacNeal-Schwendler Corp.*, 914 F.2d 1256, 1259 (9th Cir. 1990). Once asserted by the defendant, the plaintiff bears the burden of proving the lack of legitimate business justifications. *High Tech. Careers v. San Jose Mercury News*, 996 F.2d 987, 991 (9th Cir. 1993).

The Complaint alleges that as part of its advocacy of the predictive model, Unocal represented that its data was non-proprietary while maintaining the secrecy of its pending patent application. Compl. ¶¶ 2, 3, 4, 35, 41, 58, 78. It is undisputed that the reason why Unocal gave CARB its data was to convince CARB to adopt a predictive model. Compl. ¶¶ 2, 37, 47. This much is apparent from the August 27 letter itself (RX 3), the testimony of CARB witnesses (*e.g.*, Venturini Dep. (CARB), 5/13/03, at 51:4-52:2) and Unocal's internal documents from the time (*e.g.*, RX 157 at 002-03; CX 240). Because a predictive model would allow Unocal—and other refiners—to produce whatever blends of gasoline they wanted so long as predicted emissions benefits were met, Unocal believed that a predictive model would be a more cost-effective and flexible way in which to regulate gasoline (*e.g.*, RX 60 at CARB0001421). As noted above, Unocal was not alone in this desire; many others in the industry, including WSPA, also lobbied for a predictive model. A predictive model—and in particular the "pure" predictive model for which Unocal advocated—did not in any way mandate that any company use Unocal's technology. In fact, just the opposite was true: a pure predictive model (as opposed to rigid fuel specifications) gave everyone in the industry the opportunity to make whatever compositions of gasoline were most cost-effective for their own company. Stellman Rpt. at 16; RX 711 at [redacted]. Hence, even if Complaint Counsel could prove there was something misleading about the language which Unocal used in attempting to persuade CARB to adopt a predictive model (which they cannot), this would not be *an antitrust claim*[61] because it is undisputed that the reason Unocal was using this language was to persuade CARB to adopt a predictive model—an action based upon Unocal's very legitimate business reasons of trying to improve the cost-effectiveness and efficiency of its refining operations. Seeking a predictive model—something which many of Unocal's competitors also did—was in no way exclusionary or anticompetitive. *See Bell v. Dow Chem. Co.*, 847 F.2d 1179, 1185 (5th Cir. 1988) (citing cost savings, shortage of supplies and more efficient production as examples of legitimate business concerns); *Ocean State Physicians Health Plan, Inc. v. Blue Cross*

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[61] *See, e.g.*, *Abcor Corp. v. AM Int'l, Inc.*, 916 F.2d 924, 931 (4th Cir. 1990) ("[C]ourts should be circumspect in converting ordinary business torts into violations of antitrust laws. To do so would be to create a federal common law of unfair competition which was not the intent of the antitrust laws.") (quoting *Merkle Press, Inc. v. Merkle*, 519 F. Supp. 50 (D. Md. 1981) (internal citation omitted)); *Olympia Equip. Leasing Co. v. Western Union Tel. Co.*, 797 F.2d 370, 376 (7th Cir. 1986) (exclusionary conduct is not determined by liability "in tort or contract law, under theories of equitable or promissory estoppel or implied contract . . . or by analogy to the common law tort" rules).

& Blue Shield, 883 F.2d 1101, 1111 n.11 (1st Cir. 1989) ("The fact remains that achieving lower costs is a legitimate business justification under the antitrust laws.").

Just as its advocacy of the predictive model was done pursuant to a legitimate business justification, so too was Unocal's conduct in maintaining the secrecy of its patent application. As noted above, Unocal was never asked whether it had any patent applications, nor did CARB, Auto/Oil or WSPA have any policies which required such disclosure.[62] So in the absence of any such request or policy, Unocal simply adhered to its ordinary business practice and did not reveal that it had filed for a patent application.

There was nothing unusual about Unocal's internal practice of not disclosing the existence or details of pending patent applications. Many other companies, including the refiner witnesses in this case, have similar policies. As noted above, there are a number of reasons why companies such as Unocal have policies that pending patent applications should be kept confidential, such as protecting the trade secret value of the invention if for some reason the invention is determined not to be patentable and avoiding the potential for provoking an interference with the application. *See* Linck Rpt. at 9; *see also Plastic & Metal Fabricators, Inc. v. Roy*, 303 A.2d 725, 733-34 (Conn. 1972) (noting that applicant retains trade secret protection contained in patent application because PTO keeps rejected applications secret).

Protecting the secrecy of one's innovations and trade secrets is a legitimate business justification that prevents the imposition of liability under the antitrust laws. *Technical Res. Servs., Inc. v. Dornier Med. Sys., Inc.*, 134 F.3d 1458, 1467 (11th Cir. 1998); *see also Berkey Photo, Inc.*

[62] Indeed, CARB has never asked anyone about pending patent applications (Simeroth Dep. (CARB), 7/9/03, at 224:23-225:17), and Auto/Oil and WSPA had explicit and implicit policies that such information should not be disclosed. *See infra.*

v. Eastman Kodak Co., 603 F.2d 263, 281-82 (2d Cir. 1979) ("a firm may normally keep its innovations secret from its rivals as long as it wishes."); *ILC Peripherals Leasing Corp. v. Int'l Bus. Mach. Corp.*, 458 F. Supp. 423, 436-37 (N.D. Cal. 1978) (IBM's policy of keeping interface information secret promoted innovation and was not exclusionary under the antitrust laws). As Judge MacGuire held in *Rambus*, not disclosing information about pending or future patent applications is not only "rational and profit maximizing behavior," but also is procompetitive because the ability to control the disclosure of intellectual property preserves incentives to innovate. *In re Rambus Inc.*, No. 9302, slip op. at 287 (FTC Feb. 23, 2004).

Indeed, the Federal Circuit has recognized that ability to keep applications secret is significant part of the United States patent system. *Eagle Comtronics, Inc. v. Arrow Comm. Labs., Inc.*, 305 F.3d 1303, 1314 (Fed. Cir. 2002). ("The integrity of the patent system is maintained in part by inventors' understanding that their patent applications will remain secret until either the patents issue or the applications are otherwise published by the PTO."). And of course, at the time of CARB's Phase 2 rulemaking, the PTO *was required by law* to keep confidential both the contents of pending patent application and the fact that an application had been made. 35 U.S.C. § 122 (1991) and 37 C.F.R. § 1.14 (1991).

Complaint Counsel cannot meet their burden that Unocal did not have a legitimate business justification for its challenged conduct. As such, Unocal did not engage in exclusionary conduct when it advocated for the predictive model while maintaining the confidentiality of its patent application on compositions of reformulated gasoline.

XI. THE STATUTE OF LIMITATIONS BARS THIS PROCEEDING

A. 28 U.S.C. § 2462 Applies to this Proceeding

Title 28, section 2462 governs this proceeding and provides in relevant part that "any action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued . . . ." 28 U.S.C. § 2462; *see also United States v. Ancorp Nat'l Servs., Inc.*, 516 F.2d 198, 201 (2d Cir. 1975) (FTC administrative enforcement action seeking civil monetary penalties and injunctions against future violations of cease and desist order is subject to § 2462); *FTC v. Green Tree Acceptance*, No. 4-86-469-K, 1987 U.S. Dist. LEXIS 16750, at **7-8 (N.D. Tex. Sept. 30, 1987) (agency acknowledges that FTC Act is governed by the five-year limitations period contained in 28 U.S.C. § 2462); *FTC v. Lukens Steel Co.*, 454 F. Supp. 1182, 1186 n.2 (D.D.C. 1978) (section 2462 applies to FTC proceedings for civil penalties). Courts have construed § 2462 as a general statute of limitations applicable "to the entire federal government." *3M Co. (Minnesota Mining and Mfg.) v. Browner*, 17 F.3d 1453, 1461 (D.C. Cir. 1994). They have also recognized that § 2462 applies to administrative as well as judicial proceedings (*see id.* at 1456), and reaches actions to determine liability as well as to actions seeking to collect penalties already imposed. *See, e.g., Fed. Election Comm'n v. Williams*, 104 F.3d 237, 239-40 (9th Cir. 1996) ("It is the law of this circuit that, for the purposes of § 2462, 'enforcement' comprises 'assessment.'"); *see generally 3M*, 17 F.3d at 1459 ("Indeed, § 2462's application to cases in which the court first adjudicates liability and then sets the penalty or fine is unquestioned.") (footnote omitted); *but see Capozzi v. United States*, 980 F.2d 872, 875 (2d Cir. 1992) ("It is the collection of amounts owed, not the assessment of them, that may be properly termed 'enforcement.'").

In this case, Complaint Counsel seek to divest Unocal of specific patent rights without compensation. In particular, Complaint Counsel seek, in effect, to prevent Unocal from enforcing its patents related to RFG in California. Compl. at Notice of Contemplated Relief. This effectuates a "forfeiture" of Unocal's patents, in other words "a divestiture of specific property without compensation." *City of Philadelphia v. Nam*, 273 F.3d 281, 286 (3d Cir. 2001); *see also Hickman v. Texas*, 260 F.3d 400, 402 (5th Cir. 2001) (same) (citation omitted). "That a patent is property, protected against appropriation by individuals and the government, has long been settled." *Hartford-Empire Co. v. United States*, 323 U.S. 386, 415 (1943) (footnote omitted). Thus, because the contemplated relief sought by the FTC would require Unocal to forfeit its patent rights, § 2462 is applicable to this case.

B. <u>Unocal's Alleged Violation Occurred Outside the Limitations' Period</u>

A cause of action accrues within the meaning of § 2462 "when the factual and legal prerequisites for filing suit are in place." *3M*, 17 F.3d at 1460. In making that determination, "courts have generally looked to the substantive elements of the cause of action on which the suit is based." *Id.* As Complaint Counsel have acknowledged, "the offense of monopolization is *complete* with the acquisition of monopoly power," whether or not that power has been exercised.[63] Similarly, the offense of attempted monopolization is complete once the three elements of the offense—specific intent, anticompetitive conduct, and dangerous probability of success—have been satisfied. *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 454-55 (1993). For purposes of 28

[63] Complaint Counsel's Post-Hearing Brief in *In re Rambus Inc.*, No. 9302, slip op. at 100 (FTC Feb. 23, 2004) (emphasis added); *see also Am. Tobacco Co. v. United States*, 328 U.S. 781, 811 (1946) ("It is not necessary that the monopoly power unlawfully obtained is exercised. Its existence is sufficient.").

U.S.C. § 2462, the running of the limitations period is measured from the date of the violation. *3M*, 17 F.3d at 1462.

The FTC chose to not file this action until after Unocal's competitors spent eight years litigating against one of Unocal's RFG patents. *See* RX 401-406 (litigating refiners asking for FTC investigation; *Union Oil Co. of Cal. v. Atlantic Richfield Co.*, 208 F.3d 989 (Fed. Cir. 2000). Even under the Complaint, Unocal's alleged misrepresentations are said to have stopped in the early 1990s.[64] In January 1995, Unocal announced its plan to license its RFG technology (CX 599) (Unocal's press release regarding the '393 patent), and thus no longer could "perpetuate the [allegedly] false and misleading impression that it did not possess, or would not enforce, any proprietary interests relating to RFG." Compl. at 4; *see also* Compl. ¶¶ 2c, 3, 79, 83, 88. One year later, Unocal's competitors informed the FTC[65] that Unocal had engaged in anticompetitive conduct which allowed it to "enjoy monopoly power over *all* gasoline sold in California beginning in March 1996 . . . ."[66] Seven years later, on March 4, 2003, the FTC initiated administrative proceedings against Unocal. Based on 28 U.S.C. § 2462, this proceeding is at least two years too late. *See United States v. Meyer*, 808 F.2d 912, 920 (1st Cir. 1987) ("Were the statute of limitations to run against, say, an F.T.C. action, the Commission would have only its own indecision to blame.").

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64 The final alleged misrepresentation was in June 1994 (Compl. at ¶ 78.c), though the Complaint and discovery focused almost exclusively on Unocal's statements in 1991 before CARB and industry groups.

65 Of course, even if a "discovery of violation" rule of accrual were to apply here, the outcome in this case would be the same given the agency's complete knowledge of the alleged offense back in 1996. *See* RX 401, RX 402, RX 403, RX 404, RX 405, RX 406.

66 January 17, 1996 Memorandum of Law on Whether the Enhancement of a Patent's Market Power to Monopoly Levels that is the Result of Misrepresentations Made to a State Agency is Actionable Under the Antitrust Laws, at p. 6 (FTC-HE000010) (emphasis added).

As a backdoor attempt to satisfy the limitations provision of § 2462, the Complaint states that Unocal's illegal conduct "continues even today" (Compl. at ¶¶ 99-103) and will continue as long as Unocal licenses its RFG technology or otherwise asserts any of its legal rights or remedies relating to its lawfully obtained patents. In other words, the FTC's view is that there is *no statute of limitations period in this case.* Not surprisingly, courts are loath to interpret statutes of limitations in a manner that render them superfluous. *See, e.g., Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1051 (8th Cir. 2000) (in merger case, court declines to adopt view of statute of limitations which would subject the merger to "continual challenge" under the Clayton Act); *Aurora Enter. v. N.B.C.*, 688 F.2d 689, 694 (9th Cir. 1982) (in antitrust tying case, court declines to interpret statute of limitations in manner that "would destroy the function of the statute, since the parties may continue indefinitely to receive some benefit as a result of an illegal act performed in the distant past."); *Crotty v. Niagara Mohawk Power Corp.*, 263 F. Supp. 2d 650, 661 (W.D.N.Y. 2003) (in environmental action governed by Section 2462, court declines to adopt position that "taken to its logical end, suggests a *de facto* elimination of any statute of limitation . . . ."). Complaint Counsel appear not to recognize that a limitations defense in itself serves a public interest, because "even if one has a just claim, it is unjust not to put the adversary on notice to defend within the period of limitations and that the right to be free of stale claims in time comes to prevail over the right to prosecute them." *Order of R.R. Telegraphers v. Railway Express Agency, Inc.*, 321 U.S. 342, 348-49 (1944); *see also Am. Pipe & Constr. Co. v. Utah*, 414 U.S. 538, 554 (1974) ("the policies of ensuring essential fairness to defendants [includes] . . . barring a plaintiff who has slept on his rights.") (internal quotation marks and citation omitted). In addition, when an enforcement action is brought to promote a public interest, as Complaint Counsel contend, the statute period encourages timely challenges, thus minimizing the potential cost to society of the alleged offense. It would be "strange to provide an unusually long basic limitations period that could only have the effect of postponing whatever public benefit" might result from an action. *Rotella v. Wood*, 528 U.S. 549, 558 (2000).

C. <u>Unocal Did Not Engage in Any Conduct Within the Five Years Prior to this Action Which Would Have the Effect of "Restarting" the Limitations' Period</u>

Complaint Counsel's characterization of the conduct at issue wrongly blurs an important distinction. Continuing violations in antitrust cases almost exclusively arise in the conspiracy context. *Concord Boat*, 207 F.3d at 1052; *see also* II PHILLIP E. AREEDA, HERBERT HOVENKAMP & ROGER D. BLAIR, ANTITRUST LAW ¶ 320c3, p. 217 (2d ed. 2002) (noting that courts are "significantly more likely to restart the statute when the action complained of is conspiratorial rather than unilateral"). A so-called unilateral continuing violation is actionable only if there are "continual unlawful acts" within the statute period, as distinguished from the "continual ill effects from a single violation" outside the limitations period. *Crotty*, 263 F. Supp. 2d at 660-661; *see also* II PHILLIP E. AREEDA, HERBERT HOVENKAMP & ROGER D. BLAIR, ANTITRUST LAW ¶ 320c4, p. 221 (2d ed. 2002) (distinguishing "independent predicate acts" that are wrongful in themselves and are sufficient to keep a claim alive, from actions that are mere reaffirmations of the initial act, which are not sufficient to restart the statute period).

The Complaint contains no allegations of wrongful conduct by Unocal subsequent to March 4, 1998 (five years prior to the filing of this action). It includes no contentions, for example, that Unocal made ongoing misrepresentations or engaged in other misconduct in connection with its licensing efforts, the infringement litigation, or the prosecution of its patents before the PTO.

Accordingly, the statute of limitations period had passed and this matter should be dismissed under 28 U.S.C. § 2462.

XII. COMPLAINT COUNSEL'S PROPOSED REMEDY IS OUTSIDE THE COMMISSION'S AUTHORITY AND DOES NOT BEAR A REASONABLE RELATION TO THE ALLEGED UNLAWFUL CONDUCT

The remedy proposed by Complaint Counsel in this case seeks to strip Unocal of its property right to claim infringement of any of Unocal's five patents based on the manufacture, sale, distribution, or use of motor gasoline sold in or exported out of California. Compl. ¶¶ 17-18. The Complaint additionally asserts that Unocal should be forced to use, at its own cost, a Commission-approved compliance officer to be its sole representative for the purpose of communicating Unocal's patent rights relating to any standard or regulations under consideration by any standard-setting organization of which Unocal is a member and/or any state or federal governmental entity that conducts rulemaking proceedings in which Unocal participates. Compl. ¶ 18.

These proposed remedies should be rejected for a multitude of reasons. First, although disguised as a "cease and desist" order, the remedy sought is in reality a punitive measure which the Federal Trade Commission does not have the authority to order. Second, an order enjoining Unocal from collecting on its pending accounting action for the '393 patent impermissibly seeks to attack the judgment of an Article III Court. Third, the proposed remedies do not bear a reasonable relation to the challenged conduct.

A. The Commission Has No Authority to Force Forfeiture of Patent Rights

Even if Complaint Counsel could prove liability, the Commission lacks authority to enter the proposed remedy. The authority to seek a forfeiture in antitrust actions—if the FTC has such authority at all—must stem from a civil action in district court. 15 U.S.C. § 53(b); *see FTC v. Mylan Labs., Inc.*, 62 F. Supp. 2d 25, 36-37 (D.D.C. 1999). But within the FTC itself, the Commission is limited to cease and desist orders for future conduct in matters brought within its agency.

This action was brought as a matter purportedly within the agency's jurisdiction under Section 5 of the FTC Act, 15 U.S.C. § 45. Thus, any proposed relief must not operate as a penalty, disgorgement, forfeiture or punitive measure. *See FTC v. Ruberoid*, 343 U.S. 470, 473 (1952) ("Orders of the Federal Trade Commission are not intended to impose criminal punishment or exact compensatory damages for past acts, but to prevent illegal practices in the future."); *Heater v. FTC*, 503 F.2d 321, 323, 324 n.13 (9th Cir. 1974) (Commission cannot "order private relief for harm caused by acts which occurred before the Commission had declared a statutory violation, and thus before giving notice that the prior conduct was within the statutory purview," and "[o]ur holding denies retroactive impact to a Commission decision, at least in so far as private rights and liabilities are involved.").

Unocal is not aware of any reported, precedential decisions in which the FTC has issued an order preventing a respondent from enforcing its patents against those who infringe them.[67] Indeed the only court to squarely address this issue appears to be the Sixth Circuit in *Am. Cyanamid Co. v. FTC*, 363 F.2d 757, 772 (6th Cir. 1966). There, the Sixth Circuit explicitly stated that "[w]e do

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[67] Complaint Counsel cite to *In re Dell Computer Corp.*, 121 F.T.C. 616, 619 (1996). Complaint Counsel's Pretrial Br. at 79-80. But *Dell* was a consent order that explicitly acknowledged that the agreement was for settlement purposes only. *Id.* at 619. Consent decrees provide no precedential value. *United States v. E.I. du Pont de Nemours & Co.*, 366 U.S. 316, 330 n.12 (1961) ("the circumstances surrounding such negotiated [consent decrees] are so different that they cannot be persuasively cited in a litigation context"), *quoted in In re Rambus, Inc.*, No. 9302, slip op. at 257 (FTC Feb. 23, 2004) (holding that *Dell* has no precedential value).

not hold that the Commission has jurisdiction either directly or indirectly to invalidate or destroy a patent, *nor do we hold that the Commission could order compulsory licensing without payment of reasonable royalties*." *Id.* (emphasis added).

Indeed, the Commission in the past has recognized that orders which deny respondents their rights to enforce their patents can be confiscatory and punitive in nature. *In re Grand Caillou Packing Co.*, 65 F.T.C. 799 (1964). In *Grand Caillou Packing*, despite the Commission's holding that the respondent had engaged in "serious abuses" of its patent rights, the Commission specifically refused to enter an order denying the respondent the right to file infringement suits: "Regardless of the facts which have given rise to the need for an order, Federal Trade Commission proceedings are not punitive . . . ." *Id.* at 859. The Commission held that "to order respondents to cease filing suits against infringers would constitute a complete confiscation of their patent rights." *Id.*

Likewise, in *In re Roberts Co.*, the Commission noted that when drafting an order proscribing the abuse of a patent, the Commission must be careful to strike a balance that preserves the reward of the inventor as much as is possible while protecting the public interest. 56 F.T.C. 1569, 1610 (1960) ("In drafting an order proscribing the abuse or misuse of a patent a careful balance must be struck between the private inventor's legitimate reward and the public interest in the elimination of undue restraints upon competition.") The Commission in *Roberts* thus tailored the remedy to go no broader than prohibiting the unlawful conduct. *Id.*; *see also FTC v. Royal Milling Co.*, 288 U.S. 212, 217(1933) (holding that trade names constitute valuable business assets and FTC should not order their destruction if less drastic means will accomplish the same result: "The orders should go no further than is reasonably necessary to correct the evil and preserve the rights of competitors and public.").

Even though framed as a "cease and desist" remedy, there is no question that the essence of the relief sought in this action is a confiscation and disgorgement of Unocal's patent rights in California. Not only does the remedy as framed purport to prohibit Unocal from ceasing to file infringement suits (as in *Grand Caillou Packing*), but presumably, the Complaint also seeks to prohibit Unocal from collecting the $280 million in damages and prejudgment interest to which it was entitled as of December 2001 under the 9/28/98 judgment of the federal District Court for the Central District of California. Complaint Counsel should not be allowed to expand the power of the Commission by attempting to achieve punitive, forfeiture remedies under the guise of "cease and desist" language.

B. <u>The Proposed Remedy with Respect to the '393 Patent Would Be an Impermissible Attack on the Judgment of an Article III Court</u>

In addition to the Commission's lack of authority to confiscate Unocal's patent rights or to compel royalty free licensing under the guise of its cease and desist authority, there are multiple additional reasons why the proposed remedies must be rejected. Here, the requested relief improperly attempts to sweep in, without distinction, all five of Unocal's patents, without regard for the judiciary's decisions with respect to the '393 patent, and without regard for the minuscule market share represented by the '393 patent technology.

Unocal received the first of its five RFG patents, the '393 patent, in 1994. Answer ¶ 11. This patent was the only one at issue in the 1997 jury trial, and the only one subsequently upheld as valid and infringed by the Federal Circuit. *Union Oil Co. of Cal. v. Atlantic Richfield Co.*, 208 F.3d 989 (Fed. Cir. 2000), *cert denied* 531 U.S. 1183 (2001). The jury in the 1997 trial found that on average approximately 29 percent of the CARB summer-time gasoline infringed, based upon the refiners' production from March through July 1996 (the only time period for which the refiners had supplied production records). '393 Tr. Trans. at 2587 (Stellman); Stellman Rpt. at 12; '393 Tr. Special Verdict Form. The damages award for these five months totaled $69 million. *See* Sept. 30, 1998 J. Pursuant to 28 U.S.C. § 1292(c)(2) ¶4; Sept. 29, 1998 Order ¶ 13. Following the Federal Circuit's decision, the defendant refiners paid this amount to Unocal, together with $27 million in prejudgment interest. *Union Oil Co. of Cal. v. Atlantic Richfield Co.*, No. CV-95-2379, slip op. ¶ 4 (C.D. Cal. Sept. 28, 1998) (Judgment Pursuant to 28 U.S.C. § 1292(c)(2)); *Union Oil Co. of Cal. v. Atlantic Richfield Co.*, No. CV-95-2379, slip op. at ¶ 13 (C.D. Cal. Sept. 28, 1998) (Order Granting Plaintiff's Rule 59(e) Motion; Granting and Staying Request for Accounting and Delaying Plaintiff's *Ex Parte* Application for Magistrate Judge Designation).

In addition to ordering the defendants to pay damages for the five months of infringement in 1996, the District Court ordered on September 28, 1998, that a further accounting would take place against these refiners:

> With respect to infringement from August 1, 1996 to the date of final judgment this Court orders that an accounting for defendants' oil production take place in order to determine the number of gallons of infringing motor gasoline, to be then multiplied by the royalty rate of 5.75¢ per gallon, prejudgment interest at the rate of 8.24%, compounded quarterly, such accounting to be stayed during the pendency of an appeal in this matter.

Union Oil Co. of Cal. v. Atlantic Richfield Co., No. CV-95-2379, slip op. at ¶ 14 (C.D. Cal. Sept. 28, 1998) (Order Granting Plaintiff's Rule 59(e) Motion; Granting and Staying Request for Accounting and Delaying Plaintiff's *Ex Parte* Application for Magistrate Judge Designation).

At the refiners' request, the court stayed this accounting of additional infringement damages pending appeal. Once Unocal had prevailed on appeal, Unocal moved forward with the accounting earlier ordered by the court, since the refiners by that time had paid Unocal for the damages and interest assessed for the earlier five-month infringement period. After receiving updated information on refiners' motor gasoline production, Unocal moved for an additional award of damages totaling $209 million for infringement of the '393 patent for the period from August 1, 1996 through September 30, 2000 (the date through which refiners had provided production records). Unocal also sought pre-judgment interest of $71 million through December 17, 2001, pursuant to the court ordered rate of 8.24 percent. The defendant refiners asked the Court to vacate the previous accounting order and its binding terms but the Court rejected this request. However, the accounting is currently not proceeding pending reexamination of the '393 patent.

The demand that Unocal must "cease and desist all efforts it has undertaken by any means . . . through or in which Respondent has asserted that any person or entity . . . infringes any of Respondent's [RFG patents]," Compl., at 17, appears to be an attempt to preclude Unocal from collecting the outstanding damages for infringement which is part of its accounting order decree. The Commission, however, as a creation of the legislative and executive branch, does not have the constitutional authority to order relief that would conflict with or ignore a binding decision of an Article III court.

The constitutional problems raised here were carefully analyzed by the Second Circuit in *Deerfield v. FCC*, 992 F.2d 420 (2d Cir. 1993). In *Deerfield*, the Court of Appeals was faced with whether FCC agency action should be set aside as contrary to law or the constitutional power of the agency, in accordance with 5 U.S.C. § 706(2).[68] The court specifically explained why the FCC exceeded its constitutional authority in relation to a court judgment:

> A judgment entered by an Article III court having jurisdiction to enter that judgment *is not subject to review by a different branch.* "It is, emphatically, the province and duty of the judicial department, to say what the law is."
>
> *Nor may an administrative agency choose simply to ignore a federal-court judgment.* "Judgments within the powers vested in courts by the Judiciary Article of the Constitution may not lawfully be revised, overturned or refused faith and credit by another Department of Government."

Id. at 428 (citations omitted) (emphasis added).

The same constitutional principles apply here. The district court entered its decision in favor of Unocal and specifically ordered the terms under which an accounting is to proceed. The Commission cannot ignore this binding decision by seeking a remedy that would preclude the court-ordered accounting from going forward or otherwise render such decision a nullity.

C. The Proposed Remedies Do Not Bear a "Reasonable Relation" to the Alleged Unlawful Conduct

Even if the Commission had the authority to force a forfeiture of patent rights, such relief would be overly broad and thus inappropriate with respect to Unocal's patents. As mandated by the Supreme Court, any remedy imposed by the Commission must bear a "reasonable relation" to the unlawful practices found to exist. *FTC v. Colgate-Palmolive Co.*, 380 U.S. 374, 394-95 (1965); *see also Standard Oil Co. of Cal. v. FTC*, 577 F.2d 653, 662 (9th Cir. 1978); *Spiegel, Inc. v. FTC*, 411 F.2d 481, 484-85 (7th Cir. 1969); *FTC v. Nat'l Lead Co.*, 352 U.S. 419, 429 (1957); A

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[68] 5 U.S.C. § 706(2) provides that the reviewing court shall "hold unlawful and set aside agency action, findings, and conclusions found to be (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; (B) contrary to constitutional right, power, privilege, or immunity; [or] (C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right . . . ."

remedy—especially one that seeks to impinge upon valuable property rights—should be tailored so that it does not affect conduct that was not determined to violate Section 5. *See La Peyre v. FTC,* 366 F.2d 117, 122 (5th Cir. 1966) (setting aside portion of cease and desist order because Court found no probable adverse effect on competition with respect to certain conduct).

Here, it must be remembered that the proposed remedy seeks a forfeiture of Unocal's right to enforce any of its five patents in California, even though nothing in the Complaint asserts that Unocal did anything wrong in obtaining its patents. To the contrary, claims of inequitable conduct were not only dismissed by the judiciary, but were sanctioned as vexatious, unsupported arguments. *Union Oil Co. of Cal. v. Chevron USA, Inc.*, 34 F. Supp. 2d 1222, 1224-25 (C.D. Cal. 1998). This, in and of itself, shows that a remedy seeking to strip Unocal of its patents lacks a reasonable relationship to the alleged conduct.

Moreover, the attempt to invoke such a drastic remedy is especially inappropriate and unfair given that Unocal's actions, as shown by Your Honor's Initial Decision, objectively appeared to be immune under antitrust law both in 1991 as well as at the time of the complaint in 2003. *In re Union Oil Co. of Cal.*, No. 9305, slip. op. at 1-2 (FTC Nov. 23, 2003) (Initial Decision). This fact dictates against any remedy seeking forfeiture of patent rights. For example, in *In re Abbott Labs.*, No. 3945 (FTC May 26, 2000) (Consent Order) and *In re Geneva Pharms., Inc.*, No. 3946 (FTC May 26, 2000) (Consent Order) the Commission explained that it was not seeking disgorgement because, *inter alia*, "the behavior occurred in the context of the complicated provisions of the Hatch-Waxman Act, and because this is the first government antitrust enforcement action in this area." Combined Statement of Commission with Analysis to Aid Public Comment, *available at* remedy—especially one that seeks to impinge upon valuable property rights—should be tailored so that it does not affect conduct that was not determined to violate Section 5. *See La Peyre v. FTC,* 366 F.2d 117, 122 (5th Cir. 1966) (setting aside portion of cease and desist order because Court found no probable adverse effect on competition with respect to certain conduct).

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But there are yet additional reasons why the remedy sought by Complaint Counsel should be denied.

1. There is no showing of market power by reason of the '393 patent

Specifically, relief impacting enforcement of the '393 patent does not bear a reasonable relation to the alleged conduct since (wholly apart from the issue of whether Complaint Counsel can show market power with respect to Unocal's other four patents), there can be no argument that the '393 patent conferred *any* market power upon Unocal.

[redacted] Image below is confidential:

[redacted]

Accordingly, any remedy which would attempt to stop enforcement of the '393 patent—and thereby prevent Unocal from collecting the more than $280 million which it is currently owed under the accounting action taken pursuant to the Court's September 28, 1998 Order—does not bear a reasonable relationship to any conduct resulting in a monopoly or attempted monopoly.

2. **The remedy is overly broad because the regulations alleged to have been affected by Unocal's conduct are no longer in effect**

The Complaint asserts that Unocal's "nondisclosure" of potential patent rights led CARB to adopt regulations in 1991 and that because of these regulations Unocal acquired an illegal monopoly. But no one is producing gasoline under these regulations. Rather, production is occurring within the confines of regulations which were adopted after Unocal's patents began to issue. The Complaint cannot validly claim that Unocal in anyway misled CARB or industry with respect to these later adopted regulations. Indeed, CARB Phase 3 RFG regulations were passed with knowledge by CARB and industry that Unocal had patented aspects of its inventions, that a jury had upheld one of Unocal's patents and that the jury had determined what the damages were for infringement of that patent. Knowing this, CARB still did not address the issue of Unocal's patent position—or anyone else's patent position—during the development of these regulations. Accordingly, it is overly broad to attempt to tie a remedy to gasoline made now or in the future under California's new regulations.

Likewise, the proposed remedy is overly broad in seeking to impact all gasoline, imported to or exported out of California, without regard to whether the gasoline is made pursuant to any CARB regulation. For example, refiners in California produce gasoline for use in Arizona or elsewhere. There is no basis for attempting to cover such gasoline with the proposed remedy.

3. **Any remedy should articulate a reasonable means of calculating gains or benefits from the alleged violation**

Even if there was authority to invoke disgorgement, Complaint Counsel has not articulated a "reasonable means of calculating the gains or benefits" from the alleged violation.[69] It is axiomatic that the amount of the disgorgement and/or forfeiture should not exceed the illegitimate profits (if any) earned by the defendant that are attributable to the antitrust violation. *See, e.g.*, *C.F.T.C. v. Sidoti*, 178 F.3d 1132, 1138 (11th Cir. 1999) (reversing order to disgorge all profits from 1990 to 1997 where no evidence of fraud after 1994). Such a desegregation is necessary because disgorgement is designed to only extract the unjust enrichment from the offender; it is intended to be remedial and not punitive.[70] Any remedy that calls for the forfeiture of gains resulting from efficiencies would punish (and deter) procompetitive conduct and thus would be inimical to the policies underlying the antitrust laws. Thus, courts consistently have rejected royalty-fee licenses as a remedy in antitrust cases and instead have required that patent holders who have violated the antitrust laws license their patents at a reasonable royalty rate.[71]

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69 FEDERAL TRADE COMMISSION, POLICY STATEMENT ON MONETARY EQUITABLE REMEDIES IN COMPETITION CASES (July 25, 2003), *available at* http://www.ftc.gov/os/2003/07/disgorgementfrn.htm.

70 *Sidoti*, 178 F.3d at 1137-38; *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978); *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1104 (2d Cir. 1971).

71 *See United States v. Glaxo Group Ltd.*, 410 U.S. 52, 59 (1973); *United States v. Nat'l*
(continued...)

Instead of articulating a "reasonable basis" for the monetary remedy sought in this case, tied to the concept of antitrust injury, Complaint Counsel have articulated a remedy that simply assumes that all revenues from the patent are monopoly profits (i.e., the competitive value of Unocal's patents is zero). Such an assumption may make the calculation simple, but it is demonstrably incorrect, as evidenced by the fact that Unocal's patents have been licensed to refiners outside of California. Any remedy that would bear a reasonable relationship with the alleged conduct in this case might focus on whether Unocal should charge the same royalty rate per gallon in California as it has outside of California.

4. A remedy forcing disclosure of patent rights is overly broad

Likewise, the proposed remedy forcing Unocal to communicate its patent rights with other standard setting bodies or regulators through an approved third party is an impermissible restraint not only on Unocal's speech but an overly broad intrusion into private and public standard-setting or regulation making. The remedy impliedly assumes that such bodies impose a duty to disclose patents, when no such showing was made or even alleged in this case. Further, if these bodies conclude that patent information is relevant, they are free to make such inquiry or conduct their own investigations into the potential impact of patent rights. But there is no precedent for forcing a company to comment on its "patent rights" much less for thrusting a "compliance" officer into such a role, especially when four of the five patents have not yet been litigated or construed by the courts.

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[71] (...continued)
Lead Co., 332 U.S. 319, 338-39 (1947); *Hartford-Empire Co. v. United States*, 323 U.S. 570, 572 (1945); *Am. Cyanamid Co.*, 363 F.2d at 770.

XIII. JURISDICTION

A. The Federal Trade Commission Lacks Jurisdiction over Substantial Questions of Patent Law

Where the right to relief depends on substantial questions of patent law, the Federal Trade Commission lacks jurisdiction to proceed administratively. The FTC Act does not expressly empower the Commission to make these determinations, and nothing in the legislative history indicates that Congress ever contemplated the Commission undertaking such a role. On the other hand, where Congress did contemplate that federal agencies undertake substantial questions of patent law, such as the International Trade Commission, it expressly provided for that power. Unocal believes the Commission's opinion of July 7, 2004, to be in error in this matter on the jurisdiction question since the Complaint against Unocal unquestionably raises substantial issues of patent law.[72] Therefore, this matter may only be brought in a federal district court which has original jurisdiction over patent questions. *See* 28 U.S.C. § 1338(a) ("district courts shall have original jurisdiction of any civil action arising under any Act of Congress relating to patents"). Unocal, accordingly, submits this jurisdiction argument to continue to preserve the issue.

1. The relief against Unocal necessarily depends on substantial questions of patent law

A case arises under the patent laws when a complaint facially discloses "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,

[72] The Commission's opinion did not determine that it has the jurisdiction to decide substantial questions of patent law, but rather that the Complaint did not mandate such questions be answered.

808-09 (1988). This inquiry asks whether patent law "is a necessary element of one of the well-pleaded [antitrust] claims." *Id.* at 809 (citing *Merrell Dow Pharms. Inc. v. Thompson*, 478 U.S. 804, 813 (1986)).

The Complaint against Unocal expressly invokes the burden of resolving substantial questions of patent law. The Complaint makes nine different allegations dependant on an alleged overlap between Unocal's patent claims and CARB's regulations. Compl. ¶¶ 5, 33, 45, 76, 79, 80, 83, 88, 92.[73] In a scenario like this where the truth or falsity of such allegations requires determining the scope and infringement of a patent, a complaint arises under the patent laws. *Additive Controls & Measurement Sys., Inc. v. Flowdata*, 986 F.2d 476, 478 (Fed. Cir. 1993) (finding substantial patent question in a business disparagement action where alleged falsity required proof of noninfringement); *Datapoint Corp. v. VTel Corp.*, No. 97 CIV. 642, 1997 WL 220306, at *2 (S.D.N.Y. Apr. 29, 1997) (claim that required resolution of alleged fraud's impact on patent royalties made it "necessary to determine the scope and validity of the underlying patent infringement claims" and thus to "determine substantial questions of patent law").

Second, the proof of harm alleged here also depends upon the resolution of substantial issues of patent law. The Complaint alleges that but for Unocal's fraud, members of two private organizations would have taken actions including, but not limited to, "advocating that CARB adopt regulations that *minimized* or *avoided infringement* on Unocal's patent claims" and "incorporating knowledge of Unocal's pending patent rights in their capital investment and refinery reconfiguration

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[73] To prove this alleged overlap, Complaint Counsel must proffer a claim construction for the patents, which then must be determined as a matter of law. *Cybor Corp. v. FAS Techs., Inc.*, 138 F.3d 1448, 1454 (Fed. Cir. 1998). Only one of Unocal's five patents was construed by a court. *See Union Oil Co. of Cal. v. Atlantic Richfield Co.*, 34 F. Supp. 2d 1208 (C.D. Cal. 1998), *aff'd*, 208 F.3d 989 (Fed. Cir. 2000).

decisions to *avoid and/or minimize potential infringement.*" Compl. ¶ 90(a), (c) (emphasis added). The Complaint further alleges that refiners cannot avoid infringement but are locked-in to current refinery configurations. *Id.* ¶ 92 ("extensive overlap between CARB RFG regulations and the Unocal patent claims makes avoidance of the Unocal patent claims technically and/or economically infeasible"); *Id.* ¶ 93 ("refiners cannot produce significant volumes of *non-infringing* CARB-compliant gasoline without incurring substantial additional costs") (emphasis added). These allegations require a determination of substantial patent questions, including the construction and scope of Unocal's patent claims, the existence of noninfringing alternatives, and the ability of refiners to avoid infringement.

These are not abstract abstract propositions. The refiners have taken the position that any gasoline composition that contains ethanol is outside the scope of Unocal's patent claims. If this construction, which Unocal vigorously disputes, is correct, virtually no RFG produced or sold in California infringes any of Unocal's patents, and Complaint Counsel's claim of monopoly power withers away. There is no way to resolve this issue without construing Unocal's patents, as refiners' expert in the previous litigation admitted. Cunningham Dep. (Turner & Mason), 8/25/03, at 235:2-18.

All of these are substantial issues of patent law. *See, e.g., Hunter Douglas, Inc. v. Harmonic Design, Inc.*, 153 F.3d 1318, 1329 (Fed. Cir. 1998) (substantial issues of patent law include infringement, validity and enforceability), *overruled in part on other grounds, Midwest Indus., Inc. v. Karavan Trailers, Inc.*, 175 F.3d 1356, 1358 (Fed. Cir. 1999); *Scherbatskoy v. Halliburton Co.*, 125 F.3d 288, 291 (5th Cir. 1997) (substantial question of patent law where infringement analysis was necessary to resolve contract claim); *Regents of the Univ. of Minn. v. Glaxo Wellcome, Inc.*, 44 F. Supp. 2d 998, 1003-06 (D. Minn. 1999) (same), *aff'd*, 58 F. Supp. 2d 1036 (D. Minn. 1999). This is more than enough to deprive the FTC of jurisdiction since a case arises under the patent laws even if just *one* such issue must be decided. *Christianson*, 486 U.S. at 809 (§ 1338(a) extends to "cases in which 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") (emphasis added).

The Opinion of the Commission rejected Your Honor's ruling that the FTC lacks jurisdiction because this case depends on resolution of substantial questions of patent law.[74] In so doing, the Commission relied, *inter alia*, on *Christianson* for the proposition that "a claim 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 52-53. The Commission cited alternative theories, such as misrepresentation, which it concluded do not require resolution of "issues regarding patent construction or infringement." *Id.* at 53. It speculated that misrepresentation could 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." *Id.* Even if this case was strictly limited to an enforcement theory, Complaint Counsel would still need to prove, based upon the face of the Complaint, illegal monopoly power which still involves the extent of infringement under the patents.

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[74] *In re Union Oil Co. of Cal.*, No. 9305, slip op. at 52 (FTC Jul. 7, 2004) (Opinion of the Commission).

2. **<u>The Commission does not have jurisdiction over substantial questions of patent law</u>**

a. **<u>Congress has mandated that substantial questions of patent law should be determined by the federal courts</u>**

In demarcating the Commission's authority, Congress vested the FTC with jurisdiction over "unfair methods of competition." 15 U.S.C. § 45. By so doing, Congress neither expressly nor impliedly authorized the Commission to decide substantial questions of patent law. A fundamental rule of statutory interpretation is that "courts do not interpret statutes in isolation, but in the context of the *corpus juris* of which they are a part, including later-enacted statutes." *Branch v. Smith*, 538 U.S. 254, 281 (2003). The body of law as a whole addressing jurisdiction over patent matters establishes that when Congress wants a forum to have such jurisdiction, it either expressly grants that authority or at minimum manifests its intent in the legislative history. For example, although it bestowed upon federal district courts original jurisdiction over federal questions in 28 U.S.C. § 1331, Congress chose to *expressly* grant the district courts original jurisdiction over patent cases in 28 U.S.C. § 1338. Similarly, 28 U.S.C. § 1491, authorizes the Court of Claims to hear claims against the United States generally. Congress, however, *expressly* articulated the court's jurisdiction over patent claims separately in 28 U.S.C. § 1498(a).

As it did with the courts, when Congress wanted federal agencies to address substantial patent questions, it said so. Of course the PTO received an express grant of authority to decide questions of patentability and invalidity. *See, e.g.*, 35 U.S.C. § 131, 151, 301. And although the International Trade Commission, like the FTC, investigates "[u]nfair methods of competition," the ITC was charged with an explicit further grant of the power to declare import trade unfair if the imported articles "infringe a valid and enforceable United States patent." 19 U.S.C. § 1337(a)(1)(B)(i).

Before Congress empowered the ITC to consider the validity and enforceability of patents, courts expressed concerns about the jurisdiction of its predecessor (the Tariff Commission) over patent matters. *See, e.g., Frischer & Co. v. Bakelite Corp.*, 17 C.C.P.A. 494, 509-10 (1930). In holding that the Tariff Commission could not determine patent validity, the court noted that Congress did not expressly grant such a right:

> The right to pass upon the validity of a patent . . . is a right possessed only by the courts of the United States given jurisdiction thereof by law. . . . Even where jurisdiction is vested in the Court of Appeals of the District of Columbia, and now in this court, to review the proceedings of the Patent Office in the issuance of patents, *it was and is expressly provided by law*[.]

Id. at 509 (emphasis added). The *Frischer* Court also noted that there was also no indication in the legislative history that Congress intended to confer this power upon the Tariff Commission. *Id.* at 509-10.

In 1974, Congress added language to § 1337 allowing the ITC to consider "[a]ll legal and equitable defenses[.]" *Lannom Mfg. Co., Inc. v. United States Int'l Trade Comm'n*, 799 F.2d 1572, 1577 (Fed. Cir. 1986). The legislative history reveals that Congress intended, by this language, to allow the ITC to "review the validity and enforceability of patents." *Id.* (citing S. Rep. No. 1298, 93 Cong., 2d Sess. at 196 (1974)); *see also* H.R. Rep. No. 571, 93d Cong., 1st Sess. at 78 (1973). The statute on its face, without looking at this legislative history, was ambiguous as to whether the ITC could address patent infringement issues. Congress eliminated any lingering doubt regarding the ITC's patent jurisdiction, when it passed the Omnibus Trade and Competitiveness Act in 1988. *See* Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, 102 Stat. 1107. The Act added to the statute, *inter alia*, 19 U.S.C. § 1337(a)(1)(B)(i)-(ii), expressly permitting the ITC to determine whether an imported article "infringe[s] a valid and enforceable United States patent." 19 U.S.C. § 1337(a)(1)(B)(i)-(ii); *see generally Texas Instruments, Inc. v. Tessera, Inc.*, 231 F.3d 1325, 1330 (Fed. Cir. 2000) ("In section 337 proceedings relevant to patent infringement, the ITC follows Title 35 of the United States Code and the case law of this court."). In stark contrast, the FTC is neither expressly nor impliedly granted such authorization.

b. <u>The FTC Act does not grant jurisdiction over patent matters</u>

Unlike the statutes cited above, the FTC Act says nothing about jurisdiction over patent questions, and the Act's legislative history evinces no Congressional intent to confer such jurisdiction. Meanwhile, the Supreme Court has stated that, "the Commission may exercise only the powers granted it by the Act." *FTC v. Nat'l Lead Co.*, 352 U.S. 419, 428 (1957). These powers do not include the right to determine substantial questions of patent law. *See Decker v. FTC*, 176 F.2d 461, 463 (D.C. Cir. 1949) ("The proceedings before the [FTC] related only to 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 a federal district court."); *Chas. Pfizer & Co., Inc. v. Columbia Pharm. Corp.*, 142 U.S.P.Q. 493, 494 (E.D.N.Y. 1964) ("The Federal Trade Commission has neither the right nor the power to pass on the patent's validity."); *Am. Cyanamid Co. v. FTC*, 363 F.2d 757, 772 (6th Cir. 1966) ("We do not hold that the Commission has jurisdiction either directly or indirectly to invalidate or destroy a patent, nor do we hold that the Commission could order compulsory licensing without payment of reasonable royalties.").[75]

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[75] The Commission's exercise of jurisdiction in *Am. Cyanamid* was based in part upon its determination that its conclusion that the questions before it were "incidental or collateral" patent matters. *In re Am. Cyanamid Co.*, 63 F.T.C. 1747, 1856 (1963). At most, *Am. Cyanamid* suggests that the Commission should look to whether a state court would have jurisdiction in determining

(continued...)

The legislative history of the FTC Act does not contemplate that the Commission should be vested with the power to decide substantial questions of patent law. In creating the Commission, Congress provided it with specific powers—among others, to investigate and restrict "unfair methods of competition." 15 U.S.C. § 45. As explained by the Report of the Senate Interstate Commerce Committee, these powers "are of great importance and will bring both to the Attorney General and to the court the aid of special expert experience and training in matters regarding which neither the Department of Justice nor the courts can be expected to be proficient." S. Rep. No. 597, 63d Cong., 2d Sess. at 12 (1914). The special expertise of the Commission is the competition field, not patent law.

After ninety years of existence without venturing into the patent law realm, the FTC only recently began to assert what it now supposes to be its authority to investigate methods of competition rooted in patent infringement contentions. "[W]ant of assertion of power by those who presumably would be alert to exercise it, is . . . significant in determining whether such power was actually conferred." *FTC v. Bunte Bros., Inc.*, 312 U.S. 349, 352 (1941). As the Supreme Court wrote in *Federal Power Comm'n v. Panhandle E. Pipe Line Co.*, 337 U.S. 498 (1949), "[f]ailure to use such an important power for so long a time indicates to us that the Commission did not believe the power existed." *Id.* at 513*; see also Bankamerica Corp. v. United States*, 462 U.S. 122, 131 (1983) (stating that "[g]overnment's failure for over 60 years to exercise the power it now claims" under the Clayton Act "strongly suggests that it did not read [the statute] as granting such power"). The FTC's attempt to assert jurisdiction over matters arising under the patent laws,

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[75] (...continued)
the scope of its own jurisdiction.

specifically the current Complaint against Unocal, is an analogous and likewise improper exercise of authority, which Your Honor properly dismissed.

c. Accepting jurisdiction in this agency would frustrate Congress's express goal of uniformity of patent law

No basis exists to read into the FTC Act any implied grant of jurisdiction over patent matters, because such an *implied* power would defeat Congress's express aim of developing a uniform body of patent law. The goal of uniformity in patent jurisprudence is realized through a statutory scheme that vests jurisdiction in federal district courts and certain federal agencies with patent expertise (such as the PTO), and ensures that appeals of actions under the patent laws are heard by the Court of Appeals for the Federal Circuit. This Congressional objective is well recognized:

> There is . . . a strong federal interest in an interpretation of the patent statutes that is both uniform and faithful to the constitutional goals of stimulating invention and rewarding the disclosure of novel and useful advances in technology. . . . Therefore, consistency, uniformity, and *familiarity with the extensive and relevant body of patent jurisprudence* are matters of overriding significance in this area of the law.

Fla. Prepaid Postsecondary Educ. Expense Bd. v. College Savs. Bank, 527 U.S. 627, 650 (1999) (Stevens, J., dissenting) (emphasis added).

Congress reinforced its strong interest in consistent and uniform patent jurisprudence when it passed the Federal Courts Improvement Act of 1982, which established the Court of Appeals for the Federal Circuit. Under 28 U.S.C. § 1295(a)(1), the Federal Circuit has exclusive jurisdiction over appeals from district court decisions where the district court's jurisdiction over patent matters was based, in whole or in part, on § 1338. Congress's express purpose was to promote predictability, uniformity, and the efficient administration of patent law. *Markman v. Westview*

Instruments, Inc., 517 U.S. 370, 390 (1996) (for the sake of "desirable uniformity . . . Congress created the Court of Appeals for the Federal Circuit as an exclusive appellate court for patent cases"); *see also* S. Rep. No. 275, 97th Cong., 1st Sess. at 5-6 (1981). Thus, appeal from the decisions of other agencies and courts that have express jurisdiction over patent law issues, such as the ITC and the Court of Claims, must be taken to the Federal Circuit. 28 U.S.C. § 1295. The same is true for appeals from PTO proceedings (35 U.S.C. § 141) and appeals from the bankruptcy courts when substantial patent issues are raised. *See In re Cambridge Biotech Corp.*, 186 F.3d 1356, 1369-70 (Fed. Cir. 1999).

Notably, no comparable provision contemplates appeals from the Federal Trade Commission to the Federal Circuit. Rather, jurisdiction for any appeal from a Commission decision is geographically determined. *See* 15 U.S.C. § 45(c). Allowing the Commission to determine substantial matters of patent law would violate the carefully constructed Congressional design to ensure that patent law matters are decided in the first instance by adjudicatory bodies with patent expertise and, on appeal, by the Federal Circuit.

Recognition that the FTC lacks jurisdiction to hear cases that turn on the resolution of substantial questions of patent law would not mean the FTC is powerless to challenge unfair methods of competition that raise patent issues. Section 13(b) of the FTC Act permits the Commission to bring actions for equitable relief in district court. *See* 15 U.S.C. § 53(b). Were a well-pleaded complaint arising under the patent laws brought by the FTC in district court, where original jurisdiction is vested, on appeal the matter would come before the Federal Circuit under § 1295, consistent with the goal of patent law uniformity.

Dated: October 6, 2004.

Respectfully submitted,

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