UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

In the Matter of	**Docket No. 9327**
Polypore International, Inc. **a corporation.**	**PUBLIC DOCUMENT**

RESPONDENT'S MOTION TO DISMISS COUNTS II AND III OF THE COMPLAINT FOR FAILURE TO STATE A CLAIM

Respondent Polypore International, Inc. ("Polypore"), pursuant to Rule 3.22(e) of the Rules of Practice of the Federal Trade Commission ("Commission" or "FTC"), 16 C.F.R. § 3.22(e), respectfully moves to dismiss for failure to state a claim, Counts II and III of the Complaint with respect to any monopolization and attempted monopolization claims regarding the alleged automotive, uninterruptible power supply stationary ("UPS") and PE separator markets. Polypore also moves to dismiss, for failure to state a claim, Counts II and III to the extent that they purport to apply to the alleged deep-cycle and motive battery separator markets based upon an undefined monopolization or attempted monopolization offense under Section 5 of the FTC Act.

In support, Respondent Polypore respectfully refers the Court to, and incorporates herein, the contemporaneously-filed memorandum.

Dated: October 15, 2008

Respectfully Submitted,

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PROPOSED ORDER

Upon consideration of Respondent's Motion to Dismiss Counts II and III of the Complaint for Failure to State a Claim and complaint counsel's response thereto, and the Court being fully informed, it is this _____ day of _________, 2008, hereby

ORDERED, that the Motion is **GRANTED**; and it is further

ORDERED, that Counts II and III of the complaint are dismissed with prejudice to the extent that they allege monopolization and/or attempted monopolization claims regarding the automotive, uninterruptible power supply stationary ("UPS") and PE separator markets and to the extent that they alleged monopolization and/or attempted monopolization claims regarding the deep-cycle and motive battery separator markets based on Section 5 of the FTC Act.

____
The Honorable D. Michael Chappell
Chief Administrative Law Judge

PPAB 1488233v1

ORIGINAL

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In the Matter of	)	
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RESPONDENT'S MEMORANDUM IN SUPPORT OF MOTION TO DISMISS COUNTS II AND III OF THE COMPLAINT FOR FAILURE TO STATE A CLAIM

Respondent Polypore International, Inc. ("Polypore" or "Daramic"), pursuant to Rule 3.22(e) of the Rules of Practice of the Federal Trade Commission ("Commission" or "FTC"), 16 C.F.R. § 3.22(e), respectfully moves to dismiss for failure to state a claim, Counts II and III of the Complaint with respect to all monopolization and attempted monopolization claims regarding the alleged automotive, uninterruptible power supply stationary ("UPS") and PE separator markets. Polypore also moves to dismiss, for failure to state a claim, Counts II and III to the extent that they purport to apply to the alleged deep-cycle and motive battery separator markets based upon an undefined monopolization or attempted monopolization claim under Section 5 of the FTC Act.

INTRODUCTION

The FTC seeks to assert monopolization and attempted monopolization claims under Section 5 of the FTC Act without making allegations that satisfy the standards for offenses under the Sherman Act. In their response to Polypore's Motion for a More Definite Statement, Complaint Counsel states that "[t]here is no claim under the Sherman Act in this complaint" and that Polypore "faces . . . monopolization and attempted monopolization claims under the FTC

Act."[1] The Complaint, however, does not plead the elements of monopolization and attempted monopolization claims that are required by Sherman Act authorities.

A comparison of the complaint here with the FTC's pleading in *In the Matter of Rambus*[2] -- a case in which monopolization and attempted monopolization claims were based on Section 5 -- shows the inadequacy of the pleading here. In *Rambus*, for the "First Violation," the FTC alleged that Rambus "engaged in a pattern of anticompetitive and exclusionary acts and practices" whereby it "obtained monopoly power."[3] For the "Second Violation," the same "pattern" was alleged along with a claim that Rambus had "a specific intent to monopolize" and that there was a "dangerous probability of monopolization."[4] These are the well-known Sherman Act elements and their use in *Rambus* evidences an understanding by the FTC that it must meet these standards in a Section 5 case.

In this case, however, the Complaint fails to make proper allegations of monopolization with respect to each of the five alleged markets (*see infra* at 14-15), fails to allege maintenance of monopoly power for each of these alleged markets (*see infra* at 15-16), and fails to allege the elements of an attempt to monopolize, including the element of specific intent (*see infra* at 16).

- Complaint Counsel alleges five product markets (*see* Complaint ¶¶ 5, 6). Yet, while the Complaint alleges a monopoly with respect to two of the five alleged markets (*see* Complaint ¶¶ 21, 22, 38 (b), (c)), the FTC fails to allege a monopoly with respect to the remaining three (the alleged automotive, UPS or PE separator markets).

- In paragraphs 39-45, the FTC alleges "market/monopoly power" and maintenance of "market power," terminology that falls short of the Sherman Act standard, and significantly does not identify the product markets to which it refers.

- Similarly, for the same three alleged markets, the Complaint fails to allege either that Polypore obtained or maintained monopoly power, but claims instead that it

[1] Complaint Counsel's Response to Respondent's Motion for a More Definite Statement at 3 (No. 9327).

[2] File No. 011-0017, Compl. ¶¶ 122-123 (June 18, 2002), a copy of which is attached hereto as Exhibit 1.

[3] *Id.* at ¶ 122.

[4] *Id.* at ¶ 123.

"*attempted* . . . to maintain monopoly power." Complaint ¶ 39 (emphasis added). As for attempted monopolization, the complaint contains no allegation of specific intent, and alleges that only one of the alleged product markets (PE seperators) has a "dangerous probability [of] lessen[ing] or destroy[ing] competition," not a "dangerous probability of achieving monopoly power."

These allegations fall short of widely accepted Sherman Act standards and confirm that the FTC plans to present its "monopolization and attempted monopolization claims under the FTC Act"[5] using uncertain sub-Sherman Act standards. For the reasons stated below, Complaint Counsel's failure to plead the requisite elements of a Section 5 claim involving claims of monopolization or attempted monopolization renders Counts II and III deficient as a matter of law.

ARGUMENT

The standard used in Commission proceedings for motions to dismiss under Rule 3.22(e) of the Rules of Practice mirrors the standard used for evaluating motions to dismiss in federal district courts under Rule 12(b)(6) of the Federal Rules of Civil Procedure.[6] Under that standard, a motion to dismiss for failure to state a claim must be granted where the complaint reveals that the allegations, even if proved, are insufficient to establish an antitrust claim.[7] And while well-pled factual allegations of the complaint are to be presumed true and all reasonable inferences are to be made in favor of complaint counsel for purposes of this motion, "conclusions of law and unreasonable inferences or unwarranted deductions of fact are not admitted."[8]

[5] Complaint Counsel, *supra* note 1, at 3.

[6] *In the Matter of Union Oil Co. of Cal.*, File No. 051-0125, Initial Decision 6 (Nov. 25, 2003), a copy of which is attached hereto as Exhibit 2, *citing In re Times Mirror Co.*, 92 F.T.C. 203 (1978) and *In re Fla. Citrus Mutual*, 50 F.T.C. 959 (1954). *See also* FTC Operating Manual § 10.7 (2004) ("[S]ince many adjudicative rules are derived from the Federal Rules of Civil Procedure, the latter may be consulted for guidance and interpretation of Commission rules where no other authority exists.").

[7] *Union Oil* at 7; *Cavalier Telephone, LLC v. Verizon Virginia Inc.*, 330 F.3d 176, 183 (4th Cir. 2003) ("*Cavalier Telephone*").

[8] *Union Oil* at 8 (citations omitted); *TV Comm'ns Network, Inc. v. Turner Network Television, Inc.*, 964 F.2d 1022, 1024 (10th Cir. 1992) ("[A] plaintiff must do more than cite relevant antitrust language to state a claim for relief . . . A plaintiff must allege sufficient facts to support a cause of action under the antitrust laws.").

Moreover, the complaint's allegations must "advance a legal theory on which antitrust relief can be granted" to survive dismissal.[9] Here, the Complaint, in Counts II and III, fails to plead the allegations required to effect cognizable claims of monopolization or attempted monopolization.

1. Counts II and III of the Complaint fail to Meet the Required Pleading Standard as to the Monopolization and Attempt to Monopolize Claims.

In identical allegations in Counts II and III of its Complaint, Complaint Counsel purports to bring claims under Section 5 of the FTC Act, 15 U.S.C. § 45. According to Complaint Counsel, the Complaint "follows traditional Section 5 and Section 7 law" and is grounded on alleged "monopolization, and attempted monopolization claims . . ."[10] While Complaint Counsel disavows any express or implied attempt to create new law,[11] that is exactly what is attempted here. This Complaint fails to meet the standard long recognized by the Commission for a monopolization or attempted monopolization claim under Section 5. As such, Counts II and III of the Complaint must be dismissed as to claims of monopolization or attempted monopolization.

(a) There is no respectable authority that supports application of Section 5 of the FTC Act in this case without adherence to Sherman Act requirements.

The required elements for pleading a proper claim of monopolization or attempted monopolization are well known.[12] Under Section 2 of the Sherman Act[13] a plaintiff must allege (1) "possession of monopoly power in the relevant market" and (2) "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."[14] And, "to demonstrate attempted

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[9] *Cavalier Telephone*, 330 F.3d at 183.

[10] Complaint Counsel, *supra* note 1, at 2-3.

[11] Complaint Counsel, *supra* note 1, at 3.

[12] *Cavalier Telephone*, 330 F.3d at 183

[13] 15 U.S.C. § 2.

[14] *Verizon Commc'n, Inc. v. Law Offices of Curtis V. Trinko*, LLP, 540 U.S. 398, 407 (2004) (*quoting United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966)).

monopolization a plaintiff must prove (1) that the defendant has engaged in predatory or anticompetitive conduct with (2) a specific intent to monopolize and (3) a dangerous probability of achieving monopoly power."[15]

In a major decision involving the issue of the standard to be applied under Section 5 of the FTC Act, the Commission, in affirmed the ALJ's dismissal of the complaint and rejected an attempt by complaint counsel to expand Section 5 to reach conduct that did not violate Section 2 of the Sherman Act. In *In the Matter of General Foods Corp.*,[16] the FTC alleged that General Foods attempted to monopolize the packaged ground coffee market by engaging in predatory pricing and related practices. Affirming the dismissal of the complaint, including the attempted monopolization claim under Section 5, the Commission reviewed the claim under traditional Section 2 standards. After carefully identifying and describing the three elements of the attempted monopolization offense,[17] the Commission followed its earlier practice of looking first to the dangerous probability of success element.[18] Finding that element not supported by the evidence, it agreed with the ALJ's dismissal of the case and held that no Section 2 Sherman Act violation had been proved.[19]

Having found no violation of Section 2 of the Sherman Act, the Commission then turned to complaint counsel's argument that even if no violation of Section 2 had been found, General Foods had nevertheless violated Section 5 of the FTC Act through the same conduct.[20] The Commission rejected this argument, refusing "to expand the reach of the prohibition against attempted monopolization in the Sherman Act by condemning less offensive conduct under the

[15] *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 456 (1984).

[16] 103 F.T.C. 204 (1984).

[17] *Id.* at 341-46.

[18] *Id.* at 346.

[19] *Id.* at 364.

[20] *Id.* at 364-65.

purview of the [FTC] Act."[21] The Commission rejected complaint counsel's attempt to expand Section 5 in an attempted monopolization case beyond Section 2 standards, saying, "[t]he record in this case does not offer a rationale for using the [FTC] Act to grant an extension onto Section 2 of the Sherman Act," and "[w]e do not believe this [Sherman Act Section 2] standard should be changed when a case is brought under Section 5."[22] While aware of earlier Supreme Court decisions that allowed it "to supplement the more specific terms of the antitrust laws,"[23] the FTC declined to expand Section 5 to areas proscribed by the Sherman Act, stating "we do not believe that power should be used to reshape those policies when they have been clearly expressed and circumscribed."[24]

Similarly, three appellate courts, in cases decided roughly contemporaneously with *General Foods*, "rejected Commission decisions challenging conduct as unfair methods of competition under Section 5"[25] where there was no underlying antitrust violation.[26] In both *Boise Cascade v. FTC* and *E.I. duPont Nemours & Co. v. FTC* ("*Ethyl*") the Commission failed to show that the joint action resulted from actual collusion. In *Boise Cascade*, the court rejected the FTC's efforts to rely on the incipiency doctrine, articulated in *FTC v. Brown Shoe Co.*, 384 U.S. 316, 322 (1966), and said that its decision would "blur the distinction between guilty and

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[21] *Id.* at 365-66.

[22] *Id.* at 366.

[23] *Id.* at 353 (*citing FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233 (1972); *FTC v. Brown Shoe Co.*, 384 U.S. 316 (1966)).

[24] *General Foods*, 103 F.T.C. at 365.

[25] Commissioner J. Thomas Rosch, *Perspectives on Three Recent Votes: The Closing of the Adelphia Communications Investigation, the Issuance of the Valassis Complaint & the Weyerhaeuser Amicus Brief* ("Rosch Valassis Speech"), Address at the National Economic Research Associates 2006 Antitrust & Trade Regulation Seminar (July 6, 2006), a copy of which is attached hereto as Exhibit 3 and *available at* http://www.ftc.gov/speeches/rosch/Rosch-NERA-Speech-July6-2006.pdf, at 8. The three cases are *Boise Cascade v. FTC*, 637 F.2d 573 (9th Cir. 1980); *Official Airline Guides v. FTC* ("*OAG*"), 630 F.2d 920 (2d Cir. 1980); *E.I. duPont de Nemours & Co. v. FTC* (the "*Ethyl*" case), 729 F.2d 128 (2d Cir. 1984).

[26] Referring to these cases in its 1989 report, the ABA Antitrust Section committee to study the FTC pointed out that "recent court decisions have rebuffed the FTC when it interpreted Section 5 expansively." *Report of the American Bar Association Section of Antitrust Law Special Committee to Study the Role of the Federal Trade Commission*, 58 Antitrust L. J. 43, 115 (1989).

innocent commercial behavior."[27] In *Ethyl*, the court expressed concern about "arbitrary or capricious administration of § 5" by the FTC and said that its standard did not "discriminate between normally acceptable business behavior and conduct that is unreasonable or unacceptable."[28]

In *Official Airline Guides v. FTC* ("*OAG*"), the respondent was the monopolist publisher of the "Official Airline Guide," the "bible" of the industry.[29] By not publishing certain commuter airline flight information in the Guide, OAG's action harmed the ability of those commuter airlines to compete; however, OAG's actions were not directed at an OAG competitor and it did not enhance OAG's market position or power.[30] The court there said that "enforcement of the FTC's order here would give the FTC too much power to substitute its own business judgment for that of the monopolist in any decision that arguably affects competition in another industry."[31]

The circumstances in this case are the same as those found in *General Foods* and in the appellate decisions of *Boise Cascade, Ethyl* and *OAG* appellate decisions. According to Complaint Counsel here, the Complaint presents "monopolization and attempted monopolization claims under the FTC Act."[32] For these alleged offenses, however, the Commission's reach, in the words of the Commission itself in *General Foods*, has "been clearly expressed and circumscribed" by Sherman Act law. Having no better or subsequent authority as a guide, the Commission here should follow the sound precedent of its *General Foods* decision and, based on Complaint Counsel's admission of having failed to plead a viable Section 2 claim ("There is no

[27] 637 F.2d at 581-82.

[28] 739 F.2d at 138-39.

[29] 630 F.2d at 921-22.

[30] *Id.* at 921.

[31] *Id.* at 927.

[32] Complaint Counsel, *supra* note 1, at 3.

claim under the Sherman Act in this complaint"[33]), dismiss the monopolization and attempted monopolization claims that are the subject of this motion.

While it can be expected that Complaint Counsel will try to save Counts II and III by using the *FTC v. Sperry & Hutchinson Co.* and *Brown Shoe* decisions, this effort would be misguided. Neither opinion addresses the specific situation involved here: where Complaint Counsel attempts to bring antitrust claims of monopolization and attempted monopolization (although even that, as discussed below, is not pled) under Section 5 of the FTC Act without pleading the requisite elements of a claim under Section 2 of the Sherman Act. This distinguishing fact was noted by the Commission itself in the *General Foods* case.[34]

Although the Court in *S&H* said, in oft cited language, that the Commission could use Section 5 to challenge conduct that does "not infringe either the letter or the spirit of the antitrust laws,"[35] that statement has no relevance to the pending case since it related to non-antitrust type conduct and ultimately served to refute the Fifth Circuit's holding that Section 5 only covered antitrust violations but not conduct harmful to consumer interests.[36] The Court, nevertheless, affirmed the Fifth Circuit's refusal to enforce the FTC's order on the ground that the FTC did not argue that S&H engaged in any conduct harmful to consumer interests and failed to show that S&H's conduct violated either the letter or the spirit of the antitrust laws.[37] As a result, the *S&H*

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[33] Complaint Counsel, *supra* note 1, at 3.

[34] *See* note 17 *supra*.

[35] 405 U.S. at 239.

[36] *Id.* at 245.

[37] The Court was forced to affirm the Fifth Circuit to this extent since the FTC failed to argue the Fifth Circuit erred in ruling that S&H's conduct did not violate the letter or spirit of the antitrust laws. 405 U.S. at 249. As a result, the Supreme Court declared that the Fifth Circuit's ruling on the antitrust point "remains undisturbed here." *S&H*, 405 U.S. at 250. Of the view that Section 5 applied only to anititrust-type conduct (and not conduct merely threatening harm to consumers) the Fifth Circuit made no determination whether the FTC's findings showed consumer harm. The Supreme Court held that the FTC order was not supported by findings relating to consumer harm but remanded the case for further proceedings relating to that issue. *Id.* at 249-50.

case did not uphold an order applying Section 5 to antitrust-type conduct that would not have been reached by the Sherman or Clayton Acts.[38]

In *Brown Shoe*, an opinion written by Justice Black over forty two years ago, the Court articulated the "incipiency doctrine," a concept that the Commission itself rejected in *General Foods* and that has not fared well in subsequent cases.[39] Justice Black, moreover, appears to have improperly lifted the doctrine from his earlier opinion in *FTC v. Motion Picture Adver. Serv. Co.*[40] -- improperly because the Court in that case did not deal with an incipient violation but found that the exclusive dealing arrangements there ran afoul of Section 5 because they violated the Sherman Act.[41] In any event, the "incipiency" concept is inherently inapplicable in this consummated merger case. And while the Court there rejected Brown's argument that the FTC needed to have found Section 3's substantial lessening of competition or tendency to monopoly, saying that the FTC may "arrest trade restraints in their incipiency," it proceeded to characterize the facts as showing that a Sherman/Clayton violation had occurred, concluding that the arrangement produced an adverse effect on competition ("anticompetitive practice") and that it "effectively foreclosed Brown's competitors from selling to a substantial number of retail shoe

[38] The Court in *S&H* first dealt with four earlier decisions that had refused to support FTC orders. *FTC v. Gratz*, 253 U.S. 421 (1920); *FTC v. Curtis Publ'g Co.*, 260 U.S. 568 (1923); *FTC v. Sinclair Ref. Co.*, 261 U.S. 463 (1923); and *FTC v. Raladam Co.*, 283 U.S. 643 (1931). *S&H*, 405 U.S. at 241. The Court then turned to *FTC v. R. F. Keppel & Bros., Inc.*, 291 U.S. 304 (1934) and *Brown Shoe*. *S&H*, 405 U.S. at 242. *Keppel*, however, is not relevant here since it was a consumer protection, non-antitrust case.

[39] In rejecting the FTC's claims of a Section 5 violation involving an industry-wide pricing practice but with no evidence of collusion, the Ninth Circuit said: "In this setting at least, where the parties agree that the practice was a natural and competitive development in the emergence of the southern plywood industry, and where there is a complete absence of evidence implying overt conspiracy, to allow a finding of a section 5 violation on the theory that the mere widespread use of the practice makes it an incipient threat to competition would be to blur the distinction between guilty and innocent commercial behavior." *Boise Cascade*, 637 F.2d at 582.

[40] 344 U.S. 392 (1953)

[41] "The vice of the exclusive contract in this particular field is in its tendency to restrain competition and to develop a monopoly in violation of the Sherman Act." 344 U.S. at 397.

dealers."[42] In short, *Brown Shoe*, a case from a bygone era with its discredited incipiency doctrine, is certainly not persuasive authority here.[43]

Rather than straying from Sherman Act standards, courts generally have affirmed FTC findings of Section 5 violations only after finding Sherman Act violations. *E.g.*, *FTC v. Ind. Fed'n of Dentists,* 476 U.S. 447 (1986); *FTC v. Nat'l Lead Co.*, 352 U.S. 419 (1957); *FTC v. Cement Inst.*, 333 U.S. 683 (1948); *Fashion Originators' Guild of Am. v. FTC*, 312 U.S. 457 (1941); *FTC v. Beech-Nut Packing Co.*, 257 U.S. 441 (1922).[44]

As a result, there is no authority authorizing Complaint Counsel to press Section 5 charges while failing to comply with Sherman Act standards, in a case like this where the FTC Complaint brandishes a "monopolization" claim. The proper standards for challenging unilateral conduct are now the subject of great debate, both nationally and internationally.[45] But that debate is keyed at the level of familiar Sherman Act standards and concepts. There has been no suggestion in this debate that sub-Sherman Act standards should apply in this situation. Scholarly comment has strongly supported the proposition that the FTC should not use Section 5 to bring antitrust cases that do not violate the Sherman and Clayton Acts. *E.g.*, 2 Areeda & Hovenkamp ¶ 302(h) (3d ed. 2007) ("Apart from possible historical anachronisms in the application of those statutes, the Sherman and Clayton Acts are broad enough to cover any anti-

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[42] 384 U.S. at 320, 321.

[43] As one commentator has noted, "[t]he real problem with the *Brown Shoe* reasoning [was] that the Supreme Court was willing to condemn exclusive dealing when no injury to competition was apparent." 2 Phillip Areeda & Herbert Hovenkamp, *Antitrust Law* ("Areeda & Hovenkamp") ¶ 302h3 (3d ed. 2007). Surely it is not a rush of excessive optimism to say that the FTC would never today bring an exclusive dealing case in which it would try to cheat on established Sherman or Clayton standards. Accordingly, *Brown Shoe* is no authority for any attempt by the FTC to use sub-Sherman Act standards in the instant case.

[44] In both *Atlantic Ref. Co v. FTC* , 381 U.S. 357 (1965) and *FTC v. Texaco, Inc.*, 393 U.S. 223 (1968) the Court again effectively applied Sherman Act standards in approving the FTC's findings of adverse effects on market competition resulting from the arrangements. The Fifth Circuit made a similar decision in *Shell Oil Co. v. FTC*, 360 F.2d 470 (5th Cir. 1966).

[45] *E.g.*, U.S. Dep't of Justice, Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act (2008), *available at* www.usdoj.gov/atr/public/reports/236681.htm, and Statement of Commissioners Harbour, Leibowitz and Rosch on the Issuance of the Section 2 Report by the Department of Justice (September 8, 2008), a copy of which is attached hereto as Exhibit 4 and *available at* http://www.ftc.gov/os/2008/09/080908section2stmt.pdf .

competitive agreement or monopolistic situation that ought to be attacked whether 'completely full blown or not.'" Areeda and Hovenkamp also state that: "[A] substantive antitrust rule that governs direct enforcement of the Sherman and Clayton Acts should also govern the Commission under § 5 as well."); Richard A. Posner, *The Federal Trade Commission: A Retrospective*, 72 Antitrust L.J. 761, 766 (2005) ("It used to be thought that 'unfair methods of competition' swept further than the practices forbidden by the Sherman and Clayton Acts, and you find this point repeated occasionally even today, but it is no longer tenable. The Sherman and Clayton Acts have been interpreted so broadly that they no longer contain gaps that a broad interpretation of Section 5 of the FTC Act might be needed to fill."); Bob Pitofsky, *More Than Law Enforcement: The FTC's Many Tools—A Conversation with Tim Muris and Bob Pitofsky*, 72 Antitrust L. J. 773, 847-48 (2005) ("I have never been comfortable with the idea that practices that are legal under the Sherman and Clayton Acts become illegal under Section 5 of the FTC Act because they fall in the 'penumbra' of some competition policy. Among other problems, it means that certain behavior would be legal or illegal depending on whether the suit was brought by the DOJ Antitrust Division under the Sherman Act or the FTC under Section 5. I have therefore believed that the unfairness jurisdiction, especially in antitrust matters, should be used very cautiously.").

In accord with this authority, Commissioner Rosch in July 2006 took the position that Section 5 should not be used to challenge conduct that is "plainly governed by the Sherman Act."[46] Unlike the monopolization and attempted monopolization claims in the instant proceeding, Commissioner Rosch pointed out that the conduct in *Valassis* was not "squarely

[46] Rosch Valassis Speech, *supra* note 25, at 11.

covered by the Sherman Act," because it involved an invitation to collude. That statement cannot be made about the conduct in the instant case.[47]

Unilateral conduct cannot and should not be subject to low-grade and uncertain antitrust standards lest vigorous competitive effort be inhibited or penalized. As the Supreme Court said in *Spectrum Sports*:

> Congress authorized Sherman Act scrutiny of single firms only when they pose a danger of monopolization. Judging unilateral conduct in this matter reduces the risk that the antitrust laws will dampen the competitive zeal of a single aggressive entrepreneur.[48]

Several years earlier, the Court had made the same point in its *Copperweld* decision.[49] There the Court observed that the Sherman Act leaves a "gap" since a single firm will not be liable for conduct "in restraint of trade" even though it accomplishes the same effect on competition that two firms acting together could accomplish for which they could be in violation.[50] But the Court said:

> Congress left this "gap" for eminently sound reasons. Subjecting a single firm's every action to judicial scrutiny for reasonableness would threaten to discourage the competitive enthusiasm that the antitrust laws seek to promote.[51]

It may be one thing for the FTC to challenge "invitations to collude" under Section 5 where the action is but one small step away from creating serious criminal exposure and efficiency claims are elusive or non-existent.[52] But it is indeed difficult to understand how the

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[47] *Id.*

[48] *Spectrum Sports*, 506 U.S. at 456 (*quoting Copperweld Corp. v. Indep. Tube Corp.*, 467 U.S. 752, 768 (1984)).

[49] *Copperweld*, 467 U.S. 752 (1984).

[50] *Id.* at 774-75.

[51] *Id.* at 775.

[52] Even so it should be noted that the FTC's recent consent decree program with "invitations to collude" has yet to be blessed by any reviewing judicial authority. Historical attempts to use Section 5 to challenge "conscious parallelism" were rebuked and caused the FTC to back down. The FTC adventure in *Triangle Conduit & Cable Co. v. FTC* is described in *Boise*

FTC could justify the application of sub-Sherman Act standards in a monopolization claim in a merger case, given the common wisdom that mergers have the capacity to achieve substantial efficiencies. Policy considerations and precedent both demonstrate that the Commission lacks the legal authority to make such expanded Section 5 claims.

(b) Under the standard set by Section 2 of the Sherman Act, Counts II and III fail to Allege a Valid Claim under Section 5 of the FTC Act.

Section 2 of the Sherman Act condemns monopolization and attempts to monopolize. 15 U.S.C. § 2. As stated *supra* at pp. 5-6, monopolization requires a showing of (1) "possession of monopoly power in the relevant market" and (2) a "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."[53] Moreover, to demonstrate an attempt to monopolize, a plaintiff must prove, among other things, a specific intent to monopolize and a dangerous probability of achieving monopoly power.[54] Here, Counts II and III fail to allege a monopoly in three purported markets, fail to allege acquisition, enhancement or maintenance of a monopoly in those three purported markets, and fail to allege an attempt to monopolize, instead alleging an "attempt to maintain a monopoly." Counts II and III must be dismissed in relevant part.

(i) Failure to Allege Monopoly

The Complaint fails to allege a monopoly with respect to the purported automotive, UPS and PE separator markets.[55]

Cascade, where it is also noted that as recently as 1974, the Commission dismissed *In re Crouse-Hinds* where the facts failed to show concerted action. 637 F.2d at 576 *citing Triangle Conduit*, 168 F.2d 175 (7th Cir. 1948) and *Crouse-Hinds*, 46 F.T.C. 1114 (1950). As is described in text, its more recent efforts to mount such cases were rejected in *Boise Cascade* and *Ethyl.*

[53] *Verizon Commc'n*, 540 U.S. at 407 (*quoting Grinnell*, 384 U.S. at 570-71).

[54] *Spectrum Sports*, 506 U.S. at 456.

[55] Polypore disputes the designations of the markets as alleged by the FTC and will assert its defenses to the market claims as necessary at the hearing before the ALJ.

- Paragraph 21 of the Complaint alleges that after the acquisition, Polypore had a monopoly in the alleged deep-cycle market and paragraph 22 alleges that Daramic and Microporous "were the only competitors in motive separators." However, the Complaint contains no such allegations for the alleged automotive, UPS or PE separator markets. Similarly, paragraphs 38(b) and (c) allege monopolies in the deep-cycle and motive markets but not in automotive, UPS or PE separator markets.

- Paragraph 23 alleges that Daramic and Entek are "direct competitors" in the alleged automotive market but makes no allegation that Daramic had a monopoly.

- Paragraph 24 (and Paragraph 38(b)) allege that Microporous and Daramic were the "only" companies selling separators in the alleged UPS market, but that they were selling "in different segments" of that market. As to this market, the word "monopoly," or any derivation thereof, does not appear in the Complaint.

- As for the PE separator market, no allegations of monopoly are set forth in paragraph 25, which states instead that Daramic, Microporous and Entek are the "only manufacturers of" the product in North America.

- While paragraph 45 alleges "market/monopoly power" and maintenance of "market power," (1) the careful distinctions made in paragraphs 21-25 and 38(b) undermine these allegations; (2) the phrase "market/monopoly power" and the reference to maintenance of "market power" fail to allege a monopoly since a monopolist must have not just some market power but *substantial* market power;[56] and (3) the allegations of paragraph 45 are, in any event, of no consequence since they fail to identify any alleged relevant market to which they apply.

In short, the Complaint fails to allege that Polypore has a monopoly in the alleged automotive, UPS and PE separator markets.

(ii) Failure to Allege Acquisition, Enhancement or Maintenance of Monopoly Power

Nowhere does the Complaint allege that Polypore "maintained" monopoly power in the automotive, UPS and PE separator markets. This omission is highlighted by paragraph 39 where

[56] *Eastman Kodak Co. v. Image Technical Servs.*, 504 U.S. 451, 481 (1991) ("Monopoly power under §2 requires, of course, something greater than market power under §1."); 3B Areeda & Hovenkamp at ¶802(a) (3d ed. 2008) ("The monopolization offense requires both 'substantial' market power and exclusionary conduct."); Phillip Areeda & Louis Kaplow, *Antitrust Analysis: Problems, Text, Cases* 554 (5th ed. 1997) ("Under §2, only substantial market power will be deemed monopoly power"), a copy of which is attached hereto as Exhibit 5.

the Complaint alleges instead that Polypore "*attempted* through anticompetitive means to maintain monopoly power" (emphasis added) in the five alleged markets. Maintenance of monopoly power, however, is the necessary element of monopolization; a mere *attempt* to maintain monopoly power is insufficient. The standard as stated by *Verizon, supra*, is quite clear: monopolization requires "willful acquisition or maintenance of that [monopoly] power," not "willful acquisition or *attempted* maintenance" of monopoly power.[57] Indeed, monopolization requires monopoly power that is durable, not monopoly power that the firm has merely "attempted to maintain" or that has existed only temporarily.[58]

The Complaint attempts to cure this defect by alleging in Paragraph 42 that "[i]n automotive, motive, UPS and all PE markets Daramic has historically maintained monopoly power." This claim, however, is inadequate since it is keyed to some undefined historical period antedating the events of the Complaint and it fails to identify or allege any anticompetitive actions that produced this "historical maintenance." [59]

Moreover, the monopolization allegations are not saved by paragraph 45, because, as discussed above, (1) its broad brush allegation of "maintenance" is inconsistent with paragraph 39's allegation of "attempt to maintain;" (2) it fails to allege, as required, "maintenance of that [monopoly] power" but, instead, alleges maintenance of "market power;" and (3) it fails to allege the markets to which it applies.

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[57] *Verizon,* 540 U.S. at 407. *See also Endsley v. Chicago*, 230 F.3d 276, 283 (7th Cir. 2000) (affirming dismissal of Section 2 claim for failure to allege monopoly power over "the relevant market.").

[58] ABA Section of Antitrust Law, *Antitrust Law Developments* 226, n.8 (6th ed 2007) (*citing Reazin v. Blue Cross and Blue Shield of Kansas, Inc.*, 899 F.2d 951, 968 (10th Cir. 1990) ("market power, to be meaningful for antitrust purposes, must be durable")).

[59] Even if the Complaint were not so fatally deficient, Count III would still be subject to dismissal since, as set forth above, the Complaint fails to allege a monopoly as to the alleged automotive, UPS and PE separators purported product markets.

(iii) Failure to Allege Attempt to Monopolize

The Complaint fails to state an attempt to monopolize claim as to all alleged markets. With respect to the alleged PE separator market, paragraph 44 does allege a "dangerous probability that, if successful, [the conduct alleged] would give Daramic the ability to lessen or destroy competition." "Dangerous probability," of course, is the third element of the attempt to monopolize offense.[60] The paragraph 44 allegations, however, are in conflict with those of paragraph 39, which alleges an "attempt[] to maintain *monopoly* power" (emphasis added) and paragraph 45, which alleges "[maintenance of] *market* power." (emphasis added)

In any event, paragraph 44 fails to make the necessary allegation of a dangerous probability of success in achieving a monopoly. Instead of meeting this standard, the Complaint inadequately contends that a "dangerous probability" exists that the conduct would convey "the ability to lessen or destroy competition." Even if this defect were corrected, the Complaint is still wanting due to the FTC's failure to allege specific intent to monopolize the PE separator market. *Endsley,* 230 F.3d at 283-84 (affirming dismissal of Sherman Act Section 2 claim for failure to allege facts demonstrating alleged anti-competitive use of power to control prices).

(c) Counts II and III Fail Even if the Claims are not Viewed Under Section 2 Standards.

Under the weight of judicial authority, and scholarly commentary that consistently cautions against an interpretation of Section 5 in antitrust matters beyond the parameters of Section 2 of the Sherman Act, Counts II and III of this Complaint should be dismissed. Even if this Court were to consider some broader and undefined standard for a claim under Section 5 of the FTC Act than under Section 2 of the Sherman Act, Counts II and III, which it should not, would still be deficient and require dismissal.

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[60] *See supra Spectrum Sports,* 506 U.S. at 456.

In a departure from the principles set out in *General Foods*, the Commission in a 3-2 vote announced in the *Negotiated Data Solutions* case ("*N-Data*") that it considers itself authorized to bring antitrust-type cases under Section 5 as unfair methods of competition where the conduct does not violate either the Sherman or Clayton Acts.[61] In its *N-Data* commentary, the Commission, while evidencing an intent to avoid Sherman Act standards, at the same time acknowledged that some "limiting principles" should be in place under Section 5. Yet, the FTC provides no clear and concise articulation of those "limiting principles," and the Complaint lacks any meaningful allegations in this regard.

Of course, problematic for Complaint Counsel in attempting to avoid dismissal through some reliance on *N-Data* is the fact that the Commission has not defined such "limiting principles" and the general comments in *N-Data* lack precision. For example, the Analysis to Aid Public Comment in *N-Data* referred to the first of two limiting principles that supposedly could be derived from the *OAG* and *Ethyl* cases, discussed above. It noted that the court in *OAG* said that a free-standing Section 5 violation could not be found where the respondent "does not act coercively,"[62] and *Ethyl* said there must be "at least some indicia of oppressiveness."[63] In his concurring opinion in *Rambus*, Commissioner Leibowitz provided a slightly fuller statement of this limiting principle when he said that conduct must be "'collusive, coercive, predatory, restrictive, or deceitful,' or otherwise oppressive."[64] And, in his July 2006 speech, Commissioner Rosch also quoted *Ethyl* and *OAG* as requiring "some indicia of oppressiveness, such as

[61] *In the Matter of Negotiated Data Solutions LLC*, File No. 051-0094, Analysis of Proposed Consent Order to Aid Public Comment ("Analysis to Aid Public Comment") 3-4 (January 23, 2008), a copy of which is attached hereto as Exhibit 6, and Statement of the Federal Trade Commission 1-2, n. 5 (January 23, 2008), a copy of which is attached hereto as Exhibit 7.

[62] 630 F.2d at 927.

[63] 729 F.2d at 139-40. However, Chairman Majoras, in her dissenting statement, noted that "[t]he majority has not identified a meaningful limiting principle that indicates when an action . . . will be considered an 'unfair method of competition." *N-Data*, File No. 051-0094, Dissenting Statement of Chairman Majoras 4 (January 23, 2008), a copy of which is attached hereto as Exhibit 8.

[64] *Rambus,* File No. 011-0017, Concurring Opinion of Commissioner Jon Liebowitz 15-16 (August 2, 2006), a copy of which is attached hereto as Exhibit 9.

evidence of anticompetitive intent or purpose on the part of the producer charged or the absence of an independent legitimate business reason for its conduct" (*Ethyl*) and "no purpose to restrain competition or to enhance or expand his monopoly, and does not act coercively" (*OAG*).[65] The conclusion of these recent "articulations" of a "limiting" "standard", is that there is no standard to apply in this or similar cases. As no standard exists against which conduct can be judged, all claims under Counts II and III as related to monopolization and attempt to monopolize the five alleged markets must be dismissed.

Even applying the broad constructs of Commissioners Leibowitz and Rosch to the Complaint here, Counts II and III fail. While the word "coercive" appears in paragraph 44 of the Complaint, it is not addressed to Polypore's conduct generally, but instead is limited specifically to "bargaining tactics." Moreover, nowhere in the Complaint is the alleged offensive conduct, as it relates to all five alleged relevant product markets, described as "collusive, coercive, predatory, restrictive or deceitful."

The second limiting principle of *N-Data* is that the conduct must have an adverse effect on competition.[66] Commissioner Leibowitz had listed a second, similar but diluted limiting principle in *Rambus* when he said the conduct "must bear a realistic potential for causing competitive harm."[67] Commissioner Rosch would also appear to require "*some* evidence, direct

[65] Rosch Valassis Speech , *supra* note 25, at 10. It should be noted that as recently as October 2, 2008, Commissioner Rosch gave a speech in which he added a third limiting principle to the two he had presented in July 2006. Commissioner J. Thomas Rosch, *Section 2 and Standard Setting: Rambus, N-Data & the Role of Causation*, Address at 13 LSI 4th Antitrust Conference on Standard Setting & Patent Pools (October 2, 2008), a copy of which is attached hereto as Exhibit 10 and *available at* http://www.ftc.gov/speeches/rosch/081002section2rambusndata.pdf. This limiting principle would weigh in favor of permitting FTC action the greater the extent to which those harmed by the conduct were limited in their ability to defend themselves. As such, that limiting principle would not operate in favor of the FTC's action in the instant case.

[66] Analysis to Aid Public Comment at 5.

[67] *Rambus*, Concurring Opinion of Commissioner Jon Leibowitz at 15-16.

or circumstantial, of actual or incipient anticompetitive effect; otherwise, the claim would arguably be too unbounded."[68]

These "standards" are not true "limiting principles." In particular, they raise grave concerns to the extent they are suggested for use in a single-firm, monopolization/attempt to monopolize context. Of course, the antitrust laws aren't even activated unless there is an actual or threatened adverse effect on competition. But terminology such as that used by Commissioners Leibowitz and Rosch, i.e., "*realistic potential* for causing competitive harm" and "*circumstantial* [evidence] of *incipient* anticompetitive effect," does not serve as a "limiting principle" but, rather, as a "liberating principle." These concepts would trigger liability at an unacceptably low level of activity. They would flout the history of the development of rational Section 2 Sherman Act standards, which have been designed so as not to discourage or impair the competitive zeal upon which the economy depends.[69]

The only rational "limiting principles" that have emerged from the Commission for application in a single-firm, monopolization context were those articulated by the Commission itself in *General Foods*. That decision is particularly relevant because, unlike almost all the other cases that arise in this context, it was a single-firm case, involving an alleged attempt to monopolize, where the FTC refused to let its own complaint counsel "cheat on" established Sherman Act standards. By holding complaint counsel to Sherman Act standards in *General Foods*, the Commission adopted the only appropriate "limiting principle" to be applied in a case like that – and like this one: "we do not believe that [Section 5] ... should be used to reshape

[68] Rosch Valassis Speech, *supra* note 25, at 11. (emphasis in original).

[69] *See* discussion and cases cited above at pp. 5-13. The court in *Ethyl* pointed out that the inadequacy of "adverse impact on competition" as a limiting principle. It observed that such a rule would prevent "the admittedly lawful unilateral closing of a plant or refusal to expand capacity" and it would also prevent a patentee from "exercising its lawful monopoly to charge whatever the traffic would bear." 729 F.2d at 138.

those [antitrust] policies when they have been clearly expressed and circumscribed."[70] Indeed, the allegations in the pending Complaint (e.g., of "attempt to maintain monopoly power") echo the position of complaint counsel in *General Foods* where the argument was that even if there had not been an attempt to monopolize, there was "an incipient attempt on the basis of potential market power."[71] The Commission rightly said that to distinguish between these two concepts was "to engage in such fine distinctions as to challenge the legal philosopher, let alone the competitor trying to conform its conduct to the law."[72] The "limiting principles" that have been more recently referred to by certain Commissioners either are not referenced in the complaint in this matter or are of no consequence since they fail in any meaningful way to prevent the FTC's enforcement discretion from being wholly "unbounded."

CONCLUSION

For the foregoing reasons, Respondent Polypore respectfully moves to dismiss for failure to state a claim, Counts II and III of the Complaint with respect to any monopolization claims regarding the alleged automotive, UPS and PE separator markets and to dismiss, for failure to state a claim, Counts II and III to the extent that they purport to apply to the alleged deep-cycle and motive battery separator markets based upon an undefined monopolization offense under Section 5 of the FTC Act.

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[70] 103 F.T.C. at 365-66.

[71] *Id.*

[72] *Id.*

Dated: October 15, 2008

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on October 15, 2008, I caused to be filed via hand delivery and electronic mail delivery an original and two copies of the foregoing ***Respondent's Memorandum in Support of Motion to Dismiss Counts II and III of the Complaint for Failure to State a Claim***, and that the electronic copy is a true and correct copy of the paper original and that a paper copy with an original signature is being filed on the same day by other means with:

Donald S. Clark, Secretary
Office of the Secretary
Federal Trade Commission
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Washington, DC 20580
secretary@ftc.gov

I hereby certify that on October 15, 2008, I served one copy via hand delivery and two copies via overnight mail delivery of the foregoing ***Respondent's Memorandum in Support of Motion to Dismiss Counts II and III of the Complaint for Failure to State a Claim*** with:

The Honorable D. Michael Chappell
Administrative Law Judge
Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, DC 20580

I hereby certify that on October 15, 2008, I served via first-class mail delivery and electronic mail delivery a copy of the foregoing ***Respondent's Memorandum in Support of Motion to Dismiss Counts II and III of the Complaint for Failure to State a Claim*** with:

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EXHIBIT 1

0110017

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

Commissioners:	**Timothy J. Muris, Chairman** **Sheila F. Anthony** **Mozelle W. Thompson** **Orson Swindle** **Thomas B. Leary**

	)	
In the Matter of	)	
	)	
RAMBUS INCORPORATED,	)	**DOCKET NO. 9302**
	)	
a corporation.	)	
	)	

COMPLAINT

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

Nature of the Case

1. Through this action, the Commission challenges a pattern of anticompetitive acts and practices, undertaken by Rambus over the course of the past decade, and continuing even today, whereby Rambus, through deliberate and intentional means, has illegally monopolized, attempted to monopolize, or otherwise engaged in unfair methods of competition in certain markets relating to technological features necessary for the design and manufacture of a common form of digital computer memory, known as dynamic random access memory, or "DRAM."

2. Rambus's anticompetitive scheme involved participating in the work of an industry standard-setting organization, known as JEDEC, without making it known to JEDEC or to its members that Rambus was actively working to develop, and did in fact possess, a patent and several pending patent applications that involved specific technologies proposed for and ultimately adopted in the relevant standards. By concealing this information – in violation of JEDEC's own operating rules and procedures – and through other bad-faith, deceptive conduct, Rambus purposefully sought to and did convey to JEDEC the materially false and misleading impression that it possessed no relevant intellectual property rights. Rambus's anticompetitive scheme further entailed perfecting its patent rights over these same technologies and then, once the standards had become widely adopted within the DRAM industry, enforcing such patents worldwide against companies manufacturing memory products in compliance with the standards.

3. The pattern of anticompetitive conduct by Rambus that is at issue in this action has materially caused or threatened to cause substantial harm to competition, and will in the future materially cause or threaten to cause further substantial injury to competition and to consumers, absent the issuance of appropriate relief in the manner set forth below.

The Respondent

4. Rambus is a public corporation organized, existing, and doing business under and by virtue of the laws of the State of Delaware, with its office and principal place of business located at 9440 El Camino Real, Los Altos, California 94022.

5. Rambus designs, develops, licenses, and markets high-speed chip-connection technology to enhance the performance of computers, consumer electronics, and communications systems. The company licenses semiconductor companies to manufacture and sell memory and logic integrated circuits incorporating Rambus chip-connection technology and markets its solutions to systems companies to encourage them to design this technology into their products. For the fiscal year that ended on September 30, 2001, Rambus reported revenues of approximately $117 million.

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

Background on the DRAM Industry

7. Within the array of components that together comprise a typical computer, the computer's "memory" functions to store digitally recorded information such that it is available to be

accessed when needed by the central processing unit ("CPU"). Computer memory is produced in the form of semiconductor "chips," which are connected with other computer components – such as the CPU and the chipset – via a collection of circuit lines, or a "bus," that routes electronic signals and, in this way, communicates commands and transports data.

8. DRAM is the most common form of computer memory in use today. Another form of memory is known as static random access memory, or "SRAM." DRAM and SRAM differ principally in the following ways: SRAM, unlike DRAM, is able to continuously hold information while power is being supplied to memory. With DRAM, on the other hand, the electronic charges that serve to hold the stored information in place dissipate over time, causing information to "leak" out of memory. To counteract this phenomenon, DRAM memory chips must be constantly "refreshed" with new electronic pulses. DRAM and SRAM also differ in that the latter generally is both faster and more expensive.

9. DRAM is an essential input into a variety of downstream products, including a wide variety of computers, such as personal computers, work stations, and servers, as well as various other types of electronic devices, such as fax machines, printers, digital video recorders, video game equipment, and personal digital assistants. Total sales of DRAM in the United States exceeded $12 billion in 2000, and for the same year worldwide DRAM sales exceeded $28 billion.

10. Over the years, a series of different architectures for designing DRAM chips has been introduced. As in most other aspects of the computer industry, over time older-generation designs have given way to newer-generation designs or to improvements on existing architectures. A driving force behind this continual process of evolution in DRAM design is the quest for improved computer performance. In particular, as the performance of other computer components and subsystems is enhanced, the marketplace demands equivalent improvements in the speed and other performance characteristics of computer memory.

11. During the late 1980s and early 1990s, developments and improvements in the performance of CPUs and other computer components were moving forward at a rapid clip. It was perceived, however, that developments in DRAM technology had not kept pace, and that performance constraints inherent in the available DRAM architectures were hindering technological progress in the computer industry, creating a virtual "memory bottleneck."

12. It was in this environment that "synchronous" DRAM was developed. The essential innovation underlying synchronous DRAM – as compared to the prior generation of DRAM, also known as "asynchronous" DRAM – was to link memory functions to a "system clock," allowing for more rapid sequencing of communications between the CPU and memory, thereby improving overall system performance. The system clock, in effect, consists of a continuous series of evenly spaced electronic pulses. The period of time (measured in nanoseconds) elapsing between the initiation of two succeeding pulses is referred to as a single "clock cycle."

13. The introduction of synchronous DRAM offered a potentially promising solution to the memory bottleneck. Yet the success of synchronous DRAM depended importantly upon the ability of the computer industry to adopt standards governing the design and implementation of synchronous DRAM.

JEDEC

14. The JEDEC Solid State Technology Association ("JEDEC") – originally known as the Joint Electron Device Engineering Council, from which the acronym JEDEC derives – is one of several standard-setting bodies affiliated with the Electronic Industries Alliance ("EIA"), a trade association representing all segments of the electronics industry. As explained in JEDEC's Manual of Organization and Procedure (hereinafter, the "JEDEC Manual"), the organization's primary purpose and function is to "promote the development and standardization of terms, definitions, product characterization, test methods, manufacturing support functions and mechanical standards for solid state products."

15. According to the JEDEC Manual, membership in JEDEC is freely available to "[a]ny company, organization, or individual conducting business in the USA that … manufactures electronic equipment or electronics-related products, or provides electronics or electronics-related services." To become a JEDEC member, an eligible company need only submit an application, pay membership fees, and agree to abide by JEDEC's rules. JEDEC members, currently numbering in excess of 200, include many of the world's top designers and manufacturers of semiconductors and related products, as well as many of the largest purchasers of such products.

16. JEDEC's internal structure consists of a Board of Directors (formerly known as the JEDEC "Council") and numerous operational committees, subcommittees, and task groups. Standards typically are proposed, evaluated, and formalized at the committee or subcommittee level and then presented for approval to the Board of Directors, which has final authority to approve or disapprove all proposed standards.

JEDEC Policies and Procedures

17. At all times relevant herein, JEDEC has steadfastly maintained a commitment to promoting free competition within the semiconductor industry. Thus, JEDEC has insisted that its members abide by all applicable laws, including but not limited to laws prohibiting anticompetitive conduct.

18. The JEDEC Manual provides that all JEDEC meetings "shall comply with the current edition of EIA Legal Guides." These Legal Guides – which are explicitly "incorporated ... by reference" into JEDEC's own governing rules, and currently are posted on JEDEC's own website under the heading "Manuals" – provide that standardization programs must be "conducted under strict policies designed to promote and stimulate our free enterprise system and to make sure that laws for maintaining and preserving this system are vigorously followed."

19. The EIA/JEDEC Legal Guides establish a "basic rule" that standardization programs conducted by the organization "shall not be proposed for or indirectly result in ... restricting competition, giving a competitive advantage to any manufacturer, [or] excluding competitors from the market."

20. Consistent with its commitment to promoting unfettered competition, at all times relevant herein JEDEC also has maintained a commitment to avoid, where possible, the incorporation of patented technologies into its published standards, or at a minimum to ensure that such technologies, if incorporated, will be available to be licensed on royalty-free or otherwise reasonable and non-discriminatory terms. Toward this end, JEDEC has implemented procedures designed to ensure that members disclose any patents, or pending patent applications, involving the standard-setting work being undertaken by the organization.

21. At all times relevant herein, meetings of the pertinent JEDEC subcommittee routinely were opened with a statement by the chairperson underscoring the existence of such disclosure obligations. This practice is in conformity with requirements set forth in the JEDEC Manual, the current edition of which provides:

> "The chairperson of any JEDEC committee [expressly defined to include, among other things, subcommittees] must call to the attention of all those present the requirements contained in EIA Legal Guides, and the obligation of all participants to inform the meeting of any knowledge they may have of any patents, or pending patents, that might be involved in the work they are undertaking."

Although the above provision was first added to the JEDEC Manual in October 1993, the existence and scope of these disclosure obligations were commonly known within JEDEC before that time, and indeed throughout the entirety of Rambus's involvement in the organization, from late 1991 through mid-1996.

22. While JEDEC does not altogether prohibit the use of patented items in the standards that it promulgates, the JEDEC Manual does mandate that the use of such items "be considered with great care." Indeed, consistent with procedures and practices followed within JEDEC throughout the relevant time period, the JEDEC Manual, at least since October 1993, has

required that no standard be drafted to include "patented items" – or "items and processes for which a patent has been applied" – absent both

(1) a well-supported technical justification for inclusion of the patented item; and

(2) express written assurance from the patent holder that a license to the patented technology will be made available either "without compensation" or under "reasonable terms and conditions that are demonstrably free of any unfair discrimination."

23. The JEDEC Manual, at least since October 1993, has expressly provided that the disclosure and licensing obligations discussed above apply "with equal force" when JEDEC members, subsequent to the adoption of a standard, discover new information about existing patent rights – or otherwise obtain new patent rights – involving that standard. In such situations, the JEDEC member must make the same disclosures and provide the same assurances as would be required if the member knew of such patent rights prior to adoption of the relevant standard.

24. Fairly interpreted, the policies, procedures, and practices existing within JEDEC throughout all times relevant herein imposed upon JEDEC members certain basic duties with regard to the disclosure of relevant patent-related information and the licensing of relevant patent rights:

a. First, to the extent any JEDEC member knew or believed that it possessed patents or pending patent applications that might involve the standard-setting work that JEDEC was undertaking, the member was required to disclose the existence of the relevant patents or patent applications and to identify the aspect of JEDEC's work to which they related.

b. Second, in the event that technologies covered by a member's known patents or patent applications were proposed for inclusion in a JEDEC standard, the member was required to state whether the technology would be made available either "without compensation" or under "reasonable terms and conditions that are demonstrably free of any unfair discrimination." Absent the member's agreement to one of these two conditions, the JEDEC rules would not allow the technology to be incorporated into a proposed standard.

JEDEC Work Involving SDRAM Standards

25. The JEDEC committee responsible for overseeing the development of standards relating to memory devices is known as the JC-42 Committee on Solid State Memories ("JC-42"), which has several subcommittees, one of which is particularly relevant for purposes of the instant

complaint: the JC-42.3 Subcommittee on RAM Devices ("JC-42.3").

26. Beginning in or around 1990, JC-42.3 commenced work on standards relating to the design and architecture of synchronous DRAM, referred to within JC-42.3 as "SDRAM." JEDEC members involved in the SDRAM-related work of JC-42.3 have over time included virtually all leading memory designers, manufacturers, and users, whether based in the U.S. or abroad.

27. During the 1990s, JEDEC issued several SDRAM-related standards, the first of which was published in November 1993 and was identified as Release 4 of the 21-C Standard. Subsequent releases of the 21-C Standard followed after that, only small portions of which related to SDRAM, as opposed to other memory-related technologies. In August 1999, however, JEDEC published a substantially augmented SDRAM standard – Release 9 of the 21-C Standard – which introduced a second generation of SDRAM. This second-generation standard became known as "double data rate," or "DDR," SDRAM.

28. Although the second-generation SDRAM standard was not issued until 1999, the work that culminated in that standard commenced, at the very latest, shortly after the first-generation SDRAM standard was adopted in 1993. Indeed, it may have commenced even earlier than that, inasmuch as at least one of the technological features initially considered (but ultimately rejected) for the first-generation SDRAM standard was later adopted in the second-generation standard. In addition, most, if not all, of the technologies encompassed in the first SDRAM standard were carried forward in the second-generation standard as well.

29. The process through which JEDEC adopted and published these standards proceeded essentially as follows:

a. At regularly scheduled meetings of the JC-42.3 Subcommittee, which typically occurred on a quarterly basis – as well as affiliated committee and task group meetings, which were scheduled as needed – members were allowed to make presentations concerning specific concepts or technologies they proposed for inclusion in a standard under development.

b. Such presentations generally were accompanied by written materials, which, in addition to being shared with all members present at the meeting, were reproduced and attached to the official meeting minutes.

c. Before any proposal could be considered for adoption, it was necessary that it be presented a second time at a later subcommittee meeting.

d. At that point, a member could move that the proposal be presented to the subcommittee membership for approval through a formal balloting process, pursuant to which written ballots were distributed and received by mail.

e. Votes were then tabulated at the subsequent meeting of the subcommittee, at which time members voting "No" were required to explain their reasons for opposing the proposal.

f. Technically, a two-thirds majority was required, but in practice proposals rarely passed without a consensus of all voting members.

g. Individual proposals, once approved by JC-42.3, were often held at the subcommittee level until a complete package of related proposals was ready to be forwarded to the Council for final ratification.

30. JEDEC's – specifically, the JC-42.3 Subcommittee's – work on SDRAM standards continues today, and a third-generation SDRAM standard, known as "DDR II," is expected to be completed later this year.

Rambus and Its Proprietary RDRAM Technology

31. Rambus was founded in 1990 by two electrical engineers, Mark Horowitz and Michael Farmwald, who together developed their own, proprietary synchronous DRAM architecture. They named the new architecture Rambus DRAM, or simply "RDRAM," and contributed the technology to the new corporation upon its formation.

32. RDRAM, as originally designed, differed from traditional DRAM architectures in several ways, including but not limited to the following:

a. First, the RDRAM architecture specified the use of many fewer bus lines than was common in traditional DRAM designs. Thus, RDRAM was said to be a "narrow-bus" architecture. By comparison to RDRAM, traditional DRAM incorporated what was referred to as a "wide-bus" or "broad-bus" design.

b. Second, in the RDRAM architecture, each bus line was capable of carrying three types of information essential to memory functionality: (1) data; (2) "address" information, specifying the location where needed data could be found, or should be placed, in memory; and (3) "control" information, specifying, among other things, the relevant command (*e.g.*, whether the computer should "read" data from memory or "write" new data to memory). By comparison, in traditional DRAM architectures, each bus line was generally dedicated to carrying only one of these three types of information. Thus, the RDRAM bus was sometimes said to be "multiplexed" or "triply multiplexed."

c. Third, rather than transmitting data, address, and control information separately, as was common in a traditional DRAM architecture, RDRAM transmitted such information together in groupings, called "packets." For this reason, RDRAM is also sometimes referred to as a "packetized" system.

33. Though Rambus has designed, and obtained patents on, various DRAM-related technological concepts or features, Rambus does not itself manufacture such technologies, choosing instead to license its designs for a fee to downstream memory manufacturers. Beginning in the early 1990s and continuing through the present, Rambus has sought to market and license its proprietary RDRAM technology to manufacturers of computer memory and related products, including a number of companies holding membership in JEDEC.

Rambus's '898 Patent Application and Its Progeny

34. On April 18, 1990, Rambus filed its first DRAM-related patent application with the United States Patent and Trademark Office ("PTO") – Application No. 07/510,898 (hereinafter, "the '898 application"). The application contained a 62-page specification and 15 drawings, all purporting to describe Rambus's DRAM-related inventions. In addition, the '898 application contained 150 separate claims, each of which was limited to a narrow-bus, multiplexed, packetized DRAM design.

35. Patents and patent applications consist of two principal parts. The first part is a written description, whereby the patent applicant (or, if the application issues as a patent, the patent holder) describes the invention, through technical specifications and drawings, in a manner that would allow a person skilled in the art to which the invention applies to understand and practice the invention without undue experimentation. The second part of the patent or patent application consists of one or more "claims" defining, or delineating, the scope – or outer bounds – of the patent holder's exclusive rights (or, in the case of an application, the exclusive rights the applicant seeks to obtain).

36. Because all 150 claims contained in Rambus's '898 patent application were limited to a narrow-bus, multiplexed, packetized DRAM design, through this application Rambus was not seeking – nor, absent amendment to the application, could it obtain – any patent rights exceeding those limitations.

37. In March 1992, Rambus broke out portions of its '898 application into 10 divisional patent applications, each of which "claimed priority back" to the '898 application and to its April 1990 filing date. The original '898 application and these 10 divisional applications, in turn, gave rise

to numerous other amended, divisional, or continuation patent applications – all technically the "progeny" of the '898 application – and eventually resulted in the issuance of numerous Rambus patents.

a. The process of obtaining patents or "perfecting" patent claims, otherwise known as patent prosecution, often involves amending, dividing, or continuing patent applications on file with the PTO.

b. Through an "amendment" to a pending patent application, a patent applicant may delete or alter certain claims contained in the pending application, or may add new claims, while at the same time retaining the same specification, drawings, and (to the extent not amended or deleted) claims of the previously pending application.

c. A "divisional" application is one that carves out one of multiple distinct inventions from a prior application and seeks to obtain patent rights over that distinct invention, without adding any new matter to the written description of the invention described in the earlier application.

d. A "continuation" application is a second application, covering the same invention described in a prior application, that is filed before the earlier application either issues as a patent or is abandoned and, again, adds no new matter to the written description of the invention described in the earlier application.

e. Before issuing any patent, the PTO first seeks to determine whether the invention claimed in the relevant patent application is preceded by "prior art" – that is, by preexisting inventions or other publicly known facts or information that demonstrates the lack of novelty in the invention for which a patent is sought.

f. Generally speaking, determinations of whether prior art exists in a given case are made by reference to the date on which the patent application is filed, otherwise known as the "priority date."

g. When a patent application is amended, divided, or continued in the manner described above, the patent applicant may "claim priority back" to an earlier-filed application – thus benefitting from the earlier filing date – but only if the amended, divisional, or continuation application "adds no new matter" to the written description of the invention described in the earlier application. As noted above, divisional and continuation applications, by definition, include no new matter not contained within the earlier-referenced application.

h. Subsequent amendments, divisionals, or continuations claiming priority back to an earlier-filed patent application are sometimes said to be within the same "family" as the earlier-filed application, or otherwise are said to be the prior application's "progeny."

i. Thus, the fact that, as stated above, each Rambus patent application in the '898 "family" – or each of the '898 application's "progeny" – claimed priority back to the '898 application, means that all of the patent applications in the '898 family contained the same specification and drawings as were contained in the '898 application itself. In fact, in each amended, divisional, and continuation patent application Rambus filed claiming priority back to the '898 application's April 1990 filing date, Rambus was required to – and did – expressly warrant to the PTO that the application added "no new matter" beyond what was contained in the '898 application's 62-page specification and 15 drawings.

38. Though all of the Rambus patent applications in the '898 family contained the same specification and drawings as the '898 application itself, over time Rambus sought to expand the claims contained within these applications in order to obtain patent rights extending beyond the narrow-bus, multiplexed, packetized design inherent in the RDRAM design. In other words, in the course of prosecuting the '898 family of patent applications, Rambus made a conscious effort to withdraw the narrow-bus limitations contained in the original application's claims, and thereby sought to significantly expand the scope of its potential patent rights, while still clinging to the '898 application's April 1990 priority date.

Rambus's Initial Involvement in JEDEC

39. Even before Rambus was formally incorporated in early 1990, its founders outlined a strategy whereby, in an effort to obtain high royalties for RDRAM, they would seek to establish RDRAM as the actual or *de facto* industry standard.

40. Partly with this goal in mind, Rambus attended its first JEDEC meeting in December 1991, and it officially joined the organization shortly thereafter. Although JEDEC was conducting other potentially relevant work at that time, of particular relevance to Rambus was the work then underway within the JC-42.3 Subcommittee, which was in the process of developing a first generation of standards for SDRAM. From December 1991 through December 1995, Rambus representatives regularly attended JC-42.3 meetings.

41. Though Rambus attended its last JC-42.3 meeting in December 1995, it remained a member of JEDEC, and continued to receive official mailings and other information from JEDEC, until June 1996, when it formally withdrew from the organization.

Rambus's Scheme to Capture the SDRAM Standards

42. Shortly after becoming involved in JEDEC, it became apparent to Rambus that JC-42.3 was committed to developing SDRAM standards based on the traditional wide-bus, non-packetized DRAM architecture, relying to the extent possible on non-proprietary technologies. In other words, it was highly unlikely JC-42.3 would be interested in standardizing RDRAM, an architecture that was both proprietary and distinctly non-traditional.

43. Rambus, of course, would have preferred that its own RDRAM technology be adopted as the industry standard. Failing that, Rambus might have preferred to see any efforts at adopting an industry-wide SDRAM standard fail, inasmuch as industry adoption of such a standard would make it more difficult for Rambus to market its proprietary RDRAM technology. By mid-1992, however, Rambus had seized upon an alternative business plan – one that, if successful, might allow Rambus to achieve the goal of charging high royalties even if the DRAM industry were to adopt as its standard something other than RDRAM. Rambus's CEO, Geoff Tate, laid out this scheme in a June 18, 1992 draft of the Rambus 1992-1997 Business Plan:

> "For about 2+ years a JEDEC committee has been working on the specifications for a Synchronous DRAM. No standard has yet been approved by JEDEC. Our expectation is a standard will not be reached until end of 1992 at the earliest.
>
> * * *
>
> [W]e believe that Sync DRAMs infringe on some claims in our filed patents; and that there are additional claims we can file for our patents that cover features of Sync DRAMs. Then we will be in position to request patent licensing (fees and royalties) from any manufacturer of Sync DRAMs. Our action plan is to determine the exact claims and file the additional claims by the end of Q3/92. Then to advise Sync DRAM manufacturers in Q4/92."

44. In what appears to be the final draft of the same Rambus Business Plan, dated September 1992, Tate further elaborated on the scheme:

> "Rambus expects the patents will be issued largely as filed and that companies will not be able to develop Rambus-compatible or Rambus-like technology without infringing on multiple fundamental claims of the patents .... Rambus' patents are likely to have significant applications other than for the Rambus Interface."

In the same document, Tate also wrote: "Sync DRAMs infringe claims in Rambus's filed patents and other claims that Rambus will file in updates later in 1992."

45. In actuality, events unfolded somewhat differently than Rambus's CEO envisioned in these

statements, in a manner that affected the timing, but not the core substance, of Rambus's scheme. For instance, although Rambus's '898 application was pending at the time these statements were written, not until 1996 was Rambus – through a separate application claiming priority back to the '898 application – able to obtain its first patent broad enough to arguably cover aspects of the wide-bus DRAM architecture incorporated into the JEDEC standards. In addition, Rambus ultimately elected to wait until late 1999, after DRAM manufacturers and their customers had become "locked in" to the JEDEC standards, before seeking to enforce its patents against memory manufacturers producing JEDEC-compliant SDRAM.

46. Aside from such timing issues, the Rambus business plans quoted in Paragraphs 43 and 44 set forth quite accurately the basic scheme upon which the company would embark – that is, a scheme whereby Rambus would actively seek to perfect patent rights covering technologies that were the subject of an ongoing, industry-wide standardization process, in which Rambus itself was a regular participant, without disclosing the existence of such patent rights (or the pertinent patent applications) to other participants, many of whom, by producing products compliant with the standards, would later be charged with infringing Rambus's patents.

Implementation of Rambus's Scheme

47. During the course of its participation in JEDEC, from late 1991 through mid-1996, Rambus observed multiple presentations regarding technologies, proposed for (and later included in) JEDEC's SDRAM standards, that Rambus either (1) knew or believed to be covered by claims contained in its then-pending patent applications, or (2) believed could be covered through amendments to those applications expanding the scope of the patent claims while adding no new matter to the underlying technical specification.

48. That is, at all times relevant herein, Rambus believed that a number of the specific technologies that were proposed for, and later incorporated in, the relevant JEDEC standards were encompassed by the 62-page technical specification and 15 related drawings common to Rambus's '898 application (filed in 1990) and the numerous amended, divisional, and continuation applications that stemmed from the '898 application. Rambus further believed that, to the extent the pending claims of the '898 application and its later-filed progeny failed to cover these technologies as proposed to be used in JEDEC's SDRAM standards, such claims could be amended to cover these technologies, while still claiming priority back to the '898 application's April 1990 filing date.

49. As Rambus's CEO described in the company's internal planning documents in mid-1992 (*see* Paragraphs 43-44 above), the initial phase of Rambus's "action plan" required that it first "determine the exact claims" in its pending applications that covered technologies being incorporated into the JEDEC standards, and then, as needed, "file ... additional claims" to

perfect Rambus's patent rights over such technologies. In executing these steps, Rambus placed heavy reliance upon two individuals: Richard Crisp, Rambus's designated representative to the JC-42.3 Subcommittee, and Lester Vincent, an attorney with the law firm of Blakely, Sokoloff, Taylor & Zafman, who served as Rambus's outside patent counsel.

50. Richard Crisp, an electrical engineer, joined Rambus in 1991. He attended his first JC-42.3 meeting in February 1992 and continued to attend such meetings regularly through December 1995. (In addition to Crisp, David Mooring, at that time Rambus's vice president for business development, and Billy Garrett, another Rambus engineer, sometimes attended JC-42.3 meetings.) In May 1992, Crisp became Rambus's designated representative to JC-42.3. As such, he personally received any information, such as meeting minutes and ballot forms, that JEDEC furnished to Rambus by mail.

51. Throughout the duration of Crisp's participation in the JC-42.3 Subcommittee, it was his customary practice to send comprehensive reports to his superiors and others within Rambus describing in detail the technologies that were being proposed for inclusion in the JEDEC SDRAM standards. Typically, these reports were communicated via e-mails authored and sent while the JC-42.3 meetings were still in progress.

52. Lester Vincent and his law firm, Blakely, Sokoloff, were retained as patent counsel by Rambus in the summer of 1991, at which time Vincent assumed primary responsibility for prosecuting Rambus's '898 application before the PTO. For several years thereafter, Vincent and his colleagues assisted Rambus with its DRAM-related patent strategy, providing frequent advice to Rambus on patent-related issues and assuming primary responsibility for drafting, filing, and prosecuting the various continuation and divisional patent applications that stemmed from the '898 application.

53. In late March 1992, Vincent met with Crisp and Allen Roberts, the Rambus vice president with responsibility for patents, to discuss, among other things, Rambus's participation in JEDEC. At this meeting, Vincent, Crisp, and Roberts discussed whether Rambus, having joined JEDEC and participated in JEDEC meetings, was at risk of forfeiting – on grounds of equitable estoppel – its rights to enforce future patents covering aspects of the JEDEC standards. Vincent advised that there could be an equitable estoppel problem if Rambus were to convey to other JEDEC participants the false or misleading impression that it would not seek to enforce its patents or its future patents. He further advised that, in order to reduce such risks, Rambus might remain silent and abstain from voting on any proposed JEDEC standards. Rambus in fact did abstain from voting on the scores of JC-42.3 ballot initiatives that arose during the course of its participation in JEDEC. Richard Crisp did vote on one occasion, however, registering a "No" vote on four separate ballot items.

54. Throughout its four and one-half years of participation in the JC-42.3 Subcommittee, Rambus engaged in a continuous pattern of deceptive, bad-faith conduct. Rambus's bad-faith participation in JEDEC, although evidenced in other ways as well, was perhaps best exemplified in the coordinated activities of Crisp and Vincent. During his four-year tenure as Rambus's representative to JC-42.3, Crisp observed multiple presentations relating to technologies Rambus believed were covered – or, through amendment, could be covered – by pending Rambus patent applications. In fact, in a number of instances, Crisp, while participating in JC-42.3 meetings, sent e-mails back to Rambus headquarters expressing a belief that Rambus had pending applications covering certain technologies being discussed in such meetings, or otherwise suggesting that Rambus's pending patent applications be reviewed, and if necessary amended, to ensure they covered such technologies. On several occasions, Crisp – based in part on information learned through attending JC-42.3 meetings – developed specific proposals for amending Rambus's pending patent claims and communicated such proposals directly (or via a Rambus colleague) to Vincent. Likewise, in some cases, Vincent sent copies of draft amendments to Rambus's patent applications to Crisp, among others, soliciting his input before finalizing such amendments. Plainly, in light of Rambus's failures to disclose pertinent patent-related information to JEDEC, the activities described in this paragraph constituted bad faith.

55. As underscored elsewhere in this complaint, Rambus never disclosed to JEDEC the fact that, throughout the duration of its membership in the organization, Rambus had on file with the PTO, and was actively prosecuting, patent applications that, in its view, either covered or could easily be amended to cover elements of the existing and future SDRAM standards.

<u>Technologies Impacted by Rambus's Scheme</u>

56. Among other specific technologies adopted or proposed for inclusion in the SDRAM standards during the period of Rambus's participation in JEDEC, which Rambus believed were covered by its then-pending patent applications or could be covered through amendments to such applications, were the following: (1) programmable CAS latency; (2) programmable burst length; (3) on-chip PLL/DLL; and (4) dual-edge clock.

57. Column address strobe (or "CAS") latency refers to the amount of time it takes for the memory to release data after receiving a signal, known as the column address strobe, in connection with a read request from the CPU. The technology known as programmable CAS latency allows memory chips to be programmed such that this aspect of the memory's operation can be tailored to facilitate compatibility with a variety of different computer environments.

58. Burst length generally refers to the number of times information (or data) is transmitted between the CPU and memory in conjunction with a single request or instruction. The technology

known as programmable burst length allows memory chips to be programmed to adjust this aspect of the memory's operation in order to facilitate compatibility with a variety of different computer environments.

59. From December 1991 through May 1992, Crisp and other Rambus representatives observed multiple JC-42.3 presentations pertaining to programmable CAS latency and programmable burst length, both of which were proposed to be incorporated in the first JEDEC SDRAM standard. Soon thereafter, in the summer of 1992, Crisp received, and voted upon, a ballot calling for inclusion of both technologies in the standard. This was the only time that Crisp voted on a JEDEC ballot, and he voted "No," for technical reasons that he was called upon to, and did, explain, but without saying anything to suggest that Rambus might possess relevant intellectual property.

60. At the time of these events, Crisp and others within Rambus believed that both programmable CAS latency and programmable burst length were encompassed by the inventions set forth in the specification and drawings of the '898 application and related applications that were then pending at the PTO, and that Rambus – by amending the claims in those pending applications – had the ability to perfect patent rights covering such technologies as used in the SDRAM standard. Indeed, beginning in May 1992, Crisp, Roberts, and other Rambus representatives began a series of consultations with Vincent for the purpose of drafting new claims, linked to the '898 application, that would cover use of certain technologies in the wide-bus architecture adopted by the SDRAM standard. Programmable CAS latency and programmable burst length were both among the technologies discussed for inclusion in these new wide-bus claims.

61. In March 1993, a Rambus representative attended the JC-42.3 meeting at which both programmable CAS latency and programmable burst length were approved for inclusion in the first SDRAM standard and were forwarded to the JEDEC Council, along with a collection of other approved technologies, as part of a comprehensive standard proposal. Despite Rambus's belief that these technologies were subject to pending Rambus patent claims, the Rambus representative remained silent throughout the meeting. In May 1993, the Council formally adopted the proposed SDRAM standard, which was published in November of that year. (Both of these technologies were later carried forward in the second-generation SDRAM standard published in August 1999.) Also in May 1993, Vincent's law firm (Blakely, Sokoloff) first filed patent claims on behalf of Rambus intended to cover use of DRAM technologies in a wide-bus architecture. From that time through the present, Rambus has continued its efforts to perfect patent rights covering use of programmable CAS latency and programmable burst length as incorporated in the SDRAM standards.

62. The design objectives served by inclusion of programmable CAS latency and programmable burst length technologies in the first- and second-generation JEDEC standards likely could have

been accomplished through use of alternative DRAM-related technologies available at the time these standards were developed. At a minimum, there would have been uncertainty at that time regarding the potential to identify or develop feasible alternative technologies. In either event, had Rambus disclosed to the JC-42.3 Subcommittee that it possessed pending patent applications purporting to cover – or that could be amended to cover – programmable CAS latency and burst length technologies in a wide-bus synchronous DRAM architecture, such disclosures likely would have impacted the content of the SDRAM standards, the terms on which Rambus would later be able to license any pertinent patent rights, or both.

63. Phase lock loop ("PLL") and delay lock loop ("DLL") are closely related technologies, both of which are used to synchronize the internal clock that governs operations within a memory chip and the system clock that regulates the timing of other system functions. The former, PLL, synchronizes the two clocks by adjusting the internal clock's frequency to match the system clock's frequency, whereas the latter, DLL, achieves synchronization by delaying the internal clock. "On-chip" PLL/DLL refers to the approach of placing these technologies on the memory chip itself, as opposed to the alternative approach of placing these technologies on, for instance, the memory module or the motherboard – the latter being known as "off-chip" PLL/DLL.

64. Beginning in September 1994, Crisp observed presentations and other work in the JC-42.3 Subcommittee involving proposals to include on-chip PLL in the second generation of the SDRAM standard. At that time, Crisp and others within Rambus believed that on-chip PLL was encompassed by the inventions set forth in the specification and drawings of the '898 application and related applications then pending at the PTO, and they had already discussed with Vincent their desire to perfect patent rights covering use of this technology in SDRAMs. Indeed, in June of 1993 Vincent's law firm filed, on Rambus's behalf, an amendment to a pending patent application – Application No. 07/847,692 – adding claims that, on their face, covered use of on-chip PLL/DLL technology in either a wide-bus or narrow-bus DRAM architecture. From June 1993 through the present, Rambus has continued its efforts to perfect patent rights covering use of on-chip DLL technology as ultimately incorporated in the second-generation SDRAM standard published in August 1999.

65. The design objectives served by inclusion of on-chip DLL technology in the second-generation JEDEC standard likely could have been accomplished through use of alternative DRAM-related technologies available at the time these standards were developed. At a minimum, there would have been uncertainty at that time regarding the potential to identify or develop feasible alternative technologies. In either event, had Rambus disclosed to the JC-42.3 Subcommittee that it possessed pending patent applications purportedly covering – or that could be amended to cover – on-chip PLL/DLL technologies in a wide-bus synchronous DRAM architecture,

such disclosures likely would have impacted the content of the SDRAM standards, the terms on which Rambus would later be able to license any pertinent patent rights, or both.

66. Dual-edge clock is a technology that permits information to be transmitted between the CPU and memory twice with every cycle of the system clock, thereby doubling the rate at which information is transmitted compared to the first generation of SDRAM, which incorporated a "single-edge clock" and hence permitted information to be transmitted only once per clock cycle.

67. Between December 1991 and April 1992, Crisp and other Rambus representatives attended JC-42.3 meetings at which they observed presentations and other work involving dual-edge clock technology and a closely related technology known as "toggle-mode." Ultimately, the JC-42.3 Subcommittee decided not to incorporate these technologies into the first-generation SDRAM standard. At the time this decision was reached, however, certain JC-42.3 members expressed the view that such technologies would be appropriate for reconsideration in connection with the next generation of SDRAM. Dual-edge clock technology was again discussed by the JC-42.3 Subcommittee in May 1995. Soon thereafter, in October 1995, a survey ballot relating in part to dual-edge clock technology was distributed to JC-42.3 members, and the same ballot was later discussed at a JC-42.3 meeting in December 1995. A formal proposal to include dual-edge clock technology in the second-generation SDRAM standard was made at a JC-42.3 Subcommittee meeting in March 1996. Following Rambus's withdrawal from JEDEC in June 1996, dual-edge clock technology was the subject of further presentations, and the technology ultimately was incorporated into the second-generation SDRAM standard.

68. In September 1994, Vincent's law firm, on behalf of Rambus, filed an amendment to Rambus's Patent Application No. 08/222,646, adding dual-edge clock claims that were not limited to a narrow-bus RDRAM design, but rather purported to cover use of dual-edge clock technology in any synchronous DRAM architecture, including a wide-bus architecture of the sort that was the focus of JEDEC's SDRAM standards. This application, as amended to include dual-edge clock claims, issued as U.S. Patent No. 5,513,327 (hereinafter, "the '327 patent") in April 1996, while Rambus was still a member of JEDEC. From September 1994 through the present, Rambus has continued its efforts to perfect patent rights covering use of dual-edge clock technology as used in a wide-bus synchronous DRAM architecture.

69. The design objectives served by inclusion of dual-edge clock technology in the second-generation SDRAM standard likely could have been accomplished through use of alternative DRAM-related technologies available at the time these standards were developed. At a minimum, there would have been uncertainty at that time regarding the potential to identify or develop feasible alternative technologies. In either event, had Rambus disclosed to the JC-42.3

Subcommittee that it possessed patents or pending patent applications arguably covering (or that, with respect the applications, could be amended to cover) dual-edge clock technology in a wide-bus synchronous DRAM architecture, such disclosures likely would have impacted the content of the SDRAM standards, the terms on which Rambus would later be able to license any pertinent patent rights, or both.

<u>Rambus's Limited and Misleading Disclosures to JEDEC</u>

70. At no time during its involvement in JEDEC did Rambus ever disclose to the organization the fact that it possessed an issued patent – the '327 patent discussed in Paragraph 68 above – that purported to cover use of a specific technology proposed for inclusion in the JEDEC SDRAM standards. Nor did Rambus ever disclose to JEDEC that it had on file with the PTO various pending patent applications that purported to cover, or could be amended to cover, a number of other technologies included or proposed for inclusion in the JEDEC SDRAM standards. More generally, Rambus never said or did anything to alert JEDEC to (1) Rambus's belief that it could claim rights to certain technological features not only when used in the context of its proprietary, narrow-bus, RDRAM designs, but also when used in the traditional wide-bus architecture that was the focus of JEDEC's SDRAM standard-setting activities; or (2) the fact that Rambus, while a member of JEDEC, was actively working to perfect such patent rights.

71. On the contrary, Rambus's very participation in JEDEC, coupled with its failure to make required patent-related disclosures, conveyed a materially false and misleading impression – namely, that JEDEC, by incorporating into its SDRAM standards technologies openly discussed and considered during Rambus's tenure in the organization, was not at risk of adopting standards that Rambus could later claim to infringe upon its patents.

72. On at least two occasions during Rambus's involvement in JEDEC, Crisp was asked by JEDEC representatives whether Rambus had any patent-related disclosures to make pertaining to technologies discussed within JC-42.3. In neither instance did Rambus elect to make such disclosures. One of these instances, however, prompted Rambus to present a letter to the JC-42.3 Subcommittee, dated September 11, 1995, which stated in part:

> "At this time, Rambus elects to not make a specific comment on our intellectual property position .... Our presence or silence at committee meetings does not constitute an endorsement of any proposal under the committee's consideration nor does it make any statement regarding potential infringement of Rambus intellectual property."

73. Beyond these statements, the September 1995 letter said nothing concerning Rambus's patent position. In particular, it made no reference to the fact that Rambus possessed pending patent

applications that purported to cover, or were being amended to cover, both (1) technologies included in already published JEDEC standards, and (2) additional technologies then being considered for inclusion in future JEDEC standards. Moreover, the episode that gave rise to Rambus's September 1995 letter involved discussion of a narrow-bus, multiplexed, packetized SDRAM design – known as "SyncLink" – that bore a strong resemblance to Rambus's own narrow-bus, multiplexed, packetized RDRAM design. As explained elsewhere in this complaint, the wide-bus, non-packetized synchronous DRAM design adopted by JEDEC differed significantly from Rambus's RDRAM design, and hence from the SyncLink design as well. Thus, to the extent Rambus's September 1995 letter could be interpreted to suggest that Rambus might possess relevant intellectual property rights, JEDEC's members would naturally have understood that any such rights related to the SyncLink design, not to the use of certain technologies in the JEDEC standards.

74. In connection with the same incident that gave rise to this September 1995 letter, Crisp and others within Rambus internally debated the extent to which, and manner in which, Rambus should consider making patent-related disclosures to JEDEC or to individual JEDEC members. In this regard, on May 24, 1995, Crisp sent an e-mail to Rambus's CEO, Geoff Tate, as well as other Rambus executives, suggesting a possible bifurcated approach to disclosure. As to any "really key" technologies, Crisp suggested that Rambus should consider making disclosures. But "[i]f it is not a really key issue," Crisp stated, "then … it makes no sense to alert them to a potential problem they can easily work around."

75. In the same e-mail, Crisp outlined a second possible approach to dealing with the disclosure issue:

> "We may want to walk into the next JEDEC meeting and simply provide a list of patent numbers which we have issued and say 'we are not lawyers, we will pass no judgment of infringement or non-infringement, but here are our issued patent numbers, you decide for yourselves what does and does not infringe.'"

Although Rambus in this particular instance did not adopt this approach to disclosure, Crisp's suggestion foreshadowed quite closely the manner in which Rambus would later announce its withdrawal from JEDEC roughly a year later, in June 1996 (*see* Paragraphs 81-88 below).

76. Prior to withdrawing from the organization in June 1996, Rambus did make one patent-related disclosure to JEDEC. In September 1993, Rambus informed JEDEC of the issuance of U.S. Patent No. 5,423,703 (hereinafter, "the '703 patent"). Although the '703 patent claimed priority back to Rambus's '898 application and thus contained the same specification and drawings, the claims of the '703 patent related to a specific clocking technology, unique to RDRAM, that differed significantly from any clocking technology considered by JEDEC. For

this reason, the patent rights conferred upon Rambus by the '703 patent – as reflected in the patent's claims – did not relate to or involve JEDEC's work on SDRAM standards. Furthermore, Rambus's disclosure of this patent did nothing to alert JEDEC's members to Rambus's belief that the specification and related drawings common to the '703 patent and all other patent applications in the '898 family provided a basis upon which it could claim additional patent rights covering technologies incorporated in the SDRAM standards.

77. Other than the foregoing, Rambus made no patent-related disclosures to JEDEC or to the JC-42.3 Subcommittee prior to withdrawing from JEDEC in June 1996. While Rambus was a member of JEDEC, however, some JEDEC members obtained (or viewed) copies of one or more foreign patent applications filed by Rambus, which contained the same specification and drawings as the '898 application and its progeny. In light of the various information (identified in, *inter alia*, Paragraphs 54-55, 60, 64, 68, 70, 73, and 76 above) that Rambus failed to disclose to JEDEC, simply viewing these foreign patent applications would have done nothing to alert JEDEC's members to the fact that Rambus believed the specification and related drawings common to the foreign applications and the '898 family of U.S. patent applications permitted it to claim additional patent rights covering the SDRAM standards.

78. Finally, before, during, and after its tenure as a JEDEC member, in connection with its ongoing efforts to market and license RDRAM, Rambus made limited, private disclosures about its technology to some of the companies participating in JC-42.3. Upon information and belief, these disclosures were made pursuant to agreements prohibiting the company receiving such information from disclosing it to others. In any event, these limited, private disclosures concerning Rambus's proprietary, narrow-bus RDRAM technology were not adequate to satisfy Rambus's disclosure obligations, nor did such disclosures do, or convey, anything to place individual JEDEC members on notice of Rambus's belief that it could claim patent rights over technologies used in the JEDEC SDRAM standards.

Rambus's Violations of the JEDEC Disclosure Duty

79. As discussed above, upon joining JEDEC, Rambus became subject to the same basic disclosure duty applicable to all JEDEC members – the duty to disclose the existence of any patents or pending patent applications it knew or believed "might be involved in" the standard-setting work that JEDEC was undertaking, and to identify the aspect of JEDEC's work to which they related. (*See* Paragraphs 21 and 24 above.)

80. Rambus violated this duty repeatedly, notwithstanding the limited patent-related disclosures discussed above. The fact is that Rambus, while participating as a JEDEC member, possessed a variety of patent applications – and at least one issued patent – that covered, or were designed to cover, technologies involved in the JEDEC standard-setting work, as well as

additional applications that Rambus believed could be amended to cover such technologies without the addition of any new matter. Rambus never disclosed these critical facts to JEDEC.

Rambus's Withdrawal from JEDEC

81. In December 1995, Vincent learned of, and discussed with Anthony Diepenbrock, an in-house Rambus attorney, the Commission's proposed consent order in *In re Dell Computer Corporation*, which involved allegations of anticompetitive unilateral conduct occurring within the context of an industry-wide standard-setting organization. In January 1996, Vincent advised Rambus that it should terminate "further participation in any standards body," including JEDEC.

82. On June 17, 1996, Rambus formally withdrew from JEDEC via a letter addressed to Ken McGhee, an EIA employee who at the time served as Secretary of JEDEC's JC-42 Committee. The letter was originally drafted by Richard Crisp; however, the final version reflected input from Lester Vincent, among others. Other than McGhee, the letter was sent to no one else within JEDEC, including no members of the JC-42.3 Subcommittee.

83. The letter opened by informing Mr. McGhee that Rambus would not be renewing its membership in the various JEDEC committees and subcommittees in which it had participated, including JC-42.3, and that it therefore was returning its membership invoices unpaid. The remainder of the letter stated as follows:

> "Recently at JEDEC meetings the subject of Rambus patents has been raised. Rambus plans to continue to license its proprietary technology on terms that are consistent with the business plan of Rambus, and those terms may not be consistent with the terms set by standards bodies, including JEDEC. A number of major companies are already licensees of Rambus technology. We trust that you will understand that Rambus reserves all rights regarding its intellectual property. Rambus does, however, encourage companies to contact Dave Mooring of Rambus to discuss licensing terms and to sign up as licensees.
>
> To the extent that anyone is interested in the patents of Rambus, I have enclosed a list of Rambus U.S. and foreign patents. Rambus has also applied for a number of additional patents in order to protect Rambus technology."

84. Although it attached a list of 23 Rambus patents, Rambus's June 1996 withdrawal letter said nothing to inform JEDEC how, if at all, the 23 listed patents – and the vague reference to additional, unspecified patent applications – might relate to the work of the JC-42.3 Subcommittee. The unstated message, as Crisp had suggested roughly a year earlier, was:

"[H]ere are our issued patent numbers, you decide for yourselves what does and does not infringe." (*See* Paragraph 75 above.)

85. The list of 23 Rambus patents attached to this letter consisted of 21 U.S. and two foreign (one Taiwanese and one Israeli) patent numbers, with no accompanying explanation.

a. Of the 21 U.S. patents on the list, five fell within the '898 family and the remaining 16 fell outside the '898 family.

b. Of the latter group of 16, several related to discrete designs for generic electronic circuits – that is, they did not relate uniquely to DRAM design or specifically to Rambus's RDRAM architecture. Several other patents included within this group of 16 did relate in some way to DRAM design but did not bear any direct connection to either Rambus's narrow-bus RDRAM architecture or the wide-bus architecture incorporated into the JEDEC SDRAM standards. The remaining few patents from this group of 16 related to specific implementations of Rambus's narrow-bus architecture. There is no indication that any of these 16 patents related to any specific technology or technological feature adopted or considered for adoption in the SDRAM standards.

c. The five U.S. patents that did fall within the '898 family included the '703 patent discussed in Paragraph 76 above, which Rambus had previously disclosed to JEDEC. Of the remaining four, three of the listed patents – like the '703 patent – contained only claims that either (1) were expressly limited to the narrow-bus RDRAM architecture, or (2) dealt with a specific aspect of the Rambus RDRAM architecture unrelated to JEDEC's work. The final patent within this group – U.S. Patent No. 5,473,575 – contained claims that, although potentially broader in scope than the other four, were limited to the low-voltage design used in Rambus's RDRAM architecture, which materially differed from the higher-voltage designs that had been the focus of JEDEC's work.

d. The remaining two Rambus patents on the list of 23 were the two foreign patents. Beyond the fact that one of these was written in Chinese, these foreign patents, had they been reviewed by JEDEC's members, would not have sufficed to place them on notice of Rambus's patent rights, or potential patent rights, for reasons discussed above.

86. More important than what the June 1996 withdrawal letter said is what it failed to say. Among other things, the letter made no mention of the fact that Rambus possessed pending patent applications covering, or that could be amended to cover, specific technologies included, or proposed for inclusion, in the JEDEC SDRAM standards. Nor did the letter say anything to

alert JEDEC to Rambus's belief that it could claim rights to certain technological features not only when used in the context of its proprietary, narrow-bus, RDRAM designs, but also when used in the traditional wide-bus architecture that was the focus of JEDEC's SDRAM standard-setting activities.

87. But this was not all the June 1996 letter failed to disclose. As of June 1996, when Rambus submitted its formal withdrawal letter to JEDEC, the company actually possessed 24 issued patents, not 23. That is, one – but only one – of Rambus's issued patents was omitted from the list attached to the June 1996 withdrawal letter. The omitted patent was Rambus's '327 patent, which issued in April 1996, two months before Rambus's withdrawal from JEDEC. As discussed in Paragraph 68 above, the '327 patent contained claims purporting to cover use of dual-edge clock technology in any synchronous DRAM architecture. As such, it was the only patent actually obtained by Rambus while a member of JEDEC that arguably covered use of a specific technology included, or considered for inclusion, in JEDEC's wide-bus SDRAM standards.

88. Even after withdrawing from JEDEC, Crisp and others within Rambus continued to closely monitor JEDEC's ongoing work on SDRAM standards, including work involving specific technologies on which Rambus sought to perfect patent rights.

Industry Adoption of the JEDEC Standards

89. In the years following the issuance of JEDEC's first SDRAM standard in November 1993, DRAM manufacturers and their customers began designing, testing, and ultimately manufacturing memory and memory-related products incorporating, or complying with, JEDEC's standardized SDRAM designs. By 1995, JEDEC-compliant SDRAM had begun to replace older-generation, asynchronous DRAM architectures. Thereafter, the shift to the more modern SDRAM technology progressed rapidly. By 1998, total worldwide sales of JEDEC-compliant SDRAM, on a revenue basis, exceeded sales of asynchronous memory. And by 1999, JEDEC-compliant SDRAM had largely replaced asynchronous DRAM in virtually all relevant uses. Toward the end of this period – roughly 1999 to 2000 – some DRAM manufacturers and their customers also began using RDRAM, but only in very limited end uses, accounting for a relatively small portion (*i.e.*, in the range of 5%) of overall DRAM production.

90. Leading up to and following the issuance of JEDEC's second-generation SDRAM standard – or DDR SDRAM – in August 1999, DRAM manufacturers and their customers began designing, testing, and (to a limited extent) producing memory and memory-related products incorporating, or complying with, the DDR SDRAM standard. By 2000, DDR SDRAM was beginning to be manufactured in increasing volumes. This trend continued during 2001, and a number of DRAM manufacturers and their customers began to replace first-generation

SDRAM and RDRAM with DDR SDRAM for certain high-end uses. Current projections indicate that total sales of DDR SDRAM, on a revenue basis, may account for as large as 40% of all DRAM produced worldwide in 2002, and by 2004 this figure is expected to exceed 50%.

Success of Rambus's Scheme

91. Throughout the late 1990s, as the DRAM industry became increasingly locked in to use of JEDEC-compliant SDRAM, and subsequently DDR SDRAM, Rambus continued the process of perfecting patent rights on certain technologies incorporated within the JEDEC SDRAM standards. By the late 1990s, Rambus had succeeded in obtaining numerous patents, not expressly limited to a narrow-bus RDRAM architecture, that purported to cover, among other technologies encompassed by the JEDEC standards, programmable CAS latency, programmable burst length, on-chip DLL, and dual-edge clock.

92. In late 1999, Rambus began contacting all major DRAM and chipset manufacturers worldwide asserting that, by virtue of their manufacture, sale, or use of JEDEC-compliant SDRAM, they were infringing upon Rambus's patent rights, and inviting them to contact Rambus for the purpose of promptly resolving the issue.

93. Thereafter, Rambus entered into license agreements with seven major DRAM manufacturers: Matsushita Electric Industrial Co., Ltd.; Elpida Memory, Inc.; Samsung Electronics Co.; NEC Corporation; Toshiba America Inc.; Oki Electric Industry Co.; and Mitsubishi Electronics America Inc. Pursuant to these licenses, Rambus allowed each company to use those aspects of its technology necessary for the design and manufacture of JEDEC-compliant SDRAM. In exchange, each company agreed to pay Rambus ongoing royalties reflecting 0.75% of revenues associated with the manufacture and sale of SDRAMs and 3.5% of revenues associated with the manufacture and sale of DDR SDRAMs. By comparison, Rambus typically licenses all the information needed to develop Rambus-compatible RDRAM memory at royalty rates ranging up to a maximum of approximately 2.5% of revenues.

94. After disclosing its patents, Rambus stated publicly that it would demand even higher royalties from any DRAM manufacturer that refused to license the Rambus patents and instead chose to litigate. Rambus also publicly threatened that it might simply refuse to license its patents to any DRAM manufacturer that was unsuccessful in litigation.

95. In January 2000, Rambus filed the first in a series of patent infringement suits. That suit, which was filed in federal district court in Delaware and named only one defendant – Hitachi – was subsequently settled, conditioned upon Hitachi's agreement to submit to Rambus's license terms.

96. With the signing of the Hitachi license, combined with the seven additional licenses discussed above, Rambus had succeeded in obtaining licenses covering roughly 50% of total worldwide production of synchronous DRAM technology. At current market prices for SDRAM, such licenses entitle Rambus to royalties in the range of $50-100 million per year, a number that could increase significantly in the event Rambus were to prevail in the ongoing litigation and secure licenses from the remaining manufacturers of SDRAMs. Indeed, under such circumstances, Rambus's SDRAM-related patent rights could allow Rambus to extract royalty payments well in excess of a billion dollars from the DRAM industry over the life of the patents.

97. In August 2000, Rambus filed suit against another DRAM manufacturer – Infineon – in federal district court in Virginia, accusing Infineon of patent infringement. Infineon later asserted various affirmative defenses and counterclaims. In April 2001, the case proceeded to trial, resulting in a jury finding of fraud against Rambus relating to its involvement in the standard-setting activities of JC-42.3 and a legal ruling that Rambus's patents were not infringed by Infineon's use of the SDRAM standards. These and other legal issues are currently pending on appeal before the U.S. Court of Appeals for the Federal Circuit, which heard oral argument June 3, 2002. (Infineon's antitrust claim against Rambus was dismissed due to a technical failure of proof concerning the relevant geographic market. This ruling has not been appealed.)

98. Also in August 2000, Rambus itself was sued, in federal district court in California, by another DRAM manufacturer – Hynix – seeking a declaratory judgment that its manufacture and sale of JEDEC-compliant SDRAM did not infringe Rambus's patents. In addition to seeking declaratory relief, Hynix accuses Rambus of, among other things, antitrust violations, unfair competition, and breach of contract. Meanwhile, Rambus counterclaimed, alleging patent infringement, and the suit was subsequently stayed pending a ruling by the Federal Circuit in the *Infineon* litigation.

99. In a second suit filed against Rambus in August 2000, in federal district court in Delaware, another major DRAM manufacturer – Micron – seeks a declaratory judgment that its manufacture and sale of JEDEC-compliant SDRAM does not infringe Rambus's patents. In addition to seeking declaratory relief, Micron accuses Rambus of monopolization, attempted monopolization, fraud, and inequitable conduct. As in the *Hynix* suit, Rambus has asserted counterclaims against Micron, accusing it of patent infringement, and the suit has been stayed, at least for purposes other than discovery, pending resolution of the *Infineon* appeal.

100. In the *Infineon*, *Hynix*, and *Micron* lawsuits combined, Rambus has asserted that a dozen or more of its patents have been infringed through the production and sale of JEDEC-compliant SDRAM by these three companies. Each of the patents upon which Rambus has sued stems from, and claims priority back to, Rambus's '898 application.

101. Upon information and belief, Rambus also possesses additional patents and patent applications, some claiming priority back to the '898 application, that it has not yet sought, but could in the future seek, to enforce against memory manufacturers producing JEDEC-compliant SDRAM, absent issuance of the relief requested below.

102. In addition to the foregoing, Rambus is involved in other litigation in various foreign countries relating to foreign patents that cover, or purport to cover, many of the same DRAM-related technologies that are at issue in the U.S. litigation.

103. Notably, while Rambus has licenses covering roughly 50% of the synchronous DRAM industry, Rambus asserts in litigation that all or virtually all synchronous DRAM produced worldwide incorporates Rambus technology and that those synchronous DRAM manufacturers that are not paying royalties to Rambus are liable in damages. In addition to facing the threat of potential damages, those companies that have chosen to litigate against Rambus have been forced to incur substantial litigation costs, reaching into the millions, if not tens of millions, of dollars. Unless they prevail against Rambus in litigation, such companies also face the prospect of being denied licenses to Rambus's patents, or otherwise being required to pay royalties significantly in excess of the amounts paid by the memory manufacturers that acquiesced to Rambus's licensing demands without resort to litigation.

104. Rambus also has licensed companies, such as Intel, that do not produce memory chips but do produce related computer components – in Intel's case, chipsets – that are designed to be compatible with synchronous DRAMs.

<u>Inability of DRAM Industry to Work Around Rambus's Patents</u>

105. Given the extensive degree to which the DRAM industry has become locked in to the JEDEC SDRAM standards, it is not economically feasible for the industry to attempt to alter or work around the JEDEC standards in order to avoid payment of royalties to Rambus. Any such effort would face innumerable practical and economic impediments, including but not limited to the out-of-pocket costs associated with redesigning, validating, and qualifying SDRAM products to conform with a revised set of standards. On top of this, such manufacturers could be forced to absorb potentially massive revenue losses if, as a result of modifying the JEDEC standards, their introduction of new products were delayed.

106. Agreeing upon revised SDRAM standards could in itself be a very costly and time-consuming process. Indeed, it is unclear whether the industry would be able to reach any such consensus, given complications inherent in the current market environment, including the fact that some DRAM manufacturers have acquiesced to Rambus's licensing demands while others have not.

107. Added to these complications is the fact that purchasers and other users of JEDEC-compliant SDRAM technology – including manufacturers of computers, chipsets, graphics cards, and motherboards – have themselves become locked in to the JEDEC standards. For this and other reasons, even if the DRAM industry were otherwise able to undertake the complicated and costly task of revising the JEDEC standards to work around Rambus's patent claims, it is unclear whether downstream purchasers of synchronous DRAM would welcome or accept such an action, given the costs that they would be forced to incur in order to conform their own product designs and manufacturing processes to a revised set of standards. Nor is it clear whether downstream purchasers and other users of SDRAM technology would tolerate the delay in the introduction of new products that likely would result from the process of changing the standard.

108. Any effort to revise the JEDEC standards on a going-forward basis could also interfere with the ability of DRAM designers, manufacturers, and users to maintain the backwards compatibility among successive generations of synchronous DRAM that JEDEC has sought to preserve.

109. For these and other reasons, the DRAM industry has had little or no practical ability to work around Rambus's patent claims, and it is not at all clear the industry could do so in the future.

Relevant Product Markets

110. Synchronous DRAM is produced throughout the world by various memory manufacturers located or doing business in the U.S. and various foreign countries. Synchronous DRAMs, and products incorporating synchronous DRAMs, are imported and exported throughout the world in large volumes.

111. Commercial DRAM chip manufacturers wishing to design and produce synchronous DRAM chips, wherever they may be located throughout the world, are practically limited to using one of two alternative architectures: the JEDEC-compliant SDRAM architecture or Rambus's own proprietary RDRAM architecture, itself a synchronous DRAM technology. No other synchronous DRAM architectures have been developed and made available for wide-spread commercial use.

112. The RDRAM and JEDEC-compliant SDRAM architectures, in turn, each consist of a variety of subsidiary technologies – or technological features – that are necessary in order successfully to design and manufacture a synchronous DRAM chip. These subsidiary technologies may be regarded as essential technology inputs into the design and manufacture of synchronous DRAMs.

113. As in other aspects of engineering, electrical engineers involved in the design of synchronous DRAM chips select from among alternative technological features, concepts, or approaches in

order to address or solve issues, or problems, that arise in the course of developing such chips. The alternative technologies available to address a given technical issue arising in the course of synchronous DRAM design together may comprise a separate, well-defined product market. At least four such markets are relevant for purposes of the instant complaint, including the following:

a. The market for technologies used to specify the length of time – or "latency" period – between the memory's receipt of a read request and its release of data corresponding with the request (hereinafter, the "latency technology market"). This market includes programmable CAS latency and any alternative technologies that may be economically viable substitutes for the use of programmable CAS latency in synchronous DRAM design.

b. The market for technologies used to specify the number of times information (data) is transmitted between the CPU and memory – *i.e.*, the "burst length" – associated with a single request or instruction (hereinafter, the "burst length technology market"). This market includes programmable burst length and any alternative technologies that may be economically viable substitutes for the use of programmable burst length in synchronous DRAM design.

c. The market for technologies used to synchronize the internal clock that governs operations within a memory chip and the system clock that regulates the timing of other system functions (hereinafter, the "clock synchronization technology market"). This market includes on-chip DLL technology and any alternative technologies that may be economically viable substitutes for the use of an on-chip DLL in synchronous DRAM design.

d. The market for technologies used to accelerate the rate at which data are transmitted between the CPU and memory (hereinafter, the "data acceleration technology market"). This market includes dual-edge clock technology and any alternative technologies that may be economically viable substitutes for the use of a dual-edge clock in synchronous DRAM design.

114. Technologies used in the design of synchronous DRAM chips, to solve separate but related design issues, may be viewed as economic complements. The complementary nature of such design technologies is evidenced by, among other things, the fact that they sometimes are licensed together in a package, as is the case with respect to the patented Rambus technologies encompassed by each of the aforementioned product markets. Where such close relationships exist among a group of technologies, all of which are necessary inputs into the design or manufacture of a common downstream product, one may appropriately define a product

market encompassing the group of complementary technologies and their close substitutes. Thus, in addition, or in the alternative, to the four product markets identified above, there is a fifth well-defined product market that is relevant for purposes of this complaint – namely, a market comprising, collectively, all technologies falling within any one of these narrower markets (hereinafter, the "synchronous DRAM technology market").

Geographic Scope of Relevant Product Markets

115. Technologies encompassed within each of the foregoing product markets are used on a worldwide basis. Technologies originating outside the United States frequently are considered for and used in JEDEC standards, and indeed have been used in both the first- and second-generation SDRAM standards promulgated by JEDEC. The technologies selected for inclusion in these JEDEC standards, in turn, have been incorporated and used by synchronous DRAM manufacturers throughout the world.

116. Both proprietary and non-proprietary technologies have been used in synchronous DRAM design. To the extent such technologies are non-proprietary, they are free to be used, on a non-royalty-incurring basis, by any synchronous DRAM manufacturer or downstream user worldwide. On the other hand, to the extent such technologies are proprietary, inasmuch as they are subject to patents or potential patent claims in one or more jurisdictions, the use of such technologies by synchronous DRAM manufacturers or downstream users may depend upon the user's agreement to specific license terms negotiated with the patent holder. In the event that patent rights are similar in most relevant jurisdictions, however, there is no apparent legal or economic impediment that would preclude licenses from being made available on a multi-national or worldwide basis. Indeed, Rambus, which holds synchronous DRAM-related patents issued in the United States and numerous foreign countries, commonly grants licenses to companies in the U.S. and abroad encompassing rights to use Rambus's patented technologies worldwide.

117. For these and other reasons, each of the technology-related product markets identified above is worldwide in scope.

118. Alternatively, or in addition, the geographic scope of such product markets might appropriately be defined as the United States if, for example, Rambus's U.S. patent rights differed significantly from rights recognized in various foreign jurisdictions, or if Rambus otherwise had the ability to vary royalty rates from one jurisdiction to another.

Anticompetitive Effects of Rambus's Conduct

119. The foregoing conduct by Rambus, during and after its involvement in JEDEC's JC-42.3 Subcommittee, has materially caused or threatened to cause substantial harm to competition and will, in the future, materially cause or threaten to cause further substantial injury to competition and consumers, absent the issuance of appropriate relief in the manner set forth below.

120. The threatened or actual anticompetitive effects of Rambus's conduct include but are not limited to the following:

a. increased royalties (or other payments) associated with the manufacture, sale, or use of synchronous DRAM technology;

b. increases in the price, and/or reductions in the use or output, of synchronous DRAM chips, as well as products incorporating or using synchronous DRAMs or related technology;

c. decreased incentives, on the part of memory manufacturers, to produce memory using synchronous DRAM technology;

d. decreased incentives, on the part of DRAM manufacturers and others, to participate in JEDEC or other industry standard-setting organizations or activities; and

e. both within and outside the DRAM industry, decreased reliance, or willingness to rely, on standards established by industry standard-setting collaborations.

Rambus's Knowing Destruction of Documents

121. Rambus has engaged in a systematic effort – blessed if not orchestrated by its most senior executives – to destroy documents and other information. Upon information and belief, among other pertinent files destroyed as a result of this campaign were notes and other documentation relating to, among other things, Rambus's involvement in the JC-42.3 Subcommittee. Upon information and belief, this document-destruction campaign was undertaken, wholly or in substantial part, with the purpose of avoiding or minimizing the adverse legal repercussions of the anticompetitive conduct described in the instant complaint. Partly as a consequence of these document-destruction activities, in combination with other bad-faith litigation conduct, Rambus was required by the federal district court presiding over the *Infineon* litigation to pay a sanction exceeding $7 million.

First Violation Alleged

122. As described in Paragraphs 1-121 above, which are incorporated herein by reference, Rambus has willfully engaged in a pattern of anticompetitive and exclusionary acts and practices, undertaken over the course of the past decade, and continuing even today, whereby it has obtained monopoly power in the synchronous DRAM technology market and narrower markets encompassed therein – namely, the latency, burst length, clock synchronization, and data acceleration markets discussed above – which acts and practices constitute unfair methods of competition in violation of Section 5 of the FTC Act.

Second Violation Alleged

123. As described in Paragraphs 1-121 above, which are incorporated herein by reference, Rambus has willfully engaged in a pattern of anticompetitive and exclusionary acts and practices, undertaken over the course of the past decade, and continuing even today, with a specific intent to monopolize the synchronous DRAM technology market and narrower markets encompassed therein, resulting, at a minimum, in a dangerous probability of monopolization in each of the aforementioned markets, which acts and practices constitute unfair methods of competition in violation of Section 5 of the FTC Act.

Third Violation Alleged

124. As described in Paragraphs 1-121 above, which are incorporated herein by reference, Rambus has willfully engaged in a pattern of anticompetitive and exclusionary acts and practices, undertaken over the course of the past decade, and continuing even today, whereby it has unreasonably restrained trade in the synchronous DRAM technology market and narrower markets encompassed therein, which acts and practices constitute unfair methods of competition in violation of Section 5 of the FTC Act.

Notice

Notice is hereby given to the Respondent that the eighteenth day of September, 2002, at 10:00 a.m., or such later date as determined by an Administrative Law Judge of the Federal Trade Commission, is hereby fixed as the time and Federal Trade Commission offices, 600 Pennsylvania Avenue, N.W., Room 532, Washington, D.C. 20580, as the place when and where a hearing will be had before an Administrative Law Judge of the Federal Trade Commission, on the charges set forth in this complaint, at which time and place you will have the right under the FTC Act to appear and show cause why an order should not be entered requiring you to cease and desist from the violations of law charged in the complaint.

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

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

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

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

Notice of Contemplated Relief

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

1. Requiring Respondent to cease and desist all efforts it has undertaken by any means, including without limitation the threat, prosecution, or defense of any suits or other actions, whether legal, equitable, or administrative, as well as any arbitration, mediation, or any other form of private dispute resolution, through or in which Respondent has asserted that any person or entity, by manufacturing, selling, or otherwise using JEDEC-compliant SDRAM and DDR SDRAM technology (including future variations of JEDEC-compliant SDRAM and DDR SDRAM technology), infringes any of Respondent's current or future United States patents that claim priority back to U.S. Patent Application Number 07/510,898 filed on April 18, 1990 or any other U.S. Patent Application filed before June 17, 1996.

2. Requiring Respondent not to undertake any new efforts by any means, including without limitation the threat, prosecution, or defense of any suits or other actions, whether legal, equitable, or administrative, as well as any arbitration, mediation, or any other form of private dispute resolution, through or in which Respondent has asserted that any person or entity, by manufacturing, selling, or otherwise using JEDEC-compliant SDRAM and DDR SDRAM technology (including future variations of JEDEC-compliant SDRAM and DDR SDRAM technology), infringes any of Respondent's current or future United States patents that claim priority back to U.S. Patent Application Number 07/510,898 filed on April 18, 1990 or any other U.S. Patent Application filed before June 17, 1996.

3. Requiring Respondent to cease and desist all efforts it has undertaken by any means, including without limitation the threat, prosecution, or defense of any suits or other actions, whether legal, equitable, or administrative, as well as any arbitration, mediation, or any other form of private dispute resolution, through or in which Respondent has asserted that any person or entity, by manufacturing, selling, or otherwise using JEDEC-compliant SDRAM and DDR SDRAM technology (including future variations of JEDEC-compliant SDRAM and DDR SDRAM technology), for import or export to or from the United States, infringes any of Respondent's foreign patents, current or future, that claim priority back to U.S. Patent Application Number 07/510,898 filed on April 18, 1990 or any other Patent Application filed before June 17, 1996.

4. Requiring Respondent not to undertake any new efforts by any means, including without limitation the threat, prosecution, or defense of any suits or other actions, whether legal,

equitable, or administrative, as well as any arbitration, mediation, or any other form of private dispute resolution, through or in which Respondent has asserted that any person or entity, by manufacturing, selling, or using JEDEC-compliant SDRAM and DDR SDRAM technology (including future variations of JEDEC-compliant SDRAM and DDR SDRAM technology), for import or export to or from the United States, infringes any of Respondent's foreign patents, current or future, that claim priority back to U.S. Patent Application Number 07/510,898 filed on April 18, 1990 or any other Patent Application filed before June 17, 1996.

5. Requiring Respondent to employ, at Respondent's cost, a Commission-approved compliance officer who will be the sole representative of Respondent for the purpose of communicating Respondent's patent rights related to any standard under consideration by any standard-setting organization of which Respondent is a member.

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

WHEREFORE, THE PREMISES CONSIDERED, the Federal Trade Commission on this eighteenth day of June, 2002, issues its complaint against said Respondent.

By the Commission.

Donald S. Clark
Secretary

EXHIBIT 2

INITIAL DECISION: 11/25/03

(PUBLIC)

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
OFFICE OF ADMINISTRATIVE LAW JUDGES

DOCKET NO. 9305

In the Matter of

UNION OIL COMPANY OF CALIFORNIA,
Respondent.

INITIAL DECISION

D. Michael Chappell
Administrative Law Judge

Date: November 25, 2003

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I. INTRODUCTION

A. Procedural Background

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

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

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

B. Summary of Decision

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

Association ("WSPA"), independent of the conduct directed toward the California Air Resources Board ("CARB").

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

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

II. POSITIONS OF THE PARTIES

A. Summary of the Allegations of the Complaint and Answer

1. Complaint

According to the Complaint, in the 1980s, the California Air Resources Board ("CARB") initiated rulemaking proceedings to determine "cost-effective" regulations and standards governing the composition of low emissions, reformulated gasoline ("RFG"). Complaint at ¶ 1. The Complaint alleges that, through misrepresentations and omissions, Respondent influenced the outcome of CARB's Phase 2 reformulated gasoline rulemaking. Complaint at ¶¶ 35, 37, 39, 41, 42, 46, 48. On November 22, 1991, CARB adopted Phase 2 RFG regulations that set particular standards for the composition of low emissions, reformulated gasoline. Complaint at ¶ 44. CARB's Phase 2 RFG regulations substantially overlap with patents held by Respondent relating to low emissions, reformulated gasoline. Complaint at ¶¶ 15, 32, 45.

In addition, the Complaint alleges that during the CARB RFG rulemaking, Respondent participated in the Auto/Oil Group, a cooperative, joint research program between automobile and oil industries, and in the WSPA, an oil industry trade association. Complaint at ¶¶ 50, 56. The Complaint alleges that Respondent made misrepresentations and material omissions to the Auto/Oil Group and WSPA and that, but for Respondent's fraud, these participants in the rulemaking process would have taken actions including, but not limited to, (a) advocating that CARB adopt regulations that minimized or avoided infringement on Respondent's patent claims; (b) advocating that CARB negotiate license terms substantially different from those that Respondent was later able to obtain; and/or (c) incorporating knowledge of Respondent's pending patent rights in their capital investment and refinery reconfiguration decisions to avoid and/or minimize potential infringement. Complaint at ¶ 90.

The Complaint further alleges that Respondent did not announce the existence of its proprietary interests and patent rights relating to RFG until shortly before CARB's Phase 2 regulations were to go into effect. Complaint at ¶ 6. By that time, the refining industry had spent billions of dollars in capital expenditures to modify their refineries to comply with the CARB Phase 2 regulations. *Id.* After CARB and the refiners had become locked into the Phase 2 regulations, Respondent commenced patent enforcement efforts by publicly announcing its RFG patent rights and its intention to collect royalty payments and fees. *Id.* Since Respondent's public announcement of the issuance of its first RFG patent on January 31, 1995, Respondent has obtained four additional patents and enforced its RFG patent rights through litigation and licensing activities. *Id.*

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

2. Answer

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

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

1. Respondent's arguments in support

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

Respondent also asserts that immunity under the *Noerr-Pennington* doctrine extends to causes of action brought under Section 5 of the FTC Act. Finally, Respondent asserts that the Complaint's allegations that Respondent made misrepresentations to two private bodies, the

Auto/Oil Group and WSPA, do not take Respondent's activities outside of the realm of *Noerr* protected political activities.

2. Complaint Counsel's arguments in opposition

Complaint Counsel argues first that the motion to dismiss is inappropriate because there are factual disputes and because the Complaint "specifically alleges" that *Noerr-Pennington* immunity does not apply here as a "matter of fact." Opposition at 2; Complaint at ¶ 96. Complaint Counsel next argues that Respondent's fraudulent statements were made to an agency acting in a quasi-adjudicative manner and that misrepresentations are not immunized when made in an adjudicatory setting or where the agency is dependent upon the petitioner for information. Complaint Counsel further asserts that *Noerr-Pennington* immunity does not extend to situations where the government agency is unaware that it is being asked to adopt or participate in a restraint of trade.

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

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

1. Respondent's arguments in support

Respondent's motion to dismiss based on failure to make sufficient allegations that Respondent possesses or dangerously threatens to possess monopoly power raises several issues. However, the only issues raised by Respondent in that motion that are decided herein are as follows: whether the allegations of the Complaint arise under patent law; and whether the FTC has jurisdiction to decide the substantial questions of patent law alleged in the Complaint. The remaining issues are not reached because the determination on the *Noerr-Pennington* motion and the determination of the jurisdictional argument make any analysis of the remaining issues raised in the Market Power Motion unnecessary.

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

2. Complaint Counsel's arguments in opposition

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

III. EVIDENTIARY STANDARDS

A. Motion to Dismiss Standard

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

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

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

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

The standard used in Commission proceedings mirrors the standard used for evaluating motions to dismiss raised in federal district courts under Rule 12(b)(6) of the Federal Rules of Civil Procedure. The Supreme Court has held that it "is axiomatic that a complaint should not be dismissed unless 'it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.'" *McClain v. Real Estate Bd. of New Orleans, Inc.*, 444 U.S. 232, 246 (1980) (quoting *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)). Moreover, it is well established that, in ruling on a motion to dismiss, allegations in the complaint must be accepted as true and construed favorably to the plaintiff. *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974). "[I]n antitrust cases, where 'the proof is largely in the hands of the alleged conspirators,' dismissals prior to giving the plaintiff ample opportunity for discovery should be granted very sparingly." *Hospital Building Co. v. Trustees of Rex Hosp.*, 425 U.S. 738, 746 (1976) (quoting *Poller v. Columbia Broad.*, 368 U.S. 464, 473 (1962)).

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

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

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

In ruling on a motion to dismiss, it is appropriate to consider the allegations of the complaint, as well as documents attached to or specifically referenced in the complaint, and matters of public record. *Hoffman-LaRouche Inc. v. GenPharm, Inc.*, 50 F. Supp. 2d 367, 377 (D.N.J. 1999) (citing *Pittsburgh v. West Penn Power Co.*, 147 F.3d 256, 259 (3d Cir. 1998); 5A Charles A. Wright & Arthur R. Miller, Federal Practice & Procedure § 1357 at 299 (2d ed. 1990)). The Complaint specifically references California Health and Safety Code § 43018 and California's Administrative Procedure Act. Complaint at ¶¶ 17, 18, 21, and 26. As set forth below, it is also appropriate to take official notice of the statutes governing CARB, the Notice of Public Hearing through which CARB initiated the rulemaking, and the Final Statement of Reasons for Rulemaking, all of which are beyond dispute.

The Commission's Rules of Practice authorize the use of official notice. 16 C.F.R. § 3.43(d) ("when any decision of an Administrative Law Judge or of the Commission rests, in whole or in part, upon the taking of official notice of a material fact not appearing in evidence of record, opportunity to disprove such noticed fact shall be granted any party making timely motion therefor"). Because the Commission Rule does not define official notice, it is appropriate to look to Federal Rule of Evidence ("F. R. Evid.") 201(b). "A judicially noticed fact must be one not subject to reasonable dispute in that it is either (1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned." F. R. Evid. 201(b).

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

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

Respondent, in its motion, specifically cited to the California Clean Air Act (Cal. Health & Safety Code § 39601) and Chapter 3.5 (commencing with Section 11340) of the Government Code, and cited to and attached the Notice of Public Hearing through which CARB initiated the rulemaking and the Final Statement of Reasons for Rulemaking. Motion at 11-12, 23 n.7, and Appendices B and D. Complaint Counsel had an opportunity to disprove these statutes and agency materials of which official notice is taken not only through the filing of its Opposition, but was also provided an additional opportunity when directed to submit additional briefing by Order dated August 25, 2003. These statutes and public documents were relied upon by Respondent and their veracity and accuracy were not disputed by Complaint Counsel.

D. Motions To Dismiss Involving *Noerr-Pennington*

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

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

E. Burden of Proof

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

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

IV. STATEMENT OF FINDINGS

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

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

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

A. Facts As Alleged in the Complaint

1. Respondent

1. Union Oil Company of California is a public corporation organized, existing, and doing business under, and by virtue of, the laws of California. Its office and principal place of business is located at 2141 Rosecrans Avenue, Suite 4000, El Segundo, California 90245. Since 1985, Union Oil Company of California has done business under the name "Unocal." Unocal is a wholly-owned, operating subsidiary of Unocal Corporation, a holding company incorporated in Delaware. Complaint at ¶ 11.

2. Unocal is, and at all relevant times has been, a corporation as "corporation" is defined by Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44; and at all times relevant herein, Unocal has been, and is now, engaged in commerce as "commerce" is defined in the same provision. Complaint at ¶ 12.

3. Prior to 1997, Unocal owned and operated refineries in California as a vertically integrated producer, refiner, and marketer of petroleum products. In March 1997, Unocal completed the sale of its west coast refining, marketing, and transportation assets to Tosco Corporation. Currently, Unocal's primary business activities involve oil and gas exploration and production, as well as production of geothermal energy, ownership in proprietary and common carrier pipelines, natural gas storage facilities, and the marketing and trading of hydrocarbon commodities. Complaint at ¶ 13.

4. In its annual report for the year 2001 filed with the United States Securities and Exchange Commission, Form 10-K, Unocal lists as another of its key business activities: "[p]ursuing and negotiating licensing agreements for reformulated gasoline patents with refiners, blenders and importers." Unocal has publicly announced that it expects to earn up to $150 million in revenues a year from licensing its RFG patents. Complaint at ¶ 14.

2. Respondent's patents

5. Unocal is the owner, by assignment, of the following patents relating to low emissions, reformulated gasoline: United States Patent No. 5,288,393 (issued February 22, 1994); United States Patent No. 5,593,567 (issued January 14, 1997); United States Patent No. 5,653,866 (issued August 5, 1997); United States Patent No. 5,837,126 (issued November 17, 1998); and United States Patent No. 6,030,521 (issued February 29, 2000). Complaint at ¶ 15.

6. On May 13, 1990, Unocal scientists presented the preliminary research results of their emissions research program to the highest levels of Unocal's management to obtain approval and funding for additional, confirmatory research. Unocal's management approved funding for additional emissions testing, and this project became known as the "5/14 Project." Complaint at ¶ 29.

7. Unocal's management approved the filing of a patent application covering the invention and discovery that sprang from the 5/14 Project. Specifically, the Unocal scientists' novel discovery of the directional relationships between eight fuel properties – RVP, T10, T50, T90, olefin content, aromatic content, paraffin content, and octane – and three types of tailpipe emissions – *i.e.*, incompletely burned or unburned hydrocarbons, carbon monoxide, and nitrogen oxides. Complaint at ¶ 30.

8. On December 13, 1990, Unocal filed with the United States Patent and Trademark Office a patent application, No. 07/628,488. This application presented Unocal's emissions research results, including the regression equations and underlying data; detailed the directional relationships between the fuel properties and emissions studied in Unocal's 5/14 Project; and set forth composition and method claims relating to low emissions, reformulated gasoline. Complaint at ¶ 32.

3. California Air Resources Board ("CARB")

9. The California Air Resources Board ("CARB") is a department of the California Environmental Protection Agency. Established in 1967, CARB's mission is to protect the health, welfare, and ecological resources of California through the effective and efficient reduction of air pollutants, while recognizing and considering the effects of its actions on the California economy. CARB fulfills the mandate by, among other things, setting and enforcing standards for low emissions, reformulated gasoline. Complaint at ¶ 16.

4. Reformulated gasoline in California

10. CARB initiated rulemaking proceedings in the late 1980s to determine "cost-effective" regulations and standards governing the composition of low emissions, reformulated gasoline. Unocal actively participated in the CARB RFG rulemaking proceedings. Complaint at ¶ 1.

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

12. Based in substantial part on the representations of oil industry executives that the oil industry could, and would develop gasoline that would be cleaner-burning and cheaper than methanol, the AB 234 study panel recommended exploring reformulated gasoline as an alternative to methanol. Complaint at ¶ 20.

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

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

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

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

Complaint at ¶ 21.

14. Following the 1998 California Clean Air Act amendments, CARB embarked on two rulemaking proceedings relating to low emissions, reformulated gasoline. In these rulemaking proceedings – Phase 1 and Phase 2 – CARB prescribed limits on specific gasoline properties. Complaint at ¶ 22.

15. CARB's Phase 2 RFG proceedings represented an effort by CARB to develop stringent standards for low emissions, reformulated gasoline. Participants to the Phase 2 RFG proceedings understood that the CARB Phase 2 RFG regulations would require refiners to make substantial capital investments to reconfigure their refineries to produce compliant gasoline. Complaint at ¶ 24.

16. In its Phase 2 RFG proceedings, CARB did not conduct any independent studies of its own, but relied on the industry to provide research and information. Complaint at ¶ 25.

17. In the course of CARB's Phase 2 RFG proceedings, CARB adhered to the procedures set forth in the California Administrative Procedure Act. CARB provided notice of proposed regulations; provided the language of these proposed regulations and a statement of reasons; solicited and accepted written comments from the public; and conducted lengthy hearings at which oral testimony was received. CARB also issued written findings on the results of its rulemaking proceedings. Following adoption of the regulations, several parties sought judicial review of the CARB Phase 2 RFG regulations that provided small refiners with a two-year exemption for compliance with the regulations. Complaint at ¶ 26.

5. Unocal's conduct before CARB

18. Prior to and after the filing of the patent application on December 13, 1990, Unocal employees and management discussed and considered the potential competitive advantage and corporate profit that could be gained through effectuating an overlap between the CARB regulations and Unocal's patent claims. Complaint at ¶ 33.

19. During the same time that Unocal participated in the CARB RFG rulemaking proceedings, specific discussions took place within the company concerning how to induce the regulators to use information supplied by Unocal so that Unocal could realize the licensing income potential of its pending patent claims. Complaint at ¶ 34.

20. Beginning in 1990, and continuing throughout the CARB Phase 2 RFG rulemaking process, Unocal provided information to CARB for the purpose of obtaining competitive advantage. Unocal gave CARB this information in private meetings with CARB, through participation in CARB's public workshops and hearings, as well as by participating in industry groups that also were providing input into the CARB regulations. Unocal suppressed facts relating to its proprietary interests in its emissions research results. Complaint at ¶ 35.

21. On June 11, 1991, CARB held a public workshop regarding the Phase 2 RFG regulations. This workshop included discussions of CARB staff's proposed gasoline specifications – *i.e.*, the levels at which certain gasoline properties should be set – to reduce the emissions from gasoline-fueled vehicles. The set of specifications proposed by CARB for discussion at this workshop did not include a T50 specification. Complaint at ¶ 36.

22. On June 20, 1991, Unocal presented to CARB staff the results of its 5/14 Project to show CARB that "cost-effective" regulations could be achieved through adoption of a "predictive model" and to convince CARB of the importance of T50. Unocal's pending patent application contained numerous claims that included T50 as a critical limitation, in addition to other fuel properties that CARB proposed to regulate. Complaint at ¶ 37.

23. Prior to the presentation to CARB, Unocal's management decided not to disclose Unocal's pending '393 patent application to CARB staff. Complaint at ¶ 38.

24. On July 1, 1991, Unocal provided CARB with the actual emissions prediction equations developed in the 5/14 Project. Unocal requested that CARB "hold these equations confidential, as we feel that they may present a competitive advantage in the production of gasoline." But Unocal went on to state: "If CARB pursues a meaningful dialogue on a predictive model approach to Phase 2 gasoline, Unocal will consider making the equations and underlying data public as required to assist in the development of a predictive model." Complaint at ¶ 39.

25. Following CARB's agreement to develop a predictive model, Unocal made its emissions results, including the test data and equations underlying its 5/14 Project, publicly available. Complaint at ¶ 40.

26. On August 27, 1991, Unocal stated in a letter to CARB that its emissions research data were "nonproprietary." Specifically, Unocal stated: "Please be advised that Unocal now considers this data to be nonproprietary and available to CARB, environmental interests, groups, other members of the petroleum industry, and the general public upon request." Complaint at ¶ 41.

27. At the time Unocal submitted its August 27, 1991 letter to CARB, it did not disclose to CARB its proprietary interests in the 5/14 Project data and equations, its prosecution of a patent application, or its intent to enforce its proprietary interests to obtain licensing income. Complaint at ¶ 42.

28. CARB used Unocal's equations in setting a T50 specification. Subsequently, in October 1991, CARB published Unocal's equations in public documents supporting the proposed Phase 2 RFG regulations. Complaint at ¶ 43.

29. On November 22, 1991, the CARB Board adopted Phase 2 RFG regulations that set particular standards for the composition of low emissions, reformulated gasoline. These

regulations specified limits for eight gasoline properties: RVP, benzene, sulfur, aromatics, olefins, oxygen, T50, and T90. Unocal's pending patent claims recited limits for five of the eight properties specified by the regulations: T50, T90, olefins, aromatics, and RVP. Complaint at ¶ 44.

30. The Phase 2 RFG regulations substantially overlapped with Unocal's patent claims. For example, CARB included a specification for T50 in its Phase 2 RFG regulations and eventually adopted a "predictive model" that included T50 as one of the parameters. Complaint at ¶ 45.

31. Although Unocal knew by July 1992 that most of the pending patent claims based on its emissions research had been allowed by the United States Patent and Trademark Office, Unocal did not disclose this material information to CARB and other participants in the CARB RFG proceedings. Complaint at ¶ 4.

32. Prior to the final approval of the CARB Phase 2 RFG regulations in November 1992, Unocal submitted comments and presented testimony to CARB opposing CARB's proposal to grant small refiners a two-year exemption for complying with the regulations. Unocal opposed this proposed exemption on the grounds that it would increase the costs of compliance and undermine the cost-effectiveness of the CARB Phase 2 RFG regulations. In making these statements, Unocal did not disclose that it had proprietary rights that would materially increase the cost and reduce the cost-effectiveness and flexibility of the regulations that CARB had adopted. Complaint at ¶ 46.

33. CARB amended the Phase 2 regulations in June 1994 to include a predictive model as an alternative method of complying with the regulations that was intended to provide refiners with additional flexibility. At the urging of numerous companies, including Unocal, this "predictive model" permits a refiner to comply with the RFG regulations by producing fuel that is predicted – based on its composition and the levels of the eight properties – to have equivalent emissions to a fuel that meets the strict gasoline property limits set forth in the regulations. Complaint at ¶ 47.

34. During the development of the predictive model, Unocal continued to meet with CARB, providing testimony and information. Unocal submitted comments to CARB touting the predictive model as offering "flexibility" and furthering CARB's mandate of "cost-effective" regulations. Complaint at ¶ 48.

35. Unocal made statements and comments to CARB relating to the "cost effectiveness" of CARB Phase 2 regulations, and the "flexibility" offered by the implementation of a predictive model to reduce refiner compliance costs. These statements and comments include, but are not limited to, both written and/or oral statements made to CARB on the following dates: October 29, 1991, November 21, 1991, November 22, 1991, March 16, 1992, June 19, 1992, August 14, 1992, September 4, 1992, June 3, 1994 and June 9, 1994. Complaint at ¶ 78.

36. Throughout its communications and interactions with CARB prior to January 31, 1995, Unocal did not disclose that it had pending patent rights, that its patent claims overlapped with the proposed RFG regulations, and that Unocal intended to charge royalties. Complaint at ¶ 79.

37. On February 22, 1994, the United States Patent Office issued the '393 patent. CARB first became aware of Unocal's '393 patent shortly after Unocal's issuance of a press release on January 31, 1995. Complaint at ¶ 49.

6. Unocal's participation in industry groups

38. During the CARB RFG rulemaking, Unocal actively participated in the Auto/Oil Air Quality Improvement Research Program ("Auto/Oil Group"), a cooperative, joint research program between the automobile and oil industries. By agreement dated October 14, 1989, the big three domestic automobile manufacturers – General Motors, Ford, and Chrysler – and representatives from fourteen oil companies, including Unocal, entered into a joint research agreement in accordance with the National Cooperative Research Act of 1984 ("Auto/Oil Agreement"). Complaint at ¶ 50.

39. The stated objective of the Auto/Oil joint research venture was to plan and carry out research and tests designed to measure and evaluate automobile emissions and the potential improvements in air quality achievable through the use of reformulated gasolines, methanol, and other alternative fuels, and to evaluate the relative cost-effectiveness of these various improvements. Complaint at ¶ 51.

40. The Auto/Oil Agreement provided that "[t]he results of research and testing of the Program will be disclosed to government agencies, the Congress and the public, and otherwise placed in the public domain." This agreement specifically provided for the following dedication of any and all intellectual property rights to the public: "No proprietary rights will be sought nor patent applications prosecuted on the basis of the work of the Program unless required for the purpose of ensuring that the results of the research by the Program will be freely available, without royalty, in the public domain." Complaint at ¶ 52.

41. While the Auto/Oil Agreement permitted participating companies to conduct independent research, and further permitted them to withhold the fruits of such independent research from the Auto/Oil Group, once data and information were in fact presented to the Auto/Oil Group, they became the "work of the Program." Complaint at ¶ 53.

42. On September 26, 1991, Unocal presented to the Auto/Oil Group the results of Unocal's emissions research, including the test data, equations, and corresponding directional relationships between fuel properties and emissions derived from the 5/14 Project. Unocal's management authorized this presentation, which was substantially similar to that made to CARB on June 20, 1991. Unocal informed Auto/Oil participants that the data had been made available

to CARB and were in the public domain. Unocal also represented that the data would be made available to Auto/Oil participants. Complaint at ¶ 55. Unocal failed to disclose Unocal's proprietary interests in its emissions research results and Unocal's intention and efforts to enforce its intellectual property rights. Complaint at ¶ 82.

43. Throughout all of its communications and interactions with the Auto/Oil Group prior to January 31, 1995, Unocal failed to disclose that it had pending patent rights, that its patent claims overlapped with the proposed RFG regulations, and that Unocal intended to charge royalties. Complaint at ¶ 83.

44. During the CARB Phase 2 RFG rulemaking proceedings, Unocal also actively participated in the Western States Petroleum Association ("WSPA"), an oil industry trade association that represents companies accounting for the bulk of petroleum exploration, production, refining, transportation and marketing in the western United States. WSPA, as a group, actively participated in the CARB RFG rulemaking process. WSPA commissioned, and submitted to CARB, three cost studies in connection with the CARB Phase 2 RFG rulemaking. Complaint at ¶ 56.

45. One cost study commissioned by WSPA incorporated information relating to process royalty rates associated with non-Unocal patents and was used by CARB to determine the cost-effectiveness of the proposed CARB Phase 2 RFG standards. This WSPA cost study estimated the costs of the proposed regulations on a cents-per-gallon basis and estimated the incremental costs associated with regulating specific gasoline properties. This WSPA study could have incorporated costs associated with potential royalties flowing from Unocal's pending patent rights. Complaint at ¶ 57.

46. On September 10, 1991, Unocal presented its 5/14 Project emissions research results to WSPA. Unocal's management authorized the presentation of the research results to WSPA. This Unocal presentation created the impression that Unocal's emissions research results, including the data and equations, were nonproprietary and could be used by WSPA or its individual members without concern for the existence or enforcement of any intellectual property rights. Complaint at ¶ 58.

47. Throughout all of its communications and interactions with WSPA prior to January 31, 1995, Unocal failed to disclose that it had pending patent rights, that its patent claims overlapped with the proposed RFG regulations, and that Unocal intended to charge royalties. Complaint at ¶ 88.

48. None of the participants in the WSPA or Auto/Oil Group knew of the existence of Unocal's proprietary interests and/or pending patent rights at any time prior to the issuance of the '393 patent in February 1994, by which time most, if not all, of the oil company participants to these groups had made substantial progress in their capital investment and refinery modifications plans for compliance with the CARB Phase 2 RFG regulations. Complaint at ¶ 59.

7. Unocal's patent prosecution and enforcement

49. Following the November 1991 adoption of CARB Phase 2 RFG specifications, Unocal amended its patent claims in March 1992 so that the patent claims more closely matched the regulations. In some cases, Unocal's patent claims were narrowed to resemble the regulations. Complaint at ¶ 60.

50. On or about July 1, 1992, Unocal received an office action from the U.S. Patent and Trademark Office indicating that most of Unocal's pending patent claims had been allowed. Unocal did not disclose this information to CARB or other participants to the CARB Phase 2 RFG rulemaking. Complaint at ¶ 61.

51. Subsequently, after the submission of additional amendments, Unocal received a notice of allowance from the U.S. Patent and Trademark Office for all of its pending claims in February 1993. Unocal did not disclose this information to CARB or other participants to the CARB Phase 2 RFG rulemaking. Complaint at ¶ 62.

52. In June 1993, Unocal filed a divisional application (No. 08/77,243) of its original patent application that allowed Unocal to pursue additional patents based on the discoveries of the 5/14 Project. Complaint at ¶ 63.

53. The U.S. Patent and Trademark Office issued the '393 patent to Unocal on February 22, 1994. On January 31, 1995, Unocal issued a press release announcing issuance of the '393 patent. The Unocal press release stated that the '393 patent "covers many of the possible fuel compositions that refiners would find practical to manufacture and still comply with the strict California Air Resources Board (CARB) Phase 2 requirements." Complaint at ¶ 64.

54. In March 1995, Unocal met separately with California Governor Pete Wilson and CARB and made assurances that Unocal would not enjoin or otherwise impair the ability of refiners to produce and supply to the California market gasoline that complied with the CARB Phase 2 RFG regulations. In or about the same time period, CARB expressed its own concern to Unocal about the coverage of the patent and even sought and received from Unocal a license to use the '393 patent in making and using test fuels. Complaint at ¶ 65.

55. On March 22, 1995, five days after meeting with CARB staff, Unocal filed a continuation patent application (No. 08/409/074) claiming priority to the original December 1990 application. Unocal did not inform CARB or Governor Wilson that it intended to obtain additional RFG patents. Complaint at ¶ 66.

56. Unocal subsequently filed additional continuation patent applications on June 5, 1995 (No. 08/464,544), August 1, 1997 (No. 08/904,594), and November 13, 1998 (No. 08/191,924),

all claiming priority based on Unocal's original December 13, 1990 patent application. Complaint at ¶ 67.

57. On April 13, 1995, ARCO, Exxon, Mobil, Chevron, Texaco, and Shell filed suit in the United States District Court for the Central District of California seeking to invalidate Unocal's '393 patent. Unocal filed a counterclaim for patent infringement of the '393 patent. The jury in this private litigation determined that Unocal's '393 patent was valid and infringed, and found that the refiners must pay a royalty rate of 5.75 cents per gallon for the period from March through July 1996 for sales of infringing gasoline in California. Complaint at ¶ 68.

58. The United States Court of Appeals for the Federal Circuit subsequently affirmed the trial court's judgment. The United States Supreme Court denied the refiner-defendants' petition for a writ of certiorari. The refiner-defendants have made payments totaling $91 million to Unocal for damages, costs, and attorneys' fees. Complaint at ¶ 69.

59. An accounting action is still ongoing in the United States District Court for the Central District of California to determine damages for infringement of the '393 patent by the refiners for the period from August 1, 1996, through December 31, 2000. The court ruled in August 2002 that the 5.75 cents per gallon royalty fee awarded by the jury would apply to all infringing gasoline produced and/or supplied in California. Complaint at ¶ 70.

60. On January 23, 2002, Unocal sued Valero Energy Company in the Central District of California for willful infringement of both the '393 patent and the '126 patent. In its complaint, Unocal seeks damages at the rate of 5.75 cents per gallon for all infringing gallons, and treble damages for willful infringement. Complaint at ¶ 71.

61. Unocal also has enforced its patent claims through licensing activities. To date, Unocal has entered into license agreements with eight refiners, blenders and/or importers covering the use of all five RFG patents. The terms of these license agreements are confidential. Unocal has announced that these license agreements feature a "uniform" licensing schedule that specifies a range from 1.2 to 3.4 cents per gallon depending on the volume of gasoline falling within the scope of the patents. As a licensee practices under the license more frequently, the licensing fee per gallon is reduced. Complaint at ¶ 72.

62. Refiners in California invested billions of dollars in sunk capital investments without knowledge of Unocal's patent claims to reconfigure their refineries in order to comply with the CARB Phase 2 RFG regulations. These refiners cannot produce significant volumes on non-infringing CARB-compliant gasoline without incurring substantial costs. Complaint at ¶ 93.

63. Were Unocal to receive a 5.75 cents per gallon royalty on all gallons of "summer-time" CARB RFG produced annually for the California market, this would result in an estimated annual cost of more than $500 million (assuming approximately 14.8 billion gallons per year

California consumption, with up to 8 months of CARB summer-time gasoline requirements). Complaint at ¶ 10.

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

1. Notice of Public Hearing

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

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

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

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

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

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

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

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

2. Final Statement of Reasons For Rulemaking

72. The California Air Resources Board issued its Final Statement of Reasons for Rulemaking, Including Summary of Comments and Agency Response relating to the public hearing to consider the adoption and amendments to Phase 2 gasoline specifications held on November 21-22, 1991. ["Final Statement of Reasons for Rulemaking"].

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

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

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

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

77. An attachment to the Final Statement of Reasons for Rulemaking shows that 51 entities, including automobile companies, assemblymen, business associations, chemical companies, environmental associations, forestry associations, labor unions, oil companies, petroleum associations, refiners' associations, and trucking associations, all provided comments to the Board during the formal rulemaking process. Final Statement of Reasons for Rulemaking, pp. A-1 - A-6.

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

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

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

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

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

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

(a) The state board shall adopt standards, rules, and regulations in accordance with the provisions of Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code, necessary for the proper execution of the powers and duties granted to, and imposed upon, the state board by this division and by any other provision of law . . . ;

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(4) Specification of vehicular fuel composition.

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

(1) Workshops on the adoption of vehicular fuel specifications for aromatic content, diesel fuel quality, light-duty vehicle exhaust emission standards, and revisions to the standards for new vehicle certification and durability to reflect current driving conditions and

useful vehicle life shall be held not later than March 31, 1989. . . .

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

(3) Workshops on the adoption of regulations governing detergent content, emissions from off-highway vehicles, vehicle fuel composition, emissions from construction equipment and farm equipment, motorcycles, locomotives, utility engines, and to the extent permitted by federal law, marine vessels, shall be held not later than January 31, 1991. . . .

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

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

4. California Administrative Procedure Act

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

87. Part 1 of Division 3 of Title 2 of the Government Code governs state departments and agencies within the executive department. Cal. Gov't. Code, Part 1, Division 3. Chapter 3.5 is entitled "Administrative Regulations and Rulemaking." Cal. Gov't. Code, Part 1, Division 3, Chapter 3.5. Chapter 3.5 encompasses Sections 11340 through 11351. *Id.*

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

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

90. Section 11346 of the California APA states:

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

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

91. Section 11346.3 of the California APA states:

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

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

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

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

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

V. ANALYSIS AND CONCLUSIONS OF LAW

A. Overview of the *Noerr-Pennington* Doctrine

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

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

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

Id. at 137.

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

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

In *California Motor Transport Co. v. Trucking Unlimited*, 404 U.S. 508 (1972), the Supreme Court extended the *Noerr-Pennington* doctrine to attempts to influence administrative and adjudicatory bodies. *Id.* at 510. Lower courts have made clear that lobbying efforts designed to influence a state administrative agency's decision are within the ambit of the *Noerr-Pennington* doctrine. *Kottle*, 146 F.3d at 1059; *Tarabishi v. McAlester Regional Hosp.*, 951 F.2d 1558, 1570 n.17 (10th Cir. 1991); *St. Joseph's Hosp.*, 795 F.2d at 955. "*Noerr-Pennington* immunity extends to efforts to influence all branches of government, including state administrative agencies." *Livingston Downs Racing Assoc. v. Jefferson Downs Corp.*, 192 F. Supp. 2d 519, 532 (M.D. La. 2001).

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

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

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

> Unocal is not shielded from antitrust liability pursuant to the *Noerr-Pennington* doctrine for numerous reasons . . . including, but not limited to, the following: (i) Unocal's misrepresentations were made in the course of quasi-adjudicative rulemaking proceedings; (ii) Unocal's conduct did not constitute petitioning behavior . . . .[1]

Complaint at ¶ 96.

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

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

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

a. Distinction made between legislative versus adjudicatory arena

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

> In surveying the "forms of illegal and reprehensible practice which may corrupt the administrative or judicial processes and which may result in antitrust violations," we have noted that "unethical conduct in the setting of the adjudicatory process often results in sanctions" and that "misrepresentations, condoned in the political arena, are not immunized when used in the adjudicatory process."

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

Circuit courts applying the *Noerr-Pennington* doctrine hold that misrepresentations made in the context of legislative activities are immune from antitrust liability. *E.g.*, *Armstrong Surgical Center*, 185 F.3d at 162 (liability for injuries caused by states acting as regulators is precluded even where it is alleged that a private party urging the action did so by bribery, deceit or other wrongful conduct that may have affected the decision making process); *Kottle*, 146 F.3d at 1060 ("the political arena has a higher tolerance for outright lies than the judicial arena does"); *Boone v. Redevelopment Agency of San Jose*, 841 F.2d 886, 894 (9th Cir. 1988) (misrepresentations of facts made by defendant real estate developer to the city council relating to the city council's decision to not construct a parking garage is conduct that "certainly falls within the ambit of the *Noerr-Pennington* doctrine"); *First Am. Title Co. v. South Dakota Land Title Assn.*, 714 F.2d 1439, 1447 (8th Cir. 1983) (lobbying campaign alleged to involve "'a misuse of the lobbying process' through the use of false statements and inaccuracies made by defendants to the state legislature" protected by *Noerr-Pennington* doctrine); *Metro Cable*, 516 F.2d at 228 (when a legislative body granted an exclusive franchise to defendant, allegedly due to defendant's illicit conduct, the complaint was dismissed, because while the legislature could have had an adjudicatory body issue the license, it chose not to do so); *Woods Exploration & Producing Co., v. Aluminum Company of America, Inc.*, 438 F.2d 1286, 1297 (5th Cir. 1971) ("The germination of the allowable formula was political in the *Noerr* sense, and thus participation in those rule-making proceedings would have been protected.").

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

Thus, apparently seeking to circumvent *Noerr-Pennington* immunity, the Complaint alleges that "CARB's Phase 2 RFG proceedings were quasi-adjudicative in nature." Complaint at ¶ 26. Complaint Counsel argues that "where, as here, a party makes material misrepresentations in the course of 'adjudicatory' proceedings, such misconduct brings the case within the independent misrepresentation exception to *Noerr*." Opposition at 20. Despite this conclusory allegation, if the conduct complained about is genuine petitioning in the legislative context, the violations alleged in the complaint must be dismissed. *See Mark Aero*, 580 F.2d at 292-93, 97. As set forth in the following section, the facts, as alleged in the Complaint, guided by the statutory authority governing CARB, and demonstrated in the Notice of Public Hearing through which

CARB initiated the rulemaking and in the Final Statement of Reasons for Rulemaking, establish that the Phase 2 RFG proceedings were legislative, and not adjudicative.

b. Determination of whether action is legislative or adjudicatory

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

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

(i) Political discretion

One factor in determining whether an executive agency is acting in a legislative or adjudicative manner depends upon the "degree of political discretion exercised by the government agency." *Kottle*, 146 F.3d at 1061. Complaint Counsel asserts that CARB, in using its technical expertise to design the applicable regulations, was merely carrying out the California legislature's mandate to implement certain policy judgments, rather than acting in an independent political manner. Opposition at 24. However, it is apparent, on the facts alleged in the Complaint, that CARB exercised political discretion. F. 9 (Complaint at ¶ 16) ("CARB's mission is to protect the health, welfare, and ecological resources of California through the effective and efficient reduction of air pollutants, while recognizing and considering the effects of its actions on the California economy."). The regulations enacted by CARB "set particular standards for the composition of low emissions RFG. These regulations specify limits for eight RFG properties: RVP, benzene, sulfur, aromatics, olefins, oxygen, T50, and T90." F. 29 (Complaint at ¶ 44).

The statutory guidelines that govern CARB's rulemaking give CARB broad discretion to do such acts as may be necessary, consistent with the goal of providing a suitable living environment for every Californian. F. 81, 82 (Cal. Health & Safety Code §§ 39600, 39601). The statute lists only benchmarks that CARB's regulations must fulfill and interests that CARB must keep in mind when formulating its regulations. F. 83, 84 (Cal. Health & Safety Code §§ 43013, 43018). CARB retains discretion in deciding what standards it will actually impose to achieve the maximum degree of emission reduction possible from vehicular or other mobile sources. *See* F. 83, 84 (Cal. Health & Safety Code §§ 43013, 43018). Nowhere does the statute state what properties of RFG must be regulated. *See* F. 83-85 (Cal. Health & Safety Code §§ 43013, 43018, 43101). Nor does the statute set limits to be placed upon such properties. *Id.* However, these two factors are critical components of the Phase 2 regulations and were the topics of Respondent's petitioning conduct as alleged in the Complaint. F. 21, 22 (Complaint at ¶¶ 36, 37).

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

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

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

(ii) Policy setting

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

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

The factual allegations of the Complaint leave no doubt that CARB's Phase 2 rulemaking was setting policy to be applied generally to the industry and affecting consumers in the future. CARB convened its rulemaking to enact regulations "governing the composition of low emissions, reformulated gasoline . . . ." F. 10 (Complaint at ¶ 1). The Complaint further avers that CARB conducted the rulemaking pursuant to legislation that required the agency "to take actions to reduce harmful car emissions." F. 13 (Complaint at ¶ 21). Approximately 14.8 billion gallons of RFG are sold each year in California. F. 63 (Complaint at ¶ 10). To comply with Phase 2, industry participants had to modify their refineries, which, in the aggregate, cost "billions of dollars." F. 15, 62 (Complaint at ¶¶ 24, 93). Phase 2 substantially affects a large number of consumers through higher prices for summer time compliant gasoline. F. 63 (Complaint at ¶ 10). No allegations in the Complaint indicate that CARB's Phase 2 rulemaking was in any way a judicial determination of the rights and obligations of specific parties before it.

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

(iii) Procedures used

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

An examination of the procedures used by CARB, as alleged in the Complaint, reveals that the procedures used by CARB do not bear the indicia of a formal adjudicatory proceeding. The Complaint does not allege that CARB, in deciding on the Phase 2 regulations, conducted trial-like hearings, including cross-examination, rules of evidence, and burdens of proof. Instead, according to the Complaint, CARB conducted the Phase 2 rulemaking pursuant to California's Administrative Procedure Act, which required CARB to issue a notice of proposed rulemaking, explain the basis and purpose of the regulations, provide an opportunity to comment, and conduct hearings. F. 17. *See also* Complaint at ¶ 17. The Complaint alleges that, in developing the RFG regulations, CARB provided notice of the proposed regulations, conferred in private meetings with various interested persons, held public workshops and hearings, solicited input from various industry groups and numerous companies, conducted lengthy hearings at which oral testimony was received, and collected written comments by interested parties. F. 17, 20, 21, 33 (Complaint at ¶¶ 26, 35, 36, 47). *See also* F. 74, 75 (the Final Statement indicates the Board conducted a hearing and public workshop). In the Final Statement of Reasons for Rulemaking, CARB included all of the meaningful, relevant comments that it analyzed in formulating Phase 2 and its responses to these comments. F. 76, 77. As alleged in the Complaint, the processes used by CARB illustrate clearly that CARB's rulemaking was undertaken in a legislative, and not an adjudicative context.

(iv) Authority invoked

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

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

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

Although CARB is empowered to conduct adjudicative proceedings (*see* Cal. Code Regs. tit. 17, §§ 60040-60053), the Notice of Public Hearing indicates that such procedures were not invoked in connection with the Phase 2 rulemaking. F. 78. Under sections 11370 et seq. of the California Government Code and Title 17 of the California Code of Regulations at sections 60040 to 60094, CARB's exercise of quasi-adjudicative powers is subject to the familiar strictures associated with adjudications. When it is conducting adjudications, CARB must provide notice, the hearing examiner controls what evidence may be admitted, oral testimony must be under oath, the parties may cross-examine adverse witnesses or offer rebuttal evidence if the hearing examiner deems it necessary to resolve disputed issues of material fact, California's rules of privilege apply, hearsay may not be used by itself to support a finding unless it falls under an exception to the hearsay rule, official notice may be taken, and affidavits are admissible. Cal. Code Regs. tit. 17, §§ 60040-60053. CARB's "adjudication procedures" need not be considered since the Complaint does not allege that CARB followed these quasi-adjudicative procedures during its development of the Phase 2 RFG regulations and since the Notice of Public Hearing explicitly states that CARB's regulatory action was proposed, instead, under sections 39600, 39601, 43013, 43018, and 43101 of the Health and Safety Code. F. 78, 80.

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

2. CARB was not wholly dependent on Respondent for information

Complaint Counsel argues that, regardless of whether CARB's rulemaking was legislative or adjudicatory, *Noerr-Pennington* immunity does not apply where the decision making agency is dependent upon the petitioner for information. Opposition at 30. Complaint Counsel relies chiefly on *Clipper Exxpress*, which holds:

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

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

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

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

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

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

In *Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.*, 382 U.S. 172 (1965), the Supreme Court held that "the enforcement of a patent procured by fraud on the Patent Office may be violative of § 2 . . . provided the other elements necessary to a § 2 case are present." *Id.* at 174. As characterized by the Court of Appeals for the Third Circuit, the Patent Office was wholly dependent on the applicant for the facts. *Armstrong Surgical Center*, 185 F.3d at 164 n.8 (3d Cir. 1999). "While the Patent Office can determine the prior art from its own records, it effectively and necessarily delegates to the applicant the factual determinations underlying the issuance of a patent." *Id.* *See also Charles Pfizer & Co. v. Federal Trade Commission*, 401 F.2d 574, 579 (6th Cir. 1968) ("The Patent Office, not having testing facilities of its own, must rely upon information furnished by applicants and their attorneys. [Respondents], like all other applicants, stood before the Patent Office in a confidential relationship and owed the obligation of frank and truthful disclosure.").

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

Instead, as set forth in the preceding section, CARB was vested with political discretion, set policy through its regulations, and was not acting in an adjudicatory manner. (Section V.B.1. *supra*). Section 43013 required CARB to consult with public or private entities that would be significantly impacted. F. 83. As alleged in the Complaint, CARB, in developing the RFG regulations, conferred in private meetings with various interested persons, held public workshops and hearings, solicited input from various industry groups and numerous companies, and collected written comments by interested parties. F. 17, 20, 21, 33 (Complaint at ¶¶ 26, 35, 36, 47). The Notice of Public Hearing states that CARB staff was to conduct an independent cost analysis using the Process Industry Modeling System refinery model. F. 69. The Final Statement of Reasons for Rulemaking contains a summary of the comments the Board received on the Phase 2 RFG regulations during the formal rulemaking process and the Board's responses to the comments. F. 76 (Final Statement of Reasons for Rulemaking, p. 3). An attachment to the Final Statement of Reasons for Rulemaking shows that 51 entities, including automobile companies, assemblymen, business associations, chemical companies, environmental associations, forestry associations, labor unions, oil companies, petroleum associations, refiners' associations, and trucking associations, all provided comments to the Board during the formal rulemaking process. F. 77 (Final Statement of Reasons for Rulemaking, pp. A-1 - A-6). The text of these comments demonstrates that CARB was not solely dependent on Respondent for information. Moreover, the Complaint alleges that CARB "relied on industry to provide research and information." F. 16 (Complaint at ¶ 25). Accordingly, because CARB was not wholly dependent on Respondent in its rulemaking proceeding, *Noerr-Pennington* applies.

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

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

Noerr protects "the right of the people to inform their representatives in government of their desires with respect to the passage or enforcement of laws," regardless of the petitioner's intent in doing so. *Noerr*, 365 U.S. at 139. "Petitioning" the government, as used in *Noerr* and its progeny, equates to advocating for or persuading the government to take some action. *Noerr*, 365 U.S. at 138 (petitioning is "solicitation of governmental action with respect to the passage and enforcement of laws"); *Omni Outdoor Advertising*, 499 U.S. at 379-80 (entities must be allowed to "seek anticompetitive action from the government").

Accepting the allegations of the Complaint as true, it is clear that Respondent engaged in petitioning conduct. *E.g.*, F. 20 (Complaint at ¶ 35 (Respondent provided information to CARB for the purpose of obtaining competitive advantage)); F. 22 (Complaint at ¶ 37 (Respondent presented to CARB staff the results of its 5/14 project)); F. 32 (Complaint at ¶ 46 (Respondent submitted comments and presented testimony to CARB opposing CARB's proposal to grant small refiners a two-year exemption)); F. 34 (Complaint at ¶ 48 (Respondent submitted comments to CARB touting the predictive model as offering flexibility and furthering CARB's mandate of cost-effective regulations)). This communication of information to government regulators regarding Respondent's "desires with respect to the passage or enforcement of laws," is without question solicitation of governmental action.

Complaint Counsel asserts that *Noerr* and its progeny protect petitioning only if the government is "actually aware of the anticompetitive restraint it is imposing and takes *state action* nonetheless." Opposition at 14-15 (emphasis added). For support, Complaint Counsel cites to Areeda & Hovenkamp, at ¶ 209a and to *FTC v. Superior Ct. Trial Lawyers Ass'n* ("*SCTLA*"), 493 U.S. 411, 424-25 (1990). Neither of these cites support Complaint Counsel's proposition.

Section 209a of Areeda & Hovenkamp sets forth the general rule for the "commercial exception" to *Noerr-Pennington*. Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 209a at 259 (2d ed. 2000). Within the context of the "general rule" that a private person dealing with the government as a buyer, seller, lessor, lessee, or franchisee has no greater antitrust privilege or immunity than in similar dealings with non-governmental parties, the Areeda treatise states, "a prerequisite for *Noerr* immunity is that the government actually know about the restraint being imposed. As a result, there is no immunity for secret price-fixing agreements directed at government purchasers . . . ." *Id.* In this case, as alleged in the Complaint, CARB is not acting as a buyer, seller, lessor, lessee, or franchisee; nor are there allegations of secret price-fixing agreements directed at government purchasers. Thus, the commercial exception to *Noerr-Pennington* does not apply, and this quote, taken completely out of context, has no persuasive value.

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

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

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

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

Id. at 383 (emphasis added). Thus, even where the antitrust violation alleged was that the petitioner conspired with city officials to harm a competitor, an analysis of the intent of the legislature was avoided. *Id.* at 368-69. *See also* Areeda & Hovenkamp, ¶ 202b at 158 ("To be sure, the legislature may be mistaken or unaware of the consequences of its actions . . . but the antitrust court may not reappraise the legislature's assessment of the public welfare . . . . [I]f a statute excludes everyone but the monopolist from a market, the monopolist cannot itself be faulted.").

Complaint Counsel also relies on cases interpreting the state action immunity developed in *Parker v. Brown*, 317 U.S. 341 (1943) and its progeny for Complaint Counsel's argument that petitioning is protected only if the government agency is aware of the restraint of trade it is being asked to adopt. Sur-reply at 11. *Parker* and subsequent caselaw interpreting this doctrine explain that there must be conscious and deliberate efforts of the state to restrain competition in order for the state action immunity to apply. *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980) (Private anticompetitive activity is impliedly exempt from antitrust scrutiny under the state action doctrine only if: (1) the alleged anticompetitive conduct was taken pursuant to a clearly articulated and affirmatively expressed state policy to displace competition with state regulation; and (2) the state actively supervises the implementation of its policy.). This doctrine, with its necessary focus on "whether the anticompetitive scheme is the State's own," *FTC v. Ticor Title Ins. Co.*, 504 U.S. 621, 635 (1992), is in no way controlling in the instant case where the alleged anticompetitive scheme was undertaken, not by the state, but instead, by the petitioner.

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

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

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

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

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

1. "Sham" exception and *SCTLA*

The Supreme Court, in *Noerr*, recognized that antitrust petitioning immunity could be withheld in circumstances where petitioning activity "ostensibly directed toward influencing government action, is a mere sham to cover . . . an attempt to interfere directly with the business relationships of a competitor." 365 U.S. at 144. Subsequent decisions have clarified that the "sham" exception referred to in *Noerr* is applicable to situations in which persons use the governmental *process*, as opposed to its *outcome*, as an anticompetitive weapon. *California Motor Transport*, 404 U.S. at 510 (sham exception where complaint alleged one group of highway carriers sought to bar competitors from meaningful access to adjudicatory tribunals); *Omni Outdoor Advertising*, 499 U.S. at 381 (1991) (no sham exception where defendant set out to disrupt plaintiff's business relationships not through the process of lobbying, but through the ultimate product of that lobbying, the zoning ordinances).

The Complaint does not allege that Respondent attempted to gain monopoly through the use of CARB's process in adopting the Phase 2 RFG regulations. Instead, the Complaint alleges that Respondent sought to and did use the outcome of the government action – the Phase 2 RFG regulations. F. 29 (Complaint at ¶ 44 (CARB Board adopted Phase 2 RFG regulations that set particular standards for the composition of low emissions, reformulated gasoline. Unocal's pending patent claims recited limits for five of the eight properties specified by the regulations.)); F. 30 (Complaint at ¶ 45 (CARB adopted Phase 2 RFG regulations that substantially overlapped with Respondent's patent claims.)). *See also* Complaint at ¶ 76 (Respondent "caused CARB to enact regulations that overlapped almost entirely with Unocal's pending patent rights.").

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

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

In *SCTLA*, it did not matter that the result was favorable legislation; what mattered was that horizontal competitors engaged in a concerted refusal to deal and entered into an arrangement designed to obtain higher prices. In the instant case, for *Noerr-Pennington* purposes, it does matter that the result of Respondent's alleged misconduct is the adoption by CARB of Phase 2 regulations that substantially overlap Respondent's patents. *See* F. 29, 30. The Complaint alleges that Respondent "obtained unlawful market power through affirmative misrepresentations, materially false and misleading statements, and other bad-faith, deceptive conduct that caused CARB to enact regulations that overlapped almost entirely with Unocal's pending patent rights." Complaint at ¶ 76. Because the anticompetitive harm alleged in the Complaint arises from the adoption of regulations that substantially overlap Respondent's patents, the harm arises from governmental action and thus *Noerr-Pennington* applies.

2. *Walker Process*

In *Walker Process*, the question presented was "whether the maintenance and enforcement of a patent obtained by fraud on the Patent Office may be the basis of an action under § 2 of the Sherman Act . . . . " *Walker Process*, 382 U.S. at 173. To the extent that some courts have held that *Walker Process* is not limited to fraud on the Patent Office, *see Clipper Exxpress*, 690 F.2d at 1260-63 (relying on *Walker Process* in the context of a ratemaking proceeding); *Whelan*, 48 F.3d at 1255-58 (relying on *Walker Process* in the context of a complaint filed with state securities commissioner and a lawsuit filed in federal district court), those cases arose in a context in which the state action at issue was quasi-adjudicatory and dependent on the petitioner for factual information and thus, as set forth above in Section V.B.2. *supra*, are distinguishable from the instant case.

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

In *Walker Process*, there could be no harm from the enforcement of a patent if the Patent Office had never issued the patent. Here, there could be no harm from the enforcement of Respondent's patents if CARB had not enacted the Phase 2 regulations that substantially overlapped with CARB's patents. Complaint at ¶ 92 ("The extensive overlap between the CARB RFG regulations and the Unocal patent claims makes avoidance of Unocal patent claims technically and/or economically infeasible."); F. 62 (Complaint at ¶ 93) (Refiners in California invested billions of dollars in sunk capital investments in order to comply with the CARB Phase 2 RFG regulations.). Thus, it is not solely private conduct – Respondent's enforcement of its valid patents – that caused the anticompetitive harm alleged. Because the alleged harm stems from the cost of compliance with CARB's regulations that substantially overlap Respondent's patents, the restraint of trade is the result of valid governmental action and *Noerr-Pennington* applies.

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

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

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

The Supreme Court further held:

> Insofar as the [Sherman] Act sets up a code of ethics at all, it is a code that condemns trade restraints, not political activity . . . . The proscriptions of the [Sherman] Act, tailored as they are for the business world, are not at all appropriate for application in the political arena. Congress has traditionally exercised extreme caution in legislating with respect to problems relating to the conduct of political activities, a caution which has been reflected in the decisions of this Court interpreting such legislation. All of this caution would go for naught if we permitted an extension of the Sherman Act to regulate activities of that nature simply because those activities have a commercial impact and involve conduct that can be termed unethical.

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

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

> "The proscriptions of Section 5 of the FTC Act, as we view them, like the proscriptions of the Sherman Act, are tailored for the business world, not for the political arena . . . .
>
> Even assuming a wrongful motive . . . and the willful use of distortion or deception, it is our view that actionable violation of Section 5 of the FTC Act is not indicated due to the overriding public interest in preservation of uninhibited communication in connection with political activity with legislative processes."

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

The Noerr-Pennington doctrine has not been strictly limited to Sherman Act cases, but has been characterized by the Supreme Court as applying more broadly to "antitrust laws." *See Omni Outdoor Advertising*, 499 U.S. at 380 (citing *Noerr*, 365 U.S. at 141). "Those who petition government are generally immune from *antitrust liability*." *Professional Real Estate Investors*, 508 U.S. at 56 (emphasis added). In *Professional Real Estate Investors*, the Supreme Court, including in its authority a case brought under Section 5 of the FTC Act, implied that *Noerr* is not strictly limited to Sherman Act cases. "Whether applying *Noerr* as an antitrust doctrine or invoking it in other contexts, we have repeatedly reaffirmed that evidence of anticompetitive intent or purpose alone cannot transform otherwise legitimate activity into a sham." 504 U.S. at 59 (citing *SCTLA*, 493 U.S. at 424; *NAACP v. Claiborne Hardware Co.*, 458 U.S. 886, 913-14 (1982)).

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

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

Complaint at ¶ 1. All five violations in the Complaint charge Respondent with "acts and practices [that] constitute unfair methods of competition in violation of Section 5 of the FTC Act." The Commission and courts routinely analyze causes of actions challenging unfair methods of competition through antitrust principles. *Atlantic Refining Co. v. FTC*, 381 U.S. 357, 369 (1965) ("When conduct does bear the characteristics of recognized antitrust violations it becomes suspect, and the Commission may properly look to cases applying those laws for guidance."); *In re American Med. Assoc.*, 94 F.T.C. 701, 994 (1979) ("It is instructive to look at cases construing the Sherman Act for initial guidance as to the reach of Section 5."). Thus, even though the doctrine was developed in cases alleging violations of the Sherman Act, it is appropriate and logical to apply the *Noerr-Pennington* doctrine of immunity from antitrust liability to a case alleging unfair methods of competition in violation of the FTC Act.

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

Despite Complaint Counsel's assertion that "no court has held that *Noerr*'s narrow exception to Sherman Act liability applies to Section 5 of the FTC Act," Sur-reply at 30, courts have analyzed the *Noerr-Pennington* defense in Section 5 cases. *E.g.*, *Ticor Title Ins.*, 998 F.2d at 1138; *Rodgers*, 492 F.2d at 228-29 (accepting Commission argument that *Noerr* doctrine is applicable to FTC Act). Both the Commission and the Supreme Court applied the *Noerr-*

Pennington doctrine to the alleged violations of Section 5 of the FTC Act in *In re Superior Court Trial Lawyers Ass'n*, 107 F.T.C. 510, 590 (1984), *vacated by* 856 F.2d 226, *rev'd in part, and remanded by*, 493 U.S. 411 (1990). The Commission stated, "[i]f the respondents' activity had been limited to 'mere attempts to influence the passage of enforcement of laws,' *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. at 135, then the respondents would merit the protection of the First Amendment under *Noerr* and succeeding cases." 107 F.T.C. at 590. The Commission then held, "[w]e think that *Noerr* and *Pennington* alone provide sufficient guidance for our conclusion that First Amendment immunity should not extend to the kind of conduct in which the respondents have engaged." *Id.* at 594.

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

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

Because Supreme Court and Commission precedent establish that the *Noerr-Pennington* doctrine is a defense to antitrust liability and have applied the doctrine in Section 5 cases, Complaint Counsel's unsupported argument that *Noerr-Pennington* should not be available where the remedy sought is an order requiring Respondent to cease and desist from enforcing its patents, in other words, de facto invalidation of Respondent's patents, rather than the "chilling" treble damages allowed under the Sherman Act, does not withstand scrutiny. For the same reason, Complaint Counsel's argument that the "unitary nature" of the FTC Act precludes application of the *Noerr-Pennington* doctrine to cases brought under the FTC Act, also does not withstand scrutiny. Again, without citation, Complaint Counsel argues that because the FTC Act applies to the closely associated areas of "unfair methods of competition" and "unfair or deceptive practices," it would be incongruous to allow the Commission to prevent unfair or deceptive acts or practices to the full extent constitutionally permitted by the First Amendment, but prevent unfair methods of competition only to the extent permitted by antitrust principles. Opposition at 33-34. Complaint Counsel has cited no cases indicating that causes of action challenging unfair methods of competition are required to be analyzed by case law relating to causes of action challenging unfair and deceptive practices rather than antitrust law.

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

E. Respondent's Conduct Before Private Industry Groups

The Complaint alleges that Respondent participated in two private industry groups, the Auto/Oil Air Quality Improvement Research Program ("Auto/Oil Group") and the Western States Petroleum Association ("WSPA"), which conducted research on automobile emissions and reported their findings to the government. F. 38-40, 44 (Complaint at ¶¶ 50-52, 56). The Complaint alleges that Respondent made statements to the Auto/Oil Group and to WSPA that were materially false and misleading in that they failed to disclose Unocal's proprietary interests in its emissions research results and Unocal's intention to enforce its intellectual property rights. F. 42, 46, 48 (Complaint at ¶¶ 58, 59, 82); *see also* Complaint at ¶ 85. In its opposition to the motion to dismiss on *Noerr-Pennington* grounds, Complaint Counsel asserts that: (1)

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

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

1. Indirect petitioning

According to the allegations of the Complaint, Respondent made knowing and willful misrepresentations to the Auto/Oil Group and to WSPA and subverted the Auto/Oil Group's and WSPA's process of providing accurate and nonproprietary research data and information to CARB. F. 20 (Complaint at ¶ 35 (Unocal participated in industry groups that provided input into the CARB regulations)); Complaint at ¶¶ 84, 89 (Unocal subverted the Auto/Oil Group's and WSPA's process of providing accurate and nonproprietary research data and information to CARB)). The Complaint does not allege that the Respondent prevented the Auto/Oil Group or WSPA from communicating with CARB.

Misrepresentations to third parties as a means of influencing the government's passage of laws fall within the bounds of *Noerr-Pennington*. In *Noerr*, the railroads' use of "the so-called third party technique," involved deception of the public, manufacture of bogus sources of reference, and distortion of public sources of information. *Noerr*, 365 U.S. at 140-42 (holding such conduct, "so far as the Sherman Act is concerned, legally irrelevant"). In *Allied Tube*, the Supreme Court held that a "claim of *Noerr* immunity cannot be dismissed on the ground that the conduct at issue involved no 'direct' petitioning of government officials, for *Noerr* itself immunized a form of 'indirect' petitioning." *Allied Tube*, 486 U.S. at 503.

To determine whether *Noerr* immunizes anticompetitive activity intended to influence the government requires an evaluation not only of its impact, but also of the context and nature of the activity. *Allied Tube*, 486 U.S. at 504. Here, it is clear from the allegations of the Complaint that Respondent's actions with respect to the Auto/Oil Group and WSPA were part of an alleged scheme to induce these third parties to influence CARB. F. 44 (Complaint at ¶ 56 (During the CARB Phase 2 RFG rulemaking proceedings, Unocal actively participated in WSPA, which actively participated in the CARB RFG rulemaking process; WSPA commissioned, and submitted to CARB, three cost studies in connection with the CARB Phase 2 RFG rulemaking.)); Complaint at ¶ 87 (Unocal participated in WSPA committees that discussed the potential cost implications of the CARB Phase 2 RFG regulations; Unocal knew that royalties were considered in a cost study commissioned by WSPA for submission to CARB)); Complaint at ¶¶ 84, 89 (Respondent's deceptive conduct subverted Auto/Oil's and WSPA's process of providing accurate and nonproprietary research data and information to CARB.)); Complaint at ¶ 90 (But for Unocal's fraud, these participants in the rulemaking process would have taken actions including, but not limited to, advocating that CARB adopt regulations that minimized or avoided infringement on Unocal's patent claims, or advocating that CARB negotiate license terms substantially different from those that Unocal was later able to obtain.)).

This case is different from the context and nature of the private standard setting process evaluated in *Allied Tube*. There, where the anticompetitive harm was found to be a result of an implicit agreement by the private standard setting association's members not to trade in a certain type of electrical conduit, the Supreme Court held that the context and nature of the conduct was "more aptly characterized as commercial activity with a political impact." 486 U.S. at 507. While *Allied Tube* does state, as quoted by Complaint Counsel (Sur-reply at 25), "the mere fact that an anticompetitive activity is also intended to influence governmental action is not alone sufficient to render that activity immune from antitrust liability[,]" this quote must be put in context. It was only after finding that the anticompetitive conduct was commercial activity, the Supreme Court held, "*at least outside the political context*, the mere fact that an anticompetitive activity is also intended to influence governmental action is not alone sufficient to render that activity immune from antitrust liability." 486 U.S. at 507 (emphasis added). But in the instant case, where according to the Complaint, Respondent's conduct was part of its attempt to influence governmental action and where the anticompetitive harm results from CARB's adoption of Phase 2 RFG regulations that "substantially overlap[] with Unocal's concealed patent claims" (Complaint at ¶ 45), the "antitrust laws should not regulate political activities 'simply because those activities have a commercial impact.'" 486 U.S. at 507 (quoting *Noerr*, 356 U.S. at 141). Thus, because Respondent's alleged misconduct occurred within the political context, *Noerr* immunity extends to protect this conduct.

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

> Any lobbyist or applicant, in addition to getting himself heard, seeks by procedural and other means to get his opponent ignored. Policing the legitimate boundaries of such defensive strategies, when they are conducted in the context of a genuine attempt to influence governmental action, is not the role of the Sherman Act. In the present case, of course, any denial to Omni of "meaningful access to the appropriate city administrative and legislative fora" was achieved by COA in the course of an attempt to influence governmental action that, far from being a "sham," was if anything more in earnest than it should have been. If the denial was wrongful there may be other remedies, but as for the Sherman Act, the *Noerr* exemption applies.

Omni Outdoor Advertising, 499 U.S. at 382. In the instant case, where it is clear from the allegations of the Complaint that Respondent's alleged conduct with respect to the Auto/Oil Group and WSPA was part of a scheme to influence CARB, Respondent's conduct with respect to these third parties falls within *Noerr*'s protection.

2. Conduct directed at Auto/Oil Group and WSPA separate from conduct directed at CARB

To the extent that the alleged misrepresentations made to the Auto/Oil Group and to WSPA were not part of Respondent's scheme to solicit favorable governmental action, the allegations of misconduct directed toward the Auto/Oil Group and WSPA, independent of the conduct directed toward CARB alleged in the Complaint, do not state an independent cause of action as a violation of Section 5 of the FTC Act over which the Commission has jurisdiction. Respondent, in its motion for dismissal of the Complaint for failure to make sufficient allegations that Respondent possesses or dangerously threatens to possess monopoly power ("Market Power Motion"), asserts that the Commission does not have jurisdiction to decide patent issues. The scope of Respondent's patents and whether or not third parties could have invented around these patents and whether any such newly created products or methods could have avoided infringement is called directly into question by the allegations of the Complaint regarding Respondent's conduct towards Auto/Oil Group and WSPA. Thus, in order to fairly and completely resolve the factual and legal allegations of the Complaint, an in depth analysis of substantial issues of patent law would be required.

(i) Allegations relating to conduct separate from conduct directed at CARB

After the conclusion that the steps that Respondent took, whether direct or indirect, to solicit CARB's adoption of the Phase 2 regulations were political petitioning conduct, immunized by *Noerr-Pennington*, the remaining allegations of the Complaint are as follows:

> Throughout all of its communications and interactions with Auto/Oil prior to January 31, 1995, Unocal failed to disclose that it had pending patent rights, that its patent claims overlapped with the proposed RFG regulations, and that Unocal intended to charge royalties. Complaint at ¶ 83.
>
> By deceptive conduct that included, but was not limited to, false and misleading statements concerning its proprietary interests in the results of its emissions

> research results, Unocal violated the letter and spirit of the Auto/Oil Agreement and breached its fiduciary duties to the other members of the Auto/Oil joint venture. Complaint at ¶ 84.
>
> Throughout all of its communications and interactions with WSPA prior to January 31, 1995, Unocal failed to disclose that it had pending patent rights, that its patent claims overlapped with the proposed RFG regulations, and that Unocal intended to charge royalties. Complaint at ¶ 88.
>
> By deceptive conduct that included, but was not limited to, false and misleading statements concerning its proprietary interests in the results of its emissions research results, Unocal breached its fiduciary duties to the other members of WSPA. Complaint at ¶ 89.
>
> But for Unocal's fraud, these participants in the rulemaking process [Auto/Oil Group and WSPA] would have taken actions including, but not limited to . . . incorporating knowledge of Unocal's pending patent rights in their capital investment and refinery reconfiguration decisions to avoid and/or minimize potential infringement. Complaint at ¶ 90(c).

In its opposition to the *Noerr-Pennington* motion to dismiss, Complaint Counsel argues that even if CARB had enacted Phase 2 knowing that the regulations substantially overlapped with Respondent's patents, the oil companies could have avoided significant harm, had Respondent not duped them independently through its fraudulent, inequitable, and bad-faith business conduct. Opposition at 36.

(ii) No independent basis for liability

The allegations in the Complaint pertaining to Respondent's conduct towards Auto/Oil Group and WSPA, separate from its alleged scheme to influence CARB, (¶¶ 83, 84, 88, 89) do not establish a legally cognizable independent cause of action under Section 5 of the FTC Act over which the Commission has jurisdiction. The issue of whether or not Respondent had a fiduciary duty arising under Section 5 of the FTC Act towards WSPA or Auto/Oil Group or breached any such duty is not reached. As discussed in detail *infra*, there is no set of facts alleged in the Complaint that could establish that any antitrust injury or harm was caused from any breach of such duty without a thorough analysis of numerous substantial patent law issues.

CARB passed regulations substantially overlapping with Unocal's patents. F. 30, 53 (Complaint at ¶¶ 45, 64). *See also* F. 29 (Complaint at ¶ 44) (Respondent's patent claims recite limits for five of the eight properties specified by the Phase 2 RFG regulations: T50, T90, olefins, aromatics, and RVP.). There is no set of facts alleged in the Complaint that, if established, would prove that anticompetitive injury and resulting harm to the Auto/Oil Group and WSPA resulted from the alleged misconduct directed at the Auto/Oil Group and WSPA, instead of from CARB's enactment of Phase 2 regulations and Respondent's subsequent enforcement of its patent rights. To the contrary, the Complaint alleges harm that resulted from compliance with the Phase 2 RFG regulations. F. 62 (Complaint at ¶ 93 (refiners invested billions of dollars in order to comply with the CARB Phase 2 RFG regulations. These refiners cannot produce significant volumes of non-infringing CARB-compliant gasoline without incurring substantial costs.)). *See also* Complaint at ¶ 92 ("extensive overlap between the CARB RFG regulations and the Unocal patent claims makes avoidance of the Unocal patent claims technically and/or economically infeasible"). Any alleged harm beyond that caused by CARB's regulations cannot be determined without knowing the scope of Respondent's patents, whether or not Auto/Oil Group and WSPA could have invented around these patents, and whether any such newly created products or methods could have avoided infringement. Accordingly, to find any other harm, as alleged, would require the substantial patent law analysis discussed herein and thus, logically, the issue of other harm can not be reached.

(iii) Allegations raise substantial patent issues

To analyze whether the allegations of the Complaint state an independent cause of action separate from the alleged violations stemming from Respondent's efforts to get CARB to adopt regulations favorable to Respondent would require a resolution of substantial patent issues. Complaint at ¶¶ 83, 88 (Respondent failed to disclose that it had *pending patent rights* and that its *patent claims overlapped* with the proposed RFG regulations.); Complaint at ¶¶ 84, 89 (Respondent made false and misleading statements concerning its *proprietary interests.*); Complaint at ¶ 90(c) (Auto/Oil Group and WSPA would have incorporated knowledge of Unocal's *pending patent rights* in their capital investment and refinery reconfiguration decisions to avoid and/or minimize *potential infringement.*) (Emphases added). To properly determine whether there is any set of facts that, if proven, could support these allegations would require an in depth and thorough analysis of what Respondent's "proprietary interests" were, which "proprietary interests" were and were not included in any patent, what was patented, what was not patented, the scope of Respondent's patents, the scope of any competitor's patents, whether any competitor products or methods exist or could be invented, whether any of the competitor products or methods that could be created or invented infringed, and whether refineries could be reconfigured so as to avoid or minimize infringement of Respondent's patents.

These are fundamental and substantial patent issues, as defined by the Supreme Court in *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800 (1988). There, the Supreme Court held that a case arises under federal patent law when the "plaintiff's right to relief necessarily depends on resolution of a substantial question of federal patent law, in that patent law is a necessary element of one of the well-pleaded claims." *Id.* at 808. Whether a claim "arises under" patent law "'must be determined from what necessarily appears in the plaintiff's statement of his own claim in the bill or declaration, unaided by anything alleged in anticipation or avoidance of defenses which it is thought the defendant may interpose.'" *Christianson*, 486 U.S. at 809 (citations omitted) (claim did not arise under patent law where complaint only obliquely hinted at patent law issues). In the instant case, as discussed herein, allegations of the Complaint do more than obliquely hint at patent law issues. After a determination that *Noerr-Pennington* immunizes Respondent's conduct before CARB, what appears in the Complaint, particularly paragraph 90(c), – third parties would have incorporated knowledge of Unocal's pending patent rights in their capital investment and refinery reconfiguration decisions to avoid and/or minimize potential infringement – plainly alleges a claim under patent law in that patent law is a necessary element of the claims. There is no fair way to determine whether any "reconfiguration decisions" would "avoid and/or minimize potential infringement" without a determination of non-infringement. As discussed below, infringement and non-infringement are clearly fundamental and substantial patent issues.

(iv) Federal courts decide substantial patent issues

The determination of the scope of the federally created property right is a substantial question of federal patent law. *Hunter Douglas, Inc. v. Harmonic Design, Inc.*, 153 F.3d 1318, 1330 (Fed. Cir. 1998) (infringement is a substantial issue in the federal scheme for it determines what is the scope of the federally created property right), *rev'd in part on other grounds, Midwest Ind., Inc. v. Karavan Trailers, Inc.*, 175 F.3d 1356 (Fed. Cir. 1999). *See also U.S. Valves, Inc. v. Dray*, 190 F.3d 811, 814 (7th Cir. 1999) (the only way to determine whether a product is covered by the licensed patents is to apply substantive patent law). Where a court must "interpret the validity and scope of a particular patent," a claim arises under patent law. *Boggild & Dale v. Kenner Products*, 853 F.2d 465, 468 (6th Cir. 1988).

The authority to decide questions of patent law arises solely under 28 U.S.C. § 1338(a), which confers original jurisdiction over patent law questions upon the federal courts. The statute gives federal district courts original jurisdiction over "any civil action arising under any Act of Congress relating to patents," and further provides that "[s]uch jurisdiction shall be exclusive of the courts of the states in patent . . . cases." 28 U.S.C. § 1338(a). *See also Scherbatskoy v. Halliburton Co.*, 125 F.3d 288 (5th Cir. 1997) ("Section 1338(a) grants *exclusive* jurisdiction to the federal district courts in cases arising under the patent laws") (emphasis added).

Complaint Counsel argues that Section 1338 operates only to preclude state courts, not federal agencies, from asserting jurisdiction over cases arising under the patent laws. Market Power Opposition at 26. Complaint Counsel further argues that because the statute explicitly prohibits state court jurisdiction, "the canon of statutory interpretation of *expressio unis est exclusio alterius* teaches that the mention of one thing (i.e., state courts) implies that Congress chose not to exclude agencies from hearing patent cases." Market Power Opposition at 27. Under this logic, one could infer, albeit not reasonably, that Congress chose not to exclude municipal courts, tax courts, the Court of Claims, etc. from hearing patent cases. Moreover, the Federal Circuit has held that this jurisdictional question arises not only in determining if state law claims are preempted, but also with respect to determining whether there is a conflict with other federal law. *Midwest Ind., Inc.*, 175 F.3d at 1357 (Federal Circuit will apply federal patent law and precedent "in determining whether patent law conflicts with other federal statutes or preempts state law causes of action."), *rev'd in part on other grounds by TrafFix Devices, Inc. v. Mktg. Displays, Inc.*, 532 U.S. 23 (2001). *E.g., Helfgott & Karas, P.C. v. Director of the United States Patent and Trademark Office*, 209 F.3d 1328, 1334 (Fed. Cir. 2000) (The question of whether the Commissioner of the Patent and Trademark Office has violated the Administrative Procedure Act raises a substantial question under the patent laws sufficient to vest jurisdiction with the district court based in part upon 28 U.S.C. 1338(a).).

(v) Commission without jurisdiction as Complaint is alleged

While the FTC may have jurisdiction over cases that "touch on patent law," as argued by Complaint Counsel, (Market Power Opposition at 4), the FTC has no jurisdiction over the allegations in this Complaint that depend on and require the resolution of substantial questions of federal patent law. In *Decker v. FTC,* 176 F.2d 461 (D.C. Cir. 1949), the FTC charged respondents with unfair and deceptive acts with regard to misrepresentations about the functions of respondent's product. Respondents asserted that the alleged misrepresentations were substantially like the statements that were included in the patent application, and thus respondents challenged the jurisdiction of the Commission on grounds that the proceedings were, in effect, an attack upon the patent itself. The Court of Appeals for the District of Columbia Circuit disagreed: "[t]he 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 district court." *Id.* at 463.

Here, unlike in *Decker*, a finding of liability based upon Respondent's conduct towards the Auto/Oil Group and WSPA can be made only upon a determination of what were Respondent's proprietary interests, what was patented, what was not patented, and whether third parties could have, in their capital investment and refinery reconfiguration decisions, avoided and/or minimized potential infringement, and whether any competing patents existed or would be valid and would not infringe. These issues draw into question the very scope of Respondent's patents and whether third parties can compete without infringing. Hence, unlike in *Decker*, the allegations here arise under the patent laws, cognizable only in federal district court. To be fair to all parties involved, a determination of the scope of Respondent's patents and any other competing, similar, or overlapping patents would be required. Due process demands that the issues raised in the allegations of the Complaint, entangled in numerous patent issues, be thoroughly and completely examined and resolved. Without such analysis and reference to federal patent law, any evidence presented would be speculative, incomplete, and not sufficient to fairly resolve the issues raised in this case.

The Federal Trade Commission is limited to the exercise of those specific powers granted to it by the Federal Trade Commission Act. *FTC v. Nat'l Lead Co.*, 352 U.S. 419, 428 (1957). Under the FTC Act, the Commission has jurisdiction to prevent unfair methods of competition and unfair or deceptive practices. 15 U.S.C. § 45. Nothing in either the language of the FTC Act or its legislative history contemplates that the Commission would exercise jurisdiction over substantial questions of federal patent law. No case was cited to, nor found, that held that the Commission has jurisdiction to decide causes of action arising under patent laws.

In *American Cyanamid*, the Commission issued a cease and desist order based on a finding that the respondent's inequitable conduct before the Patent and Trademark Office constituted a violation of Section 5 of the FTC Act. *American Cyanamid*, 63 F.T.C. 1747, 1855-57 (1963), *vac. on other grounds*, 363 F.2d 757 (6th Cir. 1966), *on rehearing*, 72 F.T.C. 623 (1967), *aff'd sub nom.*, *Charles Pfizer & Co. v. FTC*, 401 F.2d 574 (6th Cir. 1968). The Commission held that there is nothing within 28 U.S.C. § 1338(a) which would prevent the Commission from investigating methods of unfair competition before the Patent Office. 63 F.T.C. at 1857. On appeal to the Sixth Circuit, the Court of Appeals held that the Commission has jurisdiction to determine whether conduct before the Patent Office resulting in the issuance of a patent, and the subsequent use of the fruits of such conduct, may constitute a violation of Section 5 of the FTC Act. 363 F.2d at 771.

Unlike *American Cyanamid*, this Complaint does not challenge conduct before the Patent Office, where "Pfizer and Cyanamid, like all other applicants, stood before the Patent Office in a confidential relationship and owed the obligation of frank and truthful disclosure." *Pfizer*, 401 F.2d at 579. Unlike the allegations in the instant matter, *American Cyanamid* did not require an examination of scope and infringement issues. 363 F.2d at 769. Here, there are allegations requiring an examination of the scope of patents and infringement or avoidance thereof.

Accordingly, if a fair and complete analysis of the allegations and violations of law is to be done, a resolution of the allegations in this Complaint goes far beyond what was required in *American Cyanamid.* Because questions of possible patent infringement and scope must be resolved in the instant case, these substantial questions of federal patent law vitiate jurisdiction under Section 5 of the FTC Act as this case is alleged.

Complaint Counsel also relies on *In re VISX, Inc.*, Docket No. 9286, 1999 WL 33577396, Initial Decision (filed May 27, 1999), and the Commission's recent proposed consent agreement in *Bristol-Myers Squibb* for the proposition that the Commission may examine antitrust considerations relating to patent law. Market Power Opposition at 24. To the extent that the Administrative Law Judge in *VISX* construed patent and patent issues in the initial decision, that initial decision was not appealed and was, in fact, dismissed. Subsequent to the issuance of that initial decision, complaint counsel filed a motion to dismiss the complaint in which complaint counsel asked the Commission to expressly state that the Commission does not adopt the initial decision. *In re VISX, Inc.*, Docket No. 9286, (motion filed December 1, 1999) (*available at* www.ftc.gov/os/adjpro/d9286/index.htm). By order of the Commission, dated February 7, 2001, the Commission dismissed the complaint. In addition, the Commission's recent proposed consent decree in *Bristol-Meyers Squibb*, relied upon by Complaint Counsel, provides no precedential value. "[T]he circumstances surrounding . . . negotiated [consent decrees] are so different that they cannot be persuasively cited in a litigation context." *E.I. du Pont*, 366 U.S. at 330 n.12. Indeed, the consent decree itself acknowledges, "[a] consent order is for settlement purposes only and does not constitute an admission of a law violation." *Bristol-Myers Squibb, Co.*, File Nos. 001 0221, 011 0046, and 021 0181 (F.T.C. March 7, 2003) (*available at* www.ftc.gov/opa/2003/03/bms.htm).

(vi) Complaint Counsel has burden of proof

Complaint Counsel, as the party required to assert jurisdiction, bears the burden of proving subject matter jurisdiction. *Kokkonen*, 511 U.S. at 377; *In re R.J. Reynolds Tobacco Co., Inc.*, 111 F.T.C. at 541, 549 n.17 (plaintiff bears burden of proving subject matter jurisdiction and failure to meet that burden requires dismissal of the proceeding). As this case is alleged in the Complaint, there is no set of facts that Complaint Counsel could prove to demonstrate that the Commission has jurisdiction to resolve these claims arising under patent law. An analysis of the conduct alleged in the Complaint that was directed at Auto/Oil Group and WSPA would require a resolution of substantial issues arising under patent law. Because the Commission does not have jurisdiction to adjudicate the scope of Respondent's patents and whether the third parties could compete with other products or methods without infringing on valid patents, the allegations of the Complaint with respect to Respondent's conduct towards Auto/Oil Group and WSPA are dismissed.

VI. CONCLUSION

For the above stated reasons, Respondent's motion to dismiss the Complaint based upon immunity under *Noerr-Pennington* is GRANTED IN PART as to all violations alleged and all allegations of the Complaint, except the allegations of Respondent's conduct directed toward Auto/Oil Group and WSPA, independent of the conduct directed toward the CARB.

As stated above, the allegations of Respondent's conduct directed toward Auto/Oil Group and WSPA, independent of the conduct directed toward CARB, requires resolution of the substantial patent issues which are entangled in and raised by the allegations and violations of the Complaint. Respondent's motion to dismiss for failure to make sufficient allegations that Respondent possesses or dangerously threatens to possess monopoly power is GRANTED IN PART to the extent that the Commission lacks jurisdiction to decide the fundamental and substantial patent issues raised by the allegations of the Complaint. The remainder of Respondent's Market Power Motion is DENIED WITHOUT PREJUDICE.

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

VII. SUMMARY OF CONCLUSIONS OF LAW

1. Respondent Union Oil Company of California ("Unocal") is a corporation, as "corporation" is defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44.

2. Respondent is engaged in commerce and affected commerce, as "commerce" is defined in Section 4 of the FTC Act, as amended, 15 U.S.C. § 44.

3. Pursuant to Section 5 of the FTC Act, the FTC has jurisdiction over the subject matter of this proceeding, except as to the claims raised in the Complaint arising under patent law.

4. Official notice is taken of the statutes governing the California Air Resources Board ("CARB"), the Notice of Public Hearing through which CARB initiated the rulemaking, and the Final Statement of Reasons for Rulemaking, all of which are beyond dispute and have not been disputed.

5. Complaint Counsel bears the burden of showing that the *Noerr-Pennington* doctrine does not immunize Respondent's conduct alleged in the Complaint.

6. Complaint Counsel bears the burden of showing that the FTC has jurisdiction on all violations of law alleged in the Complaint.

7. *Noerr-Pennington* immunizes Respondent's efforts to induce CARB to adopt regulations on low emissions, reformulated gasoline ("RFG").

8. CARB's Phase 2 RFG rulemaking process was a legislative exercise.

9. CARB was not wholly dependent on the Respondent for information during the RFG rulemaking process.

10. *Noerr-Pennington* immunity exists even if CARB did not know that it was being asked to enact a regulation that would restrain trade.

11. The restraint of trade or monopolization alleged in the Complaint is the result of valid governmental action, CARB's adoption of Phase 2 regulations that substantially overlapped with Respondent's patent claims.

12. The sham petitioning exception does not apply in this case.

13. The *Walker Process* exception does not apply in this case.

14. The *Noerr-Pennington* doctrine provides immunity in this case alleging unfair methods of competition under Section 5 of the FTC Act.

15. To the extent that Respondent's alleged conduct towards Auto/Oil Group and WSPA were part of Respondent's scheme to induce CARB to act, it constitutes indirect petitioning protected by *Noerr-Pennington*.

16. There is no set of facts alleged in the Complaint that, if established, would prove that anticompetitive injury and resulting harm to the Auto/Oil Group and WSPA resulted from the alleged misconduct directed at the Auto/Oil Group and WSPA, instead of from CARB's enactment of Phase 2 regulations and Respondent's subsequent enforcement of its patent rights.

17. There is no set of facts alleged in the Complaint that could establish that any antitrust injury or harm was caused from any breach of a fiduciary duty without a thorough analysis of substantial patent law issues.

18. To determine whether there is any set of facts that, if proven, could support the allegations of conduct directed at Auto/Oil Group and WSPA separate from the alleged violations stemming from Respondent's efforts to get CARB to adopt regulations favorable to Respondent would require an in depth and thorough analysis of what Respondent's "proprietary interests" were, which "proprietary interests" were and were not included in any patent, what was patented, what was not patented, the scope of Respondent's patents, the scope of any competitor's patents, whether any competitor products or methods exist or could be invented, whether any of the competitor products or methods that could be created or invented infringed, and whether refineries could be reconfigured so as to avoid or minimize infringement of Respondent's patents.

19. The scope of Respondent's patents, the scope of any competitor's patents, whether any of the competitor products or methods that could be created or invented infringed, and whether refineries could be reconfigured so as to avoid or minimize infringement of Respondent's patents are issues raised by the allegations of the Complaint and are substantial patent law issues.

20. Due process and fairness require that the issues raised in the allegations of the Complaint, entangled in numerous patent issues, be thoroughly and completely examined and resolved.

21. The FTC has no jurisdiction over the allegations in this Complaint in Docket 9305 that depend on the resolution of substantial questions of federal patent law.

22. Complaint Counsel can prove no set of facts in support of its Complaint in Docket 9305 that would entitle it to relief.

ORDER

For the reasons stated above,

IT IS ORDERED that Respondent's Motion to Dismiss the Complaint Based Upon Immunity Under *Noerr-Pennington* is GRANTED IN PART as to all violations alleged and all allegations of the Complaint, except the allegations of Respondent's conduct directed toward Auto/Oil Group and WSPA, independent of the conduct directed toward the CARB.

IT IS ORDERED that Respondent's Motion to Dismiss the Complaint for Failure to Make Sufficient Allegations That Respondent Possesses or Dangerously Threatens to Possess Monopoly Power is GRANTED IN PART as to all violations alleged with respect to the allegations of Respondent's conduct directed toward Auto/Oil Group and WSPA, independent of the conduct directed toward CARB. The remainder of Respondent's Market Power Motion is DENIED WITHOUT PREJUDICE.

IT IS ORDERED that all violations of the Complaint be, and hereby are, dismissed.

ORDERED:

D. M. Chappell

D. Michael Chappell
Administrative Law Judge

Dated: November 25, 2003

EXHIBIT 3

"PERSPECTIVES ON THREE RECENT VOTES: THE CLOSING OF THE ADELPHIA COMMUNICATIONS INVESTIGATION, THE ISSUANCE OF THE VALASSIS COMPLAINT & THE WEYERHAEUSER AMICUS BRIEF"

J. THOMAS ROSCH[1]
COMMISSIONER, FEDERAL TRADE COMMISSION

before

THE NATIONAL ECONOMIC RESEARCH ASSOCIATES
2006 ANTITRUST & TRADE REGULATION SEMINAR
Santa Fe, New Mexico
July 6, 2006

Rather than recount everything the Commission has done since I joined it six months ago, I thought I would discuss my votes in three significant antitrust matters, and, since I did not explain them at the time, explain why I cast those votes.

ADELPHIA COMMUNICATIONS (January 2006)

A few days after I was sworn in, the Commission was forwarded a staff recommendation to close the investigation of the purchase by Comcast and Time Warner of the assets of Adelphia, a bankrupt cable operator that provided cable service in a variety of local markets. The staff concluded that the transaction was efficiency-enhancing because of the overhead/administrative savings realized from consolidating adjacent service areas and services. However, staff and the Commission considered arguments that the transaction would facilitate exclusive dealing arrangements of Comcast and Time-Warner with respect to Regional Sports

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1 The views stated here are my own and do not necessarily reflect the views of the Commission or other Commissioners.

Network ("RSN") offerings and thereby foreclose rivals from competing effectively for consumers who regarded RSN offerings as a "must have" offering in the Adelphia service areas.

Commissioners Harbour and Leibowitz voted against closing the investigation and issued a statement describing their reasons.[2] The Chairman, Commissioner Kovacic and I voted to close it.[3] These are my reasons for voting to close.

The threshold issue in any merger investigation is whether there is reason to believe the transaction would violate Section 7 of the Clayton Act because it was *likely* to result in anticompetitive effects. This is a prophylactic standard. Under Section 7, the Commission does not have to show there *already is* an anticompetitive effect. That said, however, the Commission *always* bears the burden of proving that the transaction is *likely* to have anticompetitive effects (*i.e.*, that it will likely injure consumers). I had doubts that the Commission could sustain that burden for the following reasons:

First, the consolidation efficiencies were not challenged, and Comcast and Time Warner's track record for innovation was better than Adelphia's, an additional benefit of the transaction in my mind. Arguably, both as a matter of law (under the Supreme Court's decision

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[2] Statement of Commissioners Pamela Jones Harbour and Jon Leibowitz (concurring in part and dissenting in part), Concerning the Closing of the Investigation into the transactions involving Comcast, Time Warner Cable, and Adelphia Communications (January 31, 2006), available at http://www.ftc.gov/os/closings/ftc/0510151twadelphialeibowitz_harbour.pdf

[3] Statement of Chairman Deborah Platt Majoras, Commissioner William Kovacic, and Commissioner J. Thomas Rosch, Concerning the Closing of the Investigation into the transactions involving Comcast, Time Warner Cable, and Adelphia Communications(January 31, 2006) available at http://www.ftc.gov/os/closings/ftc/0510151twadelphiamajoras_kovacic_rosch.pdf

in *Cargill v. Monfort*[4]) and as a matter of policy, where – because of efficiencies – it is doubtful that a transaction is likely to have a *net* anticompetitive effect (*i.e.*, cause injury to consumers), it is better to wait and see if those net anticompetitive effects occur and challenge the transaction under Sherman Act § 2 if they do. It was acknowledged that § 2 would afford a post-transaction remedy if there were exclusive dealing arrangements that injured consumers. However it was claimed that "soft" foreclosure (foreclosure resulting from the licensing of RSN broadcasts to rivals on exorbitant terms) might be hard to detect.

Second, it was doubtful on the record that *the transaction* would increase the likelihood of *either* "soft" or "hard" foreclosure. Several examples of hard and soft RSN exclusives were cited as evidence that the transaction was likely to increase that likelihood in the future. However, it was acknowledged that this phenomenon can occur *whether or not the cable company is vertically integrated.* A cable company can engage in "hard" foreclosure in a contract with an independent provider of RSN – just like Direct TV has done with the NFL Ticket. Moreover, it was striking that there was no allegation of any current or past foreclosure in the 7 or 8 different markets where it was argued the post-merger market shares would be high. There was no suggestion that Comcast or Time Warner had engaged in foreclosure in any of those markets – with or without vertical integration – and there was nothing to suggest that the *transaction* would alter the incentives for the firms to engage in such foreclosure.

Additionally, it was acknowledged that the cable companies would have an incentive to deny their RSN offerings to rivals *only if* their subscriber revenues from not licensing would exceed the revenue they received from rivals for the licenses. Some of the arguments against the

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4 479 U.S. 104 (1986)

transaction presented by third parties used projections of the *total* number of contestable subscribers in certain markets where there had been – or were going to be – RSN exclusives post-transaction. In my view, the analysis should have focused instead on the number of subscribers *for which RSN was "must have" programming.* However, the third parties did not focus on *that* number. One could not extrapolate that number from the larger number of overall subscribers. Thus, in the few markets where there had been/or were going to be RSN exclusives, the economic data purporting to demonstrate harm – even to competitors – did not hold up.

Third, *Paddock Publications v. Tribune Co.*[5] teaches that exclusives can help firms differentiate themselves and compete more effectively. In this case, it was possible that MSVDs that were cut off from a RSN might compete harder with differentiated programming, and at a minimum compete harder for the RSN contract the next time it is available (if there were no vertical integration). There was nothing in the record to demonstrate that these pro-competitive effects would not occur.

The Commission would have been confronted with all of the above even if it could establish consumer harm. As to competitive injury, it is a fundamental tenet of antitrust law that injury to competitors is not necessarily injury to competition. I found convincing none of the theories of consumer harm ultimately convincing in this case.

It was argued that RSN exclusives would reduce subscriber choice. However, the Supreme Court in *Jefferson Parish v. Hyde*[6] appeared to reject a reduction in consumer choice, standing alone, as a viable theory of consumer injury. At the very least, the Court limited the

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5 103 F.3d 42 (7th Cir. 1996), cert denied 520 U.S. 1265 (1997)

6 466 U.S. 2 (1984)

theory to situations where there are high switching costs – which do not exist when switching between cable and satellite television.

There were also complaints about raising rivals' costs, but there was no suggestion that it would competitors would be eliminated. Nor was it suggested that the higher costs for RSN would be passed on to subscribers in the local markets – given the competitors' national pricing model.

Finally, some forecasted an increase in the rates Comcast and Time Warner charged its subscribers for RSN. However, there was no evidence that subscribers who "must have" RSN in any local market would be so numerous that such a strategy would be profitable (and there was scant evidence of ability to discriminate). In other words, an increase in RSN prices would only be profitable if enough customers continued to subscribe to the service; if enough subscribers abandoned the service when faced with a price increase then the increase would be unprofitable.

Net, net, the Commission had the burden to show:

- - foreclosure was likely; and

- - it could not just harm rivals, but would have an anticompetitive effect (on consumers)

In the end, I did not believe that the Commission could bear that burden. The battle continues before the FCC, which has a different statute that may be more forgiving to some of the arguments presented to the Commission.[7]

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[7] On July 13, 2006, the FCC announced that it would allow the transaction to proceed subject to conditions. Approval was conditioned on the cable companies making available all of their RSN programming except Comcast's Philadelphia RSN offering to rivals, including DTV; the order provides for baseball style arbitration in the event the parties cannot agree on terms. The conditions are similar to those imposed by the FCC when it approved NewsCorp's acquisition of DTV several years ago.

VALASSIS (March 2006)

In March 2006, the Commission voted 5-0 to issue a complaint that challenged an invitation to collude by Valassis in a duopoly market (newspaper inserts) *solely* on the basis that its conduct constituted an unfair method of competition under Section 5 of the FTC Act.[8] Because there was a consent decree and the Aid To Public Comment focused primarily on the context in which the invitation to collude occurred – namely in an analyst conference call – the significance of the *way* the conduct was challenged went largely unnoticed. But a few cognoscenti are starting to ask whether *Valassis* was a harbinger of things to come or an outlier (to mix a few metaphors).

The answer is – I really don't know. The Aid to Public Comment issued from the staff rather than the Commission, and there is nothing on the public record to indicate how any individual Commissioner would answer that question. I will flesh out my tentative – very tentative, I should stress – thinking about when a stand-alone unfair methods of competition claim might be brought.

By its terms, Section 5 of the FTC Act prohibits all "unfair methods of competition." That's very broad language- -much broader than any language found in the Sherman or Clayton Acts. But apart from treating conduct that would violate those bedrock antitrust statutes as a kind of *per se* unfair method of competition, until Valassis, the Commission had not challenged conduct as an unfair method of competition for many years – and the challenges based on the bedrock antitrust statutes were tried essentially as Sherman or Clayton Act cases. This led many

[8] In the matter of Valassis Communications, Inc. FTC File No. 051 0008 (March 16, 2006) available at http://www.ftc.gov/os/caselist/0510008/0510008.htm

commentators to suggest that the unfair methods of competition prohibition was a dead letter and that the Commission would not challenge conduct on that basis alone.

I do not believe it is a dead letter. The Supreme Court's decision in *FTC v. Sperry & Hutchinson Co.*,[9] endorses an expansive reading of Section 5 and unfair methods of competition. In that case, the Supreme Court held that Section 5 empowered the FTC to "define and proscribe an unfair competitive practice, even though the practice does not infringe either the letter or the spirit of the antitrust laws" and to "proscribe practices as unfair or deceptive in their effect on competition."[10] This expansive reading of Section 5 was not surprising. About two decades earlier the Court declared that "[t]he 'unfair methods of competition' which are condemned by Section 5(a) of the Act, are not confined to those that were illegal as common law or that were condemned by the Sherman Act."[11]

An expansive reading of Section 5 is not only supported by Supreme Court precedent but it also seems sound as a matter of policy. A Commission decision finding conduct to be an unfair method of competition under Section 5 is not given collateral estoppel or prima facie evidentiary effect in a subsequent antitrust treble-damages action against the respondent, based on the same conduct.[12] Nor is such a finding a basis, even theoretically, for follow-on federal or state criminal actions based on the Sherman Act or its state law equivalents. Consequently, a Commission conclusion that an act or practice is an unfair method of competition under Section

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9 405 U.S. 233 (1972)

10 *Id.* at 239.

11 *FTC v. Motion Picture Advert. Serv. Co.*, 344 U.S. 392, 394-95(1953).

12 *See, In re Antibiotic Antitrust Actions*, 333 F. Supp. 317, 322 (S.D.N.Y. 1971); 15 U.S.C. § 16(a) (2006).

5 is less likely than a finding that an act or practice is a Sherman Act violation to do collateral damage.

I believe that S&H is alive and well, notwithstanding the trilogy of appellate cases decided in the early 1980s that rejected Commission decisions challenging conduct as unfair methods of competition under Section 5.[13]

In the first of these cases, *Boise Cascade v. FTC*[14], the Ninth Circuit overturned the Commission's decision that the plywood industry's use of a non-collusive delivered price system was an unfair method of competition. The Ninth Circuit held that, absent proof of overt collusion (which would have made the practice a *per se* violation of Section 1 of the Sherman Act), the Commission could not use Section 5 to get around the lack of evidence of actual anticompetitive effect.[15] The court rejected a *standalone* unfair methods of competition claim when there was "well forged" Sherman Act case law governing the conduct, lest it "blur the distinction between guilty and innocent commercial behavior."[16]

Subsequently, in *Official Airline Guides v. FTC* ("OAG")[17], the Second Circuit overturned a Commission decision holding that it was an unfair method of competition for the then sole provider of airline flight schedule information to refuse to publish listings of

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13 *See, Boise Cascade v. FTC*, 637 F.2d 573 (9th Cir. 1980); *Official Airline Guides ("OAG") v. FTC*, 630 F.2d 920 (2d Cir. 1980); *E.I. duPont de Nemours & Co. v. FTC*, 729 F.2d 128 (2d Cir. 1984).

14 637 F.2d 573 (9th Cir. 1980)

15 *Id.* at 579.

16 *Id.* at 581-82.

17 630 F.2d 920 (2d Cir. 1980)

connecting flights of commuter airlines. The practice was not proscribed by Section 2 of the Sherman Act because *OAG* was not a participant in the airline market in which competition was allegedly affected. The court acknowledged that the refusal was arbitrary and that it had an adverse effect on competition between certificated and commuter air carriers. However, the court held that treating the practice as an "unfair method of competition," notwithstanding its legality under the Sherman Act, "would give the Commission too much power to substitute its own business judgment for that of the monopolist in any decision that arguably affects competition in another industry."[18]

In the third of these cases, *E.I. duPont de Nemours & Co. v. FTC* ("Ethyl"),[19] the Second Circuit overturned a Commission decision holding that various parallel "price-signaling" and other unilateral practices by oligopolists was an unfair method of competition, notwithstanding the absence of an actual agreement. The court described a more specific standard for unfair methods of competition than had been described in the *Boise Cascade* or *OAG* cases, stating that "at least some indicia of oppressiveness must exist such as (1) evidence of anticompetitive intent or purpose on the part of the producer charged, or (2) the absence of a legitimate business reason for its conduct."[20]

None of these decisions directly challenges the holding in *S&H* that conduct not governed by the Sherman Act may be treated as an unfair method of competition. Indeed, after these decisions issued, the Supreme Court (albeit in dictum) repeated the teaching of *S&H* that

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18 *Id.* at 927.

19 729 F.2d 128 (2d Cir. 1984)

20 *Id.* at 139-40.

"[t]he standard of 'fairness' under the FTC Act is, by necessity, an elusive one, encompassing not only practices that violate the Sherman Act and other antitrust laws, but also practices that the Commission determines are against public policy for other reasons. . . ."[21]

The Commission initially responded to these decisions by downplaying their significance. *OAG* was said to have been incorrectly decided.[22] The holding in *Ethyl* was said to be very narrow, imposing no requirement to prove anticompetitive purpose or effects.[23] I believe these readings of the Second Circuit decisions are too cramped. Moreover, I think that the decisions articulate important *limiting principles* for unfair methods of competition analysis.

First, the Second Circuit cases appear to require proof of anticompetitive *purpose* (and the lack of legitimate business justification). In *Ethyl*, the court described an unfair method of competition as requiring "at least some indicia of oppressiveness, such as evidence of anticompetitive intent or purpose on the part of the producer charged or the absence of an independent legitimate business reason for its conduct.[24] And, in *OAG*, the court held that a monopolist could refuse to deal with whomever he pleases "as long as he has no purpose to restrain competition or to enhance or expand his monopoly, and does not act coercively, retains this right."[25]

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21 *FTC v. Indiana Federation of Dentists*, 476 U.S. 447, 454 (1986).

22 *See, General Motors Corp.*, 99 F.T.C. 464, 580 n.45 (1982).

23 *See Coca-Cola Co.*, 117 F.T.C. 795, 915 n.24 (1994).

24 *Ethyl,* 729 F.2d at 139.

25 *OAG,* 630 F.2d at 927.

Second, the Ninth Circuit's decision in *Boise Cascade* appears to teach that in the absence of *per se* illegal conduct, proof of actual or incipient anticompetitive *effect* is also required.[26] Indeed, former Chairman Tim Muris has written that sound antitrust analysis must always be grounded in anticompetitive effects.[27] His focus was on single firm conduct cases under Section 2, but his views would seem to apply with equal force to an unfair method of competition claim under Section 5. It may be that the effect element of the claim can be inferred from clear evidence of anticompetitive intent (and lack of legitimate business purpose). The Analysis to Aid Public Comment in *Valassis*, for example, stated that an invitation to collude could be treated as an unfair method of competition where there was clear evidence of anticompetitive intent and of a dangerous probability of an anticompetitive effect.[28] However, I think there must be *some* evidence, direct or circumstantial, of actual or incipient anticompetitive effect; otherwise, the claim would arguably be too unbounded.

Net, net, the Commission's action in *Valassis* should not be read to endorse the treatment of conduct as an unfair method of competition when the conduct is plainly governed by the Sherman Act. In *Valassis*, the alleged conduct was *not* squarely covered by the Sherman Act. An invitation to collude is conduct that does not fit neatly within the language of Section 1 or Section 2. It is unilateral conduct not governed by Section 1. Moreover, *United States v.*

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26 *See*, *Boise Cascade,* 630 F.2d at 582.

27 *See,* Timothy J. Muris, "FTC and The Law of Monopolization," 67 ANTITRUST L.J. 693 (2000).

28 *In the Matter of Valassis*, File No. 051-0008 (Consent Order, March 14, 2006, Analysis to Aid Public Comment at p. 5) available at, http://www.ftc.gov/os/caselist/0510008/060314ana0510008.pdf.

American Airlines[29] is the only decision that has blessed treating an invitation to collude as a Section 2 offense. Numerous decisions have held that there is no such offense--that the monopolization referred to in Section 2 is inherently a single firm concept.[30] Thus, in my view, *Valassis* was an "out-of-round" Sherman Act case that could, and should, legitimately be brought simply and solely as an unfair method of competition case under Section 5 – and the case involved the anticompetitive intent and incipient anticompetitive effect required by the Trilogy for a stand alone unfair method of competition claim.

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29 743 F.2d 1114 (5th Cir. 1984)

30 *See e.g., Harkins Amusement Eters. v. General Cinema Corp.*, 850 F.2d 477, 490 (9th Cir. 1988); *Sun Dun, Inc. v. Coca-Cola Co.*, 740 F.Supp. 381, 390 (D. Md. 1990).

WEYERHAEUSER (May 2006)

I suspect many of you know that Commissioner Leibowitz and I voted *against* the joining the United States' *amicus* brief filed in the *Weyerhaeuser* case.[31] The brief recommended that the Supreme Court grant cert. Here's why I voted the way I did.

The central premise of the *amicus* brief was said to be the passage at page 12, asserting that the Sherman Act protects sellers in an input market as well as buyers in an output market. The brief cited the Supreme Court's 1948 decision in *Mandeville Farms*[32] as its support for this premise. Based on that premise, the government's brief argued that *Brooke Group*[33] applied foursquare to a buyer case alleging predatory pricing as well as to a seller case alleging predatory pricing. However, I believe this premise is wrong and would create bad law for the following reasons.

First, it has long been settled that the antitrust laws do not protect buyers or sellers, as such. They protect *consumers*.

Second, the Guidelines adopted by *both* agencies have made it clear that agreements among competitors as buyers (which would probably be condemned as per se illegal if engaged in by those same competitors as sellers) will be treated as illegal only when the agreements are likely to injure consumer welfare.[34] The Guidelines for Collaborations Among Competitors, for

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31 *See,* Brief for the United States as Amicus Curiae, No. 05-381 (May 31, 2006); *Confederated Tribes of Siletz Indians of Oregon v. Weyerhaeuser Co.,* 411 F.3d 1030 (9th Cir. 2005);

32 *Mandeville Farms, Inc. v. American Sugar Co.*, 334 U.S. 219 (1948)

33 *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.,* 509 U.S. 209 (1993)

34 *See,* United States Department of Justice and Federal Trade Commission, Guidelines for Collaborations Among Competitors (April 7, 2000), *reprinted in* 4 Trade Reg.

example, identifies three situations where buy-side agreements can have that effect.[35] The first is where the buyers enjoy monopsony power such that their buying agreement can depress output and thereby produce supra-competitive prices in the long run (to the detriment of consumers). The second is where the buy-side agreement can standardize costs of an input that is so important in output prices that they can effectively fix sell-side prices (to the detriment of consumers). The third is where the buy-side agreement will enable participants to monitor important input prices so as to facilitate prediction of competitor production levels and thereby influence output and pricing decisions on the sell-side (to the detriment of consumers).

The Health Care Guidelines likewise treat threats to consumer welfare as the defining characteristics of buy-side agreements that should be condemned and challenged.[36] Absent evidence of consumer injury, buy side conduct – whether unilateral or concerted – that reduces input costs and thus is efficiency-enhancing is likely to help, not harm, consumer welfare, and thus should not be condemned or challenged. In short, there is nothing in the government Guidelines to suggest that we should be concerned about seller (rather than consumer) welfare,

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Rep. (CCH) ¶ 13,160; United States Department of Justice and Federal Trade Commission, Policy Statements on Health Care Antitrust Enforcement (August 18, 1996), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,153. *But cf.,* Federal Trade Commission and United States Department of Justice, IMPROVING HEALTH CARE : A DOSE OF COMPETITION, Chapter 6 at pp.13-20 (July 2004), available at http://www.ftc.gov/reports/healthcare/040723healthcarerpt.pdf

[35] *See,* United States Department of Justice and Federal Trade Commission, Guidelines for Collaborations Among Competitors, § 3.31(a) at p. 14 (April 7, 2000)

[36] *See,* United States Department of Justice and Federal Trade Commission, Policy Statements on Health Care Antitrust Enforcement, Statement 7 on Joint Purchasing Arrangements Among Health Care Providers (August 18, 1996), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,153.

much less to support the sweeping assertion made in the *amicus* brief that the antitrust laws are designed to protect sellers and buyers equally.

Third, *Mandeville Farms* does not compel that conclusion either. As previously stated, the government's brief argued that the Supreme Court's 1948 decision in *Mandeville Farms* supported its position. It does, to be sure, contain the language quoted in the brief. However, *Mandeville Farms* is nearly a half century old, and that language was written long before consumer welfare became the lodestar of antitrust analysis for the courts (including the Supreme Court) and commentators. Moreover, even in *Mandeville Farms*, the Supreme Court said in its analysis of the facts that the defendant sugar beet processors enjoyed monopsony power on the buy-side *and* market power on the sell-side so that their buy-side agreement had the potential to impact sell-side prices (and thus injure consumers).[37]

In short, I thought this critical portion of the *amicus* brief was not just out of step with modern (and proper) antitrust analysis. By suggesting that the antitrust laws broadly protect sellers, I was concerned that it would chill buy-side conduct that would reduce input costs and thereby advantage, not hurt, consumers.

This is not to say that I thought the Ninth Circuit's decision affirming the judgment against Weyerhaeuser was right. Ironically, I think it was dead wrong. In the jury verdict underlying the judgment, the jury found that Weyerhaeuser lacked any market power in the alleged relevant product market (namely lumber). If that is so, its buy-side conduct could not harm consumers. But a wrong result in an appellate court decision, standing alone, is usually not

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37 *Mandeville Farms* at 240-41.

a sufficient basis for *certiorari*. I, therefore, could not join the Commission majority in recommending that it be granted.

EXHIBIT 4

STATEMENT OF COMMISSIONERS HARBOUR, LEIBOWITZ AND ROSCH ON THE ISSUANCE OF THE SECTION 2 REPORT BY THE DEPARTMENT OF JUSTICE[1]

Today the Department of Justice ("the Department") issued a Report that, if adopted by the courts, would be a blueprint for radically weakened enforcement of Section 2 of the Sherman Act.[2] We recognize that, in response to our concerns, today's Report includes more balanced discussion sections than earlier drafts we reviewed. Nevertheless, the final Report's descriptions and conclusions respecting how Section 2 is and should be enforced cannot be said to represent the consensus, or even the prevailing, view of the myriad of stakeholders interested in Section 2 enforcement. The Report also goes beyond the holdings of the Supreme Court cases upon which it relies. The Federal Trade Commission ("FTC") does not endorse the Department's Report.

We have two overarching concerns with the Department's Report. First, the U.S. Supreme Court has declared that the welfare of *consumers* is the primary goal of the antitrust laws.[3] However, the Department's Report is chiefly concerned with firms that enjoy monopoly or near-monopoly power, and prescribes a legal regime that places these firms' interests ahead of the interests of consumers. At almost every turn, the Department would place a thumb on the scales in favor of firms with monopoly or near-monopoly power and against other equally significant stakeholders.

Second, the Report seriously overstates the level of legal, economic, and academic consensus regarding Section 2. For example, the witnesses who participated on the hearing panels were far from unanimous in their opinions about what the settled law was, much less what it should be.[4] Indeed, in hindsight, we are concerned that the testimony gathered during the hearings was not representative of the views of all Section 2 stakeholders, despite the best efforts of the two agencies to assemble balanced witness panels. In particular, we are concerned that voices representing the interests of consumers were not adequately heard. And insofar as the Report relies on economic

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[1] Chairman William E. Kovacic does not join this statement and writes separately.

[2] U.S. DEP'T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT (2008), *available at* http://www.usdoj.gov/atr/public/reports/236681.pdf [hereinafter REPORT]. Section 2 prohibits, among other things, monopolization and attempts to monopolize.

[3] Reiter v. Sonotone Corp., 442 U.S. 330, 342 (1979).

[4] We express our appreciation to Commission and Department staff members who labored long and hard to put together the Section 2 hearings. We are equally appreciative of the time and effort invested by all of the witnesses who testified at the hearings (identified in an Appendix to the Department's Report), and we join the Department in saluting them for their contributions.

theory, the recent warning of Justice Breyer bears repeating: while economic theory is an important consideration in applying antitrust law, economic theory is not tantamount to the law itself.[5]

We envisioned a Report that would identify outstanding issues in Section 2 enforcement; provide neutral and balanced illustrations of the conflicting positions that have been taken on those issues; and suggest topics for further study to help resolve the debate. Such a Report would carefully distinguish between Supreme Court holdings and *dicta* in terms of their precedential value. Additionally, it would take special care not to imply that the testimony at the hearings was representative of the views of all of the Section 2 stakeholders. Such a Report would have made a significant contribution to Section 2 jurisprudence.

I. <u>The Report's Premises</u>

The Department's descriptions of its Section 2 enforcement intentions are based on four fundamental premises. First, the Report embraces the theory that the promise of monopoly profits drives firms to innovate and compete.[6] Anticipated financial rewards certainly drive innovation and competition. But this does not guarantee that profits resulting from monopoly power will have the same beneficial market effects as profits resulting from competition. Monopolies have been appropriately criticized because they tend toward inefficiency and have reduced incentives to

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[5] Leegin Creative Leather Prods. v. PSKS, Inc., 127 S. Ct. 2705, 2729 (2007) (Breyer, J., dissenting) ("[A]ntitrust law cannot, and should not, precisely replicate economists' (sometimes conflicting) views. That is because law, unlike economics, is an administrative system the effects of which depend upon the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients.").

[6] *See, e.g.,* REPORT, Chapter 1 at 7-8; Chapter 2 at 1; Chapter 4 at 49 (low prices); Chapter 7 at 119 (refusals to deal with rivals).

innovate.[7] Monopolies also have been criticized because monopoly power in one market (even where legitimately acquired or maintained) may be used to leverage power in other markets.[8]

Second, the Report concludes that the risk of over-enforcement of Section 2 is greater than the risk of under-enforcement, contending that fear of liability leads firms to compete less aggressively.[9] The Report notes that it is often difficult to distinguish between aggressive competition and exclusionary conduct.[10] This may be true in some cases, but that challenge also exists in other areas of antitrust law and is not unique to Section 2. Regardless of the underlying theory of potential liability, antitrust counseling and enforcement decisions require an in-depth, context-specific assessment of the facts. We believe that the federal antitrust enforcement agencies and the private antitrust bar are (and will remain) up to that task, in the Section 2 realm and elsewhere.

At the same time, the Report downplays the risks of under-enforcement. The Report espouses the economic theory that monopoly power is self-destructive and that markets are self-correcting.[11] In other words, it is said that a firm with monopoly power (however that power was obtained or maintained) will not have that power forever; thus, the risks of under-enforcement are outweighed by the risks of over-enforcement. Even if correct, however, this hypothesis does not

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7 Standard Oil Co. v. United States, 221 U.S. 1, 52 (1911) (citing the danger that a monopoly will "fix the price," impose a "limitation on production," or cause a "deterioration in the quality of the monopolized product"); United States v. Aluminum Co. of Am., 148 F.2d 416, 427 (2d Cir. 1945) (Hand, J.) ("unchallenged economic power deadens initiative, discourages thrift and depresses energy"); *Federal Trade Commission and Department of Justice Hearings on Section 2 of the Sherman Act: Single-Firm Conduct As Related to Competition*, Sept. 26, 2006 Hr'g Tr., Empirical Perspectives at 13 (Scherer), *available at* http://www.ftc.gov/os/sectiontwohearings/docs/transcripts/sept26EmpiricalPerspectivestrans.pdf (observing that reluctance to "cannibalize the rents that they are earning on the products that they already have marketed" may make monopolists "sluggish innovators").

8 Town of Concord v. Boston Edison Co., 915 F.2d 17, 23-24 (1st. Cir. 1990); *compare* REPORT, Chapter 5 at 77, 90 (declaring that tying is ubiquitous, typically benefits consumers, and is often procompetitive, with no exception for situations where engaged in by a firm with monopoly or near-monopoly power).

9 *See, e.g.,* REPORT, Chapter 1 at 14-15; Chapter 3 at 46-47; Chapter 4 at 49, 69 (low prices); Chapter 5 at 88, 90 (tying); Chapter 6, section 1 at 102 (bundled discounts); Chapter 6, section 2 at 116 (loyalty discounts); Chapter 7 at 126, 129 (refusals to deal with rivals).

10 *See, e.g.,* REPORT, Chapter 1 at 9, 12-13, 18; Chapter 3 at 33-34, 43; Chapter 4 at 49 (predatory pricing); Chapter 5 at 88 (tying); Chapter 6, section 1 at 102, 104-05 (bundled discounts); Chapter 6, section 2 at 116-17 (loyalty discounts); Chapter 7 at 125-26 (refusals to deal with rivals).

11 *See, e.g.,* REPORT, Chapter 2 at 25.

adequately consider the harm consumers will suffer while waiting for the correction to occur. Markets can and do take years, even decades, to correct themselves. For one reason or another, it may take a long time for rivals to surmount entry barriers or other impediments to effective competition. Indeed, the monopolist's own deliberate conduct may further delay a market correction and prolong the duration of consumer harm.

Third, the Department repeatedly cites the "costs of administration" as a factor weighing against enforcement of Section 2.[12] Of course those costs must be considered, by the federal antitrust enforcement agencies as well as by the courts. For example, if it would be impossible to fashion a meaningful remedy for an alleged violation, arguably it is not worth challenging the suspect conduct in the first place. But no one – including the Department – has yet provided a methodology for weighing the costs and benefits of Section 2 enforcement (including potential remedies), or for comparing the relative costs and benefits to businesses versus consumers. Therefore, we do not agree that any category of conduct can be excluded from the scope of Section 2 based on the difficulty of devising an appropriate remedy.

Fourth, the Report emphasizes a need for clear and administrable rules, asserting that this need has motivated courts to fashion "bright line" tests.[13] While clear rules are desirable in the abstract, the benefits of clarity must be balanced against the benefits of effective and reasonable law enforcement, lest the interests of consumers be compromised.[14] Drawing an analogy to Section 1 enforcement, rules of *per se* illegality largely have been tempered by rule of reason analysis, despite the clear guidance afforded by earlier *per se* rules. Similarly, the Report overstates the extent to which the Supreme Court has embraced bright-line rules of *per se* legality. The only "safe harbors" blessed by the Supreme Court relate to alleged predatory pricing and bidding;[15] they were adopted because of the unique threat to consumer welfare that otherwise might result from challenges to low

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12 *See, e.g.,* REPORT, Chapter 1 at 9, 16; Chapter 2 at 4; Chapter 3 at 45; Chapter 6, section 1 at 102 (bundled discounts); Chapter 7 at 123, 126-27 (refusals to deal with rivals).

13 *See, e.g.*, REPORT, Introduction at 2; Chapter 1 at 13-15, 17-18; Chapter 3 at 34-35; Chapter 4 at 49-50, 61, 73 (predatory pricing); Chapter 6, section 1 at 97-98, 105 (bundled discounts); Chapter 6, section 2 at 116 (loyalty discounts); Chapter 8 at 141 (exclusive dealing).

14 We recognize that businesses are key stakeholders interested in Section 2 enforcement. Firms that enjoy monopoly or near-monopoly power are among these stakeholders, as are their rivals and customers. To the extent the federal antitrust enforcement agencies can provide detailed and transparent guidance to the business community regarding our interpretation of Section 2 and our enforcement priorities – without compromising the interests of consumers – of course we should do so.

15 Brooke Group v. Brown & Williamson Tobacco Corp, 509 U.S. 209 (1993); Weyerhauser Co. v. Ross-Simmons Hardwood Lumber Co., 127 S.Ct. 1069 (2007). The Court has not, however, adopted the "average avoidable cost" safe harbor set forth in the Report. REPORT, Chapter 4 at 65-67.

prices.[16] The Report incorrectly suggests that the Court in *Trinko* adopted a rule of *per se* legality for refusals to deal with rivals, ignoring both the context of the case and the Court's express language to the contrary.[17]

This is not to say that the Department's premises are entirely without merit. These premises are not totally lacking in support from some of the witnesses at the Section 2 hearings, Supreme Court *dicta* in some cases, and additional scholarship. But these premises do not represent the consensus, or even the prevailing, views of the section 2 stakeholders. They do not reflect the conclusions of those who enacted Section 2 and its counterparts, who decided that, on balance, the negatives associated with the acquisition or maintenance of monopoly power outweigh the positives. Nor do these premises represent the views of the Supreme Court, as those views have been expressed by the Court in its holdings in Section 2 cases. As law enforcement agencies, the Department and the Commission must respect existing law. Of course, the agencies have an equally important obligation to encourage the development of the law – a role that the Commission, in particular, has always taken quite seriously. But with respect to Section 2 enforcement policy, neither the views of the many stakeholders, nor the Supreme Court's holdings, provide clear guidance regarding whether the drastic changes proposed by the Department are necessary. Therefore, we strongly distance ourselves from the enforcement positions stated in the Report.

II. <u>The Report's Law Enforcement Standards</u>

The Department's premises lead it to adopt law enforcement standards that would make it nearly impossible to prosecute a case under Section 2 of the Sherman Act. For example, the Department's baseline test for Section 2 liability would only condemn conduct if the demonstrable anticompetitive effects are "disproportionately" greater than the procompetitive potential.[18] The disproportionality test distorts the rule of reason standard, which simply asks whether the anticompetitive harm "outweighs" the procompetitive effects. The existing rule of reason standard already poses a significant hurdle to liability, unless care is taken to ensure that a Section 2 plaintiff does not bear a prohibitively high burden of proof.[19]

The Department also adopts specific tests for a variety of conduct such as predatory pricing, loyalty discounts, price bundling, tying, refusals to deal with rivals, and exclusive dealing. In almost every case, the Department adopts standards that are tougher – and in some cases much tougher – than existing standards as defined by Section 2 case law.

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16 *Brooke Group*, 509 U.S. at 226-27.

17 Verizon Comms. Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004).

18 REPORT, Chapter 3 at 45.

19 *See, e.g.*, United States v. Microsoft, 253 F.3d 34 (D.C. Cir. 2001).

1. Predatory Pricing

With respect to predatory pricing, the Department states that as long as prices are above a firm's "average avoidable costs" (which would not include any costs incurred before the alleged predatory pricing occurs), the firm's pricing is legal.[20] The Department adopts this broad rule of legality despite acknowledging that the rule could enable a firm with monopoly or near-monopoly power to exclude a rival who otherwise could constrain the firm's exercise of monopoly power. This would occur, for example, where the firm and its rival must incur large up-front costs but the "avoidable costs" of producing each unit are *de minimis*.[21] Moreover, in the event that a firm's pricing falls outside this price-cost safe harbor, the Department would allow proof of "efficiencies" as a "defense even in a setting where there is existing monopoly power."[22] No Supreme Court decision has embraced either the Department's "average avoidable cost" safe harbor or the proof of "efficiencies" as an extra defense of conduct that could facilitate foreclosure effects.[23] Indeed, the Department acknowledges that the latter defense "received little attention" at the Section 2 hearings.[24]

2. Loyalty Discounts

Similarly, in the case of loyalty discounts, the Department states that it "would likely apply a standard predatory pricing test."[25] That price-cost "safe harbor" would apply even when the loyalty discounts are so-called "first dollar" or "non-linear" discounts.[26] The Department again adopts this price-cost "safe harbor" despite recognizing that this legal standard could permit a firm with monopoly or near-monopoly power to foreclose a weaker rival from the minimum viable scale

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20 REPORT, Chapter 4 at 65-67.

21 *Id.* at 63-64.

22 *Id.* at 71-72.

23 In *Brooke Group*, the Court stated only that "an appropriate measure of cost" should be used. *Brooke Group*, 509 U.S. at 222-24. The Court did not say it would be "appropriate" to use a price-cost test that could facilitate foreclosure of rivals in a market where monopoly power exists, and the Court has never blessed an additional "efficiencies" defense in those circumstances.

24 REPORT, Chapter 4 at 71.

25 REPORT, Chapter 6, section 2 at 116.

26 "First dollar" or "non-linear" discounts are discounts offered not only on the "contestable" portion of sales made to customers (sales for which the firm and its rival can both compete) but also on "uncontestable" sales (sales for which a rival cannot compete because, for example, the rival lacks the economies of scale or scope to do so). *See* REPORT, Chapter 6, section 2 at 111-12.

it would need to constrain the exercise of monopoly power.[27] In an even more striking declaration, the Department says that if a rival "remains in the market" (no matter how crippled the rival may be), the rival's existence will be treated as evidence that the loyalty discounts are legal, even if the practices fall outside the ambit of the price-cost "safe harbor."

There is no authority for these law enforcement prescriptions in the holdings of the Supreme Court or, for that matter, the holdings of the "lower court" invoked by the Department.[28] Moreover, the Department's use of the "standard" price-cost "safe harbor" (or any kind of price-cost "safe harbor"), rather than using an exclusive dealing analysis for these kinds of loyalty discounts, is inconsistent with the Report's recognition that these practices represent a form of exclusive dealing.[29]

3. Bundled Discounts

The Department acknowledges that bundled discounts can be used by a firm with monopoly or near-monopoly power to foreclose a rival from the scale it needs to constrain the firm's exercise of monopoly power, especially when the rival cannot offer all of the products in the bundle.[30] Yet the Department declares that if the rival can offer all of the products in the bundle, the "standard" price-cost safe harbor will be used.[31] If the rival cannot do so, the price-cost "safe harbor" will still be used, modified only to attribute the discount at which the bundle is sold to the products sold in common by the firm and the rival.[32] Additionally, even if the bundled discount falls outside of these price-cost "safe harbors," the Department will nevertheless consider it legal, unless a public or private plaintiff demonstrates that the practice has "no procompetitive benefit" or that the harm is "disproportionate" to the benefit.[33]

Again, no Supreme Court decision has ever blessed the use of any price-cost rules of legality for any practice except predatory pricing, and the Department is the sole author and authority for

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27 *Id.* at 107, 111-12.

28 The Supreme Court has never blessed the use of any price-cost rules of *per se* legality for any practice except predatory pricing. It is not clear that any of the lower court decisions cited in the Report involved "first dollar" or "non-linear" discounts granted by a firm with monopoly or near-monopoly power. In any event, even if such discounts were involved, the lower courts did not address their exclusionary potential.

29 REPORT, Chapter 6, section 2 at 114-15.

30 REPORT, Chapter 6 at 105-06.

31 *Id.* at 105.

32 *Id.*

33 *Id.* at 117.

use of the "disproportionality" safety net.[34] Moreover, the Report does not mention the possibility of analyzing bundled discounts as a form of exclusive dealing instead of affording them the protection of price-cost "safe harbors" and requiring proof of "disproportionality," despite the Department's recognition of the kinship between bundled discounts and "first dollar" loyalty discounts (the latter having been identified by the Department as a form of exclusive dealing).

4. Tying

The Department declares that tying is ubiquitous.[35] Contrary to existing Supreme Court case law,[36] the Department says that tying (presumably even by a firm with monopoly or near-monopoly power) "typically benefits consumers" and is "often procompetitive."[37] Tying surely benefits consumers in some instances, but the Department draws no distinction between the use of tying by a firm with monopoly power or near-monopoly power and the use of the practice by other firms.[38] Additionally, lest the practice of tying be challenged despite these admonitions, the Department would require public and private plaintiffs to prove that the anticompetitive consequences of a tying scheme are "significantly disproportionate" to any benefits.[39] As previously stated, the disproportionality test is of the Department's own making.[40] The Department's position enjoys no support in the law, and it is so ill-defined that it will be hard, if not impossible, for any public or private plaintiff to satisfy it.

5. Unilateral Refusals to Deal with Rivals

The Report flatly declares that unilateral refusals to deal with rivals "should not play a meaningful role in antitrust enforcement," regardless of a firm's monopoly power or the potential for foreclosure.[41] The Department incorrectly implies[42] that the Commission subscribed to this

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34 REPORT, Chapter 3 at 45-46.

35 REPORT, Chapter 5 at 77.

36 Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2 (1984).

37 REPORT, Chapter 5 at 90.

38 *Id.*

39 *Id.*

40 *See* REPORT, Chapter 3 at 45-46.

41 REPORT, Chapter 7 at 127, 129.

42 *Id.* at 124 and n. 71.

position in the agencies' joint April 2007 report on intellectual property issues ("IP Report").[43] The IP Report concluded that "mere unilateral, unconditional refusals to license will not play a meaningful part in the interface between patent rights and antitrust protection."[44] That statement reflected the agencies' view that the simple act of refusing to license intellectual property may not constitute a violation of the antitrust laws. That view is consistent with the Supreme Court's holding in *Illinois Tool Works* that intellectual property may or may not confer monopoly power.[45]

If a patent does confer monopoly power, however, then denial of access to the patented technology may not be a "mere" unilateral refusal to license intellectual property. A firm with monopoly power or near-monopoly power may violate Section 2 if it refuses to license to, or otherwise refuses to deal with, a rival. The Commission has never itself, or in conjunction with the Department, said otherwise. Indeed, the Supreme Court repeatedly has held, as it stated long ago in its *Colgate* decision, that when there is a "purpose to create or maintain a monopoly" there may be a duty to deal with a rival.[46] Although the Court held in *Trinko*[47] that a firm with monopoly power had no duty to deal with rivals when the public was protected by regulation of the firm's practices, the Court declared in *Trinko* that the right to refuse to deal with rivals is not unqualified.[48] The Department acknowledges this aspect of *Trinko* in its Report but fails to apply such a standard to the conclusions in this chapter.[49]

6. Exclusive Dealing

Finally, with respect to exclusive dealing, the Department adopts another "safe harbor," declaring that the practice is legal if no more than thirty percent of the market is foreclosed to a

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43 U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION (Apr. 2007), *available at* http://www.ftc.gov/reports/innovation/P040101PromotingInnovationandCompetitionrpt0704.pdf.

44 *Id.* at 6, 32.

45 Illinois Tool Works Inc. v. Independent Ink, Inc., 547 U.S. 28 (2006).

46 United States v. Colgate & Co., 250 U.S. 300 (1919) (*dictum*); Otter Tail Power Co. v. United States, 410 U.S. 366 (1973); Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 602 (1985); Eastman Kodak Co. v. Image Technical Services, Inc., 504 U.S. 451, 466-467 (1992).

47 *Trinko*, 540 U.S. 398.

48 *Id.* at 408 (*citing Aspen Skiing*, 472 U.S. at 601).

49 REPORT, Chapter 7 at 122, 125.

rival.[50] According to the Report, that rule applies despite the Department's acknowledgment that a rival may need greater access to the market in order to achieve sufficient scope and scale to constrain the exercise of monopoly power.[51] The Department further declares that exclusive dealing will be considered legal, even if outside the "safe harbor," unless the public or private plaintiff can establish that the conduct has no procompetitive effects or that its anticompetitive effects are "disproportionate" to its benefits under the Department's newly-created "disproportionality" requirement.[52]

III. Conclusion

The Department's Report does not consider all of the exclusionary practices that may be used to obtain or maintain monopoly power and cause harm to consumers.[53]

The Department embraces a series of "safe harbors" applicable to individual practices, even though each of these practices has substantial potential to lead to anticompetitive foreclosure if employed by a firm with monopoly power or near-monopoly power. In other words, each practice might be used by a firm with monopoly power or near-monopoly power to foreclose a rival from making sales the rival needs to compete effectively. As a result, the dominant firm might be sheltered from competition that otherwise would constrain its exercise of monopoly power.

Even for practices that fall outside the "safe harbors," the Department would impose rigorous burdens of proof on both public and private plaintiffs. These burdens of proof will be difficult, if not impossible, for plaintiffs to meet.

In short, the Department's Report erects a multi-layered protective screen for firms with monopoly or near-monopoly power. As an inevitable consequence, dominant firms would be able to engage in these practices with impunity, regardless of potential foreclosure effects and impact on consumers. Indeed, it appears that the Department intends for this screen to apply even when a firm uses two or more of these practices collectively, instead of just one practice individually.

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50 REPORT, Chapter 8 at 141.

51 *Id.* at 137.

52 *Id.* at 140.

53 As one notable example, except for a passing reference, the Report ignores forms of "cheap exclusion;" that is, virtually costless forms of exclusionary conduct, which may be employed by a firm with monopoly or near-monopoly power. *See* Susan A. Creighton, D. Bruce Hoffman, Thomas G. Krattenmaker & Ernest A. Nagata, *Cheap Exclusion*, 72 ANTITRUST L.J. 975 (2005) (citing, as examples, the Commission's *Unocal* case and the Commission's Orange Book exclusion payment cases).

This Commission stands ready to fill any Sherman Act enforcement void that might be created if the Department actually implements the policy decisions expressed in its Report. We will continue to be vigilant in investigating and, where necessary, prosecuting Section 2 violations.

The Department's Report undoubtedly will spark lively discussion and spur additional Section 2 scholarship, and we look forward to being a part of that process. In addition, we will continually seek to strengthen our relationships with our foreign counterparts, as we look around the world for additional perspectives on dominant firm conduct and other competition issues.

EXHIBIT 5

ANTITRUST ANALYSIS

Problems, Text, Cases

Fifth Edition

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cial inquiries into market power. Paragraph 343 summarizes the discussion, emphasizing points where confusion is common. This textual presentation is followed by government guidelines and two leading market power decisions in the monopolization context.

336. Monopoly and market power. (a) *Defining monopoly in terms of market power.* Although the monopolization offense is routinely assumed to require market power in an economic sense, it is useful to trace the motivation for this approach. Sherman Act §2 does not speak of power or markets but merely condemns those "who shall monopolize . . . any part of the trade or commerce among the several states, or with foreign nations." Conventional definitions of monopoly explicitly refer to *exclusive* possession or control. But §2 does not adopt this dictionary definition. It has been clear from the earliest days of the Sherman Act that one can be a monopolist and monopolize within the meaning of the statute without being the sole supplier of a product. Rather, the courts have defined the possession of monopoly power as the power to control price or to exclude competition. A dominant firm might possess such power even though it accounts for, say, only 90 percent of the sales of a product. Moreover, a firm accounting for 100 percent of such sales might lack power over price if customers are readily satisfied by substitute products or if new entry is very easy.[2]

This power to elevate prices above (and to restrict output below) competitive levels is called market power by economists (and, increasingly, by courts as well). It is possessed to some degree by every firm that is not constrained by perfect competition. But we have already seen that it does not appear to be the purpose of the Sherman Act to bring about a regime of perfect competition.[3] Under §2, only substantial market power will be deemed monopoly power. Thus, two problems face the courts: (1) How do we determine how much market power exists in a given case? (2) At what point on the spectrum between perfect competition and perfect monopoly should market power be deemed sufficient?[4] The factors

2. For example, consider a trucking company that offers the only regular delivery between two cities. Its 100 percent share may make it a literal monopoly, but it has hardly any power to exploit consumers because even modest price increases above the competitive level would induce shippers to telephone other trucking companies to arrange for them to haul the freight at a better price. After all, there are few industries in which the relevant capital stock is more mobile.

3. See ¶¶125-127.

4. This second formulation is itself overly simplistic, since a perfect monopolist can have no power or substantial power, depending on the circumstances.

described in ¶335 should determine, in principle, what threshold is appropriate in a given context.[5]

Although the ability to charge 50 percent more than the competitive price is generally understood to show market power and be of equal legal concern whether the product is steel or paper clips, the impact on consumer welfare varies. Even in markets of similar magnitude, the economic loss from a given excess of price over cost varies with the shape of demand and cost curves at monopoly and competitive levels of output, although these variations are typically too complex to be considered in antitrust litigation. Secondly, the assumed 50 percent excess impairs consumer welfare much more in the multibillion dollar steel market than in the far smaller clip market. Does this mean that society should be readier to control possible misbehavior in the larger market and thus to set a lower threshold of market power before doing so? (To put the same question from the opposite angle, should we insist on higher-than-usual power thresholds before intervening in smaller markets?) In favor of doing so, the cost and complexity of antitrust litigation does not rise proportionally with the economic stakes. On the other hand, varying the legal standard according to the absolute size of the market may overcomplicate the system. In addition, the social consequence of an erroneous condemnation may also be greater in the larger market.

(b) *The price of monopoly.*[6] Since market power is to serve as our measure of the evil effects of monopoly, we must begin by recalling the reasons that we object to monopoly and value competition. Monopoly, for example, produces economic inefficiency. In the formal model of perfect competition, the output of a commodity tends to expand until price falls to the point just equal to each firm's marginal cost of production, which, in equilibrium, will also equal long-run average cost (including normal profits but no more). Where a single firm controls the production of that commodity, the output will be smaller and price higher.[7] Thus, the monopolist profits at the expense of buyers, who are forced to pay more. Consumers unable to pay the monopolist's high price will spend their funds elsewhere and thus induce increased production of other commodities — commodities that consumers would not want under competitive pricing conditions. Thus, monopolistic limitations on output divert society's productive energies to less valued undertak-

5. Market power inquiries in contexts other than §2 will employ similar analysis as to the first question, but the appropriate answer to the second may differ substantially.

6. For a more detailed statement, see ¶¶112-113.

7. See ¶112a.

ings and thereby distort resource allocation away from the maximum satisfaction of consumer wants.

(c) *Market power as power over price.* Given this statement of the economic harms for monopoly, market power is measured by the extent to which price can be elevated above the competitive level, which corresponds to cost. Common statements of market power — the power to control price, the range of discretion, or choice that the firm possesses — are suggestive of this definition but leave some room for confusion. Such terms are meant to contrast the powerful firm with the perfectly competitive firm that has no choice but to match the market price. It cannot obtain more than its rivals charge, and it has no reason to take any less (because, by definition, the perfectly competitive firm is too small to have any impact on market price and thus can sell all it can produce at the going price). By contrast, a monopolist maximizes profits by choosing the price at which any further increase would cost it more in lost sales than it gains in increased profit on sales retained. Typically, there is only one such price that maximizes profits.[8] Thus, at least if the monopolist is a rational, profit-maximizing firm, it, like the perfect competitor, has only one choice. But the absence of discretion for a profit maximizer, is, of course, irrelevant. The evil of monopoly is that the profit-maximizing price, even if not truly discretionary, harms consumers and reduces economic efficiency, while that of the perfect competitor does not.[9]

(d) *Market power and the goals of the antitrust laws.* This definition of market power focuses entirely on competitive prices and economically efficient results. Is that narrow focus inconsistent with the broader social and political values that the antitrust laws are sometimes said to foster?[10] That question has not been much explored, but several answers are possible. First, the behavior of firms without market power might be thought too inconsequential to affect any of those broader purposes of the antitrust laws. Second, some would argue that the noneconomic motives for the legislation are less important than serving the economic function or that pursuing competitive prices and efficiency actually serves the broader objectives to the extent that Congress intended. Third, the difficulty of formulating standards to serve the broader objectives may leave the courts, by default, with those of the economic model of competi-

8. Id.

9. The monopolist that chooses not to charge the full monopoly price still exploits consumers and impairs efficient resource allocation. Even the monopolist that chooses the competitive price still has the power to do otherwise (although we may not be able to detect it when prices and profits are merely at the competitive level).

10. See *Alcoa,* Ch. 3A, and ¶¶117, 130, 505.

tion: allocative or productive efficiency, innovation, and consumer welfare. The last point, however, might still leave some room for these broader concerns — to whatever extent that can be articulated and sensibly applied — in setting the market power threshold for particular offenses, resolving uncertainties concerning market power in individual cases, defining the range of conduct that subjects firms to liability in the presence of market power, and limiting permissible defenses to such conduct.

337. Ways of measuring market power. (a) *Introduction.* Although we shall see that the conventional approach to measuring market power is to define a relevant market, the resulting market share merely offers a basis for *inferring* market power — that is, the degree to which price will be elevated above the competitive level. When the existence of monopoly is the issue, would it not be simpler to go directly to the ultimate question, that is, to ask whether and how much price is above cost? The remainder of this Paragraph notes the limitations on this approach and helps explain the role of the market definition concept.

(b) *Difficulty of direct measurement.* We seldom measure power directly because it is difficult to obtain and appraise the relevant data.[11] Although identifying the price is often straightforward, measuring the relevant cost is not. An alternative would be to ask whether the firm's profits on the product exceed the normal return to which they would be driven in a competitive equilibrium. Cost and profits involve many components buried within mounds of accounting information, where the books do not directly reflect economic concepts of cost and profit. Problems with overhead, inventories, depreciation, joint production costs, and allocations of charges within a conglomerate make such inquiries notoriously difficult.[12]

11. Recently some studies have attempted to show how market power could be directly measured. See D. Kamerschen & J. Kohler, Residual Demand Analysis of the Ready-to-Eat Breakfast Cereal Market, 38 Antitr. Bull. 903 (1993); D. Kamerschen & J. Park, An Alternative Approach to Market Structure and Market Price, 25 Applied Econ. 111 (1993); J. Baker & T. Bresnahan, Empirical Methods of Identifying and Measuring Market Power, 61 Antitr. L.J. 3 (1992); J. Baker & T. Bresnahan, Estimating the Residual Demand Curve Facing a Single Firm, 6 Intl. J. Indus. Org. 283 (1988). And courts have expressed a willingness to consider direct evidence of market power. See Rebel Oil Co. v. Atlantic Richfield Co., 51 F.3d 1421 (9th Cir.), cert. denied, 116 S. Ct. 515 (1995) (in predation case, market power may be shown by direct evidence of its exercise or by more common method of circumstantial evidence pertaining to market structure).

12. This problem was explored in ¶232a and is addressed further in the excerpt in ¶347, at note 107.

EXHIBIT 6

ANALYSIS OF PROPOSED CONSENT
ORDER TO AID PUBLIC COMMENT

***In the Matter of Negotiated Data Solutions LLC,* File No. 051 0094**

The Federal Trade Commission ("Commission") has accepted, subject to final approval, an Agreement Containing Consent Order ("Agreement") with Negotiated Data Solutions LLC ("N-Data"), a limited liability company whose sole activity is to collect royalties in connection with a number of patents. The Agreement settles allegations that N-Data has violated Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, by engaging in unfair methods of competition and unfair acts or practices relating to the Ethernet standard for local area networks. Pursuant to the Agreement, N-Data has agreed to be bound by a proposed consent order ("Proposed Consent Order").

The Proposed Consent Order has been placed on the public record for thirty (30) days for comments by interested persons. Comments received during this period will become part of the public record. After thirty (30) days, the Commission will again review the Agreement and the comments received and will decide whether it should withdraw from the Agreement or make final the Agreement's Proposed Consent Order.

The purpose of this analysis is to facilitate comment on the Proposed Consent Order. This analysis does not constitute an official interpretation of the Proposed Consent Order, and does not modify its terms in any way. The Agreement has been entered into for settlement purposes only, and does not constitute an admission by N-Data that the law has been violated as alleged or that the facts alleged, other than jurisdictional facts, are true.

Background

The Institute of Electrical and Electronics Engineers ("IEEE") is a standard-setting organization active in a number of different industries. IEEE standards often enhance the interoperability of communications products. One important example, which is at issue here, is the 802 series of networking standards. Many of the standards in the 802 series allow users to reliably access and share information over communications systems by interconnecting many compatible products manufactured by different producers.

The IEEE 802.3 standard, first published in 1983, and commonly referred to as "Ethernet," applies to local area networks ("LANs") built on copper, and more recently fiber optic, cables. That standard initially accommodated a maximum data transmission rate of 10 megabits per second (10 Mbps) between networked devices. By 1994, the 802.3 Working Group was developing a new 802.3 standard for "Fast Ethernet," which would transmit data across a copper wire at 100 Mbps. The Working Group determined that it would be desirable for Fast Ethernet equipment to be compatible, to the extent possible, with existing LAN equipment and with future generations of equipment. A technology, variously known as "autodetection" and "autonegotiation," was developed that would permit such compatibility.

Employees of National Semiconductor Corporation ("National") were members and active participants in the 802.3 Working Group. In 1994, National proposed that the 802.3 Working Group adopt its autonegotiation technology, referred to as "NWay," into the Fast Ethernet standard. At the time, National disclosed to the Working Group that it had already filed for patent protection for the technology. Several other participants also had developed competing technologies and the Working Group considered several alternatives, each having advantages and disadvantages compared to NWay. The 802.3 Working Group also considered adopting the Fast Ethernet standard without any autonegotiation feature.

At IEEE meetings to determine which autonegotiation technology to include in 802.3, one or more representatives of National publicly announced that if NWay technology were chosen, National would license NWay to any requesting party for a one-time fee of $1,000. In a subsequent letter dated June 7, 1994, and addressed to the Chair of the 802.3 Working Group of IEEE, National wrote:

> In the event that the IEEE adopts an autodetection standard based upon National's NWay technology, National will offer to license its NWay technology to any requesting party for the purpose of making and selling products which implement the IEEE standard. Such a license will be made available on a nondiscriminatory basis and will be paid-up and royalty-free after payment of a one-time fee of one thousand dollars ($1,000).

Based on National's licensing assurance, and following its normal balloting and voting procedures, IEEE incorporated NWay technology into the Fast Ethernet standard, which IEEE published in final form in July 1995. To maintain compatibility with the installed base of Ethernet and Fast Ethernet equipment, subsequent revisions of the 802.3 standard also have incorporated NWay autonegotiation technology. The "Fast Ethernet" standard became the dominant standard for LANs, and users are now locked in to using NWay technology due to network effects and high switching costs. Therefore, today, autonegotiation technologies other than NWay are not attractive alternatives to NWay for manufacturers who want to include inter-generational compatibility in their Ethernet products.

NWay contributed to the success of Fast Ethernet technology in the marketplace. An installed base of millions of Ethernet ports operating at 10 Mbps already existed when IEEE published the Fast Ethernet standard. The autonegotiation technology in the Fast Ethernet standard allowed owners of existing Ethernet-based LANs to purchase and install multi-speed, Fast Ethernet-capable equipment on a piecemeal basis without having to upgrade the entire LAN at once or buy extra equipment to ensure compatibility.

National benefitted financially from its licensing assurance. The assurance accelerated sales of National products that conformed to the Fast Ethernet standard by first, allaying concerns about the future costs of autonegotiation, and so speeding completion of the standard, and second, making Fast Ethernet-compatible products backward compatible with Ethernet equipment already installed on existing LANs, increasing the demand for Fast Ethernet products by those with existing systems.

In 1997, the United States Patent and Trademark Office issued U.S. Patent Nos. 5,617,418 and 5,687,174 (the'418 and '174 Patents) to National. Both patents arose from the patent application that National disclosed to the IEEE in 1994. National later received equivalent patents in other countries.

In 1998, National assigned a number of patents, including the '418 and the '174 Patents, to Vertical Networks ("Vertical"), a telecommunications start-up company founded by former National employees. Before the assignment, National gave Vertical a copy of the June 7, 1994 letter to the 802.3 Working Group. Vertical's outside patent counsel, Mr. Alan Loudermilk, acknowledged in writing that National had informed him "that several of the patents may be 'encumbered'" by actions National had taken with respect to the IEEE standards. The final agreement between Vertical and National stated that the assignment was "subject to any existing licenses that [National] may have granted." It further provided, "Existing licenses shall include ... [p]atents that may be encumbered under standards such as an IEEE standard ...."

In 2001, Vertical turned to its intellectual property portfolio in an effort to generate new revenues by licensing its technology to third parties. One aspect of this strategy was Vertical's effort to repudiate the $1,000 licensing term contained in National's 1994 letter of assurance to the IEEE. On March 27, 2002, Vertical sent a letter to the IEEE that purported to "supersede" any previous licensing assurances provided by National. Vertical identified nine U.S. patents assigned to it by National, including the '174 and '418 patents, and promised to make available to any party a non-exclusive license "on a non-discriminatory basis and on reasonable terms and conditions including its then current royalty rates."

In the Spring of 2002, Vertical developed a list of "target companies" that practiced the IEEE 802.3 standard and which it believed infringed on the '174 and '418 patents. Vertical sought to enforce the new licensing terms on these companies. These companies, which included many large computer hardware manufacturers, represented a substantial majority of all producers of 802.3 ports. Vertical's patent counsel, Mr. Loudermilk, sent letters to most of these companies between 2002 and 2004 offering a license for patents covering aspects of "the auto-negotiation functionality" in networking products, including products compliant with IEEE 802.3. Vertical also filed suit against a number of companies alleging that "switches, hubs, routers, print servers, network adapters and networking kits" having autonegotiating compatibility, infringed its '174 and '418 patents. Vertical entered into several licensing agreements producing licensing fees far in excess of $1,000 from each licensed company.

In late 2003, Vertical assigned some of its patent portfolio, including the '174 and '418 patents, to N-Data, a company owned and operated by Mr. Loudermilk.[1] N-Data was aware of National's June 7, 1994 letter of assurance to the IEEE when Vertical assigned those patents to N-Data. Yet it rejected requests from companies to license NWay technology for a one-time fee of $1,000. Instead, N-Data threatened to initiate, and in some cases prosecuted, legal actions against companies refusing to pay its royalty demands, which are far in excess of that amount.

The Proposed Complaint

Vertical and N-Data sought to exploit the fact that NWay had been incorporated into the 802.3 standard, and had been adopted by the industry for a number of years, by reneging on a known commitment made by their predecessor in interest. Even if their actions do not constitute a violation of the Sherman Act, they threatened to raise prices for an entire industry and to subvert the IEEE decisional process in a manner that could cast doubt on the viability of developing standards at the IEEE and elsewhere. The threatened or actual effects of N-Data's conduct have been to increase the cost of practicing the IEEE standards, and potentially to reduce output of products incorporating the standards.[2] N-Data's conduct also threatens to reduce the incentive for firms to participate in IEEE and in other standard-setting activities, and to rely on standards established by standard-setting organizations.

The Proposed Complaint alleges that this conduct violates Section 5 of the FTC Act in two ways: first, N-Data engaged in an unfair method of competition; and second, N-Data engaged in an unfair act or practice.

1. Unfair Method of Competition

N-Data's conduct constitutes an unfair method of competition. The Supreme Court in *FTC v. Sperry & Hutchinson Co.* endorsed an expansive reading of the "unfair method of competition" prong of Section 5, stating that the Commission is empowered to "define and proscribe an unfair competitive practice, even though the practice does not infringe either the letter or spirit of the antitrust laws" and to "proscribe practices as unfair ... in their effect on

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[1] Vertical subsequently sold its remaining business assets and ceased operations.

[2] The conduct by Vertical and N-Data has led to, or threatened to lead to, increased prices in the markets for autonegotiation technology (1) used in 802.3 compliant products and (2) used in products that implement an IEEE standard enabling autonegotiation with 802.3 compliant products.

competition."[3] That description of the scope of Section 5 accords with the legislative history of Section 5.[4]

Notwithstanding that broad description, the unfair method of competition prong of Section 5 is subject to limiting principles. The first relates to the nature of the conduct. In *OAG*, the Second Circuit held that such a violation could not be found where the respondent "does not act coercively."[5] Similarly, in *Ethyl* the Second Circuit held that "at least some indicia of oppressiveness must exist ...."[6] This requirement is met here, given N-Data's efforts to exploit the power it enjoys over those practicing the Fast Ethernet standard and lacking any practical alternatives. This form of patent hold-up is inherently "coercive" and "oppressive" with respect to firms that are, as a practical matter, locked into a standard.

The second limiting principle relates to the effects of the conduct. Although the Supreme Court has made it clear that the respondent's conduct need not violate the letter (or even the spirit) of the antitrust laws to fall under Section 5, that does not mean that conduct can be considered an unfair method of competition if it has no adverse effect at all on competition. That requirement, however, is also satisfied here, given the conduct's adverse impact on prices for autonegotiation technology and the threat that such conduct poses to standard-setting at IEEE and elsewhere.

Respondent's conduct here is particularly appropriate for Section 5 review. IEEE's determination to include National's technology in its standard rested on National's commitment to limit royalties to $1,000. That commitment had substantial competitive significance because it extended not to a single firm, but rather to an industry-wide standard-setting organization. Indeed, in the standard-setting context with numerous, injured third parties who lack privity

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[3] *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 239 (1972); *see also FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 454 (1986). *See generally* Concurring Opinion of Commissioner Jon Leibowitz, *In re Rambus, Inc.*, Docket No. 9302, *available at* http://www.ftc.gov/os/adjpro/d9302/060802rambusconcurringopinionofcommissionerleibowitz.pdf; Statement of Commissioner J. Thomas Rosch, "Perspectives on Three Recent Votes: the Closing of the Adelphia Communications Investigation, the Issuance of the Valassis Complaint & the Weyerhaeuser Amicus Brief," before the National Economic Research Associates 2006 Antitrust & Trade Regulation Seminar, Santa Fe, New Mexico (July 6, 2006) at 5-12, *available at* http://www.ftc.gov/speeches/rosch/Rosch-NERA-Speech-July6-2006.pdf.

[4] *See, e.g.*, Cong. Rec. 12,153 (1914) (statement of Sen. Robinson) ("unjust, inequitable or dishonest competition" proscribed), 51 Cong. Rec. 12,154 (1914) (statement of Sen. Newlands) (conduct that is "contrary to good morals" proscribed).

[5] *Official Airline Guides v. FTC*, 630 F.2d 920, 927 (2d Cir. 1980) ("*OAG*").

[6] *E.I. Du Pont v. de Nemours & Co. v. FTC*, 729 F.2d 128, 139-40 (2d Cir. 1984) ("*Ethyl*").

with patentees and with the mixed incentives generated when members may be positioned to pass on royalties that raise costs market-wide contract remedies may prove ineffective, and Section 5 intervention may serve an unusually important role.

N-Data's conduct, if allowed, would reduce the value of standard-setting by raising the possibility of opportunistic lawsuits or threats arising from the incorporation of patented technologies into the standard after a commitment by the patent holder. As a result, firms may be less likely to rely on standards, even standards that already exist. In the creation of new standards, standard-setting organizations may seek to avoid intellectual property entirely, potentially reducing the technical merit of those standards as well as their ultimate value to consumers.

A mere departure from a previous licensing commitment is unlikely to constitute an unfair method of competition under Section 5. The commitment here was in the context of standard-setting. The Supreme Court repeatedly has recognized the procompetitive potential of standard-setting activities. However, because a standard may displace the normal give and take of competition, the Court has not hesitated to impose antitrust liability on conduct that threatens to undermine the standard-setting process or to render it anticompetitive.[7] The conduct of N-Data (and Vertical) at issue here clearly has that potential.[8]

2. Unfair Act or Practice

N-Data's efforts to unilaterally change the terms of the licensing commitment also constitute unfair acts or practices under Section 5 of the FTC Act. The FTC Act states that "unfair or deceptive acts or practices in or affecting commerce[] are . . . unlawful." An unfairness claim under this part of Section 5 must meet the following statutory criteria:

> The Commission shall have no authority . . . to declare unlawful an act or practice on the grounds that such act or practice is unfair unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably

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[7] *See Standard Sanitary Mfg. Co. v. United States*, 226 U.S. 20, 41 (1912); *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 500 (1989); *Am. Soc'y of Mech. Engineers, Inc. v. Hydrolevel Corp.*, 456 U.S. 556, 571 (1982).

[8] It is worth noting that, because the proposed complaint alleges stand-alone violations of Section 5 rather than violations of Section 5 that are premised on violations of the Sherman Act, this action is not likely to lead to well-founded treble damage antitrust claims in federal court. *See* Herbert Hovenkamp, Federal Antitrust Policy at 588 (2d ed. 1999).

> avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition.[9]

The Commission may consider established public policies as evidence to be considered with all other evidence, though not as a primary basis for a determination of unfairness.[10] As the Eleventh Circuit emphasized in *Orkin Exterminating Co. v. FTC*,[11] the Commission has applied limiting principles requiring a showing that (1) the conduct caused "substantial consumer injury," (2) that injury is "not . . . outweighed by any countervailing benefits to consumers or competition that the practice produces," and (3) it is an injury that "consumers themselves could not reasonably have avoided."[12]

This Section 5 claim against the efforts of Vertical and N-Data to unilaterally increase the price for the relevant technology by knowingly reneging on National's commitment meets these statutory criteria, and thus constitutes a violation of Section 5's prohibition of unfair acts and practices. NWay was chosen for the standard on the basis of the assurances made by National to the IEEE 802.3 Working Group. Further, the industry relied, at least indirectly, on National's assurances regarding pricing, and made substantial and potentially irreversible investments premised on those representations. After the standard became successful, and it became difficult, if not impossible, for the industry to switch away from the standard, Vertical and then N-Data took advantage of the investments made by these firms by reneging on National's commitment. Because it is now no longer feasible for the industry to remove the technologies, the value that N-Data was able to extract from market participants was due to the opportunistic nature of its conduct rather than the value of the patents.[13]

Accordingly, an action against this conduct meets the criteria set forth in the statute and in *Orkin*. First, N-Data's reneging on its pricing commitments here involved "substantial consumer

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[9] 15 U.S.C. § 45(n) (1992).

[10] *Id.*

[11] *Orkin Exterminating Co. v. FTC*, 849 F.2d 1354, 1364 (11th Cir. 1988).

[12] See Letter from Federal Trade Commission to Senators Ford and Danforth (Dec. 17, 1980), reprinted in H.R. Rep. No. 156, Pt. 1, 98th Cong., 1st Sess. 33-40 (1983) *available at* http://www.ftc.gov/bcp/policystmt/ad-unfair.htm, appended to the Commission's decision in *International Harvester,* 104 F.T.C. at 949, 1061 (1984), and subsequently codified by Congress at 15 U.S.C. § 45(n).

[13] The IEEE designed its rules to avoid just such a result. IEEE's stated purpose for requesting letters of assurance was to avoid giving "undue preferred status to a company" and to ensure that the adoption of a technology would not be "prohibitively costly or noncompetitive to a substantial part of the industry." 1994 *IEEE Standards Operations Manual* §6.3.

injury." The increase in royalties demanded by Vertical Networks and later N-Data could result in millions of dollars in excess payments from those practicing the standard, not to mention the legal fees those firms might spend defending lawsuits.[14] In addition, often in market-wide standard-setting contexts, the licensees have an incentive to pass along higher costs to the ultimate consumers who purchase the products.[15] Thus, these end consumers who purchase products using N-Data's technology may face increased prices due to the higher royalties. Further, those demands also have no apparent "countervailing benefit" to those upon whom demands have been made, ultimate consumers, or to competition so the second requirement is also met. With respect to the third requirement, both the Commission and the Eleventh Circuit in *Orkin* stated that consumers "may act to avoid injury before it occurs if they have reason to anticipate the impending harm and the means to avoid it, or they may seek to mitigate the damage afterward if they are aware of potential avenues to that end."[16] Here, those who created the standard had no way to anticipate the repudiation of the price commitment before it occurred and, apart from expensive litigation, those locked into the standard had no way to avoid the threatened injury posed by the demands that they faced. Thus, those practicing the standard were locked in to even a greater extent than the consumers in *Orkin.* Put simply, this is a form of what has been described as "patent hold-up."

The facts alleged in the complaint here are similar to those found in the Commission's decision in *Orkin*, which was affirmed by the Eleventh Circuit.[17] In that case, the respondent signed contracts with consumers to supply lifetime extermination services at a fixed annual renewal fee. Years later, the respondent unilaterally increased these fees. Consumers needing extermination services had no reason to anticipate Orkin's unilateral price increase and there was no evidence that they could contract with Orkin's competitors on terms similar to Orkin's initial terms. The Commission held, and the Eleventh Circuit agreed, that Orkin's unilateral price increase was an unfair act or practice under Section 5. Similarly, National made non-expiring royalty commitments that Vertical and N-Data later repudiated with unilateral increases, which

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[14] The Commission has a "longstanding position that the statutory prohibition against 'unfair or deceptive acts or practices' includes practices that victimize businesspersons as well as those who purchase products for their own personal or household use," given that businesses "clearly do consume goods and services that may be marketed by means of deception and unfairness." Brief of Federal Trade Commission as Amicus Curiae at 3-4, 8-9, *Vermont v. International Collection Service, Inc.*, 594 A.2d 426 (Vt. 1991) (citing cases); *see also, e.g.*, 16 C.F.R. § 436.1 (FTC rule protecting franchisees); *United States Retail Credit Ass'n v. FTC*, 300 F.2d 212 (4th Cir. 1962) (deception involving business clients); *United States Ass'n of Credit Bureaus, Inc. v. FTC*, 299 F.2d 220 (4th Cir. 1962) (same).

[15] Susan A. Creighton, *Cheap Exclusion*, 72 ANTITRUST L.J. 975, 994 (2005).

[16] *Orkin,* 849 F.2d at 1365.

[17] *In re Orkin Exterminating Co.*, 108 F.T.C. 263 (1986), *aff'd*, 849 F.2d 1354 (11th Cir. 1988).

the industry could not have reasonably anticipated before the market wide adoption of the standard and which consumers had no chance of avoiding due to network effects and lock-in.

Clearly, merely breaching a prior commitment is not enough to constitute an unfair act or practice under Section 5. The standard-setting context in which National made its commitment is critical to the legal analysis. As described above, the lock-in effect resulting from adoption of the NWay patent in the standard and its widespread use are important factors in this case. In addition, the established public policy of supporting efficient standard-setting activities is an important consideration in this case.[18] Similarly, it must be stressed that not all breaches of commitments made by owners of intellectual property during a standard-setting process will constitute an unfair act or practice under Section 5. For example, if the commitment were immaterial to the adoption of the standard or if those practicing the standard could exercise countermeasures to avoid injury from the breach, the statutory requirements most likely would not be met. Finally, it needs to be emphasized that not all departures from those commitments will be treated as a breach. The *Orkin* court suggested that there might be a distinction between an open-ended commitment and a contract having a fixed duration.[19] That distinction does not apply here because the context of the commitment made it plain that it was for the duration of National's patents. However, most such commitments, including the one here, are simply to offer the terms specified. Indeed, those principles are reflected in the remedy set forth in the consent decree.

The Proposed Consent Order

The Proposed Consent Order prohibits N-Data from enforcing the Relevant Patents, defined in the order, unless it has first offered to license them on terms specified by the order. The terms of that license follow from those promised by National Semiconductor in its letter of June 7, 1994, to the IEEE. Specifically, N-Data must offer a paid-up, royalty-free license to the Relevant Patents in the Licensed Field of Use in exchange for a one-time fee of $1,000. The form of this license is attached as Appendix C to the order. The Licensed Field of Use is defined in the license as the "use of NWay Technology to implement an IEEE Standard," and this includes "optimization and enhancement features" that are consistent with such use. NWay Technology is defined in the license to have the same meaning as it did in the June 7, 1994 letter, and the license gives examples of documents describing the use of NWay Technology.

The Commission recognizes that some firms may inadvertently allow the $1,000 offer from N-Data to languish. Therefore, if an offeree has failed to accept such an offer within 120

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[18] *See Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 500-01 (1998) (regarding the potential procompetitive advantages of private associations promulgating safety standards).

[19] *Orkin*, 849 F.2d at 1361.

days, the Proposed Consent Order allows N-Data to sue to enforce the Relevant Patents. At the time N-Data files suit, however, it must make a second offer. This second offer provides a prospective licensee with an opportunity to accept the patent license specified by the order in return for a payment of thirty-five thousand dollars ($35,000). The requirement that the second offer be delivered in the context of litigation gives N-Data an incentive to pursue patent enforcement only against companies over which it has a reasonable likelihood of prevailing in court. It will also ensure that the second offer will receive the full attention of knowledgeable counsel for the offeree. A $35,000 license fee will offset some of N-Data's costs of litigation, and it will discourage recipients of an initial offer from simply waiting to be sued, and <u>then</u> accepting the first offer. The offeree's time to accept the second offer expires with the time to file a responsive pleading to the filing that accompanies the second offer. After that, the amount that N-Data can collect from an accused infringer is not limited by the order.

The Proposed Consent Order requires N-Data to distribute copies of the complaint and the Proposed Consent Order to specified persons. It also prohibits N-Data from transferring any of the Relevant Patents, except to a single person who has agreed to be bound by the Proposed Consent Order and by the patent licenses formed thereunder. The Proposed Consent Order also contains standard reporting, notification and access provisions designed to allow the Commission to monitor compliance. It terminates twenty (20) years after the date it becomes final.

EXHIBIT 7

STATEMENT OF THE FEDERAL TRADE COMMISSION
In the Matter of Negotiated Data Solutions LLC
File No. 0510094

The Federal Trade Commission ("Commission") has voted to issue a Complaint against Negotiated Data Solutions LLC ("N-Data") and to accept the proposed consent agreement settling it.[1] The Complaint in this matter alleges that N-Data reneged on a prior licensing commitment to a standard-setting body and thereby was able to increase the price of an Ethernet technology used by almost every American consumer who owns a computer. Based on the facts developed by staff during the investigation, we find reason to believe that this conduct violated Section 5 of the FTC Act.[2]

The impact of Respondent's alleged actions, if not stopped, could be enormously harmful to standard-setting.[3] Standard-setting organization participants have long worried about the impact of firms failing to disclose their intellectual property until after industry lock-in. Many standard-setting organizations have begun to develop policies to deal with that problem. But if N-Data's conduct became the accepted way of doing business, even the most diligent standard-setting organizations would not be able to rely on the good faith assurances of respected companies. The possibility exists that those companies would exit the business, and that their patent portfolios would make their way to others who are less interested in honoring commitments than in exploiting industry lock-in.[4] Congress created the Commission precisely to challenge just this sort of conduct.

To prohibit such unacceptable behavior, the Commission today accepts a proposed consent agreement premised on a Complaint that identifies two separate violations. First, we find that N-Data's alleged conduct is an unfair method of competition. Second, we find that this conduct is also an unfair act or practice.

There is little doubt that N-Data's conduct constitutes an unfair method of competition.[5] The legislative history from the debate regarding the creation of the

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[1] Commissioners Harbour, Leibowitz, and Rosch support the issuance of the Complaint and proposed consent agreement and join in this statement.

[2] Section 5 of the FTC Act prohibits "unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce." 15 USC § 45(a)(1).

[3] One dissent recites a different set of facts than those alleged in the Complaint. We do not agree with that version of the facts. Rather, we believe that staff's investigation, as described in the Analysis to Aid Public Comment, accurately depicts the facts in this case.

[4] *See generally* Fed. Trade Comm'n , *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy* ch. 2 at 31, n. 220; ch. 3 at 38-41, *available at* http://www.ftc.gov/os/2003/10/innovationrpt.pdf (2003) (conduct by "non-producing entities" – sometimes referred to as 'patent trolls' – may harm consumers when such firms force manufacturers to agree to licenses after the manufacturers have sunk substantial investments into technologies).

[5] *See, e.g.,* E.I. du Pont de Nemours & Co. v. FTC, 729 F.2d 128 (2d Cir. 1984) ("*Ethyl*"); Official Airline Guides v. FTC, 630 F.2d 920 (2d Cir. 1980). The conduct falls squarely within the parameters of cases like *Ethyl.* One dissent quotes a passage from the *Ethyl* decision; even that excerpt

Commission is replete with references to the types of conduct that Congress intended the Commission to challenge. *See, e.g.,* 51 Cong. Rec. 12,153 (1914) (statement of Sen. Robinson) ("unjust, inequitable or dishonest competition"), 51 Cong. Rec. 12,154 (1914) (statement of Sen. Newlands) (conduct that is "contrary to good morals"). The Supreme Court apparently agrees as it has found that the standard for "unfairness" under the FTC Act is "by necessity, an elusive one, encompassing not only practices that violate the Sherman Act and the other antitrust laws, but also practices that the Commission determines are against public policy for other reasons." *F.T.C. v. Ind. Fed'n of Dentists,* 476 U.S. 477, 454 (1986); *see also F.T.C. v. Sperry & Hutchinson Co.,* 405 U.S. 233, 242 (1972) (FTC has authority to constrain, among other things "deception, bad faith, fraud or oppression").

We also have no doubt that the type of behavior engaged in by N-Data harms consumers. The process of establishing a standard displaces competition; therefore, bad faith or deceptive behavior that undermines the process may also undermine competition in an entire industry, raise prices to consumers, and reduce choices.[6] We have previously

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makes clear that a Section 5 violation can be found when there are "some indicia of oppressiveness" such as "coercive...conduct." For the reasons stated in the Analysis to Aid Public Comment, we find reason to believe that Respondent engaged in conduct that was both oppressive and coercive when it engaged in efforts to exploit licensees that were locked into a technology by the adoption of a standard. We believe the Analysis to Aid Public comment adequately describes the limiting principles applicable here. *See generally* Statement of Commissioner J. Thomas Rosch, *Perspectives on Three Recent Votes: the Closing of the Adelphia Communications Investigation, the Issuance of the Valassis Complaint & the Weyerhaeuser Amicus Brief,* before the National Economic Research Associates 2006 Antitrust & Trade Regulation Seminar, Santa Fe, New Mexico (July 6, 2006) at 5-12, *available at* http://www.ftc.gov/speeches/rosch/Rosch-NERA-Speech-July6-2006.pdf; Concurring Opinion of Commissioner Jon Leibowitz, *In re Rambus, Inc.,* Docket No. 9302, *available at* http://www.ftc.gov/os/adjpro/d9302/060802rambusconcurringopinionofcommissionerleibowitz.pdf.

One dissent cites the Areeda and Hovenkamp antitrust treatise as well as several other sources to mistakenly suggest that there is a "scholarly consensus" that an unfair method of competition cannot be found under Section 5 unless there is liability under the antitrust laws. Most of the sources cited by the dissent, however, actually support the Analysis to Aid Public Comment, which notes that, although Section 5 extends beyond the antitrust laws, there are limitations on its reach. Indeed, Professor Hovenkamp has explicitly acknowledged that there is a *lack* of consensus on the scope and application of Section 5. *See* HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY at 596-97 (3d ed. 2005). Professor Hovenkamp states that "[t]here are two views about the wisdom of the FTC's use of Section 5" and goes on to discuss "[A]n alternative view, perfectly consistent with the proposition that the FTC's antitrust concern should be limited to identifying practices that are economically anticompetitive." Under that alternative view, it is appropriate to apply "the FTC Act to practices that do not violate the other antitrust laws . . . when (1) the practice seems anticompetitive but is not technically covered by the antitrust laws; and (2) the social cost of an error seems to be relatively small." The social cost of an error here is small given the nature of the remedy and the low likelihood that a Commission consent order will be followed by a valid antitrust-based class action suit. *See id.* ("Findings of violations of the FTC Act that are not also antitrust violations will not support subsequent private actions for treble damages"). We nevertheless recognize Commissioner Kovacic's concern that FTC "unfair methods" cases may support private actions based on state law, and join him in encouraging comment on that issue.

[6] *See* Allied Tube & Conduit Corp. v. Indian Head, Inc., 486 U.S. 492, 500 (1989); Am. Soc'y of Mech. Engineers, Inc. v. Hydrolevel Corp., 456 U.S. 556, 571 (1982); Standard Sanitary Mfg. Co. v. United States, 226 U.S. 20, 41 (1912). *See generally* Broadcom Corp. v. Qualcomm Inc., 501 F.3d 297, 310-314 (3d Cir. 2007).

noted that "[i]ndustry standards are widely acknowledged to be one of the engines driving the modern economy."[7] Conduct like N-Data's – which undermines standard-setting – threatens to stall that engine to the detriment of all consumers.

N-Data's conduct is also an unfair act or practice under Section 5(n) of the FTC Act and *Orkin Exterminating Co.,* 108 F.T.C. 263 (1986), aff'd, 849 F.2d 1354 (11th Cir. 1988). This Commission – *unanimously* – has often found an unfair act or practice proscribed by Section 5 in conduct that victimizes businesses (as well as individuals) who are consumers. The dissent would distinguish those cases on the ground that the businesses here are all "large, sophisticated computer manufacturers" who are able to protect themselves. There is no basis for that distinction in Section 5. In any event, moreover, there is no basis in the record of this investigation for describing all of the "locked in" licensees that way. Similarly, as discussed in detail in the Analysis to Aid Public Comment, no meaningful distinction can be drawn between the circumstances in *Orkin,* where the respondent sought to exploit consumers who were "locked into" long term contracts, and the unique circumstances of this case, where licensees are "locked into" the standard containing technology controlled by this Respondent.

We recognize that some may criticize the Commission for broadly (but appropriately) applying our unfairness authority to stop the conduct alleged in this Complaint. But the cost of ignoring this particularly pernicious problem is too high. Using our statutory authority to its fullest extent is not only consistent with the Commission's obligations, but also essential to preserving a free and dynamic marketplace.

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[7] U.S. Dep't of Justice & Fed. Trade Comm'n , *Antitrust Enforcement And Intellectual Property Rights: Promoting Innovation And Competition* 33, *available at* http://www.ftc.gov/reports/innovation/P040101PromotingInnovationandCompetitionrpt0704.pdf (2007).

EXHIBIT 8

Dissenting Statement of Chairman Majoras
***In the Matter of Negotiated Data Solutions LLC*, File No. 0510094**

I respectfully dissent from the decision to lodge a Complaint in this matter and to accept the settlement described in the majority's *Analysis of Proposed Consent Order to Aid Public Comment* ("Analysis"). The facts do not support a determination of antitrust liability. The preconditions for use of stand-alone Section 5 authority to find an "unfair method of competition" are not present. And the novel use of our consumer protection authority to protect large corporate members of a standard-setting organization ("SSO") is insupportable.

This case presents issues that appear on first inspection to resemble those in our line of standard-setting "hold up" challenges, including *Unocal*,[1] *Dell*,[2] and *Rambus*.[3] As we and the Justice Department have explained jointly, "multiple technologies may compete to be incorporated into the standard under consideration"[4] by an SSO. Once a technology has been selected and the standard that incorporates the technology has been specified, however, the standard's adopters often will face significant relative costs in switching to an alternative standard. "[T]he chosen technology may lack effective substitutes precisely because the SSO chose it as the standard. Thus, . . . the owner of a patented technology necessary to implement the standard may have the power to extract higher royalties or other licensing terms that reflect the absence of competitive alternatives. Consumers of the products using the standard would be harmed if those higher royalties were passed on in the form of higher prices."[5] In an effort to avoid the hold-up problem, some SSOs take measures to protect their members, such as imposing patent disclosure rules or securing agreement on licensing terms.[6]

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1 *In re Union Oil Company of California*, 2004 FTC LEXIS 115 (FTC 2004) ("Unocal"), *available at* http://www.ftc.gov/os/adjpro/d9305/040706commissionopinion.pdf.

2 *In re Dell*, 121 F.T.C. 616 (1996).

3 *In re Rambus*, FTC Dkt. No. 9302 (Liability Opinion, July 31, 2006), *appeal pending*, Docket Nos. 07-1086, 07-1124 (D.C. Cir. 2007).

4 U.S. Department of Justice and Federal Trade Commission, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION (April 2007) at 35-36 [hereinafter "DOJ/FTC Intellectual Property Report"], *available at* http://www.ftc.gov/reports/innovation/P040101PromotingInnovationandCompetitionrpt0704.pdf.

5 *Id.* at 36. *See also* Chairman Deborah Platt Majoras, *Recognizing the Procompetitive Potential of Royalty Discussions in Standard Setting*, Remarks before the Stanford University Conference on Standardization and the Law: Developing the Golden Mean for Global Trade (September 2005), *available at* http://www.ftc.gov/speeches/majoras/050923stanford.pdf.

6 DOJ/FTC Intellectual Property Report, *supra* note 4, at 36.

This case departs materially from the prior line, however, in that there is no allegation that National engaged in improper or exclusionary conduct to induce IEEE to specify its NWay technology in the 802.3u standard. No one contends that National deceived SSO members at the time of its initial licensing offer in 1994. Further, from the time National submitted its letter of assurance in 1994 and at least until 2002, some patent holders changed or clarified the terms of their letters of assurance – even after the relevant standard was approved. And although a new IEEE bylaw, passed in January 2002, purported to make patent letters irrevocable, it did not address whether it was to apply retroactively. When Vertical submitted its 2002 proposal under which it would offer its entire patent portfolio that originated with National for license on reasonable and nondiscriminatory terms, the IEEE's Patent Administrator did not object to the departure from the $1,000 commitment, even while requesting and securing specific changes to Vertical's proposal. The IEEE then appeared to have accepted the revised proposal by posting Vertical's letter on its web site along with National's June 7, 1994 letter.

There is also a substantial question as to whether N-Data enjoyed measurable market power, even with the adoption of the IEEE standard. Under the terms of the standard, the NWay technology was an optional technique. Although National in 1994 had offered to grant a paid-up, royalty-free license to the technology for $1,000 to anyone seeking to practice the standard, no company had sought to accept the offer until after publication of the 2002 revision on the IEEE web site. And despite ongoing licensing efforts by National's successors, Vertical and N-Data, only one company paid materially more than the originally-quoted $1,000 for rights to the NWay technology.[7] Most users evidently have preferred to infringe, running the risk of presumably minimal patent damages that they might face at the outcome of litigation.

Thus, the facts do not support antitrust liability here.

The majority evidently agrees that respondent's conduct does not amount to improper acquisition or maintenance of monopoly power so as to fall within the ambit of Section 2 of the Sherman Act. Instead, the majority seeks to find liability purely under Section 5 of the FTC Act. This is not advisable as a matter of policy or prosecutorial discretion.

The majority's first theory is that N-Data engaged in an unfair method of competition. Although Section 5 enables the Commission to reach conduct that is not actionable under the Sherman or Clayton Acts, we have largely limited ourselves to matters in which respondents took actions short of a fully consummated Section 1 violation (but with clear potential to harm

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[7] Paragraph 31 of the Complaint alleges that "several companies" entered into license agreements that have produced fees "far in excess" of $1,000 per company. In fact, three companies entered into license agreements (with Vertical) for the patents. N-Data has never received royalties or fees from those agreements, nor, as I understand it, has it collected any royalties for the relevant patents on terms inconsistent with those offered in the 1994 letter. N-Data itself has initiated suit against one company, with which it had a dispute involving numerous patents other than those at issue in this case.

competition), such as invitations to collude.[8] This limitation is partly self-imposed, reflecting the Commission's recognition of the scholarly consensus that finds the Sherman and Clayton Acts, as currently interpreted, to be sufficiently encompassing to address nearly all matters that properly warrant competition policy enforcement.[9] But the limitation also reflects the insistence of the appellate courts that the Commission's discretion is bounded and must adhere to limiting principles. In *E.I. du Pont de Nemours & Co. v. FTC*, for example, the Second Circuit stated: "[w]hen a business practice is challenged by the Commission, even though, as here, it does not violate the antitrust or other laws and is not collusive, coercive, predatory or exclusionary in character, standards for determining whether it is 'unfair' within the meaning of § 5 must be formulated to discriminate between normally acceptable business behavior and conduct that is unreasonable or unacceptable."[10] Writing in the context of a challenge to parallel conduct that

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8 *See, e.g., In re Valassis Communications, Inc.*, Docket No. C-4160, FTC File No. 051 008 (Complaint), *available at* http://www.ftc.gov/os/caselist/0510008/0510008c4160ValassisComplaint.pdf. In its *Analysis*, the Commission explained that competition would not be adequately protected if antitrust enforcement were directed only at consummated cartel agreements. The Commission further explicated the several legal (including precedent) and economic justifications that support the imposition of liability upon firms that communicate an invitation to collude where acceptance cannot be proven. Prior to the *Valassis* case, the Commission entered into consent agreements in several cases alleging that an invitation to collude – though unaccepted by the competitor – violated Section 5 of the FTC Act. *MacDermid, Inc.*, Docket No. C-3911, FTC File No. 991 0167 (Decision & Order), *available at* http://www.ftc.gov/os/2000/02/macdermid.do.htm; *Stone Container Corp.*, 125 F.T.C. 853 (1998); *Precision Moulding Co.*, 122 F.T.C. 104 (1996); *YKK (USA) Inc.*, 116 F.T.C. 628 (1993); *A.E. Clevite, Inc.*, 116 F.T.C. 389 (1993); *Quality Trailer Products Corp.*, 115 F.T.C. 944 (1992).

9 *See, e.g.,* 5 JULIAN O. VON KALINOWSKI, PETER SULLIVAN & MAUREEN MCGUIRL, ANTITRUST LAWS AND TRADE REGULATION, § 77.02 at 77-3 (2007) ("the prevailing view is that there are limitations on Section 5's applicability to conduct which stretches beyond the letter of [the Sherman or Clayton Acts]."); 2 PHILIP AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 302(h) (2006) ("Apart from possible historical anachronisms in the application of those statutes, the Sherman and Clayton Acts are broad enough to cover any anti-competitive agreement or monopolistic situation that ought to be attacked whether 'completely full blown or not.'"); Richard A. Posner, *The Federal Trade Commission: A Retrospective*, 72 ANTITRUST L.J. 761, 766 (2005) ("It used to be thought that 'unfair methods of competition' swept further than the practices forbidden by the Sherman and Clayton Acts, and you find this point repeated occasionally even today, but it is no longer tenable. The Sherman and Clayton Acts have been interpreted so broadly that they no longer contain gaps that a broad interpretation of Section 5 of the FTC Act might be needed to fill."); John F. Graybeal, *Unfair Trade Practices, Antitrust And Consumer Welfare In North Carolina*, 80 N.C. L. REV. 1927, 1949 (2002) ("Undoubtedly, the FTC today will proceed with great caution under section 5 to claim as an unfair method of competition any conduct that does not violate the Sherman or Clayton Acts."). *See also* ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS (6th ed. 2007) ("FTC decisions have been overturned despite proof of anticompetitive effect where the courts have concluded that the agency's legal standard did not draw a sound distinction between conduct that should be proscribed and conduct that should not.").

10 729 F.2d 128, 138 (2d Cir. 1984).

did not arise from an agreement but that facilitated oligopolistic coordination, the Second Circuit adopted this test:

> In our view, before business conduct in an oligopolistic industry may be labelled "unfair" within the meaning of § 5 a minimum standard demands that, absent a tacit agreement, at least some indicia of oppressiveness must exist such as (1) evidence of anticompetitive intent or purpose on the part of the producer charged, or (2) the absence of an independent legitimate business reason for its conduct. . . . In short, in the absence of proof of a violation of the antitrust laws or evidence of collusive, coercive, predatory, or exclusionary conduct, business practices are not "unfair" in violation of § 5 unless those practices either have an anticompetitive purpose or cannot be supported by an independent legitimate reason.[11]

In its *Analysis*, the majority extends the *du Pont* formulation to the monopolization family, asserting that respondent's conduct was "coercive" and "oppressive" and had an "adverse impact on prices for autonegotiation technology[.]"[12] These assertions are impossible to prove on the evidence we have. N-Data asserts that its renegotiation of its licensing terms was motivated by nothing other than an independent, business reason – that is, the aim of collecting royalties for a new bundle of intellectual property rights on reasonable and non-discriminatory terms. Even if N-Data were motivated by a desire to strike a better bargain than National made several years earlier, that alone should not be considered a competition-related offense. If the majority's theory is that the evasion of contractual price constraints triggers liability under Section 5 without a concurrent determination that the conduct violates the Sherman Act, then we are headed down a slippery slope, and I take no comfort from the majority's representation to the contrary. Parties often enter into contractual commitments involving asset-specific investments, creating the potential for opportunism. The majority has not identified a meaningful limiting principle that indicates when an action – taken in the standard-setting context or otherwise – will be considered an "unfair method of competition."

Pursuing a second theory, the majority invokes consumer protection doctrine to find that respondent has engaged in an "unfair act or practice" in violation of Sections 5(a) and (n) of the FTC Act.[13] Section 5(n) provides a clear limitation of the Commission's authority: "[t]he

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11 *Id.* at 139-140.

12 *Analysis* at 5.

13 In *Rambus*, the Commission drew upon its experience with the law regarding deceptive acts or practices, which has been developed largely in consumer protection contexts, to inform our analysis of deception before an SSO as part of an exclusionary course of conduct. *Rambus*, *supra* note 3, at 29-30. We did so, however, within a framework based on Sherman Act jurisprudence, recognizing, *inter alia*, the need to examine competitive effects. *Id.* at 28-31. The majority's extension of our authority over unfair acts or practices, which Congress has specifically limited in Section 5(n), raises altogether different issues.

Commission shall have no authority under this section or section 57a of this title to declare unlawful an act or practice on the grounds that such act or practice is unfair unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition."[14] The evidence simply does not support the requisite findings.

In particular, finding "substantial consumer injury" here requires the majority to treat large, sophisticated computer manufacturers as "consumers." I do not agree with such a characterization, and I have serious policy concerns about using our consumer protection authority to intervene in a commercial transaction to protect the alleged "victims" here. The *Analysis* accurately states that the FTC has used its authority under Section 5 to protect small businesses against unfair acts and practices. We have taken care to exercise this authority judiciously, however, to protect small businesses, non-profits, churches, and "mom and pop" operations[15] that lack the resources and, in some cases, the experience or understanding to defend themselves adequately against fraud. Indeed, certain of these small business owners, non-profit volunteers, and clergy had personally guaranteed the contracts at issue. There is a clear qualitative difference between these entities and the computer manufacturers that the majority treats as injured consumers in this matter.[16]

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14 15 U.S.C. § 45(n) (2000). *See also International Harvester Co.,* 104 F.T.C. 949, 1061 (1984).

15 *See, e.g., FTC v. Websource Media, LLC,* No. H-06-1980 (S.D. Tex. filed June 12, 2006) (unfair practice of "cramming" unauthorized charges onto the telephone bills of small businesses); *FTC v. Certified Merchant Services, Ltd.*, No. 4:02CV44 (E.D. Tex. filed February 11, 2002) (unfair practice of unilaterally inserting additional pages that describe substantial, undisclosed charges into credit card processing contracts with small business merchants); *FTC v. IFC Credit Corp.*, No. 07C3155 (N.D. Ill. filed June 6, 2007) (unfair practice of accepting and collecting on invalid, fraudulently induced equipment contracts with small businesses and religious and other nonprofit organizations). The majority cites to the Franchise Rule as another example of the Commission using its Section 5 consumer protection authority to protect small businesses from deceptive practices. While the Franchise Rule, which requires certain disclosures prior to the sale of a franchise, sometimes protects businesses, it typically protects individual consumers that are purchasing franchises rather than sophisticated corporations. In adopting amendments to the Franchise Rule earlier this year, the Commission exempted from the Rule's coverage several categories of sophisticated investors. 16 C.F.R. § 436.8(a).

16 Some may argue that the Commission has already made the policy decision to treat businesses as consumers, and that there is no rational distinction between the companies we have protected and large corporations. I disagree. Although it is important to draw lines, there is such a vast difference between sophisticated corporations, on the one hand, and storefront shops, on the other, that we do not need to draw a bright line to distinguish this matter from previous cases the Commission has brought to protect small businesses.

As I stated above, I am not convinced that any party was injured. And certainly the evidence does not support the finding that the alleged injury here was "not reasonably avoidable" (assuming, of course, that injury can be made out at all). The membership of IEEE includes computer networking equipment manufacturers and telecommunications companies. IEEE knew that its members sometimes made or attempted to make changes in patent commitment letters, and it could have acted sooner to protect its members from potentially adverse changes to commitment letters. IEEE also could have objected to Vertical's revisions, but instead it accepted and published them without objection. Moreover, any individual company could have entered into a binding agreement with National, but none sought timely to accept the 1994 royalty offer.

In re Orkin Exterminating Co., Inc.,[17] on which the majority relies, is fundamentally different from the instant matter. Orkin unilaterally increased its fees for more than 200,000 consumers, all of whom had signed written contracts that could readily be understood to be binding and that committed to a lifetime fee structure that would not increase.[18] If consumers paid the amount specified in their contracts, Orkin's policy was to return the payments. Thus, unlike the situation here, *Orkin* involved both (a) large numbers of individual consumers, and (b) widespread injury that the consumers could not reasonably avoid.

For all of these reasons, I respectfully dissent.

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17 108 F.T.C. 263 (1986), *aff'd, FTC v. Orkin*, 849 F.2d 1354 (11th Cir. 1988).

18 Orkin pamphlets echoed this commitment, promising that the annual fee would "never increase." 108 F.T.C. at 356.

EXHIBIT 9

CONCURRING OPINION OF COMMISSIONER JON LEIBOWITZ
IN THE MATTER OF RAMBUS, INC.
DOCKET NO. 9302

I. INTRODUCTION

Rambus's deception of JEDEC and its members injured competition and consumers alike. The company exploited the DRAM standard-setting process for its own anticompetitive ends. JEDEC's members – including Rambus – understood that this information was to be gathered and shared to benefit the industry and its consumers as a whole, yet Rambus effectively transmogrified JEDEC's procompetitive efforts into a tool for monopolization. As detailed in the Commission's Opinion, such conduct meets all the requisite elements of a Section 2 violation.

It would be equally apt, though, to characterize Rambus's conduct as an "unfair method of competition" in violation of Section 5 of the FTC Act. Section 5 was intended from its inception to reach conduct that violates not only the antitrust laws[1] themselves, but also the policies that those laws were intended to promote. At least three of these policies are at issue here. From the FTC's earliest days, deceitful conduct has fallen within Section 5's province for its effects on competition, as well as on consumers.[2] Innovation – clearly at issue in this case – is indisputably a matter of critical antitrust interest.[3] In addition, joint standard-setting by rivals has long been an "object[] of antitrust scrutiny" for its anticompetitive uses, notwithstanding its great potential also to yield efficiencies.[4] In this case, Rambus's deceptive conduct distorted joint

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1 15 U.S.C. § 12 (a) (2006). The antitrust laws include the Sherman Act and the Clayton Act (as modified by the Robinson-Patman Act). The FTC Act is not an antitrust law.

2 Cal. Dental Ass'n v. F.T.C., 526 U.S. 756, 772 n.9 (1999) ("That false or misleading advertising has an anticompetitive effect, as that term is customarily used, has been long established). *Cf.* F.T.C. v. Algoma Lumber Co., 291 U.S. 67, 79-80 (1934) (finding a false advertisement to be unfair competition)."; F.T.C. v. Winsted Hosiery, 258 U.S. 483 (1922) (per Brandeis, J.) (holding that false labeling that misled consumers constituted unfair competition against competitors). *See also* F.T.C. v. Gratz, 253 U.S. 421, 427 (1920) (holding that "unfair methods of competition" do not apply to practices that were "never heretofore regarded as opposed to good morals because characterized by deception, bad faith, fraud, or oppression, or as against public policy because of their dangerous tendency unduly to hinder competition or create monopoly"). Notably, the *Gratz* view of Section 5's scope was later abandoned as *too narrow*. F.T.C. v. R.F. Keppel & Bros., Inc., 291 U.S. 304 (1934).

3 *See generally* FED. TRADE COMM'N, TO PROMOTE INNOVATION: THE PROPER BALANCE OF COMPETITION AND PATENT LAW AND POLICY (Oct. 2003), *available at* http://www.ftc.gov/os/2003/10/innovationsrpt.pdf.

4 *See, e.g.,* Allied Tube & Conduit Corp. v. Indian Head, Inc., 486 U.S. 492, 500-01 (1988) (holding that "private standard-setting associations have traditionally been objects of antitrust scrutiny" because of their potential use as a means for anticompetitive horizontal agreements, but that the associations' "potential for

standard-setting decisions and innovation investments in ways that seriously injured the operations of the competitive market to the detriment of consumers; it thereby transgressed the policies and spirit of the antitrust laws in all three respects. While respondent's behavior before JEDEC might well have been challenged solely as a pure Section 5 violation, Complaint Counsel did not litigate this theory before the administrative law judge. Thus, I write separately to discuss and reemphasize the broad reach and unique role of Section 5.

I also address the scope of Section 5 because some commentators have misperceived the Commission's authority to challenge "unfair methods of competition," incorrectly viewing it as limited, with perhaps a few exceptions, to violations of the Sherman and Clayton Acts.[5] Others are unclear just how far Section 5 can reach beyond the antitrust laws.[6] Regardless of the reasons for these cramped or confused views, a review of Section 5's legislative history, statutory language, and Supreme Court interpretations reveals a Congressional purpose that is unambiguous and an Agency mandate that is broader than many realize.

The Commission, in my view, should place greater emphasis on developing the full range of its jurisdiction and making it more clear to the bar, the public, the business community, and potential antitrust malefactors what Section 5 embraces and what it does not. Although the Commission has not left fallow its Section 5 jurisdiction to challenge conduct outside the antitrust laws, neither has the Agency fully exercised or explained it. In discussing Section 5 in the context of Rambus, I hope to encourage the Commission (and its staff) to develop further and employ more fully this critical and unique aspect of our statutory mandate. If we do, benefit will accrue both to consumers and to competition.

II. THE MANDATE UNDERLYING SECTION 5

A. Legislative History

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procompetitive benefits" has influenced "most lower courts to apply rule-of-reason analysis to product standard-setting by private associations"). *See also* TIMOTHY J. MURIS, BUREAU OF CONSUMER PROT., FED. TRADE COMM'N, STAFF REPORT ON THE STANDARDS AND CERTIFICATION RULE 9 (1983) ("Standard setting can be misused to exclude competitors unreasonably, injuring consumers. The Commission can pursue anticompetitive restraints as unfair methods of competition, using a rule of reason approach, or as unfair acts or practices under the Commission's unfairness protocol, in each case weighing the benefits and costs of the challenged activity.").

5 *See, e.g.*, Richard A. Posner, *The Federal Trade Commission: A Retrospective*, 72 ANTITRUST L.J. 761, 765-66 (2005) ("It used to be thought that 'unfair methods of competition' swept further than the practices forbidden by the Sherman and Clayton Acts, and you find this point repeated occasionally even today . . . .").

6 Antitrust Law Special Comm., Am. Bar Ass'n, REPORT ON THE ROLE OF THE FEDERAL TRADE COMMISSION, 58 ANTITRUST L.J. 53, 63-64 n.11 (1989) (observing that "[a]lthough it is well established that Section 5's ban on 'unfair methods of competition' permits the FTC to proscribe conduct not reached by prevailing interpretations of the Sherman and Clayton Acts, there is a debate about how far Section 5 reaches beyond those Acts.").

Debates regarding the need for, and nature of, a "federal trade commission" roiled for more than a decade prior to its creation in 1914.[7] These debates involved four of the most brilliant minds of the time – Roosevelt, Taft, Wilson, and Brandeis – and coalesced into a significant issue in the election of 1912.[8] One of the flashpoint events that led Congress to act was the *Standard Oil* case, in which the Supreme Court in 1911 adopted "rule of reason" analysis for the Sherman Act's prohibition on "restraints of trade."[9] Many within and outside of Congress viewed the Supreme Court's reasonableness test as judicial invention – what some more recently would term "legislat[ing] from the bench"[10] – that threatened both to undermine Congress's aim in passing the Sherman Act and to yield inconsistent applications from court to court.[11]

Congress's bipartisan reaction was to create an administrative agency with antitrust expertise, an enforcement mandate *more expansive than that of the antitrust laws*, and the structure and flexibility to identify, analyze, and challenge new forms of "unfair methods of competition" as they developed.[12] Legislators in the Congressional debates repeatedly expressed these goals. Senator Robinson, for example, indicated that "unfair methods of competition" encompassed practices that constituted "unjust, inequitable, or dishonest competition."[13] Senator Pomerene and Senator Thomas both stated that the proposed Act would authorize the Commission to determine whether certain forms of business conduct constituted unfair methods of competition, regardless of whether that conduct involved a restraint of trade.[14] Senator Newlands, the Chairman of the Senate Commerce Committee, responded to concerns about this process by explaining that "[y]ou can not [sic] take a body of five men, intelligent men,

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7 The FTC's predecessor, the Bureau of Corporations, was created in 1903.

8 Marc Winerman, *The Origins of the FTC: Concentration, Cooperation, Control, and Competition*, 71 ANTITRUST L.J. 1 (2003) (providing the most thorough examination of the FTC's creation and the competing forces and philosophies that gave the agency its ultimate form and powers). *See also* Robert Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65 (1982); Neil Averitt, *The Meaning of 'Unfair Methods of Competition' in Section 5 of the Federal Trade Commission Act*, 21 B.C. L. REV. 229 (1980).

9 Standard Oil Co. v. U.S., 221 U.S. 1 (1911).

10 *See, e.g.,* 140 CONG. REC. 10,109 (1994) (statement of Sen. Thurmond during Senate hearing on nomination of Justice Breyer).

11 *See, e.g.*, 47 CONG. REC. 1,225 (1911) (statement of Sen. Newlands).

12 Another, related Congressional response, also in 1914, was passage of the Clayton Act, 15 U.S.C. § 12, which, *inter alia*, contained specific provisions regarding discriminatory pricing, tying, stock acquisitions, and interlocking directorates.

13 51 CONG. REC. 12,153 (1914) (statement of Sen. Robinson).

14 51 CONG. REC. 12,161 (1914) (statement of Sen. Pomerene); 51 CONG. REC. 12,197 (1914) (statement of Sen. Thomas). In Senator Cummins's view, the discretion and judgment of the Commission should not even be subject to judicial review. 51 CONG. REC. 12,151 (1914) (statement of Sen. Cummins).

composed as this body will be of lawyers, economists, publicists, men engaged in industry, who will not be able to determine justly whether the practice is contrary to good morals or not."[15]

Section 5 was not enacted merely to mirror the antitrust laws. Senator Cummins, one of the bill's main proponents, squarely addressed this issue on the Senate floor when he responded to the question, "why, if unfair competition is in restraint of trade, [are we] attempting to add statute to statute and give a further remedy for the violation of the [Sherman Act]?" Senator Cummins replied that the concept of "unfair competition" seeks:

> to go further [than "restraints of trade"] and make some things offenses that are not now condemned by the antitrust law. That is the only purpose of Section 5 – to make some things punishable, to prevent some things, that can not [sic] be punished or prevented under the antitrust law.[16]

Echoing this point, he later described Section 5 as new substantive law that would involve the Commission in activities beyond the simple enforcement of antitrust law.[17] Many other legislators similarly expressed their intent and understanding that Section 5 would extend beyond the Sherman Act.[18]

While the Act's legislative history makes its "sweep and flexibility . . . crystal clear,"[19] the plain language of the statute further bolsters this conclusion. If Congress had wanted Section 5's reach to be merely coterminous with that of the Sherman Act, it easily could have written the

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15 51 CONG. REC. 12,154 (1914) (statement of Sen. Newlands). Had he made his comment in more recent times, Senator Newlands doubtlessly would have phrased it to apply to a body of five men and women.

16 51 CONG. REC. 12,454 (1914) (statement of Sen. Cummins). Senator Cummins, an "insurgent" Republican, was a member both of the Commerce Committee, which prepared the Commission bill, and the Judiciary Committee, which prepared the bill that became the Clayton Act. He authored the "Cummins Report," which provided critical support for the Commission bill and helped influence its ultimate content.

17 51 CONG. REC. 12,613 (1914) (statement of Sen. Cummins).

18 *See, e.g.,* 51 CONG. REC. 14,333 (1914) (statement of Sen. Kenyon, remarking that the proposed federal trade commission "can take hold of matters that not in themselves are sufficient to amount to a monopoly or to amount to restrain [sic] of trade"); 51 CONG. REC. 14,329 (1914) (statement of Sen. Nelson, stating that the FTC Act "can be used in a lot of cases where there is no trust or monopoly"); 51 CONG. REC. 12,135 (1914) (statement of Sen. Newlands, observing that although "[a]ll agree that while the Sherman law is the foundation stone of our policy on [appropriate business conduct], additional legislation is necessary").

19 F.T.C. v. Sperry & Hutchinson Co., 405 U.S. 233, 241 (1972). *See also* F.T.C. v. Cement Inst., 333 U.S. 683, 693 (1948) ("All of the committee reports and the statements of those in charge of the Trade Commission Act reveal an abiding purpose to vest both the Commission and the courts with adequate powers to hit at every trade practice, then existing or thereafter contrived, which restrained competition or might lead to such restraint if not stopped in its incipient stages."); *Id.* at 693 n.6 (offering many citations to the Congressional Record).

statute accordingly. There would have been no logic in doing so, of course, since the Sherman Act already existed.

In drafting Section 5, Congress did not mimic the Sherman Act or try to enumerate a list of unfair practices. Rather, the Senate Report explains, Congress left it to the Commission "to determine what practices were unfair" because "there were too many unfair practices to define, and after writing 20 of them into law it would be quite possible to invent others."[20] To ensure there would be no misunderstanding, Congress carefully crafted the term "unfair methods of competition" to distinguish it from the narrower common-law concept of "unfair competition."[21] Thus, Congress made clear its intent, both to those who would later enforce Section 5 and those who would be subject to its strictures, that this provision was not confined to the collection of violations then-recognized in antitrust or common law, but rather conferred a broader and more adaptable authority on the Commission.[22] Now, as more fully developed by the courts and Commission, Section 5 permits the FTC to challenge conduct outside the bounds of the antitrust law that (a) violates the policies that underlie the antitrust laws or (b) constitutes incipient violations of those laws.

B. Supreme Court Interpretations

The FTC's statutory mandate comes not just from the legislature of almost a century ago. For more than 70 years, an unbroken line of Supreme Court opinions has interpreted Section 5 as encompassing a broader array of behavior than the antitrust laws.[23]

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20 S. Rep. No. 63-597, at 13 (1914) (internal quote omitted).

21 H.R. Rep. No. 63-1142, at 19 (1914) (Conf. Rep.) ("There is no limit to human inventiveness in this field. . . . If Congress were to adopt the method of definition, it would undertake an endless task."); *Keppel*, 291 U.S. at 310-12, n.2 (stating that the Conference Committee substituted the phrase "unfair methods of competition" for "unfair competition" to ensure that the scope of the FTC Act would not be "restricted to those forms of unfair competition condemned by the common law.").

22 *See Keppel*, 291 U.S. at 310 ("It would not have been a difficult feat of draftsmanship to have restricted the operation of the Trade Commission Act to those methods of competition in interstate commerce which are forbidden at common law or which are likely to grow into violations of the Sherman Act, if that had been the purpose of the legislation.").

23 *See Sperry & Hutchinson*, 405 U.S. at 244 (commenting that, after *Keppel*, "unfair competitive practices were not limited to those likely to have anticompetitive consequences after the manner of the antitrust laws; nor were unfair practices in commerce confined to purely competitive behavior."). Prior to the 1934 *Keppel* case, Supreme Court opinions tended to articulate a narrower view of Section 5's range. *See, e.g.,* F.T.C. v. Raladam Co., 283 U.S. 643 (1931); *Gratz*, 253 U.S. 421. Notably, however, even *Gratz*, which was authored only six years after the FTC's creation, emphasized Section 5's use to redress conduct such as that at issue in the present case, namely, "deception, bad faith, fraud, or oppression, or [practices that are] against public policy because of their dangerous tendency unduly to hinder competition or create monopoly." *Id.* at 427.

Most recently, the Court in *Indiana Federation of Dentists* (*"IFD"*) observed that the standard for "unfairness" under the FTC Act is, "by necessity, an elusive one, encompassing not only practices that violate the Sherman Act and the other antitrust laws, but also practices that the Commission determines are against public policy for other reasons."[24]

The Court in *IFD* relied on *Sperry & Hutchinson*, the Court's most recent, substantive analysis of Section 5's history and breadth. In *Sperry*, the Court answered two critical questions:

> First, does § 5 empower the Commission to define and proscribe an unfair competitive practice, even though the practice does not infringe either the letter or the spirit of the antitrust laws? Second, does § 5 empower the Commission to proscribe practices as unfair or deceptive in their effect upon consumers regardless of their nature or quality as competitive practices or their effect on competition? We think the statute, its legislative history, and prior cases compel an affirmative answer to both questions.[25]

Drawing on its review of Section 5's legislative history and other authority, the Court concluded that the Commission:

> does not arrogate excessive power to itself if, in measuring a practice against the elusive, but congressionally mandated standard of fairness, it, like a court of equity, *considers public values beyond simply those enshrined in the letter or encompassed in the spirit of the antitrust laws*.[26]

Supreme Court opinions prior to *IFD* expressed similar views. In *F.T.C. v. Brown Shoe Company*, the Court stated:

> [t]his broad power of the Commission is particularly *well established with regard to trade practices which conflict with the basic policies of the Sherman and Clayton Acts* even though such practices may not actually violate these laws. . . .[27]

and further quoted *F.T.C. v. Motion Picture Advertising Service Company* for the proposition:

> [i]t is . . . clear that the Federal Trade Commission Act was designed to supplement and bolster the Sherman Act and the Clayton Act . . . *to stop in their incipiency acts and practices which, when full blown, would violate those Acts* . . .

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24 F.T.C. v. Ind. Fed'n of Dentists, 476 U.S. 447, 454 (1986) (citations omitted).

25 *Sperry & Hutchinson*, 405 U.S. at 239.

26 *Id.* at 244 (emphasis added).

27 F.T.C. v. Brown Shoe Co., 384 U.S. 316, 321 (1966) (emphasis added).

as well as to condemn as "unfair methods of competition" existing violations of them.[28]

I know of no Supreme Court case in the past 70 years that disagrees with these goals, contracts this scope, or disputes the flexibility and elasticity inherent in Section 5.[29]

C. *Important Appellate Cases*

In the early 1980s, courts of appeals rebuffed FTC efforts to apply Section 5 in three frequently-cited cases: *Official Airline Guides*, *Boise Cascade*, and *Ethyl*.[30] Each of these cases was decided before *IFD*, with its reliance on *Sperry & Hutchinson's* reiteration of Section 5's breadth. These appellate opinions support the propositions that Section 5 does not condemn pure conscious parallelism (*i.e.,* unaccompanied by any "plus factors") or conduct justified by an independent, legitimate business purpose. The decision in each, however, turns primarily on an evidentiary failure to demonstrate that the challenged conduct constituted an effort to acquire market power, tacitly collude, or manipulate price for anticompetitive purposes. *None* of these cases significantly constrains the FTC's authority to apply Section 5 to violations of the policies that underlie the antitrust statutes or that cause actual or incipient antitrust injury.

In *Official Airline Guides ("OAG")*, the FTC challenged the refusal by a monopolist/publisher of airline schedules to include in its compendium schedules of commuter airlines. This refusal to deal was discriminatory, unjustified, and injurious to commuter airlines in their competition with certificated airlines. The monopolist, however, did not act coercively, did not compete in the commuter airlines' market, where the antitrust injury occurred, and did not seek or have any prospect of gaining power in that market. Although the court acknowledged

28 *Id.* at 322 (quoting F.T.C. v. Motion Picture Adv. Serv. Co., 344 U.S. 392, 394-95 (1953) (emphasis added)). *See also* F.T.C. v. Texaco, 393 U.S. 223, 225-26 (1968).

29 *See, e.g.,* Atl. Ref. Co. v. F.T.C., 381 U.S. 357, 369 (1965) ("As our cases hold, all that is necessary in § 5 proceedings to find a violation is to discover conduct that 'runs counter to the public policy declared in the' Act."); *Cement Inst.*, 333 at 694 ("[A]lthough all conduct violative of the Sherman Act may likewise come within the unfair trade practice prohibitions of the Trade Commission Act, the converse is not necessarily true. It has long been recognized that there are many unfair methods of competition that do not assume the proportions of Sherman Act violations."); Fashion Originators' Guild of Am. v. F.T.C., 312 U.S. 457, 466 (1941) ("Nor is it determinative in considering the policy of the Sherman Act that petitioners may not yet have achieved a complete monopoly. For 'it is sufficient if it really tends to that end and to deprive the public of the advantages which flow from free competition.' . . . [I]t was the object of the Federal Trade Commission Act to reach not merely in their fruition but also in their incipiency combinations which could lead to these and other trade restraints and practices deemed undesirable."); *Keppel*, 291 U.S. at 312 n.2 (concluding from a detailed review of the legislative history that Congress wanted "unfair methods of competition" to confer a broad, flexible mandate that would exceed the "forms of unfair competition condemned by the common law").

30 Official Airline Guides, Inc. v. F.T.C., 630 F.2d 920 (2d Cir. 1980); Boise Cascade Corp. v. F.T.C., 637 F.2d 573 (9th Cir. 1980); and E.I. du Pont de Nemours & Co. v. F.T.C., 729 F.2d 128 (2d Cir. 1984) [hereinafter *Ethyl*].

that FTC determinations as to what practices constitute an "unfair method of competition" deserve great weight,[31] it declined to uphold the Commission's order. Rather, it opted to characterize the respondent's action as a unilateral refusal to deal protected by *United States v. Colgate & Company.*[32] In explaining its decision, the court expressed concern that declaring such conduct unlawful would give the Commission too much latitude to substitute its own judgment for a respondent's independent business decisions that were taken without any anticompetitive purpose or prospect. In essence, although the challenged conduct was discriminatory and harmful, it did not violate the policies underlying the antitrust laws. The opinion does not discuss Section 5's jurisdictional breadth, and the facts of the case are so unusual that the case has little import for that legal issue.[33]

Boise Cascade involved the use of an industry-wide delivered pricing system. Industry members effected this system by including an artificial freight factor in the price charged to customers. The Commission contended that this practice tended to stabilize prices and therefore violated the Sherman and FTC Acts. The Ninth Circuit disagreed, however, concluding that the use of delivered pricing in this instance was a natural and independent, albeit consciously parallel, response to customer preferences. The court found no need to opine whether consciously parallel conduct, without more, could ever violate Section 5; it declined, however, to hold such behavior illegal *per se* where, as here, persuasive evidence of an anticompetitive effect was lacking. Although the court acknowledged "the unique features of the FTCA,"[34] it held that delivered pricing warranted the same legal assessment under both the FTC and Sherman Acts, since the relevant case law had been well-developed in both court and Commission litigation, as well as through prior Commission statements and practices on the issue. The court concluded that this history had resulted in a requirement that "the Commission must find either collusion or actual effect on competition to make out a §5 violation for use of delivered pricing."[35] The court

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31 *Official Airline Guides*, 630 F.3d at 927 (citing *Cement Inst.*, 333 U.S. at 692-93, and *Atl. Ref.*, 381 U.S. at 367-68).

32 U.S. v. Colgate & Co., 250 U.S. 300 (1919).

33 In In re General Motors, 99 F.T.C. 464, 580 n.45 (1982), the Commission declared its position that the Second Circuit's decision was incorrect and that "unless it is repudiated by the Supreme Court we hold to our interpretation of the case law on arbitrary refusals to deal by monopolists. . . ." Nonetheless, a 2003 Commission letter observed that "the Commission has not issued a decision [since *OAG*] holding that a monopolist violated the FTC Act by using unfair methods of competition that affected customers in an adjacent market in which the monopolist did not operate." Letter from Fed. Trade Comm'n, to the U.S. Dep't of Transp. (Jun. 6, 2003) (on file with FTC Office of General Counsel).

34 *Boise Cascade*, 637 F.2d at 581.

35 *Id.* at 582. Much of this history is based on a series of delivered and base-point pricing cases that reached their doctrinal limits in *Cement Institute*. 333 U.S. at 721 n.19 (holding that "[w]hile we hold that the Commission's findings of combination were supported by evidence, that does not mean that the existence of a 'combination' is an indispensable ingredient of an 'unfair method of competition' under the Trade Commission Act."). *See also* Triangle Conduit & Cable Co. v. F.T.C., 168 F.2d 175 (7th Cir. 1948). Shortly thereafter, the

was clear, however, to confine this requirement to situations involving delivered pricing; consequently, it does not materially affect the well-recognized scope of Section 5.

In *Ethyl* – perhaps the most misunderstood and frequently mis-cited case regarding the scope of Section 5 – the Commission challenged four producers of gasoline anti-knock compounds for their use of delivered pricing, most-favored nation clauses, 30-day advance notice to customers of price changes, and announcement of price increases in the press. The producers did not act collusively in adopting and employing these practices; rather, they followed industry tradition and responded to customer demand. The FTC concluded that the practices nonetheless violated Section 5 because they constituted interdependent conduct that substantially reduced competition in the market. The appellate court disagreed, however, because it did not find substantial evidence that the challenged practices led to an adverse competitive impact.[36] Thus, this case, like *Boise Cascade*, was not decided on grounds of statutory interpretation but evidentiary sufficiency.[37]

Despite the outcome, the court engaged in a significant analysis of Section 5 and reconfirmed that it extends to conduct that does not fall within the antitrust laws. In particular, the court noted that "Congress' aim was to protect society against oppressive anticompetitive conduct and thus assure that the conduct prohibited by the Sherman and Clayton Acts would be supplemented as necessary and any interstices filled."[38] Subsequently the court elaborated that:

> [a]lthough the Commission may under § 5 enforce the antitrust laws, including the Sherman and Clayton Acts, it is not confined to their letter. It may bar incipient violations of those statutes, and conduct which, although not a violation of the

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Commission declared that the use of base point pricing could violate Section 5, even when not adopted or implemented as part of a combination or conspiracy. INTERIM REPORT ON STUDY OF FEDERAL TRADE COMMISSION PRICING POLICIES, S. Doc. No. 27, 81st Cong., 1st Sess. 41 (1949) [hereinafter "Interim Report"]. In Congress, however, legislation was introduced to reverse this position, and FTC Commissioners were subjected to "demanding" questioning in Senate Committee hearings. The legislation was abandoned only "after a majority of the commissioners recanted and testified that Section 5 prohibits only conspiracies to adopt base point pricing." Mary Azcuenaga, FTC Comm'r, *Shimmers in the Penumbra of Section 5 and Other News*, Address Before the 13th Annual Antitrust and Trade Regulation Seminar XX (Jul. 9, 1992) at 9-11(on file with FTC Office of General Counsel); S. Doc. No. 27 at 59-63.

36 *Ethyl*, 729 F.2d at 140-41. The court noted that the FTC's majority opinion observed that non-collusive facilitating practices violate Section 5 only where the evidence demonstrates that they substantially lessen competition and reveal a "clear nexus" between the practices and the competitive harm. The court found such evidence lacking in this case. *Id.*

37 For a detailed discussion of the Commission analysis in *Ethyl* regarding facilitating practices, *see* Donald S. Clark, *Price-Fixing Without Collusion: An Antitrust Analysis of Facilitating Practices After Ethyl Corp.*, 1983 WISC. L. REV. 887 (1983).

38 *Ethyl*, 729 F.2d at 136 (quoting Report of the Conference Committee, H.R.Rep. No. 1142, 63d Cong., 2d Sess. 19 (1914)).

> letter of the antitrust laws, is close to a violation or is contrary to their spirit. In prosecuting violations of the spirit of the antitrust laws, the Commission has, with one or two exceptions, confined itself to attacking collusive, predatory, restrictive or deceitful conduct that substantially lessens competition.[39]

Section 5's intentionally unparticularized phrase, "unfair methods of competition" is not, therefore, an all-encompassing, unfocused warrant as some would claim. Rather, it is a flexible and powerful Congressional mandate to protect competition from unreasonable restraints, whether long-since recognized or newly discovered, that violate the antitrust laws, constitute incipient violations of those laws, or contravene those laws' fundamental policies.[40]

III. LIMITING ATTRIBUTES OF SECTION 5

Congress had good reasons for leaving Section 5's metes and bounds unspecified. Any effort in the name of "guidance" to provide a detailed plat defining its coverage would undermine Congress's clear intent to create a statute with sufficient scope, elasticity, and adaptability to accomplish its purpose. Thus, the influential treatise, Antitrust Law, observes, that:

> [i]t is now commonly said that Federal Trade Commission § 5 is not confined by the prohibitions of the Sherman Act or the Clayton Act. Indeed, § 5 is not confined by antitrust concepts at all. It allows the Commission to condemn conduct that is "unfair" in senses "beyond simply those enshrined in the letter or encompassed in the spirit of the antitrust laws." Or as the Supreme Court more

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[39] *Id.* at 136-37 (citations and footnote omitted). *See also* F.T.C. v. Abbott Lab., 853 F. Supp. 526 (D.D.C. 1994) (relying on *Ethyl* and *Sperry & Hutchinson*).

[40] This same period, 1980-1984, also yielded significant FTC efforts to rein in the use of Section 5. The most important of these is In re General Foods Co., 103 F.T.C. 204, 364-66 (1984). In this case the Commission rejected application of Section 5 to an alleged attempt to monopolize where the evidence did not reveal a dangerous probability of success, an element that had long been required under Section 2 of the Sherman Act. In the Commission's view, the concept of an incipient attempt to monopolize was simply beyond parsing. Moreover:

> [w]hile 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.

Id. at 352. The Commission expressly limited its holding in this regard to the dangerous probability issue and declined to comment whether Section 5 required the same measure of intent as did Section 2 of the Sherman Act. Other significant Commission actions from this period that bear on Section 5 jurisdiction regarding competition policy enforcement include: In re Kellogg Co., 99 F.T.C. 8 (1982) (summarily dismissing the appeal of an initial decision rejecting allegations that non-collusive efforts to maintain shared monopoly control of the ready-to-eat cereal market violated Section 5); and In re Exxon Co., 98 F.T.C. 453 (1981) (terminating an investigation into shared monopoly in the petroleum industry).

> recently put it, the "standard of 'unfairness' under the FTC Act is, by necessity, an elusive one, encompassing not only practices that violate the Sherman Act and the other antitrust laws but also practices that the Commission determines are against public policy for other reasons."
>
> We have no general quarrel with these holdings; our own concern is limited to § 5 holdings that follow "the letter or ... spirit of the antitrust laws.[41]

My concerns here are also confined to matters implicating "the letter or spirit" of the antitrust laws. Section 5's "standard of unfairness" in this regard may yet strike some as "elusive," but it is far from unknowable or unbounded. Congress's mandate is that Section 5 should supplement and bolster the antitrust laws by challenging conduct that not only violates the antitrust laws but that also falls within the "penumbra"[42] of those statutes. Two critical attributes of Section 5 – the limited consequences of a Section 5 violation, and the inherent relationship between Section 5's reach and the scope of the antitrust laws – help ensure that respondents find enforcement efforts under this mandate to be neither punitive nor overreaching.

A. The Consequences of a Section 5 Violation Are More Limited than Those Resulting from a Violation of the Antitrust Laws

Section 5 violations involving conduct outside the antitrust statutes entail far more limited consequences than do violations of the Sherman or Clayton Acts. The FTC nearly always brings such cases as administrative litigation, and violations generally result only in cease-and-desist orders designed to prevent future violations and, on occasion, injunctive measures to help preserve or restore conditions for vigorous competition in the market.[43] In addition, although the Commission may seek disgorgement or restitution in competition matters, it must do so from a

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41 PHILLIP AREEDA, HERBERT HOVENKAMP & ROGER BLAIR, II ANTITRUST LAW ¶ 302h, p.21 (2d ed.) (Aspen Law and Business, 2000) (footnotes omitted).

42 *Sperry & Hutchinson*, 405 U.S. at 244 n.5 (quoting Unfair or Deceptive Advertising and Labeling of Cigarettes in Relation to the Health Hazards of Smoking, 29 Fed. Reg. 8324, 8355 (Jul. 2, 1964) (codified at 15 C.F.R. pt. 408)). *See also* Chuck's Feed & Seed Co., Inc. v. Ralston Purina Co., 810 F.2d 1289, 1292-93 (4th Cir. 1987); Mary Azcuenaga, FTC Comm'r, *FTC Enforcement: An Idiosyncratic Journey*, Address Before the 15th Annual Antitrust and Trade Regulation Seminar 5 (Jul. 7, 1994) (on file with FTC Office of General Counsel); Mary Azcuenaga, *Shimmers in the Penumbra of Section 5 and Other News*, *supra* note 35; William E. Kovacic, *The Federal Trade Commission and Congressional Oversight of Antitrust Enforcement*, 17 TULSA L.J. 587, 625-627 (1982).

43 *But see e.g.*, In re Xerox, 86 F.T.C. 364 (1975) (consent order compelling limited royalty free licensing of patents for dry paper copier technology).

court. Moreover, the Agency's policy is to request equitable monetary relief in such matters only where the violation is relatively clear.[44]

The FTC Act contains no provisions for private enforcement. A Commission action brought under Section 5 has little value in subsequent "follow-on" treble-damage litigation,[45] and proof of Section 5 violations, standing alone, provide no basis for seeking criminal penalties under the Sherman Act or comparable state provisions.

Because of these relatively mild consequences, Section 5 can fairly extend more broadly than the antitrust laws. This characteristic makes Section 5 especially well designed to apply in circumstances where exposing the respondent to treble damage jeopardy might be unfair or inappropriate, even though the conduct itself may warrant prohibition. Such circumstances might arise in situations involving unseasoned legal or economic theories, innovative business strategies, new or complex markets, or a substantially altered regulatory context.

The FTC Act also provides a right of review in the courts of appeals. Respondents are protected from both unfairness and surprise, especially because the review becomes increasingly searching as the violation becomes more novel. As the Second Circuit declared:

> As the Commission moves away from attacking conduct that is either a violation of the antitrust laws or collusive, coercive, predatory, restrictive or deceitful, and seeks to break new ground by enjoining otherwise legitimate practices, the closer must be our scrutiny upon judicial review.[46]

Although courts sometimes have overturned Commission determinations or remedies – typically on grounds that the evidence does not establish the offense or the order is broader than necessary – appellate courts have almost always reaffirmed the breadth of the FTC's Section 5 jurisdiction.[47]

Finally, the Agency does not enforce Section 5 in a vacuum. Congress also plays an active role, especially in oversight regarding the Commission's authority and statutory

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44 FED. TRADE COMM'N, POLICY STATEMENT ON MONETARY EQUITABLE REMEDIES IN COMPETITION CASES (2003), *available at* http://www.ftc.gov/ow/2003/07/disgorgementfrn.htm. *See also* F.T.C. v. Mylan Lab., Inc., 62 F. Supp. 2d 25, 36-37 (D.D.C. 1999) (mem.), *aff'd in pertinent part*, 99 F. Supp. 2d 1, 4-5 (D.D.C. 1999).

45 *See* 15 U.S.C. § 16(a) (1984). "[I]n any action or proceeding brought under the antitrust laws, collateral estoppel effect shall not be given to any finding made by the Federal Trade Commission under the antitrust laws or under section 45 [*i.e.*, Section 5]." *See also* Pool Water Prods. v. Olin Corp., 258 F.3d 1024, 1030 (9th Cir. 2001).

46 *Ethyl*, 729 F.2d at 137.

47 *See, e.g.*, *id.* at 136-137.

interpretations. FTC officials frequently appear before Congressional committees or meet with Congressional staff to describe or defend its policies or practices. Put differently, there are no secrets as to what the Commission is doing or what Congress wants us to do; insufficient, excessive, or misdirected zeal commonly invites scrutiny and correction.[48]

For example, Congressional reaction to the *Cement Institute* and *Triangle Conduit* decisions, as well as to the Commission's declaration that base point pricing could violate Section 5 even when not part of a conspiracy, induced a majority of the commissioners to reverse their position on this issue.[49] It was also Congressional uncertainty regarding the scope of the Commission's Section 5 authority to challenge "unfair acts or practices" that led the Commission to issue a "consumer unfairness statement" in 1980.[50] Then, in 1994, Congress went further and codified this statement, in substance, as Section 5(n) of the FTC Act.[51]

Agency officials have regularly incorporated the lessons of appellate and Congressional review into FTC practice, as they should. The Commission has long since put to rest the issues at the center of its most controversial Section 5 matters. It has not, for example, held unlawful the unilateral adoption or use of delivered or base point pricing since the Second Circuit issued its opinion in *Ethyl* 22 years ago. Nor, since that time, has the FTC condemned consciously parallel pricing in the absence of evidence of "oppressiveness" or some "plus factor" suggesting overt or tacit collusion. The Commission also terminated its two controversial shared monopoly matters.[52] This history gives me confidence that the FTC will be equally responsive in the future, even if we employ Section 5 more expansively, as we should.

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48 *See* Kovacic, 17 TULSA L.J. 587 (1982).

49 *See Boise Cascade*, 637 F.2d at 582; *see also Cement Inst.*, 333 U.S. at 721 n.19; Kovacic, 17 TULSA L.J. at 625-27. *See generally Triangle Conduit*, 168 F.2d at 176; Interim Report, S. Doc. No. 27; Azcuenaga, *Shimmers in the Penumbra of Section 5 and Other News*, *supra* note 35, at 9-11.

50 Commission Statement of Policy on the Scope of the Consumer Unfairness Jurisdiction, *included in* Letter from Chairman Pertschuk and Commissioners Dixon, Clanton, Pitofsky and Bailey to the Honorable Wendell H. Ford and the Honorable John C. Danforth (Dec. 1, 1980) (available as appendix to *Int'l Harvester Co.*, 104 F.T.C. 949, 1071 (1984)). This statement was based, in significant part, on Unfair or Deceptive Advertising and Labeling of Cigarettes in Relation to the Health Hazards of Smoking, 29 Fed. Reg. 8324, 8355 (Jul. 2, 1964) (codified at 15 C.F.R. pt. 408), as quoted in *Sperry & Hutchinson*, 405 U.S. at 244 n.5. The Commission issued a companion policy statement regarding "deception" in 1983. Policy Statement on Deception, contained in Commission letter on deception to the Honorable John D. Dingell, Chairman, Subcommittee on Oversight and Investigations, Committee on Energy & Commerce, Oct. 14, 1983, appended to In re Cliffdale Assoc's., 103 F.T.C. 110, 174 (1984).

51 15 U.S.C. § 45(n) (2006).

52 *In re Kellogg Co.*, 99 F.T.C. at 269 (summarily dismissing further appeal); *In re Exxon Co.*, 98 F.T.C. at 461 (dismissing the complaint without prejudice).

B. Section 5's Scope Is Hinged to That of the Antitrust Laws

As noted previously, when using Section 5 to enforce competition policy, the Commission and courts have largely confined Section 5's reach beyond the antitrust laws to incipient violations of those laws, and violations of those laws' underlying purposes. Because each of these categories finds its touchstone in the antitrust laws themselves, the application of Section 5 is necessarily hinged to the goals, interpretations, and analysis of conduct pursuant to those laws. These sources influence both the content and constraints for "unfair methods of competition," just as they provide both sense and substance for the Sherman Act's equally non-specific phrase, "restraint of trade."

The economic principles and analysis that guide application of the antitrust laws also guides competition policy enforcement under Section 5, notwithstanding the statutory differences. As the antitrust laws expand, shift, or contract, so too does Section 5 adjust and adapt. For example, antitrust analysis has lessened its concern with firm size and market concentration in recent decades and focused more on consumer welfare, innovation, and efficiency. Section 5 jurisprudence has traveled the same path, sometimes leading and sometimes learning. In my view, despite the important differences in breadth and effects, competition policy enforcement under Section 5 appears on balance to be as wise and well-reasoned – no more and no less – as under the antitrust laws.

Section 5's connection with the antitrust laws has led the Agency to rely on antitrust jurisprudence – the cases, principles, and associated economic analysis – as its most significant source of guidance. The Supreme Court articulated the nature of this reliance more than 40 years ago in *Atlantic Refining Company*, when it observed that:

> [i]t has long been recognized that there are many unfair methods of competition that do not assume the proportions of antitrust violations. *Federal Trade Comm'n v. Motion Picture Advertising Service Co.,* 344 U.S. 392, 394 (1953). When conduct does bear the [central competitive] characteristics of recognized antitrust violations it becomes suspect, and the Commission may properly look to cases applying those laws for guidance.[53]

Or, as the Fourth Circuit expressed more recently:

> In the area of anticompetitive practices, the FTC Act functions as a kind of penumbra around the federal antitrust statutes. An anticompetitive practice need not violate the Sherman Act or the Clayton Act in order to violate the FTC Act. However, the scope of the FTC is nonetheless linked to the antitrust laws. . . . The

[53] *Atl. Ref.*, 381 U.S. at 369-70.

> federal [sic] Trade Commission itself looks to antitrust principles in deciding whether § 5 of the FTC Act has been violated.[54]

Section 5 does not replicate the antitrust laws; the relationship between the provisions is better described as complementary rather than as congruent. In many instances, Section's 5's unique coupling of broad scope with modest consequences may prove to be the most apt enforcement tool. The critical connection between Section 5 and antitrust law and analysis, however, helps ensure that Section 5 remains in harmony with the laws it was designed to bolster and support.

IV. THE ELEMENTS OF A SECTION 5 VIOLATION

If we are to use Section 5 to enforce competition policy in a manner consistent with the intent of its framers, I suggest that there should be two requisite elements for a violation. The first is that the respondent must have engaged in identifiable, culpable conduct. The second is evidence of actual or incipient injury to competition.

Conduct. The conduct aspect of this test ensures that the respondent recognizes – or should have recognized – in advance that its conduct was inappropriate. This requirement is met where the respondent engages in actions that are "collusive, coercive, predatory, restrictive, or deceitful,"[55] or otherwise oppressive, and does so without a justification grounded in its legitimate, independent self-interest.[56] Unlike Section 2 of the Sherman Act, which requires proof of specific intent to prove the offense of attempted monopolization,[57] stand-alone applications of Section 5 do not require that element to establish an unfair method of competition. Nonetheless, firms are almost always aware of, and intend, the anticompetitive implications of the types of conduct that would be sufficient for a Section 5 violation. Significantly, although "unfair methods of competition" is not limited to the categories of conduct noted above, Rambus's conduct in this matter could easily have been characterized as falling within several of them.[58]

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54 *Chuck's Feed,* 810 F.2d at 1292-93 (citations omitted).

55 *Ethyl,* 729 F.2d at 137.

56 *See generally Boise Cascade,* 637 F.2d at 573 (finding independent, legitimate reasons for *Boise Cascade's* use of a delivered pricing system).

57 In contrast, Section 2 does not require a showing of specific intent to prove unlawful monopolization; for this offense, proof of general intent to engage in the challenged anticompetitive conduct will suffice. U.S. v. Grinnell Corp., 384 U.S. 563, 570-71 (1966); Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.3d 263 274 (2d Cir. 1979).

58 Significant information regarding the Commission's prosecutorial policies is available not only through the Commission's cases, but also its consent agreements and the testimony, speeches, and public communications of FTC officials.

Injury. Section 5 does not require proof of an actual injury to competition. Rather, established precedent holds that:

> a showing of an actual anticompetitive effect is unnecessary to prove a violation of Section 5 because that section was designed to stop [in] their incipiency acts and practices that could lead to violations of the Sherman or Clayton Acts.[59]

For conduct within the penumbra of the antitrust laws, it is sufficient if the competitive injury is only suspected or embryonic. While conduct violating Section 5 must bear a realistic potential for causing competitive harm, more manifest injury should not be required.

Other Section 5 standards. Other formulations of Section 5's requirements are worded differently, yet they are strikingly similar in substance. For example, the Second Circuit stated in *Ethyl* that:

> [i]n our view, before business conduct in an oligopolistic industry may be labeled "unfair" within the meaning of § 5 a minimum standard demands that, absent a tacit agreement, at least some indicia of oppressiveness must exist such as (1) evidence of anticompetitive intent or purpose on the part of the producer charged, or (2) the absence of an independent legitimate business reason for its conduct. If, for instance, a seller's conduct, even absent identical behavior on the part of its competitors, is contrary to its independent self-interest, that circumstance would indicate that the business practice is "unfair" within the meaning of § 5. In short, in the absence of proof of a violation of the antitrust laws or evidence of collusive, coercive, predatory, or exclusionary conduct, business practices are not "unfair" in violation of § 5 unless those practices either have an anticompetitive purpose or cannot be supported by an independent legitimate reason.[60]

In essence, the Second Circuit held that a Section 5 cause of action may be predicated on: (a) evidence of tacit agreement, or collusive, coercive, predatory, or exclusionary conduct;[61] *or* (b)

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59 In re Coca Cola Co., 117 F.T.C. 795, 970 n.25 (1994) (citing *Sperry & Hutchinson*, 405 U.S. at 244, and In re Dean Foods Co., 70 F.T.C. 1146, 1289-90). The FTC also expressly "disagree[d] with respondent's legal premise" that it must demonstrate "an anticompetitive purpose or effect to find a violation of Section 5 where there is no violation of the Clayton or Sherman Acts." *Id.* at 915.

60 *Ethyl*, 729 F.2d at 139-40. *See also Abbott Lab.*, 853 F. Supp. at 536 (quoting, with apparent approval, the footnoted passage from *Ethyl*). The holding in *Boise Cascade,* 637 F.2d at 577, is not inconsistent with the quoted view. *Boise Cascade*'s holding that the FTC must demonstrate that the parallel pricing system helped to fix or rigidify market prices if proof of overt collusion is lacking merely reflects the court's view that a Section 5 challenge to non-collusive parallel pricing requires evidence suggesting that the conduct injured competition.

61 "Restrictive" and "deceitful" conduct probably also belong in this listing as well, since the court included them when noting the categories of conduct ("collusive, predatory, restrictive, and deceitful") to which the Commission has usually confined its Section 5 efforts, and the types of conduct ("collusive, coercive, predatory,

evidence of an anticompetitive intent or purpose; *or* (c) lack of an independent, legitimate reason for the conduct. Any of these characteristics will suffice as a predicate. Although *Ethyl* does not expressly require actual or incipient injury to competition, each of the three indicia mentioned above raises the prospect that the challenged conduct will harm competition.

Elaborating in a footnote, the court observed that "[t]he requirement [of oppressiveness] is comparable to the principle that there must be a 'plus factor' before conscious parallelism may be found to be conspiratorial in violation of the Sherman Act."[62] As examples, the court suggested that this "plus factor" requirement could be satisfied by conduct that "is contrary to the defendants' independent self-interest," that reflects a "strong motive on a defendant['s] part to enter an alleged conspiracy," or that may result in the "artificial standardization of products."[63]

The appellate court in *Ethyl* was discussing conduct in oligopolistic markets. Nonetheless, factors such as the ones mentioned – the list is not exhaustive – can help flag "unfairness" in other situations as well. Conduct contrary to a firm's legitimate, independent self-interest has frequently been a hallmark of predatory or exclusionary conduct by a dominant firm.[64] The presence of "oppressiveness" or an "anticompetitive intent or purpose," may help distinguish anticompetitive from vigorously competitive conduct.[65] Conduct that leads to the artificial standardization of products – often due to misuse of the standard-setting process – may serve to deter entry, exploit rivals, secure market power, or preserve dominance.[66]

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restrictive, or deceitful") beyond which, efforts to apply Section 5 tend to be more novel and therefore to warrant more searching scrutiny on appellate review. *Ethyl*, 729 F.2d at 136-137.

62 *Id.* at 140 n.10.

63 *Id.* (citations omitted).

64 Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993) (observing that predatory pricing is unlikely, because it is contrary to a firm's *independent* self interest except when it has the ability to recoup its investment in the strategy); James Hurwitz & William E. Kovacic, *Judicial Standards of Predation: The Emerging Trends*, 35 VAND. L.REV. 63 (1982) (examining theories of predatory pricing and circumstances when pricing below various measures of cost will be contrary to a firm's legitimate self-interest and thus warrant legal condemnation).

65 In *Official Airlines Guide*, the court was swayed by the appellant's apparent lack of an anticompetitive motive or purpose for its refusal to deal, since OAG did not compete in the market where its conduct had its anticompetitive impact.

66 *See, e.g., Allied Tube*, 486 U.S. at 500-01. In the present case, Rambus's deceptive conduct *artificially* misdirected JEDEC's standard to one that fell within the respondent's secretly expanded patent claims, contrary to the organization's clear goals to avoid standards that would subject members to substantial royalty payments. The FTC has also challenged misdirection of standard-setting efforts in In re Union Oil Co. of Cal., 2005 WL 2003365 (2005) (consent resolving both Unocal's proposed merger with Chevron and a separate administrative case alleging that Unocal misrepresented to the California Air Resources Board that Unocal's research regarding low-emissions gasoline was non-proprietary) and In re Dell Computer Corp., 121 F.T.C. 616 (1996) (consent regarding FTC's allegation that Dell Computer failed to disclose its patent rights to the Video Electronics Standards Association despite the group's "affirmative disclosure requirements.").

The Areeda treatise offers a comparable formulation. It recommends that:

> [t]he Commission should feel free to "enjoin" any unjustified behavior that tends to impair competition and is capable of being differentiated adequately from permissible behavior.[67]

I agree.

In sum, where there is no identifiable, culpable conduct, there is no violation. "Culpable" in this respect does not require specific intent or actual antitrust injury. It must, however, display sufficient anticompetitive attributes – *e.g.*, oppressiveness, lack of an independent business justification, anticompetitive intent, predation, collusion, deceit, a tendency to impair competition – to warrant characterizing it as unfair, and be at least potentially injurious. Where such qualities are present, it is neither inappropriate nor unwise to find Section 5 liability.[68]

V. RAMBUS'S CONDUCT

Such anticompetitive attributes are clearly present here and, sadly, in abundance. Indeed, Rambus's attempts to deceptively subvert JEDEC's laudable standard-setting efforts is precisely the type of behavior that Congress envisioned would fall within Section 5's mandate.

In considering the application of a "stand-alone" Section 5 cause of action to this behavior, it is not necessary to restate the Commission's findings regarding Rambus's deception since these have been detailed elsewhere in the Commission Opinion. Nonetheless, a brief review of some of the most salient facts demonstrates that finding liability under a "stand-alone" Section 5 cause of action would have been fully appropriate in this matter.

Rambus's conduct occurred in the context of a standard-setting effort involving rivals. In most situations involving direct competitors, one might expect, and even encourage, bare-

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67 AREEDA, HOVENKAMP, & BLAIR, *supra* note 41, at ¶ 302h3. The treatise offers this statement in criticizing the concepts of "incipient violations" and "policy violations" of the antitrust laws, as they are presented in *Brown Shoe,* 384 U.S. 316, which expressly does not require proof of anticompetitive effects. Although I find these categories useful and well supported in Section 5's history, I agree that the use of Section 5 to enforce competition policy should require at least the tendency to impair competition.

68 The Commission, on occasion, has used Section 5 in recent years to address conduct beyond the scope of the antitrust laws, usually in the context of invitations to collude. *See e.g.,* In re Valassis Communications, Inc. (FTC File No. 051 008) (Mar. 16, 2006), *available at* http://www.ftc.gov/os/caselist/051008/051008.htm. In my view, of course, Section 5 offers far greater potential and should be used more fully. While this concurrence discusses the limiting attributes of Section 5 and the predicates of a violation, it does not attempt to prescribe future generic or specific applications of the statute. That, hopefully, will be done by the Commission in future cases.

knuckled competition, including strategies based on secrecy, misinformation, and misdirection.[69] But standard-setting is not a typical "everyone for himself" competitive situation. It is one in which collaboration can yield a valuable result – in this case, the establishment of a useful foundation for future, competitive and innovative efforts. But it is also a setting in which a participant's deceptive strategies can usurp the group's efforts – and industry-wide force supporting them – to serve its own anticompetitive ends. Participants must play by the rules if the joint goal is to be achieved. If competition policy permits easy subversion of these joint efforts, however, then there is little justification in the first place for risking the collaboration among rivals that effective standard-setting often requires. From a competition policy perspective, standard-setting efforts such as JEDEC's are "high risk/high gain" activities. They can be particularly valuable, on balance, if procedures ensuring fairness are adopted and followed in good faith.[70]

In this instance, Rambus violated any reasonable conception of good faith and fairness, and the proximate, competitive impact of its conduct is clear. Rambus misled the standard-setting body with regard to its own intellectual property interests, while simultaneously participating in JEDEC to learn about the organization's developing standards. Based on this wolf-in-sheep's-clothing pose, Rambus was in a position to, and did, amend its own patent claims in order to secretly convert what was intended to be an openly available industry-standard into a private source of revenues.

For example, early during its participation in JEDEC, Rambus's JEDEC representative, Richard Crisp, learned what technologies were being considered for the SDRAM standard. Crisp related that knowledge to Rambus's patent counsel, and together they considered how to amend Rambus's patent claims so that they would cover the emerging JEDEC standard. Rambus even assigned an engineer to provide technical assistance and ensure the amendments would do their job. Rambus continued to use the knowledge gained at JEDEC to amend its patents in this manner. As noted in a December 1992 Rambus planning document, Rambus sought to "get a copy of the SDRAM spec and check it for features we need to cover as well as features which violate our patents."[71] Crisp's September 1995 statement to Rambus management further sums up Rambus's strategy. He urged that Rambus:

> should redouble our efforts to get the necessary amendments completed, the new claims added and make damn sure this ship is watertight before we get too far out to sea.[72]

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69 *Berkey Photo*, 603 F.2d at 281 (2d Cir. 1979).

70 *Allied Tube,* 486 U.S. at 500-01.

71 *See supra*, Commission Opinion, at 36-39.

72 CX 837 at 2.

Rambus's patent strategy relating to the JEDEC standard clearly had the imprimatur of its management. This strategy was known to senior executives at the company in 1992, implemented by an executive vice president, and approved by its CEO Geoff Tate.[73] Finally, Rambus's 1996 withdrawal letter further misled JEDEC members by omitting the only issued patent that Rambus believed covered JEDEC's DRAM standards, and including a patent that Rambus knew (or should have known) was entirely irrelevant.[74]

Rambus did not merely take advantage of the knowledge it gained at JEDEC to ensure it would cover the relevant DRAM standards in its own patent applications; it also did so in direct contravention of JEDEC's broadly-acknowledged purpose: to create consensus-based standards that reflect the interests of all of its members.[75] JEDEC participants' testimony at trial consistently emphasized the wish of JEDEC members to either avoid patented technologies or to secure protections against the unrestricted exercise of patent rights.[76] Even Richard Crisp understood that "[t]he job of JEDEC is to create standards which steer clear of patents which must be used to be in compliance with the standard whenever possible."[77]

While the Commission does not object to covert maneuvers and non-disclosure in typical head-to-head market competition, Rambus's end run around the standard-setting process goes too far. It undermines the policies of the antitrust laws that seek to promote useful innovation and permit joint efforts by rivals that may enhance competition and efficiency. As such, Rambus's conduct would be an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act.

Indeed, Rambus's behavior epitomizes what Senator Robinson in 1914 viewed to be the essence of unfair competition, namely "oppression or advantage obtained by deception or some questionable means. . . .".[78] Or, turning to more modern expressions, Rambus's behavior contravenes "public values beyond simply those enshrined in the letter or encompassed in the spirit of the antitrust laws."[79] It likewise runs afoul of the Second Circuit's statement in *Ethyl* that the Commission's role under Section 5 is to "protect society against oppressive

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73 *See supra*, Commission Opinion, at 37-42.

74 CX 887 (withdrawal letter); CX 5013 at 2 (Rambus memorandum noting that the '327 patent covered dual edged clocking).

75 *See, e.g.*, Becker, Tr. 1152; J. Kelly, Tr. 1784-85; CX 2767 at 1.

76 *See, e.g.*, Sussman, Tr. 1333; Landgraf, Tr. 1693-94; G. Kelley, Tr. 2393-96; Lee, Tr. 6598.

77 CX 903; Crisp, Tr. 2941-42.

78 51 CONG. REC. 12,248 (1914) (statement of Sen. Robinson).

79 *Sperry & Hutchinson*, 405 U.S. at 244.

anticompetitive conduct."[80] Indeed, that court expressly noted that one attribute of "oppressiveness" could be the "artificial standardization of products."[81] It is fair to say that, through its deceptive and exploitative conduct, Rambus effectively co-opted JEDEC's standard-setting process and rendered the JEDEC outcome "artificial."

VI. CONCLUSION

Rambus's abuse of JEDEC's standard-setting process was intentional, inappropriate, and injurious to competition and consumers alike. The Commission Opinion finds that these deceptive practices violate Section 2. Even if this conduct did not violate the Sherman Act, it would have fallen within Section 5's broader province had this claim been argued at trial.

As for our future enforcement efforts, the framers of the FTC Act gave the Agency a mandate – one unique to the Commission – to use Section 5 to supplement and bolster the antitrust laws by providing, in essence, a jurisdictional "penumbra" around them. The framers also gave the FTC deliberative processes for examining suspected incipient or policy violations of the antitrust laws, and provided remedial measures dedicated more to protecting and restoring competition than to punishing malfeasors. Although the Agency has not ignored its Congressional mandate entirely, we need to build on this foundation and further develop this aspect of our enforcement responsibility – and to use all the arrows in our jurisdictional quiver to ensure that competition is robust, innovative, and beneficial to consumers.

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80 *Ethyl*, 729 F.2d at 136.

81 *Id.* at 139 n.10.

EXHIBIT 10

Federal Trade Commission

Section 2 and Standard Setting: Rambus, N-Data & The Role of Causation

J. THOMAS ROSCH[1]
COMMISSIONER, FEDERAL TRADE COMMISSION

LSI 4th Antitrust Conference on Standard Setting & Patent Pools
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I had prepared some general remarks on the antitrust issues in standard setting and patent pools. But I will leave it to others to discuss the competitive benefits and risks of those practices. You are fortunate to have some great panelists here today and I know they plan on covering many of the issues outlined in my presentation. That gives me the liberty to focus on two Commission matters that have attracted a great deal of attention this year – Rambus and N-Data. Specifically, I will discuss the role of causation in these cases. Why? Because causation is important to understanding not only my vote in *N-Data* but also, I believe, the D.C. Circuit's decision in *Rambus*. I suggest that the Court's analysis of causation, which was squarely contrary to its teaching in *Microsoft*, is the most fundamental reason that decision was flawed.

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[1] The views stated here are my own and do not necessarily reflect the views of the Commission or other Commissioners. I am grateful to my attorney advisor Kyle Andeer for his invaluable assistance in preparing this paper.

As demonstrated by our enforcement actions in Dell Computer[2], Unocal[3], Rambus[4], and most recently N-Data[5], single firm conduct in the standard setting context has been a priority for the Commission for over a decade. In these and other matters, we have focused on allegations that a standard setting participant has manipulated the process so that its proprietary technology is incorporated into the standard. Often referred to as "patent hold-up" problem, a competitive problem may arise if the standard setting organization is deceived about the participant's intellectual property ownership interest and the standard confers market power.

I. The D.C. Circuit's Decision in Rambus: A Move Away from *U.S. v. Microsoft*?

This won't surprise anyone but let me say at the outset that I think the D.C. Circuit got it wrong in *Rambus*.[6] I, for one, hope that the Commission will file a petition for certiorari with the Supreme Court later this Fall. Before I turn to the role of the causation let me briefly discuss two *sub silentio* concerns the court of appeals seemed to have with the Commission's final order and decision.

First, the opinion seemed to suggest that much of the blame for the hold-up problem rested with the standard setting organization, JEDEC. The problem it seemed was not whether Rambus engaged in a deceptive course of conduct designed to manipulate the outcome of the

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2 Dell Computer Corp., 121 F.T.C. 616 (1996).

3 In re Union Oil Company of California, FTC Dkt. No. 9305 (2004) *available at* http://www.ftc.gov/os/adjpro/d9305/index.shtm.

4 In re Rambus, FTC Dkt. No. 9302, Liability Opinion (2006) *available at* http://www.ftc.gov/os/adjpro/d9302/060802commissionopinion.pdf; *rev'd,* Rambus Inc. v. Federal Trade Commission, 522 F.3d 456, 468 (D.C. Cir. 2008).

5 In re Negotiated Data Solutions, LLC, Dkt. No. 051-0094 (2007) *available at* http://www.ftc.gov/os/caselist/0510094/index.shtm.

6 Rambus, 522 F.3d 456.

standard setting process. The D.C. appellate panel instead faulted the standard setting organization and suggested that JEDEC could have avoided the problem posed by Rambus with better patent disclosure policies. For example, the court echoed the Federal Circuit's observation that "JEDEC's patent disclosure policies suffered from a 'staggering lack of defining details.'"[7] With the benefit of twenty-twenty hindsight, the court observed that "one would expect that disclosure expectations ostensibly requiring competitors to share information that they would otherwise vigorously protect as trade secrets would provide 'clear guidance' and 'define clearly, what, when, how, and to whom the members must disclose.'"[8]

Second, I also think the court believed that the Commission's approach would extend the reach of Section 2. More specifically, the court relied on the Supreme Court's decision in *NYNEX Corp. v. Discon, Inc.*[9] According to the court, the Supreme Court held in that case that although deceptive conduct by a monopolist designed to exploit its monopoly power might be tortious, it would not constitute monopolization or attempted monopolization in violation of Section 2.[10] Indeed, the D.C. Circuit seemed to suggest that the exploitation of monopoly power was a good thing, declaring that "high prices and constrained output tend to attract competitors, not to repel them."[11] As numerous other commentators have noted, the court's reading of *NYNEX* was unwarranted because the defendant in that case acquired monopoly power lawfully

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[7] *Id.* at 468.

[8] *Id.* (quoting and citing Rambus Inc. v. Infineon Technologies AG, 318 F.3d 1081, 1102 (Fed. Cir. 2003)).

[9] NYNEX Corp. v. Discon, Inc., 525 U.S. 128 (1998).

[10] Rambus, 522 F.3d at 466.

[11] *Id.*

wheras the Commission found that Rambus's acquisition of that power was unlawful. Moreover, the court's latter observation seems to conflict with the views of the framers of Section 2 respecting the merits and demerits of monopoly power.

Yet the court's holding was not based on the first of these two concerns. Nor can it be said that it was based exclusively on the second concern or the reasoning of the district court in the *Qualcomm* case where the judge there held that deceptive conduct in a standard setting context could not injure competition as a matter of law.[12] No, the clearest key to understanding the appellate decision is causation.

The Commission carefully analyzed the link between the exclusionary conduct and the creation of Rambus's monopoly power. In *Rambus*, there were two links in the causal chain – the first was the adoption of the standard by the standard setting organization and the second was the adoption of the standard by the marketplace. The Commission found that Rambus's conduct caused JEDEC to unknowingly adopt standards that read on Rambus's patents. That in turn led the Commission to conclude "that a properly informed JEDEC may have selected a substitute technology suggests a causal link between Rambus's deceptive course of conduct and JEDEC's decision making process."[13] The second link in the causal chain was the adoption of the standard by the marketplace. The Commission found that the market was likely to gravitate around a single standard given the strong need for interoperability with complementary products.[14] Thus,

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12 Broadcom Corp. v. Qualcomm Inc., 2006 U.S. Dist. LEXIS 62090 (D.N.J. 2006) rev'd 501 F.3d 297 (3d Cir. 2007). It is far from clear, however, that the D.C. Circuit's decision did not create a circuit split. It certainly can be read that way.

13 Commission Liability Op. at 77.

14 *Id.* at 77-79.

monopoly power accrued to Rambus only after the manufacturers had fully bought into the standard and begun to implement it.

In these cases, it is often difficult to definitively say what the world would have looked like "but for" the bad acts. The *Rambus* case was no different. The Commission in its liability decision, at the outset of its causation discussion, identified two possible outcomes in a hypothetical world free from Rambus's deceptive conduct: "JEDEC either would have excluded Rambus's patented technologies from the JEDEC DRAM standards, or would have demanded RAND assurances, with an opportunity for *ex ante* licensing negotiations."[15] The Commission did not opine which outcome was more likely. On the one hand, as I say, it did hold that the standardization of Rambus's technologies was not inevitable.[16] On the other hand, the Commission did not rule out the *possibility* that JEDEC may have standardized Rambus's technologies even if it had known about its patents.[17]

The D.C. Circuit opinion focused on the questions whether Rambus's deceptive course of conduct enabled it to avoid a RAND commitment, and whether that was an antitrust violation. Relying on *NYNEX*, the court concluded that it was not an antitrust violation. I don't agree with the court's analysis or its conclusion. A RAND commitment would have checked Rambus's

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[15] Commission Liability Op. at 74; *see also* In re Rambus, FTC Dkt. No. 9302, Commission Remedy Op. at 12 (Feb. 5, 2007) *available at* http://www.ftc.gov/os/adjpro/d9302/070205opinion.pdf.

[16] Commission Liability Op. at 81-96 (Rambus had argued that JEDEC would have adopted its technologies even had full disclosure been made because its technologies were superior to alternatives.).

[17] Rambus, 522 F.3d at 463 ("the Commission expressly left open the likelihood that JEDEC would have standardized Rambus's technologies even if Rambus had disclosed its intellectual property.").

monopoly power. It would have also signaled the marketplace that JEDEC's standard required a licensing agreement from Rambus. Manufacturers and others practicing JEDEC's standards would have had to decide whether they would implement a standard that required such a license. At the time the first JEDEC DRAM standard was published it was not the only alternative, and one cannot say that the market would have inevitably adopted JEDEC's standard if it was subject to a Rambus license. JEDEC's standards enjoyed widespread acceptance in part because the market believed they were relatively costless in terms of licensing. Like I said, I think the court got it wrong in its analysis of this question, but more importantly I think the question is beside the point.

Let me explain. Assume for the sake of argument that the court was right and that "JEDEC's loss of an opportunity to seek favorable licensing terms is not . . . an antitrust harm."[18] That means the court was confronted with two possible scenarios – one in which it was willing to assume was an antitrust violation, and another, in which the court concluded there would not be an antitrust violation. As I said, in its liability decision the Commission did not say which scenario or outcome was more likely. Nor do I think the law required the Commission to make that determination. To understand the Commission's analysis, one must first look to *Microsoft*, for that decision served as our touchstone.

The link between anticompetitive conduct on the one hand and the creation or acquisition of monopoly power as a basis for Section 2 liability is little explored in the case law and commentary. *Microsoft* is one of the few cases to analyze the issue head-on.[19] In *Microsoft,* as

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18 *Id.* at 467.

19 United States v. Microsoft, 253 F.3d 34 (D.C. Cir. 2001).

I'm sure you remember, the monopoly maintenance claim rested on the theory that Microsoft sought to destroy Netscape and Java because they posed a potential threat to its operating system monopoly. However, the threat was nascent, and the theory that Netscape and Java would mature into a competitive alternative to Windows was fairly speculative. In its appeal, Microsoft argued that the government had failed to demonstrate that Microsoft's campaign to destroy Netscape and Java had caused it to maintain its operating system monopoly.[20] The D.C. Circuit, sitting en banc, rejected Microsoft's argument. It was willing to infer a causal connection between Microsoft's exclusionary conduct and its continuing monopoly position in the operating system market.

The D.C. Circuit in *Microsoft* refused to require the government "to reconstruct the hypothetical marketplace absent a defendant's anticompetitive conduct."[21] Instead, it was willing to "infer causation" if exclusionary conduct "reasonably appear[s] capable of making a significant contribution to creating or maintaining monopoly power."[22] The court explained that it drew this inference because "to some degree the defendant is made to suffer the uncertain

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[20] *See* Brief for Defendant-Appellant at 115, United States v. Microsoft, Nos. 00-5212, 00-5213 (D.C. Cir. 2001) ("plaintiffs relied on a speculative chain of causation consisting of at least three steps: (i) Netscape would successfully develop Navigator into a platform that exposed enough high quality APIs to allow ISVs to write full-fledged applications; (ii) large numbers of ISVs would write applications that relied solely on APIs exposed by Navigator (or other middleware like Sun's Java technologies) without making calls to the underlying operating system, thus eliminating the 'applications barrier to entry'; and (iii) the business of providing Intel-compatible PC operating systems that provide low-level support for this middleware—essentially an operating system kernel—would be sufficiently attractive commercially to entice new entrants into the market, even though the principal value of an operating system would have been usurped by the middleware layer.").

[21] Microsoft, 253 F.3d at 79.

[22] *Id.*

consequences of its own undesirable conduct."[23] The court did not hold that in the hypothetical but for world that Navigator and Java would have evolved into a threat. It merely said that it was possible (and left unsaid that it was also possible that they would have simply fizzled out).[24] A lesson to be drawn from *Microsoft* is that uncertainty cuts against the defendant when it comes to causation . . . at least when it comes to liability.

Like *Microsoft*, the "but for" world in *Rambus* was uncertain. In both cases, one could reasonably find that the conduct may have caused the defendant to acquire or maintain its monopoly power. Of course, at the same time, it was also possible that the defendants in those cases would have acquired or maintained their monopoly power even absent the anticompetitive behavior. The question is who bears the brunt of that uncertainty. In *Microsoft,* the D.C. Circuit said it was the defendant. Seven years later, in *Rambus*, the same court said it was the government plaintiff.

So far I've limited my discussion to the Commission's liability decision. Let me take a moment to address the significance of the remedial opinions. The D.C. Circuit read the Commission majority's remedial decision to opine that a "RAND" outcome was more likely here, and that clinched its decision that a Section 2 violation could not be found.[25] However, its

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[23] *Id.*

[24] Indeed, the D.C. Circuit noted that the District Court explicitly did not adopt the position that Microsoft would have lost its position in the operating system market but for its anticompetitive behavior. United States v. Microsoft, 253 F.3d at 78 and 107 (citing the District Court's Findings of Fact ¶ 411, "There is insufficient evidence to find that, absent Microsoft's actions, Navigator and Java . . . would have ignited genuine competition in the market for Intel-compatible PC operating systems.").

[25] Rambus, 522 F.3d at 464 ("the Commission made it clear in its remedial opinion that there was insufficient evidence that JEDEC would have standardized other technologies had it known the full scope of Rambus's intellectual property.").

conclusion *ignored* the difference in the analysis between liability and remedy. Ironically, it was a difference the D.C. Circuit *itself* emphasized in *Microsoft*. There, the court held the burden on a Section 2 plaintiff seeking a structural remedy is *heavier* in terms of causation than the burden on the plaintiff at the liability stage of the proceedings.[26] Indeed, Rambus itself acknowledged the point when it argued that "the burden to justify a remedy that would restrict Rambus's ability to license its patents is heavier than the burden to establish liability."[27] The Commission heeded these admonitions in analyzing Complaint Counsel's royalty-free licensing proposal. It held that Complaint Counsel's proposal for royalty-free licensing was a structural remedy that required "special proof" that it was necessary "to restore the competitive conditions that would have prevailed absent Rambus's misconduct."[28]

A majority of the Commission found that Complaint Counsel had failed in its proof.[29] Along with Commissioner Harbour, I dissented on this point. Both of us felt that there was "strong evidence . . . that if JEDEC had been aware of the potential scope of Rambus's patent portfolio, it would have adopted standards that would have avoided Rambus's patents."[30] Based

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[26] Microsoft, 253 F.3d at 80 ("Microsoft's concerns over causation have more purchase in connection with the appropriate remedy issue, i.e., whether the court should impose a structural remedy or merely enjoin the offensive conduct at issue"); Id. at 107 ("In devising an appropriate remedy, the District court also should consider the strength of the causal connection between Microsoft's anticompetitive conduct and its dominant position in the OS market."); *see also* Massachusetts v. Microsoft, 373 F.3d 1199, 1233 (D.C. Cir. 2004).

[27] Brief of Respondent Rambus Inc., Addressing Issues Relating to Remedy at p. 7 (Sept. 2006) *available at* http://www.ftc.gov/os/adjpro/d9302/060915rambusremedybrief.pdf

[28] Remedy Op. at 10.

[29] *Id.* at 16.

[30] In re Rambus, FTC Dkt. No. 9302, Statement of Commissioner J. Thomas Rosch, Concurring in Part and Dissenting in Part from the Commission Opinion on Remedy (Feb. 5,

on that finding, we would have imposed a royalty-free licensing remedy. If that had been the majority opinion, arguably the D.C. Circuit would have upheld the Commission's decision. But like I said earlier, I think the court missed the point in its analysis. The question, at least in terms of liability, is not whether a "but for" world with a RAND assurance was an antitrust violation. Based on the commentary and the D.C. Circuit's own landmark decision in *Microsoft*, the fact that the Commission found that at least one potential outcome in a "but for" world would have been a violation should have been sufficient. Nor should the analysis turn on the Commission majority's remedy decision as to which outcome was more likely. *Microsoft* made it clear that when the issue is whether or not a structural remedy is appropriate, the brunt of uncertainty is borne by the plaintiff, not the defendant, and there must be "special proof" of the causal link. The D.C. Circuit's decision in *Rambus* is a potentially dramatic shift away from *Microsoft* and towards a much more demanding standard in terms of establishing causation.

II. N-Data

Let me turn to another standard setting matter that has attracted a great deal of attention this year – N-Data. In a consent decree that was finalized just last week, the Commission condemned a breach of a licensing commitment made to a standard setting organization and subsequently relied upon by the market as both unfair method of competition *and* an unfair act or practice. Although I am sure many of you are familiar with the matter, let me briefly sketch out the facts.

The case involved proprietary technology that was included in the IEEE's Ethernet standard. In 1994, the IEEE standard setting body voted to include National Semiconductor's

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2007) *available at* http://www.ftc.gov/os/adjpro/d9302/070205roschstmnt.pdf.

NWay technology in the Ethernet standard. The decision was made, at least in part, because National offered to license its technology for a onetime paid-up royalty of $1000 per licensee to manufacturers and sellers of products that use the IEEE standard. Several years later, National transferred the patents to a third party for use in applications that did not implicate the IEEE Ethernet standard. The third party was fully aware of the licensing commitment and made no effort to enforce the patents against firms practicing the IEEE standard or change the terms of the licensing commitment. N-Data acquired the relevant patents in 2001. By that time, virtually every computer in the United States read on the IEEE Ethernet standard and the patents conferred potentially significant monopoly power. Soon after its acquisition of the patents, N-Data sought to renegotiate the terms of a licensing commitment with IEEE and impose the new terms on dozens of firms practicing the IEEE Ethernet standard. That's when the Commission stepped in. As I said, a majority of the Commission condemned N-Data's conduct as both an unfair method of competition and an unfair act or practice.

I felt N-Data's conduct was an "unfair act or practice" under the Commission's *Orkin* decision, which was upheld by the Eleventh Circuit.[31] There, you will recall, the Commission (and the Eleventh Circuit) found an unfair act or practice when *Orkin* unilaterally breached a contract, resulting in the exploitation of consumers who could not adequately defend themselves. I also believed it was appropriate to condemn N-Data's conduct as an unfair method of competition based on my reading of the relevant case law.[32] The Supreme Court in *FTC v.*

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[31] Orkin Exterminating Co. v. FTC, 849 F.2d 1354 (11th Cir. 1989).

[32] Commissioner J. Thomas Rosch, "Perspectives on Three Recent Votes: the Closing of the Adelphia Communications Investigation, the Issuance of the Valassis Complaint & the Weyerhaeuser Amicus Brief," before the National Economic Research Associates 2006 Antitrust & Trade Regulation Seminar, Santa Fe, New Mexico at 5-12 (July 6, 2006) *available at*

Sperry & Hutchinson Co. endorsed an expansive reading of the "unfair method of competition" prong of Section 5.[33]

To be sure, both of these prongs of Section 5 are subject to limiting principles, as subsequent appellate decisions have made clear. One limiting principle relates to the nature of the conduct. In *OAG*, the Second Circuit held that such a violation could not be found where the respondent "does not act coercively."[34] I felt the standard setting context in which the conduct occurred here was critically important. N-Data's efforts to exploit the power it enjoyed over those practicing the Fast Ethernet standard satisfied this requirement because the market lacked any practical alternatives. I felt that this form of patent hold-up was inherently "coercive" and "oppressive" with respect to firms that were practically locked into a standard.

The second limiting principle relates to the effects of the conduct. Although the Supreme Court has made it clear that the respondent's conduct need not violate the letter (or even the spirit) of the antitrust laws to fall under Section 5, that does not mean that conduct can be considered an unfair method of competition if it has no adverse effect at all on competition. I felt that requirement was also satisfied here, given the importance of the breached commitment to the *ex ante* competition that precedes the adoption of a standard like the standard at issue in that case.

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http://www.ftc.gov/speeches/rosch/Rosch-NERA-Speech-July6-2006.pdf.

33 FTC v. Sperry & Hutchinson Co., 405 U.S. 233, 239 (1972); *see also* FTC v. Ind. Fed'n of Dentists, 476 U.S. 447, 454 (1986).

34 Official Airline Guides v. FTC, 630 F.2d 920, 927 (2d Cir. 1980) ("OAG"); *see also* E.I. Du Pont v. de Nemours & Co. v. FTC, 729 F.2d 128, 139-40 (2d Cir. 1984) ("*Ethyl*"). Similar to OAG, the Second Circuit held that "at least some indicia of oppressiveness must exist....").

The third limiting principle relates to the ability of the "victims" of the conduct to defend themselves. The commitment here extended not to a single firm, but rather to an industry-wide standard setting organization. Indeed, in the standard-setting context – with numerous, injured third parties, big and small, who lack privity with the patentee and with the mixed incentives generated when members must decide whether to pass on royalties that raise costs market-wide – contract remedies may prove ineffective, and Section 5 intervention may serve an unusually important role. Indeed, the SEC reporting requirements, which would require the biggest businesses to acknowledge that they were potential infringers, and hence subject to multiple damages and attorney fees if they planned to defend infringement claims by N-Data, tended to inhibit even those firms from defending themselves as easily they could if they faced mere breach of conduct claims.

The Commission did not allege that N-Data's conduct violated Section 2 of the Sherman Act. Speaking only for myself, I did not believe the facts supported a viable Section 2 claim. The facts in N-Data were different from those of the Commission's earlier standard setting cases. For example, unlike in *Rambus*, there were no allegations of misconduct or anti-competitive behavior at the time the standard was adopted by the IEEE. Nor were there any allegations of anticompetitive behavior that led the market to subsequently implement IEEE's standard. The conduct in the case – the breach of the licensing commitment – did not cause N-Data to either acquire or maintain its monopoly power. The monopoly power exploited by N-Data was conferred by the standard setting organization and the subsequent marketplace adoption of the standard.

Put different, it might be argued that N-Data's renege on the original commitment made by National Semiconductor constituted an "exclusionary" act or practice. However, I doubted that the renege could be considered "exclusionary" in any meaningful sense of that term. It had nothing to do with the *ex ante* competition that occurred before the standard at issue was adopted, and it could not be said that there was any causal connection between that act or practice and the adoption of the standard (which allegedly produced monopoly power in the "autonegotiation technology market.") That act or practice occurred years after the standard was adopted and the market was "locked in" to the technology.

III. Concluding Remarks: What's Next?

So what's next for the Commission? First and most immediately there is a decision to be made on whether to pursue an appeal in Rambus. As I said earlier, I personally support a petition for certiorari in Rambus. I think the D.C. Circuit's decision is wrong and given the fact that it rests on important legal principles respecting causation in Section 2 cases. I think its implications are much broader than the standard setting context. The petition is due in mid-November and it is my hope that the Solicitor General weighs in to support us on this important effort.

Second, the Commission will have to decide whether it will continue to prioritize these cases if the D.C. Circuit's decision is allowed to stand. Again, personally I continue to favor aggressive enforcement in this area. To be sure, in future cases, the Commission will have to focus even more attention on causation. The added burden may add some challenges but the stakes are high. It is important to remember that the costs will be borne by consumers. A patent holder engaged in deceptive or manipulative conduct that enable it to capture a market standard may distort the competitive process and injure consumers. Standard setting in some industries may eliminate competition but we are willing to sacrifice that competition because it also promises great efficiency. However, if we allow firms to manipulate or distort the process then we risk the very efficiencies we are looking to capture.

Third, I think it is safe to say that Section 5 is on the table. N-Data may only be the beginning. The Commission is holding hearings on uses of Section 5, and at least one of the panels will consider Section 5 in the standard setting context. I hope you will offer your comments on the future scope of Section 5.