PUBLIC

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

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

RESPONDENT'S POST-TRIAL BRIEF

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I. INTRODUCTION

The central thesis of Complaint Counsel's case, upon which the Complaint must stand or fall, is that Unocal committed fraud. According to the Complaint, "[b]ut for Unocal's fraud," the California Air Resources Board ("CARB") would not have adopted "regulations that substantially overlapped with Unocal's concealed patent claims" or "the terms on which Unocal was later able to enforce its proprietary interests would have been substantially different." (Complaint ¶ 5). But the evidence shows that no fraud ever occurred. Unocal's statements to CARB, made in the course of petitioning a government agency engaged in a quasi-legislative rulemaking, were true and correct. And Complaint Counsel never seriously attempted to prove that the harm alleged in this case would have been avoided had the alleged misconduct not occurred. Indeed, Complaint Counsel's own economic expert did not even assert that consumers would have been better off had the allegedly fraudulent conduct not occurred.

A. The Complete Failure of Proof of Harm to Competition

The Complaint offers two theories of harm from Unocal's alleged misconduct before CARB. The first is that, but for the alleged fraud, CARB would have adopted regulations different from those that it actually adopted. The only evidence offered by Complaint Counsel to support this allegation was the testimony of a CARB employee that the agency, in contradiction to its official pronouncements on the subject, would have abandoned the regulations that it actually adopted and would have instead adopted the U.S. Environmental Protection Agency's reformulated gasoline ("RFG") regulations. (Venturini, Tr. 787-88). But even if this claim were credited, Complaint Counsel's economic expert, Professor Carl Shapiro, was unable to state that adopting the EPA regulations would have made consumers better off. Because he had "not conducted an evaluation

of the relative merits" of any alternatives to the regulations that CARB actually adopted, Professor Shapiro could "not rule out" that the actual regulations adopted by CARB would have been the agency's best choice in the absence of the alleged misconduct. (Shapiro, Tr. 7160). The testimony of Unocal's expert that adoption of EPA regulations would have made California consumers far worse off (Griffin, Tr. 8368-69) stands unrebutted. In short, Complaint Counsel have failed to prove that consumers would have been better off absent the alleged misconduct.

Complaint Counsel also offered no evidence that but for the alleged fraud, the terms on which Unocal is able to enforce its patents would have been different. Their economic expert offered no testimony regarding the terms on which Unocal would have been able to enforce its patents had it not engaged in the allegedly fraudulent conduct. Indeed, he conceded that it was possible that the terms on which Unocal enforced its patents would have been the best alternative available to CARB had the alleged fraud not occurred. (Shapiro, Tr. 7160). In other words, he conceded that Unocal's alleged fraud may not have caused any of the harms alleged by the Complaint.

To arrive at harm to competition, Professor Shapiro "assumed" that Unocal offered to license its patents on a royalty-free basis. (Shapiro, Tr. 7241-42). This assumption was "fundamental" to his analysis of the case. (Shapiro, Tr. 7241-42). But there is not a shred of evidence in the record—even in testimony from Complaint Counsel's own witnesses—that anyone understood Unocal to have made such an offer. And the unsupported assumption is irrelevant in any event given Professor Shapiro's concession that the current regulations with Unocal's royalties could well have been the best alternative available to CARB even if the alleged misconduct had not occurred.

Complaint Counsel's economic expert also did not offer any support for the Complaint's other theories of anticompetitive harm. He offered nothing to support the claim that Unocal's alleged misconduct conferred or dangerously threatened to confer monopoly power upon Unocal in the market for reformulated gasoline. (Shapiro, Tr. 7326). He thus left unrebutted the testimony of Unocal's economic expert that no such power or prospects of it existed in a market in which Unocal did not even compete. (Teece, Tr. 7525). And Professor Shapiro also offered no support for the claim that Unocal's alleged deception of refiners caused harm to competition by preventing the refiners from making investments to avoid Unocal's patents. He left unrebutted the testimony of Unocal's economic expert that showed that, absent the alleged misconduct, the refiners would not have made any different decisions. (Griffin, Tr. 8427; Shapiro, Tr. 7381).

In short, the Complaint's theories of competitive harm stand bereft of any support from any economic expert, including Complaint Counsel's own expert. And this lack of support exists even if the Complaint's allegations of deception by Unocal are credited. The evidence, of course, is overwhelming that no deception occurred.

B. The Complete Failure of Proof of Fraud or Misrepresentation

Unocal stands accused of having misrepresented to CARB the existence of a patent application related to reformulated gasoline. But Unocal merely told CARB that it considered data that it had provided to CARB to be nonproprietary and available to CARB and others. (CX 29). Unocal's August 1991 letter to CARB, the centerpiece of Complaint Counsel's case, expressly stated in its heading that it was addressing the "public availability of data," and went on to state that Unocal was agreeing to "make the data public." (CX 29). Both Unocal and CARB understood that the letter referred to data contained in a specific data base that Unocal had made available to CARB, and no

more. Unocal's letter, by its express terms, conferred nonproprietary status upon data contained in a "data base" that Unocal had made "available to staff." (CX 29). CARB described the disk on which Unocal had provided the data as "the original diskette containing the data base referred to in Dennis Lamb's August 27, 1991 letter." (RX 327).

There is no claim that Unocal has acted inconsistently with this letter by asserting proprietary rights over its data. And indeed, the evidence at trial showed that Unocal has not charged any one for the use of its data. Instead, based on this letter, Complaint Counsel claim that Unocal represented that it had no patent applications related to RFG. On the basis of the same letter, Complaint Counsel's economic expert assumed that Unocal had agreed to license its future patents on a royalty-free basis. But the express terms of the letter, and CARB's acknowledgment that the letter referred to a data base, wholly refute both of these interpretations. The letter permitted CARB to make public disclosure of data contained in a data base, no more and no less.

The evidence adduced at trial on this issue is devastating to Complaint Counsel's case. Upon receiving the letter through which Unocal allegedly defrauded CARB, "the thought did not occur" to the CARB executive in charge of the rulemaking that the letter had "anything to do with patent rights." (Venturini, Tr. 821-22). Moreover, the same official acknowledged that the actions he took based on the letter would have been no different had Unocal stated that the data was "not confidential" instead of nonproprietary. (Venturini, Tr. 346). When CARB learned of the issuance of Unocal's first RFG patent, moreover, the agency entertained no thought that Unocal had defrauded it. CARB's internal analysis of the issue did not suggest that Unocal had done anything to mislead the agency. (*See* RX 64 at 18-20). In accordance with this understanding, CARB's Executive Officer sought assurances that Unocal would "not raise patent infringement issues" as to a

reformulated gasoline test program that CARB was then conducting. (CX 50). This request cannot be reconciled with a belief by CARB that in 1991 Unocal had forsaken its rights under the patent.

Documents from 1991 evidencing Unocal's contemporaneous intent are just as devastating to the fraud claim. They reveal an intention to do precisely what the company's letter to CARB said—permit the public disclosure of data. A summary of an internal meeting five days before Unocal sent the letter states that "Unocal will notify CARB that it will waive its rights to confidentiality of the 5/14 project data." (CX 266 at 004). And an internal Unocal memorandum sent by the letter's author a day after sending the letter states that "[w]e have agreed to make our 5/14 data public . . . ." (CX 1755 at 001).

Complaint Counsel's other theory of misrepresentation is that Unocal told CARB that regulations based on a predictive model that regulated emissions levels but did not dictate the composition of gasoline formulations would be cost effective and flexible. A statement on the desirability of such a regulatory approach is a paradigmatically political statement on the desirability of a particular regulatory regime. The evidence shows, moreover, that CARB and other third parties have endorsed this opinion. Even after learning of Unocal's patents, CARB took the position that the predictive model "[i]ncreases gasoline producer's flexibility" and "[r]educes compliance costs/improves production capability." (Simeroth, Tr. 7480-81; RX 190 at 019). And Texaco advocated for the adoption of the predictive model even after it became aware of the issuance of Unocal's '393 patent. (Kulakowski, Tr. 4554, 4651-52). In short, there was a complete failure of proof of any kind of misrepresentation, let alone the fraud alleged in the Complaint.

C. The Complete Failure of Proof of Misrepresentation in a Non-Political Setting

Unocal's alleged transgression was making a misrepresentation in the course of lobbying a government agency prior to the commencement of a quasi-legislative rulemaking. The Supreme Court has characterized such rulemakings as "significantly political" in nature. *United States v. Mistretta*, 488 U.S. 361, 393 (1989). The conduct of the rulemaking, and the events that preceded its commencement, make it clear that the rulemaking was a quintessentially political affair in its substance and not just in its legal characterization. Unocal's attempt to influence its outcome is therefore entitled to an absolute antitrust immunity under the *Noerr* Doctrine. *See Eastern R.R. President's Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961).

The Complaint attempted to bring this case within a misrepresentation exception to *Noerr* that some cases have recognized in the context of adjudicative and quasi-adjudicative proceedings by alleging that the rulemaking was actually "quasi-adjudicatory." (Complaint ¶¶ 26, 96). But Complaint Counsel completely failed to prove this allegation. Instead, they now take the position that the quasi-legislative nature of the rulemaking is irrelevant because the rulemaking allegedly was not a "political exercise." Complaint Counsel are wrong. No case has withheld *Noerr* immunity to participants in quasi-legislative proceedings that establish legal standards to govern future conduct.

Moreover, the evidence overwhelmingly shows that CARB's Phase 2 RFG rulemaking was political in its every facet. The state legislature delegated extensive power to CARB to clean up California's air. The evidence leaves no doubt that CARB had sufficient discretion to regulate whatever gasoline properties it chose, to not regulate these properties at all, and even to ban the sale of gasoline altogether. (CX 5 at 163). To make these judgments, CARB had to weigh an internally

inconsistent mandate to maximize emissions reductions and minimize costs. The mandate left the agency with enormous discretion to find the right balance between these conflicting goals. And it opened the door to intense political jockeying to influence the agency.

In the high stakes forum of the Phase 2 RFG rulemaking, interested parties jostled with each other and spared no efforts in attempts to influence the regulations. Representatives of Atlantic Richfield Company ("ARCO"), for example, "met with governmental agencies, CARB staff . . . political leaders and members of the Governor's cabinet." (RX 83 at 006). They contacted every CARB board member, two governors, members of the governors' staffs, and legislators. (Clossey, Tr. 5488; RX 589 at 003). A single ARCO representative participated in "dozens" of meetings with CARB officials. (Clossey, Tr. 5485-86).

These "dozens" of meetings reflected a special relationship that ARCO had developed with CARB, which resulted in the adoption of regulations based on an ARCO gasoline formulation called EC-X. ARCO's president acknowledged publicly that the gasoline specifications mandated by CARB's regulations were "almost identical" to EC-X. (CX 773 at 146). This special relationship also manifested itself in ARCO receiving preferential access to information. CARB staff favored ARCO with a private meeting at which they gave ARCO alone a preview of the agency's regulatory proposal. (Clossey, Tr. 5506; Boyd, Tr. 6792-93; RX 73 at 001). At this meeting, CARB cautioned ARCO to treat this information carefully and instructed ARCO not to pass this information on. (RX 73 at 001-002). That preview satisfied ARCO that CARB staff "have opted to take the bulk of our recommendations and go with them as is." (Clossey, Tr. 5506; RX 073 at 001).

Other companies used similar means to lobby CARB, albeit without the same success. For example, Chevron representatives met privately with CARB staff 22 times between 1990 and 1994.

(CX 7042 (Bea, Dep. at 31-32)). A registered lobbyist working on behalf of Texaco prepared a "Legislative/Regulatory Action Plan" that proposed that Texaco "take our lobbying activities beyond CARB" (RX 95 at 005) to counter ARCO's influence as "a major player in California politics" (RX 95 at 002). Recognizing that "ARCO goes so far as to twist arms," Texaco emphasized the need "to keep the pressure" to counter ARCO's influence. (RX 99 at 004). This was in keeping with Texaco's belief that "CARB can and will disregard sound science and economic arguments. Therefore, overwhelming political opposition is the only alternative." (RX 434 at 007). Accordingly, Texaco's lobbyists met with members of the governor's staff and had "lots of meetings" with representatives of the California legislature. (CX 7057 (McHugh Dep. at 30, 33, 37, 40)).

In the course of this highly political process, CARB staff engaged in political horse trading. Having favored ARCO with unique access to information regarding regulatory plans, CARB staff privately enlisted ARCO for "help in defeating" a regulatory proposal advanced by General Motors. (Clossey, Tr. 5507-08; RX 75 at 001). In this environment of mutual back-scratching, "CARB adopted," in ARCO's words, "reformulated gasoline specifications for all gasoline sold in California after March 1, 1996 that are equivalent to the EC-X formula." (RX 83 at 006). Chevron, which similarly concluded that CARB's regulations embraced the EC-X formula, attributed this outcome to the fact that "decisions of this Board [CARB] are influenced largely by politics rather than science." (RX 528 at 003). The politics continued after the adoption of the regulations. In advertisements published in major California newspapers, which it published after showing the proposed ad copy to CARB's executive officer and eliciting no objections, ARCO claimed credit for the enactment of the regulations. (Boyd, Tr. 6791-92).

It was in this political context that Unocal is alleged to have made its misrepresentations. Even if Unocal had misrepresented a material fact to CARB—and the evidence at the hearing showed that it had not—the quintessentially political character of the process in which Unocal acted makes this a paradigmatic case for the application of *Noerr* immunity. Complaint Counsel's presentation of testimony underscores the reasons why *Noerr* immunity exists. In contravention of the Supreme Court's warning against "deconstruction of the governmental process and probing of the 'official intent,'" *City of Columbia v. Omni Outdoor Advertising*, 499 U.S. 365, 377 (1991), Complaint Counsel's entire case centered on imputing reasons for governmental action that are not apparent from the government's official pronouncements. A dozen current and former CARB officials testified in person or by deposition in an effort to probe CARB's "official intent." Many were impeached multiple times by prior testimony or by the agency's own official statements.

But what the record left unmistakably clear is that the Phase 2 RFG rulemaking was, by any conceivable standard, a political proceeding. Even if Complaint Counsel could show that Unocal made a misrepresentation to CARB, that the misrepresentation influenced the outcome of the CARB rulemaking, and that this influence caused harm to competition, this action would be barred by *Noerr* because there is no evidence that Unocal used the governmental process itself—"as opposed to the *outcome* of the process—as an anticompetitive weapon." *Omni*, 499 U.S. at 380 (emphasis in original). But Complaint Counsel cannot show any of these things. There was no misrepresentation. Unocal did not influence the outcome of the Phase 2 RFG regulations, which CARB copied from ARCO's EC-X formula. And there is no evidence of harm to competition. It is difficult to conceive of a more unmeritorious case.

II. FACTUAL BACKGROUND

A. The Air Pollution Problem

During the late 1980s, Californians were confronted with dangerous levels of air pollution. (Venturini, Tr. 84). Los Angeles had the worst air quality in the nation, exceeding air quality standards on two out of every three days. (CX 7063 (Sharpless, Dep. at 76)). Vehicle emissions were a major source of this pollution. (CX 7063 (Sharpless, Dep. at 52)).

Faced with this pollution crisis, the California Legislature, through California Assembly Bill 234, directed the Governor to establish an advisory panel to assess methanol and other fuel alternatives. (CX 1021 at 008-009; Venturini, Tr. 81, 196-97; CX 7063 (Sharpless, Dep. at 70-71); Beach, Tr. 1744; Boyd, Tr. 6695-96). This panel included representatives from the automotive, petroleum and methanol industries, state agencies, non-attainment districts, the business community and the public-at-large. (Beach, Tr. 1744; CX 1021 at 003-004). In October of 1989, this panel found that reformulated gasolines "might be able to qualify as cleaner fuels, but research is only beginning and success is uncertain." (CX 1021 at 019).

One of California's agencies, the California Air Resources Board, ("CARB") was charged with the responsibility of adopting regulations which would achieve the maximum reductions in pollution caused by vehicular sources as quickly as possible. CAL. HEALTH & SAFETY CODE § 43018(a). As a result of the AB 234 study panel, CARB looked to reduce exhaust emissions by changing the formulation of blended gasoline. (Boyd, Tr. 6700-03; Beach, Tr. 1745-46).

Facing regulators motivated to regulate, the refining industry and automobile manufacturers came together to jointly conduct research into how gasoline emissions could be reduced for the express purpose of influencing potential regulations at state and national levels. (CX 4001 at 002).

This research project became known as the Air Quality Improvement Research Program ("Auto/Oil"). By written agreement, its members acknowledged that the work performed by and paid for by the group jointly could not be patented and that the group would jointly publish its work. At the same time, members were free to conduct research independently of the program and to maintain for themselves whatever benefits that research yielded. (CX 4001 at 014-015).

Independent research is particularly poignant in this case in that the Auto/Oil members rejected the opportunity to use a Unocal-designed experiment test matrix that would have examined multiple different gasoline properties, and instead embarked on a plan to only look at four fuel variables. (Croudace, Tr. 622, 625-26; CX 121; CX 142). As a result, Unocal undertook its own independent research studies.

B. The Unocal Studies

After their multiple-variable proposal was rejected by Auto/Oil, two scientists at Unocal, Drs. Jessup and Croudace, "decided to see whether we could do it in-house." (Croudace, Tr. 623; CX 142). The scientists argued to their management that, "It is necessary for Unocal to embark on a program of this nature because the Auto/Oil program, as it is currently set up, will not tell us how to reformulate gasoline to reduce emissions." (Croudace, Tr. 626; CX 142 at 003). In particular, the Unocal scientists were concerned that studies being trumpeted by companies like ARCO would influence the Auto/Oil program and regulators to make political and not scientific decisions on how to reformulate gasoline to reduce emissions. (CX 121 at 002; Jessup, Tr. 1583-84). They further argued that, the "almost assured failure of the Auto/Oil program will be a severe blow to the oil companies and give credence to the methanol lobby." (Croudace, Tr. 627; CX 142 at 003). Drs. Jessup and Croudace were also concerned that regulations could force Unocal to spend huge amounts

of money in its refineries, but that the regulations would not actually lead to cleaner air, and thus years down the road Unocal and others would have to reconfigure all over again. (Jessup, Tr. 1155).

The two scientists then conducted an in-house experiment running a total of 22 different fuels (15 of which were designed test fuels with the others being control and check fuels) through a1988 Oldsmobile Regency 98. (Jessup, Tr. 1525-26; RX 79 at 016-018). By March of 1990, Drs. Jessup and Croudace had collected data from this "one-car study" and analyzed it to determine what properties of gasoline they could vary and what compositions could eventually be made that would produce lower emissions. (Jessup, Tr. 1155, 1158; Croudace, Tr. 634-36). The analysis that the two scientists conducted used the emissions data generated from combusting 15 different test fuels in the one-car study through use of a computer program known as SAS system. (RX 793 at 016). The computer program, however, did not dictate the analysis, rather the scientists were required to make numerous choices in how to analyze the data. (Jessup, Tr. 1526-30).

This one-car study led to many new discoveries, including a dramatic new understanding of which physical properties and compositional characteristics affected exhaust emissions for particular pollutants and which ones did not. (Jessup, Tr. 1159). The scientists developed equations from this one-car study predicting the amount of individual criteria pollutants, CO, HC, and NOx from gasoline. (Croudace, Tr. 445-46; RX 793 at 015). A patent would later issue to Unocal directed to compositions of motor gasoline based on this one-car study. (Croudace, Tr. 636; CX 617).

Following the one-car study, the scientists requested funding from their management to do additional research work. (Lamb, Tr. 2179). This project became known as the "5/14 project," and included a ten-car test conducted at the Southwest Research Institute. (Jessup, Tr. 1160-61). Equations were also developed from the ten-car test and differed from those of the one-car study.

(Croudace, Tr. 445-46; RX 793 at 018-019). Unocal would later conduct further testing with 13 cars using Southwest Research Institute and the National Institute of Petroleum and Energy Research.

C. The Patent Application Process

By July of 1990, the scientists had drafted an internal invention disclosure document describing just some of the aspects of their invention, in accord with company policy. (Croudace, Tr. 509-10; Jessup, Tr. 1500-01; CX 186). The disclosure went through the usual course of being reviewed by a "conception committee" and was sent to Unocal's patent group with instructions to file an application for a patent. (Wirzbicki, Tr. 881-83; CX 661 at 003). Unocal's chief patent counsel decided to handle the application himself and would file the application on December 13, 1990. (Croudace, Tr. 458).

The patent application itself claimed compositions of unleaded fuel, suitable for combustion in an automotive engine, having certain defined ranges for gasoline measurement tools: paraffin volume percentage, olefin volume percentage, Reid vapor pressure, octane number, and distillation points for 10%, 50% and 90% (referred to as T10, T50 and T90, respectively). (CX 1788 at 013-092). The application was later separated into later filed applications (referred to as continuation applications) claiming methods and processes of refining, distribution and combustion of gasolines with certain defined ranges. (Wirzbicki, Tr. 917-18). In February 1994, the Patent and Trademark Office ("PTO") issued to Unocal the '393 patent. (RX 793). The PTO continued its evaluation of Unocal's continuing applications through February 29, 2000 when it issued the fifth patent arising from Unocal's application. (CX 621).

D. CARB's Statutory Mandate

As described earlier, the 1988 California Clean Air Act directed CARB to take regulatory action "to achieve the maximum degree of emissions reduction possible from vehicular and other mobile sources . . . at the earliest practicable date." CAL. HEALTH & SAFETY CODE § 43018(a). The Act also instructed CARB to take actions that "are necessary, cost-effective and technologically feasible" to achieve various percentage reductions of specific emissions types by December 31, 2000. CAL. HEALTH & SAFETY CODE § 43018(b). The Act provided no guidance as to the types of measures that CARB could take to reduce emissions, leaving it to CARB to determine what types of regulations to adopt. It also provided no guidance on how CARB was to reconcile the apparently contradictory goals of achieving "the maximum degree of emission reduction possible" while enacting cost-effective regulations. CAL. HEALTH & SAFETY CODE § 43018(a)-(b). CARB considered a variety of regulatory options that even included banning the use of gasoline. (CX 5 at 163-164). CARB ultimately decided to carry out its mandate by regulating both automobile emission systems and gasoline composition.

In 1990, CARB adopted new regulations, known as the Phase 1 reformulated gasoline ("RFG") rules, which established new requirements for the Reid vapor pressure ("RVP") levels in gasoline, mandated the use of gasoline additives, and banned the use of lead in gasoline. (CX 10 at 010). CARB then set upon a more ambitious program to develop new regulations, which became known as the Phase 2 RFG rules, to achieve further, and more dramatic, reductions in emissions from mobile sources by regulating gasoline composition. To develop these regulations, CARB embarked upon a process of extensive informal consultations with various interest groups to obtain ideas for how best to structure its regulatory program. (Venturini, Tr. 370-72; Kenny, Tr. 6652-53).

In the course of this process, CARB officials met informally on numerous occasions with representatives of the automobile industry, the refining industry, and health and environmental advocacy groups. (Courtis, Tr. 5733-34, 5893-94). CARB has no prohibitions against *ex parte* communications by either its staff or its board members. (Kenny, Tr. 6652). Accordingly, CARB staff held "extensive meetings with various affected stakeholders" throughout the regulation development process. (Fletcher, Tr. 6460; Kenny, Tr. 6652). This included "numerous meetings with both individual oil companies and also with organizations like the Western States Petroleum Association." (Courtis, Tr. 5733). Indeed, CARB staff was encouraged to meet with as many parties as possible. (Kenny, Tr. 6652). CARB viewed the rulemaking process as "an iterative [sic] process" that "involves the ongoing communication between the regulated public as well as the consuming public. It involves the board staff participation in those conversations." (Kenny, Tr. 6519).

CARB's board members also met with industry lobbyists on an *ex parte* basis. No restrictions existed on such contacts prior to the notice of proposed rulemaking (Kenny, Tr. 6652), and the only restriction on *ex parte* contacts by board members after the commencement of the rulemaking was that the contacts had to be publicly disclosed (Kenny, Tr. 6656).

E. The Pre-Rulemaking Consultation Process

During CARB's informal consultations, and before having any substantive communications with Unocal relevant to its regulatory process, CARB's staff was informed of a potential relationship between gasoline emissions and a gasoline property known as T50, which refers to the temperature at which 50 percent of the gasoline is distilled or evaporates. (CX 5 at 025). For example, in the fall of 1990, representatives from Toyota met with CARB staff to discuss the effects of distillation temperatures on exhaust emissions. (RX 19 at 014; Venturini, Tr. 346-47; Courtis, Tr. 5916-17).

Toyota emphasized to CARB that a "T50 decrease of 10-15° C produces 12-25% Reduction of HC and CO emissions." (RX 19 at 014, 018). Additionally, Toyota urged CARB that a reduction in the range of T50 distribution would improve air quality. (RX 19 at 014, 018).

Also in the fall of 1990, Chevron representatives told CARB staff that T50 was the dominant factor in a measure called Driveability Index. (CX 207; Ingham, Tr. 2656-57). Chevron claimed that the Driveability Index was correlated to hydrocarbon emission levels and urged CARB to regulate it in the Phase 2 rules. (CX 7042 (Bea, Dep. at 38-40); RX 254 at 003; RX 256).[1]

CARB staff became interested in learning about the effects of T50 on emissions no later than January 1991. (RX 677). In a January 1991 communication regarding a potential study of the impact of various gasoline properties on emissions, CARB staff wrote that "it is critical for the purposes of the study and the regulation to have lower T50." (RX 677). Lobbying activities by various interested parties reinforced CARB's interest in learning about T50. For example, at a meeting with CARB staff in April 1991, Toyota urged CARB to regulate T50 and shared with CARB research disclosing the importance of T50 in reducing emissions. (Venturini, Tr. 346-47; RX 19). At a public workshop on June 11, 1991, Toyota addressed the Driveability Index measure and argued that "T50 deserves a greater weighting than is in the current equation." (RX 757 at 003).

Throughout the regulatory development phase, CARB staff maintained very close contacts with representatives of the Atlantic Richfield Company ("ARCO"). (*See* RX 73; RX 75; Clossey, Tr. 5507-08). In 1989, CARB issued a press release in which it praised ARCO's efforts in developing a "new gasoline" that "reflects the direction of the ARB's future regulation." (CX 7063

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[1] During the Phase 2 RFG rulemaking, Chevron had a pending patent application relating to the Driveability Index, which it did not disclose to CARB. (CX 7067 (Toman, Dep. at 50)).

(Sharpless, Dep. at 59); RX 108 at 001). In 1991, as CARB's staff was gearing up for a reformulated gasoline rulemaking, the staff was particularly interested in the composition of ARCO's EC-X, which was a successor to the "cleaner gasoline" touted in CARB's 1989 press release. (*See* RX 108; CX 7063 (Sharpless, Dep. at 58).

On June 7, 1991, before Unocal discussed any aspect of its research with CARB, CARB staff met privately with ARCO representatives to discuss the specifications of EC-X. (RX 180). At this meeting, CARB staff members asked ARCO's representatives about the T50 level of two EC-X samples and were given two values—190° F and 200° F. (Fletcher, Tr. 6464; RX 180 at 003). Before July 21, 1991 (Fletcher, Tr. 6921), CARB staff prepared two drafts of proposed Phase 2 regulations, one of which specified a T50 value of 190° F (RX 198 at 012) and the other of 200° F (RX 184 at 028). CARB's staff used ARCO's EC-X specification to develop the regulations that the agency ultimately adopted. (Fletcher, Tr. 6917-18). In a briefing paper on reformulated gasoline prepared by CARB staff in August 1991, the only gasoline used by the staff to compare to government specifications was ARCO's EC-X. (Fletcher, Tr. 6923-24; CX 803). The following month, CARB Chairwoman Jananne Sharpless stated that the ARCO's EC-X "has specifications similar to what we are proposing for Phase 2 reformulated gasoline." (Fletcher, Tr. 6930; RX 111 at 001). CARB's Robert Fletcher, who obtained the T50 values for EC-X from ARCO, admitted that "ARCO's EC-X was part of the information used to help develop the standards that were put in place." (Fletcher, Tr. 6918).

F. <u>The Inventors Desire Recognition for Their Work</u>

In the meantime, Unocal's inventors were attempting to get their management's attention to publish the research they had done. (Croudace, Tr. 643-44). On November 27, 1990, Dr. Croudace

wrote his manager, Wayne Miller, and told him that it was inevitable that other studies to be conducted in the immediate future would uncover for CARB two of the key variables to reducing emissions. (CX 207 at 001). Dr. Croudace believed CARB was on course to discover the effects of these two variables—RVP and T50—on emissions in its own study by April 1, 1991, and would then regulate these variables in the Phase 2 gasoline specifications. (Croudace, Tr. 644; CX 207 at 001). Referencing others' previous or future studies, Dr. Croudace told Dr. Miller that if Unocal intended to use its results to its advantage in the marketplace and/or to influence CARB that "we have to use our information NOW!" (CX 207 at 001 (emphasis in original)). It is evident that "influenc[ing] CARB" did not mean trying to convince CARB to include a T50 specification in its regulations, as Dr. Croudace acknowledged that it was inevitable that this would occur without Unocal's input. (CX 207 at 001). Additionally, Dr. Croudace wanted to get credit for what he and Dr. Jessup had discovered. (Croudace, Tr. 645).

Drs. Croudace and Jessup would continue to pepper their superiors with various memoranda or presentations in which they raised various justifications for telling others about or otherwise using parts of their discoveries. (*E.g.*, CX 210; CX 238). For example, in a memorandum dated December 11, 1990, the scientists argued for an opportunity to go to Auto/Oil and present an alternative analysis of Unocal data which would suggest that a mathematical construct of T50, T90 and T10 (known to the industry as a Driveability Index ("DI")) was a key variable to reduce emissions and not just the T90 parameter Auto/Oil was investigating. (CX 210 at 002). This option, they argued, would "leave the door open" for Unocal to use its research results and license gasoline formulations to other oil companies. (CX 210 at 002). The scientists also argued that allowing publication of research results could allow Unocal to avoid expensive equivalency testing with the EPA or that

publishing could make their CEO a "hero" in the oil industry by showing scientifically that emissions from gasoline could be reduced. (CX 210 at 003-004). And, the scientists argued that because their work showed that low olefins reduced emissions, Unocal could benefit from a regulation that recognized this fact since one of its refineries did not produce olefins. (CX 210 at 004).

Drs. Jessup and Croudace also spoke of $114 million in royalties per year in potential licensing. (CX 210 at 002, 004; Croudace, Tr. 595-96). In this memorandum and in others, the scientists used a variety of potential royalty numbers, including one-thousandth of a cent, one-hundredth of a cent, one-tenth of a cent, and a penny a gallon. (Croudace, Tr. 595-96; *see*, *e.g.*, CX 238 at 018).

Dr. Jessup, however, explained that at the time that he came up with his "licensing" numbers, he had no responsibility for licensing. (Jessup, Tr. 1587). He had no prior experience with licensing at Unocal and had not been given any training on what factors to look for, if any, in determining appropriate licensing amounts. (Jessup, Tr. 1587). According to Dr. Croudace, none of the licensing numbers that Drs. Jessup and Croudace came up with (including the $1 billion per year in CX 493) were based on any sort of licensing analysis that they had done. (Croudace, Tr. 595-96). When asked how they came up with the numbers, Dr. Croudace explained that they simply "wanted a number big enough that it would interest people in our company" and that they basically picked the numbers "out of thin air." (Croudace, Tr. 596).

In another attempt to get attention for their research, Dr. Jessup prepared a poster board, (CX 2), that was displayed at a meeting that included Unocal senior management, in the spring of 1991. (Wirzbicki, Tr. 933-34). The Science and Research Division had more than one poster in order to try to impress management to continue to have funding for science. (Miller, Tr. 1452-53).

The inventors wanted to make the point "that research is valuable to the operating divisions." (Jessup, Tr. 1589). The atmosphere at Unocal in the early 1990s had been tense for researchers like Drs. Jessup and Croudace as Unocal had gone through tight monetary times and was starting to target restricting the budget for Unocal's research center. (Jessup, Tr. 1588). The poster board showed a clip art type rainbow and pot of gold. (Jessup, Tr. 1242). It also used a royalty figure of one cent per gallon, applied to all of the gallons of gasoline sold in the U.S. in a year, to come up with a figure of $1 billion, which Dr. Jessup "pulled out of the air" as part of their attempt to get attention. (Jessup, Tr. 1589; CX 2).

While Drs. Jessup and Croudace attempted to draw attention to the idea that their invention could bring royalties to Unocal, there were no plans at Unocal in 1990 or 1991 to charge royalties on the 5/14 research. (Beach, Tr. 1763). Despite the fact Mr. Beach, then president of Unocal's Refining and Marketing Division, knew generically about the potential for licensing income from inventions, he made his decisions regarding an advocacy strategy to CARB based on what he thought would best limit the amount of capital costs in his refineries to be imposed by the regulations. (Beach, Tr. 1761-62). Mr. Beach's focus was as an "operating person." (Beach, Tr. 1761-62). And, as an operating person, "anything about patents was a big black hole." (Beach, Tr. 1761-62).

G. Unocal's Intent in its Advocacy Before CARB

Mr. Beach appointed Dennis Lamb to head Unocal's Fuels Issues Team on November 6, 1989. (Beach, Tr. 1675, 1748; CX 540). Mr. Beach wanted Mr. Lamb to lobby the regulators in the direction that would require Unocal to make the least amount of capital investments and to help formulate Unocal's positions regarding future regulations. (Beach, Tr. 1749). As head of the Fuels Issues Team, Mr. Lamb supervised those within Unocal who were dealing with CARB. (Beach, Tr.

1675). Thus, with respect to the CARB Phase 2 regulations, Mr. Lamb was involved at the inception of Unocal's advocacy efforts before CARB. (Lamb, Tr. 2169-70).

Unocal's thinking with respect to its Phase 2 CARB advocacy strategy was motivated by a concern for the operations of its refining business. (Beach, Tr. 1764-65). One of Unocal's concerns with respect to the potential regulations was whether CARB would mandate the use of oxygenates. (Lamb, Tr. 2176). Unocal did not have its own manufacturing capacity for oxygenates and was concerned about the expense of either having to develop that capacity itself or having to purchase oxygenates from others. (Lamb, Tr. 2176).

In an October 2, 1990 memo to Roger Beach, Mr. Lamb recommended to Mr. Beach that Unocal continue to advocate for performance standards rather than advocate in favor of any mandated formula—including one based on the 5/14 project research. (Lamb, Tr. 2186-88, Beach, Tr. 1756; CX 194 at 003). In response to this memorandum, Mr. Beach agreed with Mr. Lamb that Unocal should not advocate for a fuel formula based on Unocal's research. (Beach, Tr. 1755) ("That was absolutely something we were not going to do."). Rather, Mr. Beach conveyed to Mr. Lamb that Unocal should approach CARB to see if they could convince CARB to go the "predictive model route." (Beach, Tr. 1757). In Unocal's particular circumstances, a predictive model could enable Unocal to take advantage of the fact that one of its refineries produced gasoline with very low sulfur and low olefins. (Lamb, Tr. 2195). Because both these properties were useful in reducing emissions, Unocal could use the low olefin/low sulfur qualities to offset the higher emissions from some other parameters of its gasolines. (Lamb, Tr. 2195). Additionally, a predictive model might enable Unocal to make gasoline with just a minimum amount of oxygen, or with no oxygen at all. (Lamb, Tr. 2195). Unocal's decision to meet with CARB and what it would advocate is reflected

in a May 10, 1991 memo showing Unocal's goal was to secure a predictive model approach and avoid "unnecessary minimums or maximums on fuel parameters (e.g., oxygen)." (CX 241 at 001).

On June 20, 1991, CARB officials met with Unocal representatives on an *ex parte* basis as part of the informal consultation process that preceded CARB's Phase 2 rulemaking. (Croudace, Tr. 462-63). This meeting occurred five months after CARB officials wrote of the criticality of T50 and also after CARB officials had secured from ARCO the T50 values of its EC-X gasoline. (*See* RX 180). At this meeting, Unocal representatives told CARB that research conducted by company scientists had shown that that automobile emissions levels could be predicted based on the levels of multiple gasoline properties. (*See, e.g.*, CX 24). One of the properties discussed at the meeting was T50, which Unocal's research had shown to be a significant predictor of emissions levels. (CX 24 at 005).

Unocal's purpose in informing CARB of these findings was to persuade CARB to adopt regulations based on gasoline performance rather than gasoline formulas. (Lamb, Tr. 1997-98: Kulakowski, Tr. 4607-08). Instead of specifying inflexible maximum or minimum levels for particular gasoline properties, a predictive model regulation could specify maximum emissions levels and determine whether a gasoline was compliant. This approach would allow each refiner to choose the most efficient method for reducing emissions in light of the characteristics of its refining operations. (Beach, Tr. 1755; Lamb, Tr. 2195). Years later, a CARB representative, in an official submission to the United States Environmental Protection Agency, would represent that the predictive model approach "[i]ncreases gasoline producer's flexibility[,] [r]educes compliance costs[, and] improves production capability." (RX 190 at 019; Simeroth, Tr. 7480).

Unocal disclosed the concept of a predictive model to CARB staff at the June 1991 meeting without giving staff the numerical coefficients of the equations it had developed, since Unocal wanted CARB staff to assemble its own data and develop its own predictive model. (Jessup, Tr. 1508-09; Kulakowski, Tr. 4605-07). CARB staff later asked Unocal to disclose the equations with coefficients that Unocal had referenced at its June 20, 1991 meeting. By letter dated July 1, 1991, Unocal provided the equations to CARB and asked that CARB maintain their confidentiality. (CX 25 at 001). Unocal's letter also stated, however, that Unocal would consider making the equations and supporting data public if CARB were to pursue a meaningful dialogue on a predictive model approach to Phase 2 gasoline. (CX 25 at 001). Releasing confidentiality of information or data is necessary if CARB is going to rely on the information or data in promulgating regulations. (Venturini, Tr. 233; Fletcher, Tr. 6469).

In the meantime, CARB staff proceeded with plans to regulate T50, preparing draft regulations on July 21, 1991 that specified two T50 values based on the T50 values given to the staff by ARCO. (*See, e.g.* RX 184). These draft regulations sought to regulate gasoline composition by specifying limits for eight specific fuel properties, including T50. On August 1, 1991, CARB published draft regulations in which it specified a T50 value of 200° F. (RX 184 at 028). In a briefing paper prepared a week later, CARB's staff recognized a direct relationship between the T50 specification in the draft regulations and the T50 level of ARCO's EC-X gasoline, which the staff had learned had a T50 value of 201° F. (CX 803 at 002).[2]

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[2] Subsequently, in response to ARCO lobbying, CARB raised the T50 specification in its proposed regulation to 210° F. (RX 73 at 001). The 210° F limit remained in the Phase 2 regulation as adopted. (RX 338 at 002).

CARB's proposal to regulate T50 had the support of a number of interest groups, including the automobile industry. For example, Toyota and Nissan supported a 200° F limit for T50. (CX 10 at 049).

H. Unocal's Waiver of Confidentiality Restrictions on its Data

On July 25, 1991, after CARB had already drafted its regulations with a proposed T50 limitation, Unocal sent to CARB for the first time a computer disk containing the data that its representatives had discussed with CARB staff the previous month. (RX 327 at 003-004). The data came from a 10-car study conducted by Unocal to test the relationship of various gasoline properties on emissions. (RX 327 at 003-004; RX 522; Venturini, Tr. 336-37). CARB understood that the emissions data on this disk was to be treated as confidential. (*See* RX 327 at 002). When printed out, the data consisted of over 50 pages of columns of numbers, of which a sample is shown below from exhibit CX 1247:

CAR146.DAT

			B2	0.08	4.07	0.03	511.1	17.95	17.80
			B3	0.18	2.14	0.35	413.7	22.25	21.85
			FTP	0.20	3.62	0.25	475.9	19.27	18.70
146-ES	8/23/90	E	B1	0.49	4.96	0.55	494.3	18.45	21.10
			B2	0.05	2.82	0.03	514.4	17.90	19.92
			B3	0.19	2.97	0.30	427.5	21.47	20.55
			FTP	0.18	3.31	0.21	486.4	18.88	20.24
146-F	7/30/90	F	B1	0.38	3.62	0.86	457.7	17.39	17.39
			B2	0.08	3.31	0.12	483.7	16.51	17.89
			B3	0.14	1.35	0.80	398.3	20.15	20.83
			FTP	0.16	2.83	0.46	454.9	17.57	18.43
146-FS	8/24/90	F	B1	0.40	4.47	0.96	466.7	17.00	24.14
			B2	0.07	2.85	0.09	475.7	16.81	14.84
			B3	0.16	1.52	0.70	396.8	20.21	17.67
			FTP	0.17	2.82	0.44	452.2	17.67	16.91
146-G	8/01/90	G	B1	0.38	2.94	0.65	476.8	17.79	17.69
			B2	0.04	2.71	0.01	493.6	17.24	17.54
			B3	0.10	1.10	0.44	404.1	21.14	21.63
			FTP	0.13	2.31	0.26	465.5	18.28	18.42
146-GS	8/27/90	G	B1	0.45	4.48	0.59	482.2	17.50	.
			B2	0.05	3.00	0.03	493.1	17.24	.
			B3	0.18	1.32	0.83	406.2	21.00	.
			FTP	0.17	2.84	0.36	467.1	18.18	.
146-GS	9/26/90	G	B1	0.44	2.85	0.62	473.4	17.91	17.57
			B2	0.02	1.91	0.03	492.2	17.33	17.31
			B3	0.17	0.98	0.39	408.1	20.93	21.34
			FTP	0.15	1.85	0.25	465.3	18.32	18.20
146-H	8/02/90	H	B1	0.47	2.34	0.50	460.0	17.64	17.39
			B2	0.08	3.27	0.12	482.1	16.83	16.84
			B3	0.12	1.49	0.52	408.1	19.97	20.44
			FTP	0.17	2.59	0.31	457.4	17.76	17.68
146-HS	8/28/90	H	B1	0.39	3.50	0.75	467.6	17.30	15.63
			B2	0.06	2.68	0.09	480.2	16.93	17.70
			B3	0.12	0.87	0.53	398.1	20.52	21.64
			FTP	0.15	2.36	0.35	455.2	17.86	18.20

CARB staff did not consider this data at any time before the conclusion of rulemaking.[3] CARB was required to place on the rulemaking record all data and information on which it relied

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[3] After its receipt of the disk containing the data, CARB sent the disk to the State of California's Teale Data Center to be loaded onto a central computer. (RX 121 at 001-002). A file containing Unocal's data was allegedly created at the Teale Data Center on August 2, 1991, a day after CARB published its regulation proposing to limit T50 to 200° F. (RX 121 at 002). There is no evidence that any CARB employee attempted to use the data at any time before the conclusion of the rulemaking.

in adopting its regulations. (Kenny, Tr. 6632; Fletcher, Tr. 6466). CARB's general counsel at the time of the Phase 2 RFG rulemaking testified as follows with respect to this requirement:

> Q: If the information on the disk was relied upon by the agency in the adoption of the CARB Phase 2 regulations, it was to be part of the rulemaking record; correct?
>
> A: Yes.

(Kenny, Tr. 6646). The data disk, however, cannot be found in the rulemaking record. (Kenny, Tr. 6641; Venturini, Tr. 693-95, 699). Moreover, there is no document that shows that CARB staff analyzed the Unocal data or even accessed a computer to look at the data prior to the adoption of the Phase 2 RFG regulations. (Venturini, Tr. 706; CX 7044 (Chan, Dep. at 23-26)).[4]

At some point after receiving Unocal's data, CARB's staff expressed its interest in the possibility of a regulation based on a predictive model. For instance, CARB publicly stated on August 1, 1991, in connection with its publication of the proposed regulations that contained the T50 specification of 200° F, that it also intended "to develop predictive models based on past and current vehicle testing programs." (RX 184 at 035-036). To facilitate the use of Unocal's data in developing a predictive model, the staff asked Unocal to lift the confidentiality designation that it had attached to its data. (Lamb, Tr. 2233; CX 29). Without the ability to make the data public,

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[4] Further, CARB could not have relied on the data when it published its draft regulations in which it proposed to set a T50 specification of 200° F. (*See* RX 184 at 028; RX 198 at 012). At that time, Unocal had not yet withdrawn its request that its data be treated as confidential. (*See* CX 29 (release on confidentiality dated August 27, 1991)). CARB may not rely on information that submitters are unwilling to disclose publicly. (Venturini, Tr. 233; Fletcher, Tr. 6469).

CARB could not consolidate it with other data in the mega-data base of vehicle tests that CARB was compiling. (Venturini, Tr. 233; Fletcher, Tr. 6469).

In response to CARB's professed interest in developing a predictive model, on August 27, 1991, Unocal's Dennis Lamb sent a letter to CARB's Executive Officer, James Boyd, that lifted the confidentiality of the data. (CX 29). The letter's subject line read: "PUBLIC AVAILABILITY OF UNOCAL RESEARCH DATA." The subject line was followed with three paragraphs of text, which are replicated here in their entirety:

> On June 20, 1991, certain Unocal representatives met with Peter Venturini and other members of his staff. During that meeting, we presented the results of three phases in Unocal's Vehicle/Fuels testing program. We subsequently made the data base available to staff and agreed to make the data public if necessary in the development of a predictive model for use in the certification of reformulated gasoline.
>
> The staff has now proposed to develop such a predictive model and requested that we make the data public.
>
> Please be advised that Unocal now considers this data to be non-proprietary and available to CARB, environmental interest groups, other members of the petroleum industry, and the general public upon request.

(CX 29).

It is obvious from the face of the letter that the subject of the letter was solely the public availability of data and that Unocal was agreeing merely to "make the data public," as requested by CARB staff. (CX 29). The data referred to in the letter is, according to the letter, contained in the "data base [that Unocal had made] available to the staff. (CX 29). This is the same data that Unocal sent to CARB on July 25, 1991, and which CARB never even examined before the conclusion of its Phase 2 rulemaking. (Venturini, Tr. 706). That the letter refers to this data—and only to this data—is not merely Unocal's conjecture. It is also CARB's position on the matter. (*See* RX 327

at 002) (producing "the original diskette containing the data base referred to in Dennis Lamb's August 27, 1991 letter").

CARB understood the letter to refer solely to the confidentiality of the data from the 10-car study of which a partial printout is reproduced above. (Jessup, Tr. 1539-41; CX 1297). According to CARB's Robert Fletcher, CARB needed Unocal's permission to make its data public because CARB "cannot base decisions on information that isn't publicly available." (Fletcher, Tr. 6480). Mr. Fletcher asserted that "publicly available" means that "there are no restrictions on its use, there are not caveats associated with what you can or cannot release to the public." (Fletcher, Tr. 6480). Unocal, of course, placed no restrictions on the use of the data that it had made public.

Unocal's intentions regarding the letter are disclosed in internal Unocal communications prepared shortly before and shortly after the letter. For example, a memorandum summarizing an internal strategy meeting that took place five days before the date of the letter states that to facilitate CARB's adoption of a predictive model "Unocal will notify CARB that it will waive its rights to confidentiality of the 514 Project data." (CX 266 at 004). And three days after sending the letter, Mr. Lamb told his management that "[w]e have agreed to make our 5/14 data public in order for CARB to use it at the workshop and in technical justification for the model." (CX 1755 at 001).

I. <u>The Phase 2 RFG Rulemaking</u>

On October 4, 1991, CARB initiated a rulemaking to promulgate Phase 2 RFG regulations by publishing a Notice of Public Hearing to Consider Adoption of and Amendments to Regulations Regarding Reformulated Gasoline. (CX 767 (October 4, 1991 Notice of Public Hearing)). Under California law, as CARB recognized, the "rulemaking process begins with the release of the notice." (CAL. GOV'T CODE § 11346.4 (1991); Courtis, Tr. 5779; CX 767 (October 4, 1991 Notice of Public

Hearing)). In the Notice, CARB stated that "[t]he public hearing will 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." (CX 767 at 010). The cited procedures are applicable "to the exercise of any quasi-legislative power" by CARB. CAL. GOV'T CODE § 11346. Under California law, CARB's rulemakings are "quasi-legislative" proceedings. *Western States Petroleum Ass'n v. Superior Court*, 9 Cal. 4th 559, 567 (1995). The promulgation of quasi-legislative rules is "an authentic form of substantive lawmaking." *Yamaha Corp. of America v. State Bd. of Equalization*, 19 Cal. 4th 1, 6 (1998).

CARB's general counsel at the time of the Phase 2 RFG rulemaking, Michael Kenny, testified that CARB rulemakings, including the enactment of the Phase 2 regulations, are quasi-legislative. (Kenny, Tr. 6535, 6650). Indeed, he took the position that CARB's performance of the quasi-legislative rulemaking function "is similar to the process used by the legislature in adopting laws." (Kenny, Tr. 6664-65).

In the proposed regulations, as in the draft regulations that CARB had published two months earlier, the agency proposed to regulate eight fuel properties, including T50. (CX 52 at 010 (Table I-2)). But whereas the August 1 draft had a T50 specification of 200° F, the draft regulations proposed a T50 specification of 210° F. (CX 52 at 010 (Table I-2)). The reason for this change is revealed in an internal ARCO memorandum in which ARCO's Timothy Clossey acknowledges, following a conversation with CARB, that, "once again," CARB staff "have opted to take the bulk of our recommendations and go with them as is." (Clossey, Tr. 5506; RX 73 at 001). One of ARCO's recommendations related to T50: "They [CARB] have decided to go with our recommendation to raise the T50 spec to 210 F." (RX 73 at 001). ARCO, in fact, had made a

recommendation to CARB to set the T50 specification at 210° F. (Clossey, Tr. 5505). ARCO learned of the contents of the draft regulations at an extraordinary private meeting at which CARB staff gave only ARCO a preview of the regulatory proposal. (Clossey, Tr. 5504; Boyd, Tr. 6792-93; RX 73 at 001).

Following the publication of the proposed regulations, CARB accepted both written and oral comments from interested persons. The record shows that Board members met with registered lobbyists, including ARCO lobbyists, during this post-notice period. (Kenny, Tr. 6657). Five of the CARB Board members disclosed that they had *ex parte* contacts with ARCO, or its lobbyists during this post-notice period. (Fletcher, Tr. 6969-72). Chairwoman Jananne Sharpless had previously met with representatives of ARCO, having also been asked to attend a press conference with ARCO regarding its EC-X gasoline. (Fletcher, Tr. 7027; Venturini, Tr. 354-55).

The oral comments were provided at a two-day hearing convened on November 21 and 22, 1991, at the conclusion of which CARB's board adopted the proposed regulations, with some modifications. (CX 773; CX 774; CX 817). Unocal, and the majority of the refining industry, opposed the proposed regulations. (*See*, *e.g.*, CX 10 at 023-024 (list of commenters supporting regulation does not include Unocal); RX 437 at 001 (WSPA and other refiners were "offset" by ARCO backing the 10/4/91 proposal; Clossey, Tr. 5566-67). Unocal opposed both the regulatory concept of regulating fuel properties generally and CARB's proposal to impose a limit on T50 specifically. According to CARB's Final Statement of Reasons for Rulemaking, Unocal had argued, among other things, that:

- "[W]e don't see the specification for T50 as necessary." (CX 10 at 047).

- "[N]o further action is necessary to achieve [statutorily-mandated emission] reductions," as "[e]xisting regulations will achieve reduction[s]" sufficient to fulfill the statutory mandate. (CX 10 at 053).

- CARB should adopt a predictive-model based approach and link the compliance date to the adoption of such a model, such that "[f]or every month delay in the adoption of a predictive model after January 1992, there should be a corresponding one month delay on the effective date of the Phase 2 regulations." (CX 10 at 171).

Not surprisingly, the one refiner to support the adoption of the regulations was ARCO. (*See, e.g.*, RX 437 at 001; Kulakowski, Tr. 4638-39). Referring to industry lobbying to relax CARB's proposed specification for T50, which was the product of a private negotiation between ARCO and CARB staff, ARCO stated that "[c]onsiderable pressure is being exerted to relax the specification for T50" and urged CARB to resist this pressure. (CX 10 at 049).

ARCO prevailed. On November 22, 1991, CARB voted to adopt the proposed regulations published by the agency the previous month with only minor modifications. (CX 10 at 007).

Unocal, however, continued to oppose the Phase 2 rules and to argue for delay in their implementation. Unocal urged CARB to delay the implementation of the regulations in June 1992 (CX 39 at 004-005) and again in September 1992 (CX 42 at 006). As late as January 1994, at a meeting with CARB Chairwoman Jananne Sharpless, Unocal argued that the Phase 2 rules were wholly unnecessary and that a low-emissions vehicle program coupled with an aggressive automobile inspection and maintenance program would be sufficient to meet air quality requirements. (RX 200).

J. <u>CARB's Analysis of Cost-Effectiveness</u>

Although the statutory mandate required CARB, among other things, to adopt cost-effective regulations, CARB's evaluation of the cost-effectiveness of its proposed Phase 2 regulations evinced a low priority for this criterion. For example, the agency assigned the task of conducting the cost-effectiveness analysis for its regulations to a junior engineer who had no prior experience in performing cost-effectiveness analysis and provided him with no training on the subject. (CX 7040 (Aguila, Dep. at 15); Venturini, Tr. 327-28). This engineer, Jim Aguila, learned about the subject from a cost-effectiveness guidance document that CARB made available to the public. (CX 7040 (Aguila, Dep. at 16-17, 21-22); RX 195). According to this document, cost-effectiveness "is neither the sole nor the dominant criterion for decisionmaking," as "[t]he primary mandate is to achieve the state air quality standards by the earliest practicable date." (RX 195 at 004).

In conducting his analysis, Mr. Aguila relied solely on information that CARB first sought from refiners, on a voluntary basis, on August 14, 1991. (CX 7040 (Aguila, Dep. at 53-54, 89-91, 134-35)). CARB requested the cost data from the refiners two weeks *after* it had already published a draft regulation that prescribed specific limits for various fuel properties, including T50. (*See* RX 184). Because of the failure of most refiners to respond, and the incompleteness of the responses of those refiners that did respond, CARB ended up relying on limited investment and operating cost data from only two out of the 30 California refineries. (Fletcher, Tr. 6958-59; CX 52 at 071; CX 7040 (Aguila, Dep. at 160-65, 176-77, 203-06); CX 5 at 137A).

The low priority that CARB attached to its cost-effectiveness "analysis" is demonstrated by the way in which the agency projected the operating costs of compliance with its proposed regulations. CARB's Final Statement of Reasons for Rulemaking, in reliance on Mr. Aguila's work,

stated that operating costs would amount to 50 percent of the capital costs of regulatory compliance. (CX 10 at 088). Mr. Aguila determined that operating costs would amount to 50 percent of capital costs on the basis of data from *only two refiners*, one of which had estimated operating costs at 25 percent and the other at 40 percent. (CX 7040 (Aguila, Dep. at 167)). No one from CARB supervised Mr. Aguila's work or reviewed it for methodological soundness. (CX 7040 (Aguila, Dep. at 16-19)). In spite of the shoddiness of this cost-effectiveness analysis, CARB rejected proposals to delay promulgating its regulations to complete more rigorous cost studies. (CX 10 at 171).

Under the guidelines on which Mr. Aguila relied, it is appropriate to "adopt measures that are less cost-effective on a dollars per ton basis, if the potential emission reductions are greater." (RX 195 at 015). In its Final Statement of Reasons for Rulemaking, CARB rejected the view "that control measures [must] be adopted in the precise order of their respective cost-effectiveness." (CX 10 at 110). CARB also rejected proposals by various refiners to conduct an incremental analysis of the cost-effectiveness of individual parameters of its Phase 2 regulation, whereby the incremental cost and benefit of each fuel property (such as T50 or RVP) would be determined. (CX 10 at 104).

In its Final Statement, CARB estimated the cost of the Phase 2 RFG regulations at $7,000-11,000 per ton of pollution avoided. (CX 10 at 091). This amount was deemed to be cost-effective under a "going rate" approach, whereby CARB compares the cost of pollution abatement on a per ton basis to "the upper cost bound for measures recently adopted or proposed for adoption." (RX 195 at 007). Under this approach, the "going rate" that defined the upper bound of cost-effectiveness was at least $32,000 per ton. (CX 7063 (Sharpless, Dep. at 205-06); CX 52 at 077 (referred to in testimony as RX 52); *see also* CX 773 at 312 ($50,000 upper bound)).

This approach to cost-effectiveness explains CARB's rejection of Unocal's objections to the cost of the proposed Phase 2 rules. Unocal argued to CARB that the then-proposed rules would impose significantly greater costs than CARB was projecting, which Unocal estimated as an increase from $16,000 to $20,000 per ton. (CX 10 at 184). Converting these figures to a cost per gallon, CARB took Unocal's estimate to mean that the regulations would impose costs of 23 cents per gallon, as compared to CARB's estimate of 12 to 17 cents per gallon. (CX 10 at 184). CARB rejected Unocal's argument on the basis that the higher cost figure supplied by Unocal was well within the zone of cost-effectiveness: "[E]ven if the cost-effectiveness of Phase 2 RFG is changed by 25 percent as suggested by Unocal, the Phase 2 RFG cost-effectiveness would still be comparable to recently adopted regulations." (CX 10 at 184). In fact, the potential 6 to 11 cent increase over its own cost estimate that CARB deemed to be cost-effective is several times the size of Unocal's patent royalty under its licensing program, which is 1.6 cents per gallon for refiners that produce only infringing gasoline. ({[redacted]}, *in camera*).

K. The Political Nature of Advocacy During the Phase 2 RFG Rulemaking

Participants in CARB's Phase 2 RFG rulemaking viewed the rulemaking as a political exercise. Texaco focused on "generat[ing] 'political heat' and attention on CARB." (RX 98 at 001). Texaco and other members of the Western States Petroleum Association ("WSPA") took "assignments to contact key legislators, administration personnel and CARB board members." (RX 98 at 001). WSPA's efforts focused on countering ARCO's lobbying. Aware that "ARCO is aggressively working this issue" with "administration personnel and CARB members," and concerned that ARCO would go "so far as to twist arms" in favor of regulations that mimicked its EC-X fuel, WSPA sought to "keep the pressure on to motivate as much movement [away from those

regulations] as possible." (RX 99 at 004). WSPA's lobbying efforts featured "advocacy efforts with legislators, administration personnel and CARB members" (RX 99 at 004), "editorial board visits" (RX 99 at 002), and a fax campaign urging trade associations "to contact legislators, administration personnel and CARB members" (RX 99 at 002).

In spite of these counter-lobbying efforts, ARCO proved to be influential throughout all phases of the process. Its success was no accident. ARCO had devised a plan "to convince California regulators to adopt reformulated gasoline specifications that mirror" the company's EC-X fuel. (RX 83 at 002). ARCO's lobbying team engaged in "selling" EC-X to CARB. (Clossey, Tr. 5532). ARCO successfully persuaded CARB staff through back-channel communications "to take the bulk of our recommendations and go with them as is." (Clossey, Tr. 5506; RX 73 at 001). To secure the company's political victory, ARCO's representatives "met with governmental agencies, CARB staff . . . political leaders and members of the Governor's cabinet." (RX 83 at 006). As ARCO's Timothy Clossey wrote, ARCO engaged in "successful lobbying efforts that led to CARB's adoption of reformulated gasoline specifications essentially identical to EC-X." (RX 83 at 002). In the course of these efforts, Mr. Clossey held "dozens" of meetings with CARB officials (Clossey, Tr. 5485-86) while he and other ARCO representatives contacted every CARB board member, two governors, members of the governors' staffs, and several legislators. (Clossey, Tr. 5488; RX 589 at 003).

ARCO was not alone in seeing the outcome of the Phase 2 rulemaking as a measure of ARCO's success in a political process. Chevron viewed the process as one in which CARB "proposed specifications very similar to EC-X" and in which ARCO "continued to dictate the terms of the debate at the hearing. . . ." (RX 528 at 003). Most fundamentally, according to Chevron, the

adoption of the regulations was driven by the fact that "decisions of this Board [CARB] are influenced largely by politics rather than science." (RX 528 at 003). Ultimately, major refiners lobbying for more flexible regulations "had no effective strategy that could cope with the politically powerful alliance of the oil industry's market leader (ARCO), a significant independent (Ultramar), the automobile industry, local air districts, medical associations and environmentalists." (RX 528 at 004).

L. Industry's Use of the Term "Proprietary" to Connote "Confidential"

Unocal's August 1991 letter waiving the confidentiality of the company's data was, as its subject line states, about the "PUBLIC AVAILABILITY OF UNOCAL RESEARCH DATA." (CX 29). Unocal used the term "non-proprietary" in that letter synonymously with "non-confidential." (*E.g.*, Lamb, Tr. 2238, 2254-55). This usage was consistent with the standard industry practice in dealings with CARB. For example, Exxon's official policy required the designation of all documents with operational or financial information as "Exxon Proprietary." (*See* RX 513 at 028). Exxon routinely marked submissions to CARB that contained confidential information as "Exxon Proprietary." (*See, e.g.*, CX 2090; RX 883; RX 552). Similarly, Texaco used the term "proprietary" to refer to "something . . . confidential." (CX 7076 (Youngblood, Dep. at 63)).[5]

It is not surprising then, that CARB's Executive Officer, to whom Unocal addressed its letter, testified that the term "proprietary" may be used as a "synonym" for confidential. (Boyd, Tr. 6839).

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[5] More broadly, the use of the term "proprietary" as a synonym for confidential is common outside the petroleum industry as well. *See, e.g.*, *Wiener v. NEC Elecs., Inc.*, 848 F. Supp. 124, 127-28 (N.D. Cal. 1994) (discovery decision using the terms "proprietary" and "confidential" interchangeably), *overruled on other grounds by*, *Cybor Corp. v. FAS Techs., Inc.*, 138 F.3d 1448 (Fed. Cir. 1998).

CARB staff discerned no material difference between the term "nonproprietary" and "nonconfidential:

> Q. If Unocal had said, quote, not confidential in its August 27, 1991 letter instead of nonproprietary, staff would have used the information, the equations, the data, the presentation of the slides as you actually did; correct?
>
> A. That is correct. We would have used the information as we used it.

(Venturini, Tr. 345-46). Indeed, Peter Venturini, CARB's Chief of the Stationary Source Division, testified that "the thought did not occur" to him when CARB received the August 27 letter that the letter had "anything to do with patent rights." (Venturini, Tr. 821-22).

There is no evidence that CARB ever examined Unocal's data prior to its promulgation of the Phase 2 rulemaking. (*See* Venturini, Tr. 706). This is not surprising, given that CARB had expressed an interest in using the data for the purpose of developing a predictive model. (*See* CX 29). CARB only initiated its study of a predictive model after the conclusion of the Phase 2 RFG rulemaking. (*See* CX 7045 (Cleary Dep. at 96) (Cleary did not begin work developing the model until November or December of 1991)). At all times since lifting the confidentiality of its data, Unocal has complied with its pledge to treat its data as "non-proprietary and available to CARB, environmental interest groups, other members of the petroleum industry, and the general public upon request." (CX 29). The company has not asserted any proprietary rights over the data and has not sought to block anyone else from using the data. (Lamb, Tr. 2236, 2238-39).

M. <u>CARB's Lack of Interest in Intellectual Property Rights</u>

Given CARB's understanding, it is unsurprising that CARB did not interpret Unocal's waiver of confidentiality to refer in any way to patents or to be a public dedication of patent rights. CARB never asked Unocal whether it possessed any patents related to its research. (CX 7040 (Aguila, Dep.

at 130); Boyd, Tr. 6834, 6908, 6821-22; Lamb, Tr. 2260-61). Indeed, CARB never inquired of any company whether it had any patent rights. (Venturini, Tr. 395, 862-83; CX 7063 (Sharpless, Dep. at 168); Eizember, Tr. 3397; Clossey, Tr. 5492; CX 7042 (Bea, Dep. at 36)). Thus, although CARB modeled Phase 2 RFG after ARCO's EC-X, CARB never considered whether ARCO had any patents or pending patents related to RFG. (Simeroth, Tr. 7470-71; Boyd, Tr. 6792; Courtis, Tr. 5901-02; Cunningham, Tr. 4315-19). In the prior Phase 1 RFG rulemaking, CARB did not inquire about patent rights after learning of a Unocal "patent-pending development" related to the subject matter of the rule. (CX 1093 at 027 (referenced in transcript as CX 131 at 012); Venturini, Tr. 187-88; Croudace, Tr. 544-45, 571-72, 654; CX 7040 (Aguila, Dep. at 10-11)).

The absence of an expression of CARB's interest in patents reflects the fact that CARB has no written or formal policy requiring rulemaking participants to disclose patent applications. (Kenny, Tr. 6518, 6590-92; Boyd, Tr. 6834). No one at CARB was responsible for determining whether proposed regulations would be affected by existing or potential patents. (Venturini, Tr. 395). CARB also had no policy against using patented technology in CARB regulations. (Boyd, Tr. 6834-35). Even today, CARB does not ask persons who comment on its proposed regulations whether they have any patent application that may relate to those regulations. (Venturini, Tr. 863-64; Kenny, Tr. 6590-92). CARB has not had a policy requiring disclosure of patents (or patent applications) because it "did not think it was necessary" to have one. (Kenny, Tr. 6518).

Unocal, as the Complaint alleges, did have a patent application pending at the Patent and Trademark Office in 1991, which related to clean-burning gasoline compositions. (Answer ¶ 32). Unocal did not disclose this application to CARB because it had never been put on notice of the existence of an obligation to disclose issued patents, let alone patent applications, which are

protected from public disclosure by patent law. (Boyd, Tr. 6908, 6834; Lamb, Tr. 2260; Beach, Tr. 1769).[6] Like many companies—including a number of the other California refiners—Unocal's internal policy was to keep patent applications confidential. (Jessup, Tr. 1473-74; CX 450; CX 7075 (Wood, Dep. at 12-13, 16-20, 28-29); CX 7067 (Toman, Dep. at 29-30)). As just seen, CARB never adopted a policy regarding patent disclosure and never asked anyone about patents (or applications). At the time of the Phase 2 rulemaking, moreover, Unocal could not have known whether its application would be granted and, if so, what claims would be allowed. (Linck, 1761-65). The only Patent and Trademark Office ("PTO") action with respect to the application prior to the November 1991 Board meeting was a notice of the rejection of all of Unocal's patent claims. (CX 1718 at 215; Wirzbicki, Tr. 1108-10). Unocal received its first patent based on that application, U.S. patent 5,288,393 ("the '393 patent"), in February 1994.

N. CARB's and the Refiners' Reaction to Unocal's Patent Grant

The major refiners that participated in the Phase 2 rulemaking learned of the issuance of the '393 patent at various points during 1994. Both Mobil (Eizember, Tr. 3249-50, 3252-54) and Texaco (CX 7047 (Hancock, Dep. at 239)) learned of the patent no later than one month after it issued. Chevron also learned of the patent at some point in 1994. (Ingham, Tr. 2728-29). Exxon learned of the patent at least by early May 1994. (Eizember, Tr. 3249-50; RX 145 at 084). But even after the refiners learned that the '393 patent had been granted, they did not inform CARB of the patent's existence until over a year had passed since its issuance. (Eizember, Tr. 3257-58, 3269-72; CX 7047

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[6] In 1991, all patent applications were deemed confidential throughout the application process.

(Hancock, Dep. at 284-85); CX 7076 (Youngblood, Dep. at 52, 55-56); Ingham, Tr. 2728-29). Even then, they told CARB that the patent was invalid. (CX 7042 (Bea, Dep. at 132-33)).

For periods ranging from two to seven years, depending on the refiner, the refiners did not attempt to take any action to avoid infringing the claims of the '393 patent. (Clossey, Tr. 5466-67; CX 7077 (Youngman, Dep. at 45); {[redacted]}, *in camera*; CX 7047 (Hancock, Dep. at 245-46); CX 7052 (Jacober, Dep. at 23); CX 7058 (Millar, Dep. at 37-38); CX 7061 (Riley, Dep. at 12-15); CX 7051 (Irion, Dep. at 27-28); {[redacted]}, *in camera*). They refrained from taking any steps to avoid the '393 patent claims even though all of them had the ability to, and ultimately did, avoid it for essentially no cost, or in at least one instance, at a claimed cost savings. (*See, e.g.*, RX 85; RX 91; RX 92; RX 200A; RX 207A; RX 215; RX 224). The refiners followed this path because they were confident the Unocal patent was invalid and unenforceable. (*See, e.g.*, Clossey, Tr. 5473; {[redacted]}, *in camera*; Engibous, Tr. 3892; Hoffman, Tr. 4982-83; Simonson, Tr. 5985; Cunningham, Tr. 4269-70).

Significantly, when CARB learned in 1995 of the issuance of the '393 patent, no CARB board member, CARB staff member, or any other California state official suggested that Unocal had misled CARB by failing to apprise it of its patent application or by telling CARB that certain of its emissions data was "non-proprietary." To the contrary, a March 1995 internal CARB memorandum that analyzed the issues surrounding the issuance of the '393 patent did not even imply that Unocal did anything to mislead CARB. (RX 64). Reflecting the agency's understanding that Unocal had not violated any duty to CARB in obtaining its patent, CARB's Executive Officer, James Boyd, sought assurances from Unocal that it would "not raise patent infringement issues" as to a reformulated gasoline test program that was then being conducted by CARB. (CX 50). Unocal

consented. Using language that clearly spoke to a waiver of specified patent rights, Unocal agreed that it "will not seek an injunction against infringement of its patent" or "collect monetary damages" against "the producer or users of the test program fuel for the announced amount of the 600,000 gallons." (CX 50).

Since that time, Unocal has obtained four other patents that are derived from the original application that led to the issuance of the '393 patent. At no time since learning of any of Unocal's patents has CARB or its staff given serious consideration to modifying the agency's regulations to make it easier for refiners to avoid any of Unocal's patents. (*See* Venturini, Tr. 863-64). The reason given for this failure was not an alleged regulatory "lock-in" as the Complaint alleges. The real reason, was that, even after Unocal won a judgment, CARB did not believe that the '393 patent was valid. (Venturini, Tr. 815-16).

Even after Unocal had won an infringement judgment against the major refiners on the '393 patent, which had been sustained by a denial of the refiners' motion for judgment as a matter of law, CARB did not take Unocal's patent into account in amending its RFG regulations. (Venturini, Tr. 815, 863-64). Even after this judicial ruling, CARB viewed the '393 patent as being still "in a state of flux" and "believed there were concerns with the validity of the patent." (Venturini, Tr. 815). CARB thus believed a patent that was sustained by a judgment after trial was surrounded with too much uncertainty prior to the exhaustion of appeals to be taken into account in its regulatory decisions. Yet according to Complaint Counsel, this same government agency would have dramatically redirected its Phase 2 regulations had it merely learned of the existence of Unocal's *application* for the same patent, which had been rejected in its entirety at the time of the promulgation of the Phase 2 RFG rules.

O. Unocal's Participation in Industry Groups' Advocacy Before CARB

During the period leading to the Phase 2 RFG rulemaking, Unocal participated in two industry groups' efforts to influence CARB. One was the Auto/Oil Air Quality Improvement Research Program ("Auto/Oil") and the other was WSPA. The Complaint alleges that Unocal misled participants in these groups into believing that it had no patents or patent applications that may read on reformulated gasoline and that, but for this alleged fraud, members of these entities would have altered their advocacy before CARB and would have incorporated knowledge of the Unocal's unissued patents into their refinery investment decisions. (Complaint ¶ 90). In addition, the Complaint alleges that Unocal's independent research actually belonged to the Auto/Oil Program as the work of the program. (Complaint ¶ 53).

Unocal had no duty to make any kind of disclosures to members of the two programs. (*See, e.g.*, RX 523 at 004, 007; RX 670 at 007; Lieder, Tr. 4760). Complaint Counsel seek to create a duty by alleging Unocal had given some cost information to WSPA for use in a cost study. (*See* Complaint ¶ 57). But Unocal had no duty to provide potential revenue from potential patent rights to an organization comprised of its horizontal competitors, and there is no evidence that Unocal provided inaccurate information in any event. (*See*, *e.g.*, RX 523 at 004, 007; RX 670 at 007; CX 7070 (Wang, Dep. at 68-70)). The only information that Unocal allegedly provided for use in the WSPA cost study related to *paid-up royalties on existing patents* for a particular hydrocracking process. (Cunningham, Tr. 4297-98). It was never asked for information about any other kind of royalty or any future patent. (*See* Jessup, Tr. 1595; CX 7070 (Wang, Dep. at 59-60)).

The Complaint also alleges that Unocal presented results of its research to WSPA. (Complaint ¶ 58). There is no evidence, however, that Unocal ever represented that it was foregoing

its patent rights by presenting information about its research. It is common for researchers to disclose data or research results in public forums without foregoing the right to exploit their intellectual property by mere virtue of such disclosure. (Teece, Tr. 7531-32). No inference about intellectual property rights may be drawn from such disclosures. Indeed, other refiners also publicly disclosed information related to inventions claimed in undisclosed patent applications. (*See* CX 7075 (Wood, Dep. at 016)).

With respect to Auto/Oil, the Complaint alleges that Unocal told the organization that it was placing its data in the public domain. (Complaint ¶ 54). The person who purportedly made this statement denies having used the words "public domain." (Jessup, Tr. 1546). The Complaint also alleges that Unocal's independent research became the "work of the program" by mere virtue of Unocal's disclosure of some of its research results to members of the group. (Complaint ¶ 53). But the Auto/Oil program's agreement regarding the group's research activities expressly provided that research conducted independently by members of the group "shall not be deemed to be undertaken by the program." (CX 4001 at 015). Unocal's research was not directed by, paid for, or published by the Auto/Oil program. (Jessup, Tr. 1548-49).

The Complaint alleges that members of the two organizations would have altered their lobbying activities had they known about Unocal's patent application. (Complaint ¶¶ 90(a), 90(b)). As discussed above, refiner members of the two programs, with the exception of ARCO, opposed the CARB Phase 2 RFG regulations, including the T50 parameter. (*See* Clossey, Tr. 5566-67; RX 437 at 001). ARCO lobbied for regulations that would force all refiners to blend gasolines that mimicked ARCO's EC-X formula. (*See* RX 83 (stating that ARCO convinced CARB to adopt standards that "mirror the *EC-X formula*") (emphasis added)).

The Complaint also alleges that refiners would have altered their refinery investments had they known about Unocal's patent application. But the evidence revealed that every major California refiner had the ability to avoid the '393 patent at little or no cost, and the refiners refrained from doing so for years after learning about the patent. (*See, e.g.*, Clossey, Tr. 5466-67; CX 7077 (Youngman, Dep. at 45) CX 7047 (Hancock, Dep. at 245-46); CX 7052 (Jacober, Dep. at 23); CX 7051 (Irion, Dep. at 27-28)). The refiners have since claimed under oath that the operating methods and/or technologies used to avoid the '393 patent were in existence in 1995. (RX 85; RX 91; RX 92; RX 200A; RX 207A; RX 215; RX 224).

P. <u>CARB's Lack of Alternatives to the Phase 2 Regulations</u>

The Complaint alleges that CARB would have adopted different regulations or brokered some license agreement had it become aware of Unocal's patent application prior to the conclusion of the Phase 2 RFG rulemaking. (*E.g.*, Complaint ¶¶ 5, 80, 90). But the testimony of CARB's witnesses leaves no room for any such alternative. CARB took the position that it would have adopted *no regulation* had it merely learned of the existence of Unocal's patent application: "[I]f Unocal had told us about the pending patent, there would not have been a regulation. . . ." (Venturini, Tr. 789-90). Indeed, according to CARB's Peter Venturini, who testified as the agency's Rule 3.33(c) witness on this topic, CARB would have made this decision regardless of the potential rate of infringement of the patent or the cost of patent avoidance. (Venturini, Tr. 788-89). In other words, even if CARB had believed that the patent would almost never be infringed or could be

avoided for a trivial cost, it would have shut down its rulemaking, according to the testimony of the CARB staff member responsible for the Phase 2 RFG rulemaking.[7]

But failure to adopt regulations would have threatened the imposition upon California of a draconian Federal Implementation Plan ("FIP") that would have been needed to bring the state into compliance with the Federal Clean Air Act. (Pedersen, Tr. 8016-21, 8032; RX 1186 at 004-005). CARB itself recognized that failure to adopt Phase 2 regulations would have caused "renewed legal challenges from U.S. EPA for failing to abide by our State Implementation Plan." (CX 812 at 003). A study commissioned by the California Governor's Office found that the imposition of a FIP would have cost the state at least $8.4 billion in direct costs and $17.2 billion in lost output, and would have resulted in the loss of 165,000 jobs. (RX 334 at 001).

The Complaint alleged that Unocal's enforcement of its patents caused consumer injury. (Complaint ¶ 5). For such injury to exist, Unocal's actions, if wrongful, would have had to deprive CARB of the ability to adopt a more cost-effective pollution abatement program than the one that it did adopt, taking Unocal's royalties into account. Significantly, Complaint Counsel's economic expert, Professor Carl Shapiro, did not even suggest that the FIP alternative would have been more cost-effective than the existing regulations, taking into account Unocal's patent royalties. (Shapiro, Tr. 7152-54 (Professor Shapiro was unable to compare cost-effectiveness of alternates)). Indeed, he did not identify a single regulatory alternative that CARB could have adopted at the time of its Phase 2 rulemaking had it known of Unocal's patent application that would have been more cost-effective. (*See* Shapiro, Tr. 7152-54).

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[7] In contrast to this testimony, CARB's official Final Statement of Reasons for the Phase 2 RFG rulemaking concluded that even a regulation that would cost 25 percent more than CARB had projected would be cost-effective and justifiable. (CX 10 at 184).

III. RESPONSES TO THE COURT'S QUESTIONS

At the close of the hearing of this matter, the Court directed the parties to respond to the five issues. These questions and Unocal's answers are set forth below.

1. **Whether any court has ever found that misrepresentations in a legislative or political proceeding fall under the sham exception or otherwise vitiate the *Noerr-Pennington* doctrine.**

1. In a 1964 decision, the Ninth Circuit refused to apply *Noerr* in the political context based on evidence that private actors had engaged in fraudulent conduct and conspired with public officials to bring about the alleged anticompetitive harm. *Harman v. Valley Nat'l Bank*, 339 F.2d 564 (9th Cir. 1964). The Supreme Court expressly repudiated the existence of conspiracy exception in *City of Columbia v. Omni Outdoor Adver., Inc.*, 499 U.S. 365 (1991). Accordingly, *Harman* is no longer good law.

2. **Whether, in evaluating a defense raised under *Noerr-Pennington*, as opposed to a defense raised under the state action doctrine, any court has inquired into (1) the intentions of a state official; (2) the factors that caused a state official to act; or (3) whether a state action was a deliberate determination of governmental policy.**

2. As shown in Section IV, *infra*, the authorities uniformly eschew conducting an inquiry into the intentions of state officials. The Supreme Court's decision in *Omni* expressly warned against "deconstruction of the governmental process and probing of the 'official intent.'" 499 U.S. at 377. Under *Omni*, it is impermissible to conduct an inquiry into "what factors prompted the various governmental bodies to erect the anticompetitive barriers at issue." *Sessions Tank Liners, Inc. v. Joor Mfg., Inc.*, 17 F.3d 295, 300 (9th Cir. 1994). *See also Hedgecock v. Blackwell Land Co.*,

1995 Trade Cas. (CCHP) 70, 960, 1995 U.S. App. Lexis 8027, at *9 (9th Cir. 1995) (impermissible for the "court to investigate the considerations motivating the [agency's] decision"); *Santana Prods., Inc. v. Bobrick Washroom Equip., Inc.*, 249 F. Supp. 2d 463, 489 (M.D. Pa. 2003) (same), *aff'd in part and vacated in part on other grounds,* 2005 WL 293473 (3d Cir. Feb. 9, 2005).

It is also improper to conduct an inquiry into whether a state action was a deliberate determination of governmental policy. Indeed, the *Noerr* case itself involved circumstances in which there was no evidence of government awareness of the competitive consequences of the actions advocated by the defendants. *Noerr* involved a sophisticated and well-concealed campaign by railroads to foster the adoption of laws that disadvantaged truckers. The railroads allegedly employed a "third-party technique" through which the advocacy "was made to appear as spontaneously expressed views of independent persons and civic groups." 365 U.S. at 130. Although the railroads allegedly sought to destroy competition, the front organizations acted under the guise of the public interest. They expressed concerns about "the enormous damage done to the roads" by trucks, the "violations of the law limiting the weight and speed of big trucks," the truckers' "failure to pay their fair share" of road construction and maintenance costs, and "the driving hazards" created by trucks. *Id.* at 131.

Three legislatures at which the petitioning was directed were not aware that they were considering anything other than public works and road safety issues. The lobbying was "fraudulent in that it was predicated upon the deceiving of those authorities through the use of the third-party technique." *Id.* at 133.[8] The legislatures' lack of awareness of the competitive consequences of

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[8] The district court's opinion makes clear that the railroads successfully concealed from public officials "the fact that the entire campaign was a creature of the railroads, and for the purpose (continued...)

their actions was irrelevant to the Supreme Court: Although the railroads "deliberately deceived the public and public officials[,]" their "deception, reprehensible as it is, can be of no consequence as far as the Sherman Act is concerned." 365 U.S. at 145.

Noerr is not alone in conferring immunity where government had no basis to believe that the petitioner was seeking a monopoly. *Boone v. Redevelopment Agency of City of San Jose*, 841 F.2d 886 (9th Cir. 1988), held that a developer who had allegedly misrepresented "the availability of parking" in San Jose, *id.* at 894, was immune from antitrust claims arising from the relocation of a planned municipal garage. The plaintiff claimed that the defendant had sought to relocate the garage to force the plaintiff to sell an office building to the defendant, which "would allegedly have given [the defendant] a monopoly on office space [in downtown San Jose]." *Id.* at 889. There is no indication that government decisionmakers understood they were deciding anything other than the need for a garage. The harm *in the office market* could not have been foreseen by officials evaluating the *adequacy of parking*.[9]

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[8] (...continued)
of hindering and destroying the railroads [sic] in the long-haul transportation industry." *Noerr Motor Freight, Inc. v. Eastern R.R. Pres. Conf.*, 155 F. Supp. 768, 810 (E.D. Pa. 1957). The railroads succeeded in "duping and using of public officials and officials of independent organizations to accomplish the same purpose of driving the plaintiffs out of competition with the defendants." *Id.* at 816. This "duping" led to legislation raising truckers' costs in New Jersey, New York, and Ohio. "Not one word of the railroads' part in the picture ever seeped through" in New Jersey. *Id.* at 780. In New York, third parties carried out a campaign "without any attribution of responsibility to the railroads." *Id.* at 783. In Ohio, the railroads performed "a magnificent job . . . in keeping any information as to the true position of the railroads in this campaign from the general public." *Id.* at 785.

[9] The alleged causal link between the relocation of the garage and the monopoly involved (a) a misrepresentation regarding parking availability, (b) leading public officials to conclude that a new garage was not needed at its planned location, (c) leading them to relocate the garage, (d) intending to force the plaintiff to sell its building, (e) resulting in the defendant's
(continued...)

Sessions Tank Liners, Inc. v. Joor Mfg., Inc., 17 F.3d 295 (9th Cir. 1993), also rebuts Complaint Counsel's claim that awareness of all competitive consequences of a governmental decision must be shown for *Noerr* to apply. There, a storage tank manufacturer "knowingly made false statements" (*id.* at 298), regarding the safety of a technology for relining tanks, which led to the adoption of a model safety code amendment that effectively banned relining (*id.* at 297). Local governments began to deny the plaintiff's permits based on the proposed amendment to the model code. The court held the conduct immune because the plaintiff's alleged injuries resulted from governmental action. The court cited no evidence that any local government thought that it was doing anything but regulating safety by following the guidance of impartial experts. Rather than expressing a need for government decisionmakers to understand the competitive consequences of their actions, the court cautioned against "deconstructing the decision-making process to ascertain what factors prompted the various governmental bodies to erect the anticompetitive barriers at issue." *Id.* at 300.

Westmac, Inc. v. Smith, 797 F.2d 313 (8th Cir. 1986), likewise discredits Complaint Counsel's attempt to constrict the *Noerr* doctrine through an artificial "awareness" test. The plaintiff alleged that the defendants had conspired to deny it government financing of a grain elevator "for the express purpose of forcing plaintiff to join an anticompetitive price maintenance conspiracy." *Id.* at 314. The defendants did not frame their opposition to the financing before a development agency and a court in terms of the need for the plaintiff to join a conspiracy. The court upheld the immunity without hinting that the awareness of those petitioned by the defendants could matter.

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[9] (...continued)
monopoly in office space

Moreover, establishing government awareness or deliberateness necessarily compels probing decisionmakers' minds for subjective explanations of governmental decisions. Thus, the same authorities that prohibit deconstructing government decision-making necessarily bar any attempt to determine the deliberateness of a governmental decision.[10]

3. Whether an administrative agency acting in an adjudicative capacity may create an exception to or otherwise limit the United States Supreme Court's First Amendment-based *Noerr-Pennington* Doctrine beyond the boundaries established by the judiciary branch of our government.

3. An administrative agency acting in an adjudicative capacity may not create an exception to or otherwise limit the United States Supreme Court's First Amendment-based *Noerr* doctrine beyond the boundaries established by the judicial branch. Ever since *Marbury v. Madison*, 2 U.S. (1 Cranch) 60, 73 (1803), it has been clear that "it is the province and duty of the judicial department to say what the law is." The Administrative Procedure Act provides that the reviewing court "shall decide all relevant questions of law." 5 U.S.C. § 706. The Act requires reviewing courts to "hold unlawful and set aside any agency action" that is "found to be . . . (A) arbitrary, capricious,

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[10] Complaint Counsel's position would characterize virtually any competitively-motivated lawsuit, regardless of its basis, as non-petitioning conduct. Plaintiffs do not typically ask courts to restrain trade; they ask courts to enforce legal rights. In *Razorback Ready Mix Concrete Co. v. Weaver*, 761 F.2d 484 (8th Cir. 1985), the defendants' state court challenge to the issuance of a bond to aid the plaintiff's business was held immune even though there was no evidence that the defendants had informed the state court of their alleged conspiracy to drive the plaintiff out of business. In *Omni Resource Dev. Corp. v. Conoco, Inc.*, 739 F.2d 1412 (9th Cir. 1984), a lawsuit to deny the plaintiff the right to mine federal lands was held *Noerr*-protected in spite of allegations that the defendants had submitted fraudulent affidavits in state court. Justice Kennedy's opinion contains no suggestion that the antitrust defendants had told the state court of the anticompetitive design that the plaintiff attributed to their lawsuit. *Id.* at 1415.

an abuse of discretion, or otherwise not in accordance with law; or (B) contrary to constitutional right, power, privilege, or immunity." 5 U.S.C. § 706 (2) (2004).

4. Whether a resolution of any of the issues raised by the complaint in this case or the defenses asserted thereto, including, but not limited to, whether it is possible to fairly and properly determine whether alternatives to patented technologies are likely to infringe, requires resolution of substantial questions of patent law and also whether it is appropriate to assume that certain technologies are likely to infringe rather than making a determination on likelihood of infringement.

4. The resolution of the issues raised by the complaint in this case necessarily require resolution of substantial questions of patent law. Please refer to Section XIV of this memorandum for a discussion of this issue. To make a determination that Unocal possesses market power, it is not appropriate to assume that certain technologies are likely to infringe rather than to make a determination on likelihood of infringement. Please refer to Section VIII(B)(2)(a) of this memorandum for a discussion of this issue. In any event, as noted, *infra*, Complaint Counsel have failed to make even a mere showing of likelihood of infringement. (*See* Section VII(B)(2)(a)(2)).

5. The legal authority in support of or in opposition to the proposed remedy and each and every provision in the proposed order.

5. Please refer to Section XIII for a discussion of the legal authority that bars the remedies that Complaint Counsel seek in this case.

IV. THIS PROCEEDING IS BARRED BY THE *NOERR* DOCTRINE

On November 25, 2003, Your Honor issued an Initial Decision granting Unocal's motion for dismissal of the Complaint based on the doctrine of antitrust petitioning immunity. *Union Oil Co.*

of Cal., No. 9305, slip op. (FTC Nov. 23, 2003) (hereinafter "Initial Op."). That decision correctly determined that Unocal's participation in CARB's rulemaking activities was a petitioning activity that was directed at influencing government action, and therefore, protected by *Noerr* immunity. *See generally E. R.R. President's Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961). In the Initial Decision, Your Honor determined that the Supreme Court has recognized only two narrow exceptions to this immunity: the "sham" invocation of governmental processes and the provision of false information under oath in the context of an *ex parte* patent application process. (Initial Op. at 49-50). The Initial Decision further found that neither exception was applicable in the context of a quasi-legislative rulemaking that established fuel regulations covering the entire state of California. (Initial Op. at 49-50).

The Commission subsequently reversed the Initial Decision and remanded this action. In its opinion, the Commission promulgated a novel seven-factor test to define the scope of the *Noerr* immunity. *Union Oil Co.*, No. 9305, slip op. at 31-32 (FTC July 7, 2004) (hereinafter "Op."). The Commission's opinion attempts to work a fundamental redefinition of the *Noerr* Doctrine in a manner that is irreconcilably at odds with a long line of Supreme Court holdings. Accordingly, Unocal expressly reserves its rights to challenge this legal standard in any future proceedings.

Because the Commission intended for Your Honor to apply its decisional framework upon remand (*see* Op. at 55), Unocal is presenting an analysis of the *Noerr* immunity within the analytical framework of that decision. Yet even application of the Commission's erroneous legal standard, which impermissibly attempts to constrict the scope of the immunity, mandates dismissal of this proceeding. Each of the factors in the Commission's test mandates the full application of the petitioning immunity to Unocal's conduct:

First, CARB had no "norms of conduct" (Op. at 32) that established expectations that persons lobbying the agency for favorable regulatory treatment will always act truthfully. To the contrary, as CARB's Chairwoman testified, the agency recognized that companies that lobbied the agency "are not always forthcoming with all information." (CX 7063 (Sharpless, Dep. at 167-68)). CARB also did not put in place procedures to ensure truthfulness, such as requiring testimony to be given under oath or subjecting parties to cross-examination. (Kenny, Tr. 6654-55; Venturini, Tr. 856-58). The informal procedures used by CARB in its rulemakings, moreover, were political in the extreme. While Complaint Counsel seek to portray a world in which CARB was engaged in a search for scientific truth, CARB conducted its rulemaking activities as a political institution. For example, CARB staff engaged in political coalition-building by enlisting the aid of one private party to defeat a regulatory proposal by another. (Clossey, Tr. 5507-08; RX 75 at 001). CARB staff passed up the opportunity to relax the T50 parameter in the RFG regulations based entirely on a political consideration—the lack of support from the automobile industry for such an action. (Ingham, Tr. 2717-18, 2721-23; Simeroth, Tr. 7474-76). Instead, CARB staff brokered an agreement between the automobile and refining industries that led to the abandonment of the proposal to raise the T50 specification. (Simeroth, Tr. 7474-76).

Second, CARB possessed enormous regulatory discretion. While the California legislature required CARB to clean up the air, it imposed few constraints on how CARB was to achieve this goal. CARB had broad policy discretion in the sphere of air quality improvements. (Kenny, Tr. 6652). The agency's exercise of quasi-legislative power, according to CARB's general counsel at the time of the Phase 2 RFG rulemaking, was "similar to the process used by the legislature in adopting laws." (Kenny, Tr. 6664-65). CARB's discretion was so broad that it encompassed not

merely the power to require the reformulation of gasoline but also the power to ban gasoline and "[r]equire the use of fuels other than gasoline." (CX 5 at 163).

Third, CARB was not reliant on Unocal for any information relating to its intellectual property rights. CARB never indicated the slightest interest in intellectual property rights during its Phase 2 RFG rulemaking, and continued to ignore such rights in its subsequent rulemakings. There is no evidence in CARB's rulemaking record that the agency relied on the absence of actual or potential patent rights in exercising its legislative judgment to enact the Phase 2 RFG regulations. (Kenny, Tr. 6614-17, 6632, 6641-46). Further, other rulemaking participants that had pending patent applications with potential relevance to the rulemaking did not disclose them to CARB. (*See* Section IV(B)(2)(a)(1), *infra*).

Fourth, it is impossible to trace the causation of CARB's regulatory outcome to any supposed Unocal misrepresentation. There is no evidence that Unocal's representations to CARB played an outcome-determinative role in CARB's decisionmaking. To the contrary, nothing in CARB's official explanation of its actions shows any reliance on any Unocal misrepresentation. CARB's rulemaking record does not contain any documents that embody or refer to either Unocal's data or on any alleged representation regarding its intellectual property rights. That record is required to contain all information on which the agency relied in support of its rules. (Kenny, Tr. 6632; (CX 7029 at 068) (CAL. GOV'T CODE §11347.3(a)(7)).

Fifth, Unocal did not make any misrepresentation or omission to disclose, let alone a material one. Unocal's representations to CARB in its August 1991 letter cannot objectively be construed as waiving any intellectual property rights or implying that no such rights existed. Indeed, competent evidence showed CARB understood Unocal to be authorizing the disclosure of data on a particular

disk, and not to be granting a broad waiver of future intellectual property rights. (Venturini, Tr. 821-22; Boyd, Tr. 6710-11; *see also* Lamb, Tr. 2254-55; CX 266 at 004). Likewise, there is no evidence that Unocal has ever asserted "proprietary" rights over its data, regardless of the meaning attached to the word. And Unocal's representation that a predictive model would be flexible and cost-effective was endorsed by CARB even after the agency learned about Unocal's patents. Indeed, CARB told the U.S. Environmental Protection Agency in January 2000 that its predictive model "[i]ncreases gasoline producer's flexibility" and "[r]educes compliance costs/improves production capability." (Simeroth, Tr. 7480-81; RX 190 at 019). This view was also held by Texaco after it became aware of the issuance of the '393 patent. (Kulakowski, Tr. 4554-55, 4651-52; CX 2128 at 078-079; RX 161 at 001). Further, contemporaneous Unocal documents immediately preceding and following its August 1991 letter to CARB clearly show no intent to misrepresent; the documents evince a clear intent to lift confidentiality restrictions on Unocal's data, no more and no less. (CX 266 at 004).

Sixth, this case does not involve a falsity that is "clear and apparent with respect to particular and sharply defined facts." (Op. at 36). Unocal's statement regarding the confidentiality of its data was not a statement about patent rights at all, and certainly not a clear statement about the absence or waiver of such rights. Moreover, Unocal's statement that a predictive model would be cost-effective plainly articulated a policy position and not a sharply defined fact. As just discussed, moreover, CARB agreed with this policy position even after learning of Unocal's patents.

Seventh, Unocal's statements to CARB did not "undermine[] the very legitimacy of the government proceeding." (Op. at 36). They could not have had this effect given that CARB never inquired about patent rights or patent applications during the rulemaking. (Venturini, Tr. 395; 863-

63; CX 7063 (Sharpless, Dep. at 168); Ingham, Tr. 2685; Eizember, Tr. 3396-97; Clossey, Tr. 5492; CX 7042 (Bea, Dep. at 36)). Moreover, CARB never investigated the existence of any actual or potential patent rights (Verturini, Tr. 395, 863-64), and disregarded inquiring into patent rights even when it became aware of a patent on gasoline (Simeroth, Tr. 7468-71; Courtis, Tr. 5884-87; Croudace, Tr. 653-54; CX 7040 (Aguila, Dep. at 10-11, 135-36)). In addition, CARB's continued disbelief as to the validity of Unocal's patents, and consequent refusal to alter its regulation to take the patents into account, even after Unocal won an infringement judgment, cannot be reconciled with any claim that awareness of a mere patent application would have been material to CARB's decisionmaking. CARB's failure to amend its regulations with full knowledge of an infringement verdict in Unocal's favor because of a belief that Unocal's patent position was "still in a state of flux" (Venturini, Tr. 815-16), belies any claim that knowledge of a mere patent application would have been central to CARB's analysis.

A. The *Noerr* Doctrine and the Commission's Opinion Reversing the Initial Decision

1. The *Noerr* Doctrine broadly protects advocacy directed toward obtaining governmental action

The Complaint directly challenges Unocal's exercise of its right to petition government by advocating a regulatory policy based on performance rules. This attempt to regulate petitioning conduct is impermissible under the *Noerr* Doctrine, which bars application of the antitrust laws to petitioning conduct that is genuinely aimed at influencing public officials. *E.R.R. President's Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127, 140-41 (1961). As the Supreme Court explained in *Noerr*, "[i]n a representative democracy . . . the whole concept of representation depends upon the ability of the people to make their wishes known to their representatives." 365

U.S. at 137. The *Noerr* Doctrine recognizes that because it is lawful for government to displace competition with regulation, it must be equally lawful to urge government to take action that would have this effect. *City of Columbia v. Omni Outdoor Adver., Inc.*, 499 U.S. 365, 379 (1991).

Noerr involved a deceptive campaign to persuade legislatures to impose regulatory burdens on truckers. Railroad companies organized the campaign for the purpose of restraining competition from truckers. The railroads successfully concealed their anticompetitive aims, and even involvement, by having the campaign carried out by seemingly disinterested civic groups that couched their advocacy in terms of the public interest. The Court held that neither the railroads' deceptive means nor their anticompetitive intent affected their immunity from antitrust liability. It held that the Sherman Act "condemns trade restraints, not political activity" and that "a publicity campaign to influence governmental action falls clearly into the category of political activity. The proscriptions of the Act, tailored as they are for the business world, are not at all appropriate for application in the political arena." 365 U.S. at 140-41. Courts subsequently expanded the immunity to reach petitioning activities aimed at the executive and judicial branches. *E.g., generally, California Motor Transp. Co. v. Trucking Unlimited*, 404 U.S. 508 (1972); *United Mine Workers of America v. Pennington*, 381 U.S. 657 (1965).

The *Noerr* Doctrine immunizes anticompetitive attempts to influence government as long as the anticompetitive outcome results from governmental action. "'Where a restraint upon trade or monopolization is the result of valid governmental action, as opposed to private action,' those urging the governmental action enjoy absolute immunity from antitrust liability for the anticompetitive restraint." *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 499 (1988) (quoting *Noerr*, 365 U.S. at 136). The antitrust immunity applies unless a private actor uses

the governmental process itself—"as opposed to the *outcome* of the process—as an anticompetitive weapon." *Omni*, 499 U.S. at 380 (emphasis in original). Even misrepresentations are "condoned in the political arena." *Prof'l Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc.*, 508 U.S. 49, 61 n.6 (1993). "[T]he *Noerr* 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." *Kottle v. Northwest Kidney Ctrs.*, 146 F.3d 1056, 1059 (9th Cir. 1998).

The *Noerr* Doctrine affirms two key constitutional principles—the right to petition for governmental action and federalism. In *Noerr*, the Court recognized that "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," and that the threat of antitrust liability arising from such communications would chill the public's ability "to freely inform the government of their wishes." 365 U.S. at 137. Using the antitrust laws to police petitioning raises equally serious federalism concerns because establishing a causal link between petitioning and anticompetitive governmental actions requires deconstructing the government's decisionmaking. The Supreme Court has warned against "deconstruction of the governmental process and probing of the 'official intent'" to identify government actions infected by improper petitioning conduct. *City of Columbia v. Omni Outdoor Advert.*, 499 U.S. 365, 377 (1991). Rather than the antitrust laws, "the remedy for such conduct rests with laws addressed to it and not with courts looking behind sovereign state action at the behest of antitrust plaintiffs." *Armstrong Surgical Ctr., Inc. v. Armstrong County Mem'l Hosp.*, 185 F.3d 154, 162 (3d Cir. 1999).

The danger that the Supreme Court highlighted is amply illustrated in this proceeding. The record contains the testimony, live or by deposition, of no fewer than 12 current and former CARB officials, whose testimony goes in one way or another to the question of CARB's "official intent." Complaint Counsel's case expressly relies on the testimony of CARB officials—in some cases, in contradiction to CARB's official statements—in an attempt to establish a link between Unocal's petitioning and the agency's decisions that are the direct cause of the competitive injury alleged by the Complaint. Evidence of any such a link is conspicuously absent from the official record of the rulemaking. Nothing in the rulemaking record reveals that, in adopting its Phase 2 RFG regulations, CARB relied either on Unocal's data or on any alleged Unocal representations concerning the company's patent position. Complaint Counsel's entire case thus hinges on an attempt, in direct contravention of the Supreme Court's *Omni* decision, to deconstruct CARB's decisionmaking process and to create an "official intent" based on after-the-fact testimony rather than the official record.

The Supreme Court has recognized only two narrow exceptions to *Noerr* immunity—for "sham" invocation of governmental processes and enforcement of a patent secured by fraud on the Patent and Trademark Office. The "sham" exception to *Noerr* relates solely to instances in which a private actor "use[s] the governmental process—as opposed to the outcome of the process—as an anticompetitive weapon." *City of Columbia*, 499 U.S. at 380. Similarly, the exception for fraud on the PTO recognized by the Court in *Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.*, 382 U.S. 172 (1965) has never been applied by any court outside the patent application setting.

2. **The Commission's decision conflicts with established precedent**

Several aspects of the Commission's opinion lie in direct conflict with established precedent. The Commission interpreted the sham exception to *Noerr* immunity in a manner that has been specifically repudiated by the Supreme Court. It also disregarded the consistent bifurcation observed in the *Noerr* caselaw between the "political arena" and adjudications and established a new, inherently subjective distinction between political and non-political proceedings. The Commission's test is not only unknown in the caselaw, but is inconsistent with the Commission's own Complaint. That Complaint incorrectly alleged that Unocal's conduct was not entitled to *Noerr* protection because CARB's rulemaking process was "quasi-adjudicatory." (Complaint ¶¶ 26, 96). The Complaint made this allegation in recognition that those courts that have accepted a misrepresentation exception to *Noerr* have done so only in the context of adjudicative proceedings. The opinion's error is compounded by its dismissive treatment of basic administrative law principles that distinguish between adjudications and quasi-legislative actions.

The reasoning of the Commission's opinion rests on a misunderstanding of the relationship between misrepresentations and the sham exception. The opinion asserts that the Supreme Court has "left open" this issue and criticizes the Initial Decision for describing the exception as being "confined to 'situations in which persons use the governmental *process* as opposed to its *outcome* as an anticompetitive weapon.'" (Op. at 24) (emphasis in original). It further asserts that nothing in the caselaw "precludes treating misrepresentation as a variant of sham." *Id.* at 25.

The Supreme Court, however, has left no doubt that it views the matter precisely as Your Honor did. The Court has specifically warned against attempting to condemn "improper means" of petitioning under the rubric of "sham." *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S.

492, 507 n.10 (1988). It emphasized that "[s]uch a use of the word 'sham' distorts its meaning and bears little relation to the sham exception *Noerr* described to *cover activity that was not genuinely intended to influence governmental action*." *Id.* (emphasis added). The Court's criticism of the concept of "sham" that the Commission has now embraced was grounded in the concern that, untethered from its foundation as a tool for identifying harm caused by private action, "sham" could easily become "no more than a label courts could apply to activity they deem unworthy of antitrust immunity." *Id.*; *see PRE*, 508 U.S. at 55.

Accordingly, the Court's recent jurisprudence underscores that the "sham" exception applies *only* to "a defendant whose activities are 'not genuinely aimed at procuring favorable government action' at all, not one 'who genuinely seeks to achieve his government result, but does so *through improper means*.'" *Omni*, 499 U.S. at 380 (internal citations omitted, emphasis in original). "To extend [sham] to a context in which the regulatory process is being invoked genuinely . . . would produce precisely that conversion of antitrust law into regulation of the political process that we have sought to avoid." *Id.* at 382. Contrary to the Commission's assertion, the Supreme Court has not left this issue open. It has closed the door firmly on attempts to broaden the narrowly circumscribed sham exception beyond its narrow purpose of limiting *Noerr* protection to conduct that seeks to influence governmental action and deny it to conduct that seeks to inflict direct competitive harm that neither depends on nor requires intervening governmental action. *See also Knology, Inc. v. Insight Comms. Co.*, 393 F.3d 656, 658 (6th Cir. 2004) (petitioning immunity may be lost "under 'very limited circumstances'" of "sham" petitioning, "where parties use the petitioning process, rather than the outcome of that process, as an anticompetitive weapon"); *Boone v. Redevelopment*

Agency, 841 F.2d 886, 895 (9th Cir. 1988) ("sham" refers to activities "not genuinely seeking official action").

The Commission's misreading of the sham exception has important consequences for the remainder of the analysis. The only context in which the Supreme Court has recognized antitrust liability for misrepresentations to an administrative agency was in *Walker Process*, which involved fraud in the *ex parte* setting of submissions under oath to a patent examiner. The Court has never extended *Walker Process* beyond those specific circumstances. Moreover, although the Commission's opinion cites *PRE* as allegedly leaving open "the relationship between misrepresentations and the sham exception" (Op. at 24), the *PRE* language cited by the Commission makes clear that the Court viewed misrepresentation as wholly separate from sham, and left open only whether *Walker Process* could be extended to judicial litigation rather than be confined to the patent application process. *See PRE*, 508 U.S. at 61 n.6. Thus, no exception to *Noerr* immunity provides a foundation for the radical pruning of the doctrine proposed by the Commission.

The Commission's opinion also erred in focusing its *Noerr* analysis on an unprecedented and ill-defined distinction between political and "non-political" proceedings. This distinction is inconsistent with the caselaw, which analyzes whether proceedings are political or *adjudicative* in assessing the scope of petitioning immunity. Even the Complaint in this action alleges that *Noerr* protection is lacking because CARB's rulemaking was *quasi-adjudicatory*. (Complaint ¶¶ 26, 96). This choice of language was deliberate and understandable, if factually unfounded. The political/adjudicative distinction has been applied by many courts. By contrast, Unocal is not aware of any decision prior to the issuance of the Commission's opinion that analyzes *Noerr* by contrasting political and "non-political" proceedings, and the Commission's opinion cites none.

The distinction between political (or quasi-legislative) and adjudicative proceedings is deeply ingrained into the caselaw discussing misrepresentations in the context of petitioning immunity. This distinction tracks the Supreme Court's suggestion that "misrepresentations, condoned in the political arena, are not immunized when used in the adjudicatory process." *California Motor Trans.*, 404 U.S. at 512-13. Quoting the same language in *PRE*, the Supreme Court underscored that it was an open question "whether, and if so, to what extent *Noerr* permits the imposition of antitrust liability for a *litigant's* fraud or other misrepresentations." *PRE*, 508 U.S. at 61 n.6 (emphasis added). This focus on contrasting adjudications with proceedings in the political arena is echoed in the leading text on antitrust law, which states that "[c]ompared with the legislative process, improper behavior in the adjudicatory or judicial context is more readily defined as improper and more widely regarded as reprehensible." I PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW 203d at 169 (2d ed. 2000).

The distinction between political and adjudicative proceedings has also been strictly followed by the lower courts in analyzing misrepresentations under *Noerr*. Even the cases cited by the Commission as ostensible support for its novel political/non-political distinction make clear that the relevant inquiry is actually focused on whether a proceeding is adjudicative or within the political arena. *See, e.g., Kottle v. Northwest Kidney Ctrs.*, 146 F.3d 1056, 1061 (9th Cir. 1998) (analyzing "whether the executive entity in question more resembled a judicial body, or more resembled a political entity"); *Boone*, 841 F.2d at 896 (distinguishing between "adjudicative" and "legislative" proceedings); *Clipper Express v. Rocky Mountain Motor Tariff Bureau, Inc.*, 690 F.2d 1240, 1261 (9th Cir. 1982) (contrasting characteristics of "political sphere" and "adjudicatory sphere"); *Metro Cable Co. v. CATV of Rockford, Inc.*, 516 F.2d 220, 228 (7th Cir. 1975) (distinguishing between the

"adjudicative, as opposed to [] political, setting" for *Noerr* immunity analysis); *Friends of Rockland Shelter Animals, Inc. v. Mullen*, 313 F. Supp. 2d 339, 343 (S.D.N.Y. 2004) (distinguishing between misrepresentations in lobbying and in the adjudicative process); *Livingston Downs Racing Assn, Inc. v. Jefferson Downs Corp.*, 192 F. Supp. 2d 519, 533 (M.D. La. 2001) (analyzing "whether the Commission, an executive agency, is more akin to a political entity or to a judicial body").

These cases use the term "political" interchangeably with "legislative" or "policymaking" to distinguish between the legislative or quasi-legislation function of establishing rules for future conduct and the adjudicative or quasi-adjudicative function of applying existing law to contested facts. *See, e.g.*, *Boone*, 841 F.2d at 896 (distinguishing "political" or "essentially legislative" actions on the one hand from "adjudicative" actions on the other). As one case cited by the Commission emphasizes, *Noerr* immunity is aimed at protecting "action designed to influence policy." *Woods Exploration & Producing Co. v. Aluminum Co. of Am.*, 438 F.2d 1286, 1298 (5th Cir. 1971); *see also DeLoach v. Phillip Morris Cos., Inc.*, No. 00 CV 01235, 2001 WL 1301221, at *44 (M.D.N.C. July 24, 2001) (immunity applies to all conduct designed to genuinely influence "the policy-making process").[11]

By departing sharply from established precedent, the Commission embraced an approach that offers only "a certain superficial certainty but no real 'intelligible guidance' to courts or litigants."

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[11] Indeed, the Commission has taken the position that *Noerr* immunity reaches even proceedings with "adjudicatory" qualities if the proceedings are imbued with policymaking components. Brief for the United States and Federal Trade Commission as Amici Curiae in *Armstrong Surgical Ctr., Inc. v. Armstrong County Mem'l Hosp.*, No. 99-905 (filed June 2000) at 19 (hereinafter "U.S./FTC *Armstrong* Br."). In *Armstrong*, according to the Commission, the fact that the government agency had "to consider all relevant factors prior to authorizing construction of additional health care facilities" rendered its activities "political in the *Noerr* sense" and mandated immunity for participants in its proceeding—even participants accused of misrepresentations. *Id.*

Allied Tube, 486 U.S. at 507 n.10. The failure of this approach is manifested in the unintelligible way in which the opinion attempts to distinguish between protected "political" petitioning and supposedly unprotected petitioning in "policy-making" settings. (*See* Op. at 33 n.73). The opinion criticizes Unocal for addressing the issue in terms of "'policy questions,' 'policy considerations,' 'policy judgments,' and 'political judgments,'" asserting that "[f]raming the inquiry in that fashion begs the questions of what is 'policy' and what is 'political.'" *Id.* But the very same opinion recognizes, albeit inadvertently, that its supposed distinction between "policy" and "political" is, in fact, meaningless for purposes of *Noerr*; the Commission characterizes the *DeLoach* case as holding that the "submission of false purchase intentions to a government agency to affect administrative determination of a tobacco production quota *involved no policy-making process* and fell outside *Noerr-Pennington* protections." *Id.* at 25 n.50 (emphasis added). In other words, under the Commission's own characterization of the case, the determinative issue was whether the proceeding in question involved a policymaking component and not whether it occurred in a forum for partisan politics.

The Commission's error in misstating the distinction between political and adjudicative proceedings is compounded by its failure to consider the implications of basic administrative law principles in characterizing government action. According to the Commission, "a much broader view than just administrative law distinctions" is required to analyze the scope of *Noerr* immunity. Op. at 30. But the Commission offers no support for its counterintuitive conclusion that a body of law developed to prescribe substantive and procedural constraints for different forms of administrative action based on the degree of discretion exercised by agencies has no role at all in assessing the "context of the proceeding" for *Noerr* purposes. *Id.* The conspicuous absence of such

support undercuts the very core of the Commission's analysis. The courts distinguish between political and adjudicative proceedings in the administrative law context and uniformly hold that rulemaking is on the "political" side of the ledger. The underpinning of their reasoning and that of courts applying the political/adjudicative distinction in the *Noerr* context is one and the same.

The Supreme Court has characterized notice-and-comment rulemakings such as CARB's Phase 2 RFG proceeding as "significantly political" in nature and "quasi-legislative." *United States v. Mistretta*, 488 U.S. 361, 393 (1989). The Court's analysis in *Mistretta* emphasized the "significant discretion" granted to the Judicial Sentencing Commission by Congress to formulate sentencing guidelines, notwithstanding that Congress had provided "detailed guidance" for the Commission. *Id.* at 377. The Court focused specifically on the distinction between adjudicative functions and rulemaking in upholding the constitutionality of the delegation of "significantly political" rulemaking responsibilities to the Commission. *Id.* at 393-94.

The Court similarly recognized the political character of rulemaking in *Chevron, U.S.A., Inc. v. NRDC*, 467 U.S. 837 (1984). In *Chevron*, the EPA conducted an APA notice-and-comment rulemaking to reinterpret a portion of its statutory mandate under the Clean Air Act following a change in administrations. In reviewing a challenge to the EPA's rule, the Court described the EPA's reinterpretation as "entirely appropriate for *this political branch of the Government* to make such policy choices—resolving the competing interests which Congress itself either inadvertently did not resolve, or intentionally left to be resolved by the agency . . . ." *Id.* at 865-66 (emphasis added). The Court emphasized that the EPA, in adopting its regulations, was engaged in a complex process of reconciling competing interests in reducing pollution and fostering economic growth. That task, which the Court repeatedly describes as "political" in *Chevron*, is identical to CARB's

function in the Phase 2 RFG rulemaking. This characterization of rulemakings is particularly significant because the California Supreme Court relied heavily on *Chevron* in describing the broad discretion exercised by CARB in its rulemakings. *W. States Petroleum Ass'n v. Superior Court*, 9 Cal. 4th 559, 572-73 (1995).

Characterization of rulemakings as "political," moreover, is not limited to the context of APA notice-and-comment procedures. The Court of Appeals for the D.C. Circuit reached the same conclusion in the context of an FTC rulemaking pursuant to the Magnuson-Moss Act, which subjects the agency to far more elaborate evidentiary constraints than CARB was required to, or did, observe. *Ass'n of Nat'l Advertisers, Inc. v. FTC*, 627 F.2d 1151 (D.C. Cir. 1979). The court recognized that lobbying and other political interaction was an accepted part of the policy dialogue relating to rulemaking: "[T]he legitimate functions of a policymaker, unlike an adjudicator, demand interchange and discussion about important issues. We must not impose judicial roles upon administrators when they perform functions very different from those of judges." *Id.* at 1168. Rejecting a role as "arbiters of the political process" of rulemaking, the Court adopted a legal standard that permitted administrators to lobby and engage in political advocacy in the course of rulemaking. *Id.* at 1174.[12]

These cases discuss rulemaking using exactly the same contrast between "political" and "adjudicative" proceedings applied by courts analyzing *Noerr* immunity. Other administrative law

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[12] This decision also underscores why the existence of procedural constraints on the agency's decision making does not render its process "non-political." This also is made clear by the Ninth Circuit's decision in *Boone v. Redevelopment Agency of City of San Jose*, 841 F.2d 886 (9th Cir. 1988), which held that misrepresentations in the context of zoning proceedings were immune under *Noerr*. The court expressly rejected the claim that the presence of "some of the trappings normally associated with adjudicatory procedures" changes the nature of a fundamentally quasi-legislative proceeding for purposes of *Noerr* immunity. *Id.* at 896.

cases use the terms "quasi-legislative" and "quasi-adjudicative" to draw the identical distinction. *See, e.g.*, *Utility Solid Waste Activities Group v. EPA*, 236 F.3d 749, 753 (D.C. Cir. 2001); *Portland Audobon Soc'y v. Endangered Species*, 984 F.2d 1534, 1540 (9th Cir. 1993). The same distinction is repeated by many other authoritative sources. *See, e.g.*, U.S. Department of Justice, ATTORNEY GENERAL'S MANUAL ON THE ADMINISTRATIVE PROCEDURE ACT 14 (1947) ("Rule making . . . is essentially legislative in nature . . . . Conversely, adjudication is concerned with the determination of past and present rights and liabilities."); 1 RICHARD J. PIERCE, JR., ADMINISTRATIVE LAW TREATISE § 6.8 (4th ed. 2002) (rulemaking "resembles the process of statutory enactment" by a legislature and "closely resembles a statute in its form and effect").

Thus, the Commission's decision disregarded settled law in drawing an artificial distinction between quasi-legislative rulemakings and the political sphere. Nevertheless, even the Commission's erroneous legal standard cannot eviscerate the *Noerr* immunity in this case. In the pages that follow, we show that even the Commission's erroneous test requires holding Unocal's challenged conduct immune under *Noerr*.

B. Examination of the Context of the Phase 2 RFG Rulemaking and the Nature of Unocal's Communications with CARB Shows That Unocal's Conduct Is Protected under *Noerr*

Although the Commission's decision is fundamentally at war with the caselaw, the Commission has directed its use upon remand. (Op. at 55). Yet there is not even the slightest doubt that Unocal's petitioning of CARB is protected by *Noerr* immunity even under the Commission's test. The Commission's analysis emphasizes seven factors relating to the "context of the proceeding" and "nature of the communication" to evaluate the application of the immunity to misrepresentations. The factors identified by the Commission as relevant to the context of the

proceeding are: (1) government expectations of truthful representations; (2) the degree of discretion possessed by the agency; (3) the extent of necessary reliance of the agency on factual assertions; and (4) the ability to determine causation. (Op. at 32-35). With respect to the challenged communications, the Commission identified as relevant factors: (1) the deliberateness of the misrepresentation or omission; (2) factual verifiability of the misrepresentation; and (3) the centrality of the misrepresentation to the legitimacy of the proceeding. *Id.* at 36. Application of these factors compels the conclusion that Unocal's petitioning conduct is immune from antitrust liability.

1. Context of the Phase 2 RFG rulemaking

a. Government expectations of truthful representations

The Commission's opinion emphasizes that "the nature of politics places government on its guard." (Op. at 32). The political arena is recognized as "often a rough and tumble affair" in which misrepresentations are condoned. *Id.* Adjudicative proceedings, on the other hand, operate pursuant to a very different set of expectations. In adjudicative proceedings, "there are well developed and highly elaborated definitions of what is or is not proper behavior." I ANTITRUST LAW 203 at 169. Similarly, the opinion defines the political arena in contrast to proceedings in which "there [are] more formal, constrained procedures for the establishment of certain types of facts and the application of particular policies." (Op. at 38 (citing ROBERT BORK, THE ANTITRUST PARADOX 360 (1978)). Accordingly, CARB's "expectations of truthful representation" must be evaluated with respect to the norms of conduct established for the Phase 2 RFG rulemaking.

CARB had no formalized procedures for the development of facts in its rulemaking and took no steps to define the parameters of "proper behavior." CARB did not require information to be submitted under oath, establish procedures governing the submission of factual information, limit

ex parte contacts between regulated parties and regulators, or otherwise restrict participation and argument in the Phase 2 RFG rulemaking. (Kenny Tr. 6651-52). Even at its most formal proceeding during the Phase 2 RFG rulemaking—the board meeting at which the board adopted the Phase 2 RFG regulations—CARB did not take testimony under oath, did not permit cross-examination, and had no rules of evidence. (Kenny, Tr. 6654-55). The same was true for workshops conducted by CARB in preparation for the rulemaking, which CARB did not even transcribe to preserve a record. (Kenny, Tr. 6653-54). More broadly, no aspect of CARB's rulemakings involved testimony under oath, cross-examination, or the application of rules of evidence. (Venturini, Tr. 856-58).

Throughout its rulemaking process, CARB permitted, and indeed encouraged, *ex parte* contacts with various interest groups. (Kenny, Tr. 6652, 6656; Venturini, Tr. 370-71). It was not unusual for an individual company to hold dozens of meetings with CARB staff. (*E.g.*, Clossey, Tr. 5486; CX 7042, (Bea, Dep. at 31-32); Fletcher, Tr. 6460; Courtis, Tr. 5733). Political lobbying, selective disclosure of information, and one-sided presentations were recognized by all as legitimate and expected in the context of highly politicized proceedings involving the interests of major industries and consumer and environmental groups. The absence of any "well developed and highly elaborated" norms of conduct in CARB's rulemaking places the Phase 2 RFG proceeding squarely within "the political arena" for *Noerr* purposes.

(1) Political elements

CARB was on its guard in its dealings with private parties throughout the Phase 2 RFG rulemaking. CARB Chairwoman Jananne Sharpless testified that companies that petition CARB "are not always forthcoming with all information." (CX 7063 (Sharpless, Dep. at 167-68)). Ms. Sharpless testified that companies that lobbied CARB selectively chose the information that they

disclosed to the agency and withheld information that "they did not want [CARB] to have." (CX 7063 (Sharpless, Dep. at 167)). Ms. Sharpless was aware that companies that lobbied CARB "look[ed] very well after their own self-interest" and disclosed information to CARB accordingly. (CX 7063 (Sharpless, Dep. at 167)).

Participants in the CARB rulemaking process made exactly the types of selective disclosures that Chairwoman Sharpless anticipated. Thus, although CARB requested refiners to provide it with cost information to aid in its cost-effectiveness analysis of the proposed Phase 2 RFG regulations, only six refiners provided such information. (CX 7040 (Aguila, Dep. at 54-55); Fletcher, Tr. 6958-59; Venturini, Tr. 376-77). Further, only two of the six provided all of the information that CARB had requested. (Courtis, Tr. 5824-25; Fletecher, Tr. 6961; CX 7040 (Aguila, Dep. at 55-57, 165); CX 5 at 137A). CARB staff recognized that each company had full discretion whether to provide the agency with cost information at all (Fletcher, Tr. 6959) or how much information to provide (Fletcher, Tr. 6961).

Selective disclosures were a two-way street. Just as participants in the CARB rulemaking disclosed information to CARB selectively, the agency's staff also disclosed information to the participants selectively. For example, ARCO reported internally that CARB's staff had "opted to take the bulk of our recommendation and go with them as is" during a private conversation with CARB's staff. (Clossey, Tr. 5506; RX 73 at 001). During this private conversation, ARCO understood that CARB's staff was sharing the substance of the proposed Phase 2 RFG regulations with ARCO before making that information available to any other person or company, and understood that ARCO was to treat this information carefully and not to pass it on. (RX 73 at 001-002). ARCO reported that CARB's staff had "decided to go with our recommendation to raise the

T50 spec to 210" and to drop a proposed specification for driveability index ("DI"). (Clossey, Tr. 5505). ARCO understood that CARB's staff "did not want to disclose the detailed info 'publicly'" but was willing to share "insights" with ARCO, provided that ARCO did "not pass it along to others." (RX 73 at 001-002).

This selective disclosure was part of a broader pattern of political horse trading in which CARB's staff engaged. A month after making its selective disclosure to ARCO, CARB's staff asked for ARCO's "help in defeating" a General Motors proposal regarding di- and tri-substituted aromatics. (Clossey, Tr. 5507-08; RX 75 at 001). ARCO cooperated with staff's request to provide letters that would defeat the GM proposal by supplying the requested opposition paper. (Clossey, Tr. 5508).

None of these interactions took place in public view. No one but CARB's staff and ARCO knew that ARCO was being favored with a private preview of the forthcoming regulatory proposal before it was disclosed to everyone else. No one but CARB's staff and ARCO knew of the staff's request for ARCO's help in defeating GM's proposal. CARB's staff took advantage of its ability to conduct *ex parte* meetings to build alliances in favor of and against various regulatory proposals.

Political horse trading also doomed a proposal to relax the T50 specification in the RFG regulations after CARB staff became aware of Unocal's patents. During the Phase 3 RFG rulemaking in 1999, CARB's staff faced competing requests from the refining and automobile industries. The refining industry sought an increase in the T50 specification (Ingham, Tr. 2717), and CARB's staff was initially supportive of the proposal (Simeroth, Tr. 7474). The automobile industry, however, opposed the proposal and countered it with a proposal to regulate the driveability index, a composite measure of T10, T50, and T90. (Simeroth, Tr. 7474-75; Simonson, Tr. 5994-95;

CX 7051 (Irion, Dep. at 75-76)). Participants in the process recognized that the inter-industry dispute was essentially a political conflict. Exxon, for example, recognized that the "[p]olitical acceptance" of the refining industry's proposal was at issue. (CX 1749 at 010).

CARB then informed the refiners that it could only support increasing the T50 specification if the proposal would garner the support of automobile manufacturers as well. (Ingham, Tr. 2717-18, 271-23). Ultimately, the two industries negotiated a compromise through CARB's staff. The refiners agreed to drop the proposal for a T50 increase and CARB staff then persuaded the automobile industry to withdraw its proposal to regulate the driveability index. (Simeroth, Tr. 7474-76).

Participants in the agency process recognized the importance of establishing "friendly" relationships with agency staff to advance their parochial interests. Chevron, for example, thought it important "that we had a good relationship with CARB to make sure that they would be receptive to whatever it is we were trying to bring to their table for them to think about." (CX 7042 (Bea, Dep. at 19)). As might be expected, Chevron advocated positions that the company thought would work to its own advantage. (CX 7042 (Bea, Dep. at 19-20, 86-87)). In doing so, Chevron representatives met privately with CARB staff 22 times between 1990 and 1994. (CX 7042 (Bea, Dep. at 31-32)).

Political maneuvering in CARB rulemaking extended beyond the agency's hallways and included efforts to enlist the support of elected officials. Industry representatives involved in the Phase 2 RFG rulemaking were open about the political nature of the process. Texaco's lead lobbyist summarized the advocacy efforts of the Western States Petroleum Association as "[t]he basic approach has been to generate 'political heat' and attention on CARB over proposed reformulated gasoline specifications." (RX 98 at 001). WSPA member companies were assigned to contact key

legislators, administration officials and CARB members. (RX 98 at 001). WSPA also drafted friendly legislators to "contact the [CARB Board] member directly on our behalf." (RX 98 at 001). To increase political pressure on CARB's board, WSPA members also made 'several editorial board visits each day in areas around the state where a CARB members reside." (RX 98 at 002).

In their efforts to influence CARB, industry participants relied heavily on the services of lobbyists. For example, Texaco relied on two representatives to provide it with access to members of the Administration and other elected officials. (CX 7059 (Moyer, Dep. at 37-39)). Texaco assigned Gavin McHugh, a registered lobbyist (CX 7057 (McHugh, Dep. at 8)), to "develop and implement a lobbying strategy to influence CARB's decision on the final adoption" of the Phase 2 RFG regulations. (RX 435 at 003 (referred to in testimony as RX 94); *see also* CX 7057 (McHugh, Dep. at 55-56)). In furtherance of Texaco's goal, Mr. McHugh drafted a "Legislative/Regulatory Action Plan," which included a proposal to "take our lobbying activities beyond CARB." (RX 95 at 004). The plan, which sought to counter ARCO's lobbying, noted, among other things, that CARB's draft RFG regulations "resembles the specification for ARCO's ECX [sic] gasoline." (RX 95 at 002). Noting that "ARCO is a major player in California politics" (RX 95 at 002), Mr. McHugh argued that a unified industry position against the regulations would be required to counter ARCO's influence (RX 95 at 002).

In the course of his lobbying, Mr. McHugh met with the policy staff of the Governor of California. (CX 7057 (McHugh, Dep. at 30, 33)). Mr. McHugh believed that the Governor's office could influence CARB in the development of the Phase 2 RFG regulations. (CX 7057 (McHugh, Dep. at 32-33)). He also attended "lots of meetings" with representatives of the California legislature in connection with the Phase 2 RFG rulemaking. (CX 7057 (McHugh, Dep. at 37, 40)).

Texaco documents detail numerous meetings with the Governor's staff, legislators, news media, and CARB members. (*See, e.g.*, RX 97; RX 98; RX 99).

Following the initiation of CARB's rulemaking, political lobbying efforts intensified in an attempt to counter ARCO's extensive lobbying in favor of regulations that favored its commercial interests. A November 1991 Texaco memorandum relates these efforts:

> We do know that ARCO is aggressively working this issue. So far, they have focused their efforts on CARB members and administration personnel. In light of ARCO's profile in Sacramento, we should not underestimate their ability to mass resources behind this effort.

(RX 99 at 004). The memorandum addressed the prospect that "ARCO goes so far as to *twist arms*" and stated that WSPA intended to "to keep the pressure" to reject the ARCO-favored approach. (RX 99 at 004) (emphasis added). This pressure included advocacy efforts with elected and appointed officials, editorial board visits, and a fax campaign urging trade associations "to contact legislators, administration personnel and CARB members." (RX 99 at 004).[13]

Following the adoption of the Phase 2 regulations, major oil companies explicitly framed CARB's decision as a politically influenced outcome. According to Texaco, "CARB has demonstrated that it can and will disregard sound science and economic arguments. Overwhelming political opposition is our only recourse." (RX 434 at 007). Chevron's analysis echoed this analysis. Among the reasons identified by Chevron for WSPA's failure to persuade CARB of the merits of its position was "the political nature of the decision-making process." (RX 528 at 003). In reviewing the adoption of the regulations, Chevron concluded that "decisions of this Board are

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[13] Another memorandum drafted by Texaco noted that "CARB board members should be more sensitive to the economic arguments for political reasons. This makes sense because the board members are also limited in their technical expertise on these matters." (RX 435 at 002).

influenced largely by politics rather than science." (RX 528 at 003). In the future, it suggested, WSPA should place more emphasis on the "political elements" over the technical, as "a different balance between science and politics may result in more effective participation in similar processes." (RX 528 at 004).[14]

The conclusion that the steamrolling effect of ARCO's political strength had defeated sound science was echoed by ARCO's own analysis of the Phase 2 RFG rulemaking. ARCO's Timothy Clossey claimed credit for ARCO's "successful lobbying efforts that led to CARB's adoption of reformulated gasoline specifications essentially identical to EC-X." (RX 83 at 002). A memorandum prepared by Mr. Clossey emphasized that ARCO had devised, and successfully executed, a plan "to convince California regulators to adopt reformulated gasoline specifications that mirror" the company's EC-X fuel. (RX 83 at 002). To advance the company's position, ARCO's representatives "met with governmental agencies, CARB staff, . . . political leaders and members of the Governor's cabinet." (RX 83 at 006). ARCO was able to "operate effectively in this political and regulatory environment" and "influence the regulatory process such that the final regulation adopted is essentially identical in every aspect to [ARCO's] proposal." (RX 83 at 006).

The extent to which ARCO operated in the political sphere to influence the outcome of the Phase 2 RFG rulemaking is apparent from RX 589, which lists individuals or organizations contacted by ARCO in connection with its lobbying activities. (Clossey, Tr. 5487-88; RX 589). The list includes 25 CARB employees, every CARB board member, two Governors, several members

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[14] This determination to work closely with elected officials affected the refiners' subsequent strategies. For example, in connection with Phase 3 RFG rulemaking in 1999, Exxon planned to advise CARB staff "that we will convey the same messages to the governor's staff." (RX 1003).

of the Governors' staffs, several legislators, and several environmental groups. (Clossey, Tr. 5488; RX 589 at 003). The ARCO list identifies 20 contacts with state officials (RX 589 at 001-002), but the number of contacts that company representatives held with public officials was considerably greater, as most of the officials contacted are not listed in the recitation of specific contacts made by ARCO (*compare* RX 589 at 003 with RX 589 at 001-002). Indeed, Mr. Clossey testified that he had held "dozens" of meetings with CARB officials alone. (Clossey, Tr. 5486).

Amazingly, Mr. Clossey maintained at trial that ARCO's meetings with the Governor's staff as well as with various state senators and assembly members during the Phase 2 RFG rulemaking were merely "courtesy briefings" to inform these public officials of what he characterized as a "technical process." (Clossey, Tr. 5587). But these were "courtesy briefings" only in the same sense that a call from a telemarketer is a "courtesy call." Mr. Clossey's own contemporaneous words leave no doubt that the purpose of ARCO's meetings with politicians was to advance ARCO's agenda of having regulators mandate a reformulated gasoline formula that mirrors ARCO's EC-X gasoline.[15] In this regard, ARCO's efforts differed little from the efforts exerted by other refiners to influence

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[15] Mr. Clossey also insisted at trial that no gasoline called EC-X existed. His testimony is contradicted by his own contemporaneous words, however. In the memorandum in which he boasted of successfully "selling" EC-X to CARB, Mr. Clossey referred to EC-X as follows: "[T]he fuel— named EC-X for Emission Control eXperimental—demonstrated reductions of hydrocarbons emissions by 31%, carbon monoxide by 26%, oxides of nitrogen by 26%, and toxic emissions by 41% as compared to industry average gasoline." (RX 83 at 004). Later on, he referred to "the EC-X formula." (RX 83 at 006). He asked that his group be given credit for developing "the reformulated gasoline of the future, ARCO's EC-X fuel." (RX 83 at 007). It is difficult to see how there could be an EC-X formula or how a group could "develop" EC-X if EC-X was not a real fuel specification. Further, ARCO president George Babikian testified at the hearing at which CARB adopted the Phase 2 RFG regulations as follows: "[t]he specifications that CARB was looking at on October 4th are very, very similar to the specifications of EC-X. They're almost identical. So, again, I go back to saying that the cost of EC-X or the October 4th specifications should be somewhere around 16 cents a gallon." (CX 773 at 146). It would have been impossible for Mr. Babikian to estimate the cost of EC-X unless a specific formulation existed.

CARB's regulations. But ARCO navigated through the political process more effectively than its opponents. This is why the Phase 2 regulations ultimately mandated the production of a gasoline that mirrored ARCO's EC-X formula.

Following the adoption of the Phase 2 RFG regulations, ARCO published full-page advertisements in major California newspapers in which it took credit for the regulations. (Boyd, Tr. 6791). Reflecting the special relationship between ARCO and its regulator, ARCO showed proofs of the advertisements to CARB's executive officer before publishing them. (Boyd, Tr. 6791). The CARB official voiced no objection to the advertisement's content. (Boyd, Tr. 6791-92).

(2) No norms of conduct

In spite of CARB's awareness that companies that lobby it in the course of the regulatory process are not always forthcoming with all information, CARB did not put in place any procedures to ensure that it received full and accurate information from all participants in its rulemaking. CARB had no rules mandating disclosure of any information to the agency, no rules mandating that all information submitted to it be complete and accurate, and no process for placing rulemaking participants under oath, cross-examining witnesses, or applying rules of evidence. (Kenny, Tr. 6651-55; Venturini, Tr. 395, 856-58).

To a large extent, this is not surprising. As Michael Kenny, CARB's general counsel at the time of the Phase 2 RFG rulemaking testified, CARB's exercise of its quasi-legislative power "is similar to the process used by the legislature in adopting laws." (Kenny, Tr. 6664-65). Yet CARB placed *fewer* constraints on participants in the rulemaking process than do elected legislative bodies, which frequently require testimony at legislative hearings to be made under oath. For example, California legislative committees have the power to compel oral testimony to be submitted under

oath. CAL. GOV'T CODE § 9404. Had it chosen to, CARB could have adopted procedures to improve the factual accuracy and reliability of information that it received. CARB had the authority "to administer oaths or affirmations" at its hearings. (CX 7029 at 062-063 (CAL. GOV'T CODE § 11346.8(b) (1991)). But CARB chose not to do so. This failure flies in the face of the self-serving claims of CARB employees that the agency placed a premium on complete candor.

Government expectations of truthfulness are communicated most directly through the "norms of conduct" that government establishes for its proceedings. By this measure, CARB's Phase 2 RFG rulemaking was unmistakably a wide-open political process. Like a legislature, CARB placed no restrictions on who was eligible to participate in the Phase 2 RFG rulemaking. It encouraged its staff to meet with as many third parties as possible. (*E.g.*, Kenny, Tr. 6652; Venturini, Tr. 370-71). The agency permitted *ex parte* contacts with both staff and Board members. (Kenny, Tr. 6652). The staff held extensive meetings with numerous companies in the refining and automobile industries and various interest groups. (Fletcher, Tr. 6460; Courtis, Tr. 5733; Clossey, Tr. 5486; CX 7042 (Bea, Dep. at 31-32)). And as seen in the preceding section, CARB staff used the cover of *ex parte* meetings to share information about its regulatory proposals selectively and secretly to seek support from one private entity to topple regulatory proposals by another private actor. Such behavior, of course, is quite normal in the political sphere.

CARB did not communicate to third parties any "norms of conduct" for the extensive lobbying activities that took place before the issuance of a notice of proposed rulemaking, which is when Unocal allegedly made its misrepresentations. CARB had no written rules procedures for participation in this stage of the process, during which time third parties share with the agency their

perspectives, concerns, or information. (*E.g.*, Venturini, Tr. 370-71 (referring to the pre-notice stage)).

More broadly, CARB never established any "norm of conduct" regarding disclosure of information. Although a central theme of the Complaint is that Unocal committed deception by failing to disclose its patent application to CARB during the Phase 2 RFG rulemaking (Complaint ¶¶ 38, 42, 45, 61, 62, 77, 78, 94), there was no "norm of conduct" that established an expectation that such a disclosure would be made. James Boyd, CARB's executive officer at the time of the rulemaking, testified that he did not know whether he would have expected a patent application to be brought to CARB's attention in 1991. (Boyd, Tr. 6821-22). He further testified that he did not even know whether he would have wanted to know about a patent application during the rulemaking. (Boyd, Tr. 6822-23).

The regulator's lack of certainty about the desired level of disclosure is a far cry from an established norm that patent applications must be disclosed. And it was reflected in the fact that CARB had no written or formal policy requiring rulemaking participants to disclose patents or patent applications. (Kenny, Tr. 6511-12, 6518, 6592; Boyd, Tr. 6830-35, 6908; Venturini, Tr., 395, 863-64). As a governmental institution, CARB is required to give notice of its policies and other rules in writing, so that persons regulated by the agency have notice of the rules by which they are governed (CX 7029 at 070 (section 11347.5(a)); Boyd, Tr. 6830-35), despite Complaint Counsel's assertion to the contrary (Tr. 6544 ("there's no requirement under the law anywhere that they have a written policy, guideline, or anything")). No participant in a CARB rulemaking could have concluded that CARB expected it to disclose patent applications.

Nor could such an expectation be inferred from CARB's conduct. The agency never asked Unocal whether it possessed any patents related to its research. (Jessup, Tr. 1595; Lamb, Tr. 2260). Indeed, CARB never inquired of any company whether it had any patent rights. (Venturini, Tr. 395, 863-64; CX 7063 (Sharpless, Dep. at 168); Ingham, Tr. 2685; Eizember, Tr. 3396-97; Clossey, Tr. 5492; CX 7042 (Bea, Dep. at 36)). And although CARB modeled Phase 2 RFG after ARCO's EC-X, CARB never considered whether ARCO had any patents or pending patents related to RFG. (Clossey, Tr. 5492).[16]

Even with awareness of a patent relating to RFG that had been issued to Talbert Fuel Systems, CARB never analyzed the patent before voting to issue the RFG regulations. (Simeroth, Tr. 7468-71; Courtis, Tr. 5884-87; Kulakowski, Tr. 4641; CX 7040 (Aguila, Dep. at 135-36)).[17] Further, in its prior Phase 1 RFG rulemaking, CARB did not inquire about patent rights after learning of a Unocal "patent-pending development" related to the subject matter of the rule. (Venturini, Tr. 187-88; Croudace, Tr. 544-45, 653-55; CX 7040 (Aguila, Dep. at 10-11); CX 1093 at 027 (referenced in transcript as CX 131 at 012)).

The absence of an understanding that rulemaking participants would disclose their patent applications is also apparent from the conduct of rulemaking participants. Although at the time of the Phase 2 RFG rulemaking, Chevron had a pending patent application relating to the Driveability

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[16] Nor did CARB ever ask ARCO, which was championing a regulatory mandate to use MTBE and had invested heavily in MTBE manufacturing facilities, whether it had any patents related to MTBE. (Boyd, Tr. 6792; Courtis, Tr. 5901-02; *see also* Cunningham, Tr. 4315-19; Clossey, Tr. 5492).

[17] CARB's Dean Simeroth contended that John Courtis had analyzed the patent (Simeroth, Tr. 7482-84), but Mr. Courtis himself testified that he had never done so (Courtis, Tr. 5884-85).

Index (CX 7071 (Welstand, Dep. at 70-71); RX 258; Ingham, Tr. 2627, 2685-86, 2691)), Chevron did not disclose the application to CARB (Ingham, Tr. 2708; CX 7071 (Welstand, Dep. at 67, 70-71, 74); CX 7042 (Bea, Dep. at 36, 40); CX 7067 (Toman, Dep. at 50)), even though it was affirmatively advocating the incorporation of the driveability index into the regulations (Ingham, Tr. 2669-70, 2674, 2680-88; CX 977 at 002; RX 251 at 001; CX 952; RX 263 at 002-003; RX 757; RX 254 at 003). Similarly, BP/ARCO did not disclose to CARB its patent applications relating to low emissions gasoline. (CX 7075 (Wood, Dep. at 6-7, 36, 38-41, 44-45, 49-51, 56); RX 662; RX 663; RX 664; RX 665; RX 666; RX 668).

An expectation that rulemaking participants should be truthful is no different from a legislative committee expecting that persons appearing before it will be truthful. This expectation, standing alone, does not place the work of a legislature outside the political sphere. Moreover, insofar as there was a difference between CARB's interactions with participants in its rulemakings and participants in the legislative process, it was that CARB chose not to exercise the power routinely exercised by legislative committees to place witnesses under oath. CARB had not communicated its expectations to participants, in writing or otherwise.

The absence of "highly elaborated definitions of what is or is not proper behavior" in CARB rulemakings is consistent with other proceedings that have been termed "political" for the purposes of the *Noerr* Doctrine. For example, in *Boone v. Redevelopment Agency*, proceedings to amend an urban redevelopment plan were termed "essentially legislative" by the Court. 841 F.2d at 896. In determining that the agency and council had acted "in the political sphere" (*id.* at 894), the court cited lobbying activity (*id.*), *ex parte* contacts (*id.* at 895), and the fact that the redevelopment agency and city council "were carrying out essentially legislative tasks" (*id.* at 896). The court emphasized

that "[s]uccessful petitioning of government often depends on the development of close relations between government officials and those who seek government benefits" and that "cultivating close ties with government officials is the essence of lobbying." *Id.* at 894. Such conduct certainly falls within the ambit of the *Noerr-Pennington* Doctrine. *Id.* As seen above, ARCO's cultivation of close ties with CARB officials, which included such mutual back-scratching as the receipt of private briefing and responding to secret requests from CARB's staff to oppose third parties' regulatory proposals (*e.g.*, RX 75 at 001; Clossey, Tr. 5507-08), resulted in CARB's wholesale adoption of ARCO's regulatory proposal. And, Chevron, as seen earlier, sought to cultivate "a good relationship with CARB" so that the agency "would be receptive" to the company's proposals. (CX 7042 (Bea, Dep. at 19-20)).

The Fifth Circuit has specifically distinguished administrative rulemakings as "political" in contrast to other proceedings in which the agency has established higher norms of conduct, thus signaling government expectations of truthful representations. *Woods Exploration & Producing Co. v. Aluminum Co. of Am.*, 438 F.2d 1286 (5th Cir. 1971). *Woods* involved a claim that certain oil and gas companies had filed false "nomination forecasts" with the Texas Railroad Commission relating to expected purchases of the output of particular fields. Under the Commission's rules, these forecasts were "sworn statements," upon which the agency was entitled to rely. *See* Kenneth Culp Davis & York Y. Willbern, *Administrative Control of Oil Production in Texas*, 22 TEX L. REV. 149, 167 (1943-44). The court withheld *Noerr* immunity from misrepresentations made in the nomination process, in which the agency applied established rules to the facts. The court also concluded, however, that "[t]he germination of the allowable formula was political in the *Noerr* sense, and thus

participation in those rulemaking proceedings would have been protected." 438 F.2d at 1297. The different norms of conduct applicable to the rulemaking placed it squarely in the political arena.

Proceedings in which misrepresentations to governmental agencies have been recognized as a basis for antitrust liability have involved established "norms of conduct" that are more circumscribed and well defined than the unconstrained environment of CARB's rulemaking. *Walker Process*, the only Supreme Court decision to recognize a theory of antitrust liability based on a misrepresentation, involved fraud upon the Patent and Trademark Office. *Walker Process,* 382 U.S. 172. A duty of good faith and candor has been recognized in PTO proceedings since at least 1945. *See, e.g.*, *Precision Instrument Mfg. Co. v. Auto. Maint. Mach. Co.*, 324 U.S. 806, 818 (1945).

Many of the other cases discussing a misrepresentation exception to *Noerr* immunity involved administrative or judicial litigation— the purest example of adjudicative proceedings. *See generally, e.g.*, *Baltimore Scrap Corp. v. David J. Joseph Co.*, 237 F.3d 394 (4th Cir. 2001) (judicial litigation); *Porous Media v. Pall Corp.*, 186 F.3d 1077 (8th Cir. 1999) (judicial litigation); *Liberty Lake Invs. v. Magnuson*, 12 F.3d 155 (9th Cir. 1993) (judicial litigation); *Clipper Exxpress v. Rocky Mountain Motor Tariff Bureau*, 690 F.2d 1240 (9th Cir. 1982) (administrative litigation). Most of the other misrepresentation cases fall within the same set of narrow circumstances analogous to *Walker Process* or *Woods Exploration*—in which specific information is being supplied to an administrative body pursuant to a formalized set of procedures. *See generally Israel v. Baxter Labs.*, 466 F.2d 272 (D.C. Cir. 1972); *DeLoach*, 2001 WL 1301221 (mandatory filing of purchase intentions for tobacco). Those circumstances have little, if any, in common with the wide-open political process of CARB's rulemaking, in which the agency accepted information from all sources on any topic that the submitter deemed to be relevant.

CARB's procedures in the Phase 2 RFG rulemaking were also less formalized than the procedures commonly applied in Certificate of Need ("CON") proceedings, as to which the courts have split over whether misrepresentations can remove *Noerr* immunity. The Commission's opinion relied on *Kottle v. Northwest Kidney Centers*, 146 F.3d 1056 (9th Cir. 1988), in support of a misrepresentation exception. The CON proceeding in *Kottle*, however, employed procedures more formal than those used in CARB's rulemaking in several significant respects. Witnesses appearing at the CON hearing could be represented by counsel and were subject to cross-examination. Written evidence was supplied in the form of comments and rebuttal comments, similar to briefing in litigation. *Ex parte* contacts were prohibited after the public hearing. Finally, the state agency issuing the CON decision in *Kottle* was required by statute to publish written findings explaining its decision in terms of specific statutory factors.

In all of these respects, CON proceedings are more constrained, and therefore more compatible with a governmental expectation of truthfulness, than the open process utilized by CARB. Even so, the most recent appellate authority to address CON proceedings rejected the claim that misrepresentations could serve as a basis for antitrust liability. *Armstrong Surgical Ctr., Inc. v. Armstrong County Mem'l Hosp.*, 185 F.3d 154 (3d Cir. 1999). The court in *Armstrong* recognized that the federalism concerns expressed by the Supreme Court in *Omni* counseled against using the antitrust laws as a means of policing wrongful conduct in the political process. "The remedy for such conduct rests with laws addressed to it and not with courts looking behind sovereign state action at the behest of antitrust plaintiffs." *Id.* at 162. The Commission's amicus brief to the Supreme Court in *Armstrong* emphasized that "[t]he CON process is administrative, and in some

respects adjudicatory, but it also has aspects that are 'political in the *Noerr* sense.'" U.S./FTC *Armstrong* Br. at 19.

CARB's rulemaking was an open process with none of the procedural constraints that have led other courts to characterize proceedings as adjudicative. CARB could have established regulations governing input into the rulemaking, could have required submissions to be made under oath, and could have adopted adversarial fact-finding procedures similar to those used in litigation. But CARB did nothing to specify "criteria of impropriety" that identify non-political proceedings. *See* I ANTITRUST LAW 203f at 174. CARB emphasized frequent and informal interaction with interested parties, recognizing that refiners and other interest groups would act self-interestedly in their advocacy and in supplying information. Under the first test set forth in the Commission's opinion, this absence of constraints characterizes the Phase 2 RFG rulemaking as political rather than adjudicative.

(3) No proof of rulemaking misconduct

Significantly, even the very modest procedural constraints that California law placed on the Phase 2 RFG rulemaking were not applicable when Unocal allegedly made its "misrepresentations" to CARB. Unocal sent its letter to CARB regarding the confidentiality of its research data before CARB initiated the Phase 2 RFG rulemaking on October 4, 1991. (*See* CX 29). This October 4, 1991, date establishes a significant demarcation line under the Commission's opinion, in light of its emphasis on the constraints created by the rulemaking process. The rulemaking process begins with the release of the notice of proposed rulemaking. (Kenny, Tr. 6611; *see also* CX 7029 at 048-049 (CAL. GOV'T CODE § 11346.4 (1991)); CX 767 at 001, 010). The pre-notice process, including Unocal's communications, is not part of the rulemaking record. (*See* Kenny, Tr. 6611; Venturini,

Tr. 370-71; CX 767 at 010). The requirements of the California Administrative Procedure Act—which the Commission characterizes as imposing significant limits on CARB's discretion—were simply not applicable to and did not inform any of CARB's dealings with Unocal (or anyone else) prior to CARB's initiation of the rulemaking in October 1991.[18] Thus, even if the minimal procedural constraints applicable to CARB's rulemaking did impose limits on CARB's discretion, no such limits existed prior to the commencement of the rulemaking, when Unocal allegedly made its misrepresentation to CARB.

This fact is of central importance under the Commission's opinion. The opinion acknowledges that the August 1991 letter "preceded the formal opening of CARB's Phase 2 RFG proceeding and therefore could not have been subject to any constraints attendant upon the rulemaking." (Op. at 38 n.81). It concluded that Complaint Counsel nevertheless could go forward with the case because the Complaint "alleges a continuing pattern of conduct that maintained the alleged false and misleading impression throughout the rulemaking." *Id.* Thus, to overcome *Noerr* immunity under the Commission's decision, it is vital for Complaint Counsel to show that Unocal engaged in deceptive conduct during the formal phase of the Phase 2 RFG rulemaking.

Complaint Counsel presented no such proof at the hearing. Complaint Counsel centered the entire case on the claim that the August 1991 letter created the deception that caused harm to competition. Indeed, the only competitive harm asserted by Complaint Counsel's economic expert was based on the "fundamental" assumption that Unocal's August 1991 letter constituted an offer

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[18] As noted earlier, even a Federal Trade Commission rulemaking under the Magnuson-Moss Act procedures, which include evidentiary hearings with sworn testimony, did not deprive the rulemaking of its political character under the D.C. Circuit's holding in *Ass'n of National Advertisers v. FTC*, 627 F.2d at 1168.

to license the company's patents on a royalty-free basis. (Shapiro, Tr. 7241-42; *see also* Shapiro, Tr. 7073, 7246-37, 7250). There is no allegation, let alone proof, that Unocal ever made such an offer, or even renewed it, after the commencement of the rulemaking. Thus, even if Unocal had made a misrepresentation, and the record shows that it did not, Complaint Counsel have failed to proffer any proof that it did so within the framework of the actual rulemaking. Under the Commission's decision, this is fatal to Complaint Counsel's case.

b. Degree of government discretion

CARB was granted a remarkable degree of discretion by the California legislature to determine how best to tackle air pollution problems throughout the state. The agency has essentially unlimited freedom to research and solicit input relevant to its mission of cleaning up California's air. When CARB chooses to address those problems through rulemaking, as it ultimately did in formulating the Phase 2 RFG regulations, those proceedings are similarly "in the political arena" for *Noerr* purposes, as defined by existing caselaw. Conversely, it is equally clear that CARB's rulemaking bore no resemblance to adjudicative action by administrative agencies, in which the scope of *Noerr* protection has been limited.

The legal framework in which CARB was operating actually confirms the broad discretion that had been granted to the agency. It is undisputed that the Phase 2 RFG rulemaking was a "quasi-legislative" proceeding under California law. (Kenny, Tr. 6612-13, 6647). The California Supreme Court has held that agencies acting through quasi-legislative rulemaking are engaged in "an authentic form of substantive lawmaking." *Yamaha Corp. v. State Bd. of Equalization*, 960 P.2d 1031, 1036 (Cal. 1998). "Because agencies granted such substantive rulemaking power are truly 'making law,' their quasi-legislative rules have the dignity of statutes." *Id.* Because "substantive

lawmaking" is the paradigmatic example of legislative action, there can be no doubt that the express delegation of quasi-legislative power to CARB placed the agency squarely in the "political arena" for *Noerr* purposes. Indeed, the California Supreme Court cited the U.S. Supreme Court's *Chevron* decision in describing the deference owed to CARB's rulemakings. *W. States Petroleum Ass'n v. Superior Court*, 888 P.2d at 1274. *Chevron* mandates, of course, deference to the administrative agency as part of the "political branch of government." 467 U.S. at 865-66. Likewise, the California Supreme Court held that "excessive judicial interference with the ARB's quasi-legislative actions would conflict with the well-settled principle that the legislative branch is entitled to deference from the courts because of the constitutional separation of powers." *W. States Petroleum Ass'n v. Superior Court*, 888 P.2d at 1274.

The exceptional breadth of CARB's discretion is equally evident in the terms of the agency's mandate. The California legislature directed CARB to consider multiple, and often conflicting, policy goals in regulating air quality. For instance, CARB was instructed to adopt control measures that were "necessary, cost-effective, and technologically feasible." CAL. HEALTH & SAFETY CODE § 43018(b) (1991). CARB was also required to achieve "the maximum degree of emission reduction possible" at the "earliest practicable date." *Id.* § 43018(a). The legislature defined none of these terms. Nor did the legislature provide CARB with any specific guidance on how its directive to achieve a "maximum degree of emission reduction" should be balanced against the contrary instruction to adopt only those measures that are "cost-effective," or "necessary." (*See* Shapiro, Tr. 7146) (CARB mandate is "internally inconsistent" because "the more you reduce emissions, the more it costs."). Instead, by not defining those terms, the California legislature delegated the discretion to define and balance these competing mandates to CARB's independent judgment.

Complaint Counsel's argument that CARB's discretion under the statute extended only to "technical decisions"could not be reconciled with either the statute or the evidence developed in this proceeding. CARB's General Counsel at the time of the Phase 2 RFG rulemaking conceded that CARB had broad policy discretion in that rulemaking. (Kenny, Tr. 6652). The extent of CARB's discretion is evident from the fact that among the options under consideration by CARB prior to enacting the Phase 2 RFG regulations was whether to phase out gasoline altogether in favor of alternative fuels. (CX 5 at 163). As CARB's Executive Officer at the time of the Phase 2 RFG rulemaking testified, CARB seriously considered replacing gasoline with methanol based on studies that "seemed to repeatedly reaffirm that methanol was a viable alternative fuel." (Boyd, Tr. 6700-01). Although CARB ultimately rejected the option of mandating the use of alternative fuels, it did so not because it believed that it lacked the power to take such an action but because it believed that mandating alternative fuels "could not be wisely done on the basis of only emissions." (CX 5 at 164).[19] The discretion to decide whether it was "wise" to ban gasoline altogether cannot possibly be characterized as a mere "technical decision."[20]

The Final Statement of Reasons issued by CARB in connection with the Phase 2 RFG rulemaking further illustrates the substantial breadth of CARB's discretion. Among the

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[19] The agency impliedly believed that it possessed the statutory authority to ban gasoline as on the very same page it rejected the alternative of regulating stationary sources based on the lack of authority to do so. (CX 5 at 164).

[20] Yet another example is CARB's consideration of a vehicle scrappage program, advocated by Unocal and other refiners as a means of removing high-polluting cars from the road. CARB's Chairwoman Sharpless testified that such programs raise important "social equity issues" for CARB to consider in its decisionmaking. (CX 7063 (Sharpless, Dep. at 101)). Nothing in CARB's statutory mandate speaks to "social equity," and the issue cannot be characterized as a "technical decision" in any event.

hotly-contested political issues in the rulemaking was whether small refiners should receive differential treatment under the regulations. Large refiners argued that CARB "lack[ed] the statutory authority to adopt the small refiner exemption." (CX 10 at 190). CARB's response to this criticism emphasized the breadth of discretion granted to the agency by the legislature:

> 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. *The ARB does not need explicit statutory language to implement any of these approaches.*

(CX 10 at 196) (emphasis added). In other words, the scope of CARB's discretionary authority included what should be regulated, how it should be regulated, when the regulations should go into effect, who should be subject to the regulation, and what exceptions to allow. Further, CARB's authority embraced the power to exempt a class of businesses from regulatory requirements without express statutory authorization. It is difficult to imagine a broader delegation of authority by the legislature to an agency to engage in "substantive lawmaking" through the issuance of rules.[21]

The fact that CARB was subject to some procedural constraints does not undercut the extent of its political discretion. The Ninth Circuit in *Boone* found that a redevelopment agency and city council that were subject to even greater constraints than CARB were "carrying out essentially legislative tasks" and acting as "political" bodies for *Noerr* purposes. 841 F.2d at 896. Like CARB

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[21] Moreover, as CARB's General Counsel testified, CARB had "a significant interest in the economy of the state" (Kenny, Tr. 6504) and considered the economy of the state in promulgating the Phase 2 RFG regulations in 1991 (Kenny, Tr. 6506). The determination of sound economic policy is a paradigm of discretionary governmental action.

rules, a redevelopment plan must be supported by an evidentiary basis. CAL. HEALTH & SAFETY CODE § 33352, 33367. The city council is required to make written findings responding to any objections. CAL. HEALTH & SAFETY CODE § 33364. Judicial review of redevelopment plans is available in California courts under the very same legal standard that is applicable to CARB. *See, e.g.*, *San Franciscans Upholding the Downtown Plan v. City & County of San Francisco*, 125 Cal. Rptr. 2d 745, 757 (Cal. Ct. App. 2002) ("[I]n reviewing an agency's adoption of a redevelopment plan or amendment under the Community Redevelopment Law, we must determine whether substantial evidence in the administrative record supports the agency's specific findings of urbanization and blight."). Finally, the list of specific, substantive findings required by the California legislature in connection with redevelopment plans far surpasses the highly generalized guidance given to CARB in connection with improving air quality. CAL. HEALTH & SAFETY CODE §§ 33352, 33367.

None of these characteristics of the agency and city council in *Boone* detracted from the political nature of their decisionmaking. The agency and city council were political entities for *Noerr* purposes because they possessed "broad discretion" to adopt and amend redevelopment plans that "obviously involve a large area and affect[] virtually every member of the community." 841 F.2d at 896. By contrast, adjudicative proceedings consist of "governmental conduct, affecting the relatively few, [that] is 'determined by facts peculiar to the individual case . . . .'" *Id.* Under *Boone*, CARB was plainly acting in the political arena when it established rules concerning allowable gasoline that could be sold throughout California. *See also Woods Exploration*, 438 F.2d at 1297 ("The germination of the allowable formula was political in the *Noerr* sense, and thus participation in those rulemaking proceedings would have been protected.").

Conversely, CARB's proceedings bear little if any resemblance to agency procedures that have been characterized as adjudicative for *Noerr* purposes, such as the Louisiana Racing Commission's denial of an application for a racing license in *Livingston Downs Racing Ass'n v. Jefferson Downs Corp.*, 192 F. Supp. 2d 519 (M.D. La. 2002). That characterization accurately reflected the fundamentally adjudicative nature of the agency's proceedings. Applicants for a racing license are required to submit an oath "stating that the information contained in the application is true." LA. REV. STAT. ANN. § 4:147.5. The Commission's proceedings are defined as adjudication under the Louisiana code and conducted pursuant to the adjudication provisions of the Louisiana APA. LA. REV. STAT. ANN. §§ 4:154, 49:961. Those provisions call for a formal hearing with the presentation of evidence and opportunity for cross-examination, preparation of an adjudicative record, and findings of fact "based exclusively on the evidence and on matters officially noticed." LA. REV. STAT. ANN. § 49:955(G). A final decision, to include "findings of fact and conclusions of law," is required. LA. REV. STAT. ANN. § 49:958. CARB's Phase 2 RFG rulemaking had no analogue for any of these procedures. It did "not involve the individualized application of established principles" and had no "enforceable standards subject to review" by an antitrust court. 192 F. Supp. 2d at 534 n.14 (citing *Manistee Town Ctr. v. City of Glendale*, 227 F.3d 1090, 1094 (9th Cir. 2000)).

CARB does have procedures comparable to those used in *Livingston Downs Racing*, which are applicable to its adjudicative proceedings. In explaining the legal background of that adjudicative proceeding to the Board, CARB's General Counsel contrasted CARB's ordinary rulemaking procedures, which it employed in Phase 2, with its adjudication of disputes as follows:

> Typically, the Board makes policy decisions in adopting regulations; this is called quasi-legislative process because it is similar to the process used by the Legislature in adopting laws.
>
> At today's hearing the Board will be exercising quasi-judicial authority, and that is deciding a dispute between two parties.

(RX 70 at 012). In contrast to the rulemaking process, in which CARB enjoyed broad policy discretion (Kenny, Tr. 6652, 6665), CARB's discretion in the quasi-adjudicative context was limited to deciding whether the weight of the evidence supported the action under review (RX 70 at 009; Kenny, Tr. 6662-63, 6666). In the Phase 2 RFG rulemaking, by contrast, CARB enjoyed discretion that was so broad as to encompass the power to ban gasoline, reformulate it, or adopt a wide range of other control measures.

c. <u>**CARB did not have the requisite reliance on Unocal's alleged factual misrepresentations**</u>

In determining whether an administrative proceeding is "political" for purposes of applying *Noerr* protection, the third factor set out by the Commission's opinion is the extent of necessary governmental reliance on a petitioner's factual assertions. (Op. at 31-32, 34). It was impossible for Complaint Counsel to show that CARB was necessarily reliant on Unocal for the accuracy of its factual representations.

The nature of the CARB Phase 2 rulemaking is substantially different from proceedings in which it can clearly be determined that the government necessarily relied on outcome determinative factual assertions made by petitioner. Significantly, the official rulemaking record does not contain any statement that even hints that CARB relied upon Unocal's alleged misrepresentations. Further, there is no written embodiment of the reasons why CARB's board members exercised their broad discretion to promulgate the Phase 2 RFG regulations, which made it impossible to show that the

agency relied on Unocal's alleged factual assertions. To the extent that evidence of CARB's reliance exists, all of which resides outside the rulemaking record, it strongly shows that Unocal's alleged factual misrepresentations were not relied upon by CARB.

Each case in which the Commission concluded that government was necessarily reliant on a party's factual submissions (Op. at 34, n.74) involved proceedings in which private parties were required to provide specific information in prescribed forms, which necessarily triggered a specific governmental action. In *Woods Exploration*, for example, applicable rules required oil and gas producers to submit sworn statements quantifying the volume of gas that they expected to be able to market from their wells. Davis & Willbern, *supra*, 22 TEX. L. REV. at 167. Based on this information, the Texas Railroad Commission determined each producer's allowable production pursuant to an *established formula*. 438 F.2d at 1292. In *DeLoach*, Agriculture Department regulations *required* purchasers to provide accurate statements quantifying their intended purchases of tobacco pursuant to a quota system imposed by law. *See* 7 C.F.R. § 723.504. The Department used these amounts to calculate production quotas pursuant to a "statutory formula" that gave it "no discretion." *DeLoach*, 2001 WL 1301221, at *2. The Orange Book listings at issue in *In re Buspirone Patent Litig.*, 185 F. Supp. 2d 363, 367 (S.D.N.Y. 2002), automatically triggered a ministerial action by the FDA as to which the agency had no discretion.

In all of these proceedings, government action flowed directly and inevitably from the submission of information by private parties. In each case, the government required participants in its regulatory proceedings to submit accurate information. The context of these proceedings placed no "emphasis on debate," which the Commission's opinion ascribes to political decisions. (Op. at 34 (citation omitted)). To the contrary, the data provided by private parties was either fed into some

preexisting formula that determined government action or automatically triggered government action. Because the agency was acting in a mechanical manner, the private parties' data on which the agencies relied was necessarily outcome-determinative.

The CARB Phase 2 RFG rulemaking bears little or no resemblance to these proceedings. CARB had no formal requirement that anyone submit information in the course of its rulemaking. (*See*, *e.g.*, Fletcher, Tr. 6958-59; Venturini, Tr. 395, 863-64). CARB also had no predetermined formula into which private parties' data submissions were fed to determine the governmental action, and its role in the rulemaking cannot possibly be described as ministerial. The agency enjoyed exceptionally broad discretion and sought information and ideas from different stakeholders in an effort to find an effective and politically acceptable means of controlling pollution. (*See*, *e.g.*, Fletcher, Tr. 6460; Kenny, Tr. 6652; Courtis, Tr. 5733).

The written record also makes it impossible to show that CARB relied upon Unocal's alleged factual misrepresentations. This in complete contrast to the governmental action in the cases cited by the Commission, in which necessary government reliance could be determined without onerous deconstruction of government decisionmaking. The difficulty in establishing reliance clearly marks CARB's rulemaking as part of the political arena.

CARB adopted the Phase 2 RFG regulations pursuant to a vote of its nine Board members after a public hearing. The transcript of the hearing does not include an explanation by any member of the reason for his or her vote, and no other written record exists. (*See* CX 773; CX 774). The Final Statement of Reasons for Rulemaking prepared by CARB staff about a year after the Board's vote, cannot support any claim of reliance. (*See* CX 10). It contains no hint of any reliance on the supposed Unocal misrepresentations at issue here; it does not refer to intellectual property rights or

their absence. The Board members, moreover, had no input into the preparation of the Final Statement. (Boyd, Tr. 6837-38). There is literally no means by which to determine "what combination of fact, arguments, politics, or other factors" was responsible for each Board member's vote to adopt the regulations apart from the deconstruction process specifically condemned by the Supreme Court in *Omni*, 499 U.S. at 377.

Even plumbing into the depths of the rulemaking record does not provide any nexus between any alleged Unocal misrepresentation and CARB's decision. Under California law, CARB was required to place in its rulemaking record anything that constitutes substantial evidence on which the agency relied in promulgating its rules. (CX 7029 at 068 (CAL. GOV'T CODE §11347.3); (Kenny, Tr. 6632)). Among other things, CARB was required to maintain in the rulemaking record "[a]ll data and other factual information, technical, theoretical, and empirical studies or reports, if any, on which the agency is relying in the adoption, amendment, or repeal of a regulation, including any cost impact estimates as required by Section 11346.53."(CX 7029 at 068 (CAL. GOV'T CODE §11347.3(a)(7))). Thus, to the extent that CARB was relying on the absence of actual or potential patent rights that may affect gasoline formulations compliant with its regulations, it was required to maintain the relevant "factual information" in its rulemaking record. There is nothing in the rulemaking record to show that CARB relied on the absence of actual or potential patent rights. Indeed, there is nothing in the rulemaking record to show that CARB relied on Unocal's data.[22]

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[22] The table of contents to the Phase 2 RFG rulemaking record is contained in CX 1815. (Fletcher, Tr. 6934; Kenny, Tr. 6615-16; CX 1815 at 016-017). The table of contents from CX 1815 appears as the first two pages of CX 838, a 4,000-page exhibit that contains the documents listed in the table of contents. (Kenny, Tr. 6618-31; CX 1815 at 016-007; CX 838 at 001-002). None of these documents contains any reference to patent rights, to any alleged Unocal representations regarding patent rights, or even to Unocal's data. (*See*, Kenny, Tr. 6641).

What the rulemaking record shows, instead, as the agency's Final Statement of Reasons for Rulemaking put it, is that "[t]he specifications adopted by the Board are similar to the ARCO specifications for EC-X gasoline" and that they were "based on staff's independent analyses of studies performed by ARCO, Auto/Oil and others, as well as comments presented during the rulemaking process." (CX 10 at 178).

The problem of tracing a link between any alleged Unocal misconduct and CARB's final rules is compounded by the inherently uncertain nature of the information alleged to have been withheld from CARB. Had Unocal disclosed to CARB that it had a pending patent application, that information would not have provided CARB members with any reliable basis for evaluating the proposed Phase 2 RFG regulation or alternative regulatory approaches. All that could have been known at the time of CARB's board hearing on the regulations, which took place on November 21 and 22, 1991, was that the patent examiner had denied all of Unocal's patent claims one week earlier.[23] (CX 1788 at 215). Knowledge of the existence of a pending patent application would not have been sufficient information on which to determine cost or to evaluate the impact of the patent application. (See CX 7050 (Ibergs, Dep. at 109); CX 7048 (Hancock, Dep. 272-76); Banducci, Tr. 3487-88).

No one could have known whether any patent would ultimately issue from the Unocal application; when any patent would issue; if any such patent were to issue; what gasoline compositions would be covered; whether any overlap would exist between the compositions proposed to be mandated by CARB's Phase 2 RFG regulations and compositions covered by any

[23] CARB was required by law to promulgate its regulations no later than January 1, 1992. CAL. HEALTH & SAFETY CODE § 43018(b).

patents ultimately issued to Unocal; whether Unocal would pursue or abandon claims allowed by the Patent Office; what the cost to refiners would be to avoid infringement while complying with the proposed CARB regulations; whether the patents (the scope of which could not be known) would be perceived by CARB and the industry to likely be valid or invalid; and what Unocal's licensing policy and royalties on patents of unknown scope might be. No one could answer any of these critical questions in the fall of 1991, leaving only after-the-fact speculation as the basis for any conclusion that CARB would have changed its regulations based on the existence of the patent application.

The Commission's opinion highlights the importance of the "specific information allegedly misrepresented." (Op. at 41). This factor is highly relevant here, as the competent evidence overwhelmingly shows that CARB: (1) never inquired about patent rights of Unocal or anyone else (let alone patent applications); (2) did not understand Unocal's August 1991 letter to refer to patent rights; and (3) did not take Unocal's patent into account in its regulatory process even after Unocal won an infringement judgment because CARB believed the patent to be "still in a state of flux" during the pendency of an appeal of that judgment. (Venturini, Tr. 815). The agency's then Executive Officer to this day does not even know whether he would have wanted to know about a patent application during the rulemaking. (Boyd, Tr. 6822-23).

CARB has never asked any participant in any rulemaking to disclose the existence of patents or patent applications. (Jessup, Tr. 1591; Lamb, Tr. 2260; Venturini, Tr. 395, 863-64; CX 7063 (Sharpless, Dep. at 168); Ingham, Tr. 2685; Eizember, Tr. 3396-97; Clossey, Tr. 5492; CX 7042 (Bea, Dep. at 36)). Neither at the time of the Phase 2 RFG rulemaking nor at any time since has CARB had any written or formal policy requiring rulemaking participants to disclose patent

applications. (Boyd, Tr. 6834-35; Kenny, Tr. 6511-12, 6518, 6592). At no time was anyone in CARB responsible for determining whether the agency's regulations would be affected by existing or potential patents.[24] (Venturini, Tr. 395). At no time since 1991 has CARB asked persons who comment on its proposed regulations whether they have any patent application that may relate to those regulations. (Venturini, Tr. 863-64).

CARB did not take into consideration during the Phase 2 regulatory process the possibility of patents that may affect its regulations. (Kenny, Tr. 6519-20). Thus, CARB did not ask ARCO whether it had patents relating to MTBE (Boyd, Tr. 6792; Clossey, Tr. 5492; *see also* Cunningham, Tr. 4315-19), even though the Phase 2 regulations effectively required the use of oxygenates in gasoline (Boyd, Tr. 6898-99; CX 10 at 047; *see also* Venturini, Tr. 768-69). More broadly, although CARB modeled Phase 2 RFG after ARCO's EC-X gasoline, CARB did not consider whether ARCO had any patents or pending patents related to RFG in promulgating its Phase 2 regulations. (*E.g.*, Courtis, Tr. 5901-02). Nor did CARB ask any other refiner about existing patents or pending patent applications during any phase (official or unofficial) of its adoption of Phase 1, 2, or 3 RFG regulations. (Eizember, Tr. 3396-97; Clossey, Tr. 5492; CX 7042 (Bea, Dep. at 36); Ingham, Tr. 2685; Venturini, Tr. 395, 863-64; CX 7063 (Sharpless, Dep. at 168)). As CARB's Peter Venturini

[24] CARB's Executive Officer, James Boyd, testified that he never issued a directive that patented technologies could not be used in CARB regulations. (Boyd, Tr.6834-35). In fact, in connection with its diesel regulations, CARB actually encouraged the licensing of trade secret technology. (*See* RX 88 at 002) (Texaco believed that licensing its secret diesel formulation would present a "favorable public relations opportunity. . . . CARB and ARCO have asked if we will license our formulations").

put it, "[i]t's not our practice and never has been to ask those specific questions." (Venturini, Tr. 863).[25]

The fact that CARB has never requested rulemaking participants to disclose patents or patent applications and did not consider patent rights in promulgating its regulations strongly evidences that CARB did not rely on the absence of a Unocal patent application relevant to its regulations.[26] In fact, CARB's Peter Venturini, whom CARB designated as its Rule 3.33(c) witness on the issue, testified that at the time that CARB received the August 1991 letter that is the linchpin of Complaint Counsel's misrepresentation case, the thought did not occur to CARB that it had anything to do with patent rights. (Venturini, Tr. 821-22). CARB could not have acted in reliance on any Unocal misrepresentation that it had no patent rights if CARB did not even think that Unocal had made any representation regarding patent rights.

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[25] Other companies also did not disclose to CARB that they had filed patent applications on inventions relating to reformulated gasoline. For example, in 1989-90, Chevron performed research into the effect of Driveability Index on emissions. (CX 7071 (Welstand, Dep. at 6-17)). Chevron shared its data with CARB in the fall of 1990 and urged CARB to include the Drivability Index in the Phase 2 regulations. (CX 7042 (Bea, Dep. at 40); Ingham, Tr. 2669-70, 2674, 2680-88; CX 977 at 002; RX 251 at 001; CX 952; RX 263 at 002-003; RX 254 at 003). Chevron, however, never told CARB that it filed a patent application on inventions that related to the Driveability Index, and CARB never asked Chevron about patents or patent applications. (RX 7042 (Bea, Dep. at 36, 40); *see also* Ingham, Tr. 2708; CX 7067 (Toman, Dep. at 50); RX 757). Similarly, ARCO never told CARB about its pending reformulated gasoline patent during the Phase 2 rulemaking. (*See* Clossey, Tr. 5492). During CARB's Phase 3 rulemaking a number of other refiners had patent applications pending which related to reformulated gasoline and the refiners never told CARB about them. (*E.g.*, CX 7075 (Wood, Dep. at 16-17, 36, 38-41, 44-45, 49-51, 56); Eizember, Tr. 3396-97; CX 7052 (Jacober, Dep. at 79-80, 82, 87-88)).

[26] None of the major refiners could recall even disclosing the existence of a patent or patent application to CARB in the context of its RFG rulemakings. (CX 7057 (Wood, Dep. at 12-13); CX 7047 (Hancock, Dep. at 295-300); CX 7067 (Toman, Dep. at 50); Eizember, Tr. at 3396-97; RX 7052 (Jacober, Dep. at 79-80, 82, 87-88)).

In adopting its Phase 3 RFG regulations in 1999, CARB did not modify the Phase 2 regulations to ease refiners' avoidance of Unocal's patents. CARB refused to act despite (1) awareness of the patents; and (2) refiner requests that it modify the regulations to make it easier to avoid the patents. (CX 2090 at 005). CARB refused to act because it believed that the Unocal royalty was "within the noise of normal price fluctuations." (RX 520 at 002; Eizember, Tr. 3293-94). Moreover, CARB's staff maintained that the Unocal patents were in "a state of flux," even though Unocal by that time had won a judgment of infringement on its '393 patent. (Venturini, Tr. 815-19). Further, CARB's focus during the Phase 3 rulemaking was on "obtain[ing] some additional benefits as part of this exercise, not just preserv[ing] existing benefits." (RX 711 at 001). The agency's objective was to increase the stringency of its regulations, not to ease patent avoidance.

Given CARB's refusal to act in the face of an adjudicated infringement of Unocal's '393 patent, CARB would not have enacted different regulations based on knowledge that Unocal had merely applied for a patent. It strains credulity to believe that CARB would have accorded the patent a greater chance of being valid when it was in the form of an application than it did after the patent had issued. That credulity must be stretched far beyond the breaking point when it is understood that all of Unocal's patent claims had been rejected at the time of adoption of the Phase 2 RFG regulations. (CX 1788 at 215).

d. <u>The requisite ability to determine causation is not present</u>

The Commission's opinion cites "[d]ifferences in the ability to establish a causal link between petitioning conduct and an ensuing governmental action" as a distinguishing factor between political and "non-political" environments. (Op. at 35). The opinion also recognizes that "any rule regarding petitioning based on misrepresentation must be fashioned and applied with care, so as not

to undermine principles of federalism and effective government decision making." (*Id.* at 21). In particular, the ability to determine causation cannot rely on "deconstruction of the governmental process and probing of the official intent." *Omni*, 499 U.S. at 377.

The difference between the CARB rulemaking and adjudicative proceedings in which causation can be traced from the misrepresentation to the subsequent governmental action is apparent from a comparison with the cases cited in the Commission's opinion. The Certificate of Need ("CON") determination in *Kottle*, for example, was based on written findings prepared by the administrative hearing officers. 146 F.3d at 156 (written findings "must issue following the hearing"). In CON proceedings, certain facts are outcome-determinative. The misrepresentation at issue in *Kottle* went directly to an outcome-determinative fact—the need for additional kidney dialysis services in the location. In *Cheminor*, the court reviewed the written opinions of the Commissioners of the International Trade Commission for evidence concerning the factors that led individual Commissioners to vote as they did. *See* 168 F.3d 119, 126-27 (3d Cir. 1999).[27] In contrast, where tracing the reasons for a governmental decision "would require the district court to investigate the considerations motivating the [agency's] decision," that is impermissible under *Noerr*. *Hedgecock v. Blackwell Land Co.*, 1995 Trade Cas. (CCH) 70,960, 1995 U.S. App. LEXIS 8027 at *9 (9th Cir. 1995). *See Sessions Tank Liners, Inc. v. Joor Manufacturing, Inc.*, 17 F.3d 295, 300 (9th Cir. 1994) (improper to inquire into "what factors prompted the various governmental bodies to erect the anticompetitive barriers at issue"); *Santana Prods. v. Bobrick Washroom Equip., Inc.*, 249 F. Supp. 2d 463, 489 (M.D. Pa. 2003) (same).

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[27] Moreover, "*Cheminor* did not hold that misrepresentations undermine a *Noerr-Pennington* defense." *Santana Prods. v. Bobrick Washroom Equip., Inc.*, 249 F. Supp. 2d 463, 491 (M.D. Pa. 2003).

Walker Process and *Nobelpharma AB v. Implant Innovations*, 141 F.3d. 1059 (Fed. Cir. 1998), also cited by the Commission, involved proceedings before the Patent and Trademark Office, which compiles an extensive written record culminating with a notice of allowance of claims. The misrepresentations in each case went to an unambiguously outcome-determinative fact. In *Walker Process*, it was whether the patented technology had been incorporated into product sold commercially more than one year before the patent application. In *Nobelpharma*, it was the failure to disclose the best method of practicing the invention. Both the existence of sales more than a year prior to the application (35 U.S.C. § 102(b)) and the failure to disclose the best method (35 U.S.C. § 112) are absolute bars to patentability.

These situations are far different from the circumstances of the CARB Phase 2 RFG rulemaking. As discussed earlier, CARB board members had substantial political and policy-making discretion to adopt Phase 2 regulations. Their substantive decisions did not automatically or predictably flow from certain factual information required to be submitted by rulemaking participants. In fact, Unocal and other refiner-participants were not required to submit *any* particular information, and, specifically, were not asked by CARB or CARB staff to disclose the existence of patents or patent applications that might have a bearing on the regulations. There is also no written record establishing why CARB members voted for the Phase 2 regulations and the factors they considered in reaching their respective decisions. *Cf. Cheminor*, 168 F.3d at 126-27. Moreover, the Final Statement of Reasons for Rulemaking prepared by CARB staff contains not even a hint that CARB considered patent rights to be relevant to its rulemaking.

Deconstruction of the reasons for CARB's actions inevitably leads to conflict between the testimony of one CARB witness and another on the same subject and between the testimony of a

CARB official and CARB's official explanation for its actions. The official record, of course, shows that CARB never communicated to any rulemaking participant the need to disclose patents. CARB lawfully may only impose requirements on third parties by clearly communicating them in writing. (CX 7029 at 070 (section 11347.5(a)). Thus, deconstruction of CARB's decisionmaking necessarily entails disregarding the agency's official pronouncements and relying on the assertions of agency officials years after the fact.

The dangers of deconstruction are even more pronounced when Complaint Counsel's witnesses express disagreement with the official pronouncements of the government agency for which they work. Thus, CARB's official Final Statement of Reasons for Rulemaking for the Phase 2 RFG regulations states that "[t]he Board has concluded that the federal reformulated gasoline regulations are not sufficient to meet the requirements of the California Clean Air Act." (CX 10 at 178). By contrast, the lynchpin of Complaint Counsel's case is Mr. Venturini's claim that CARB would have abandoned its Phase 2 RFG rulemaking and relied instead on the federal regulations to satisfy these requirements had it known of Unocal's patent application. (*See* Venturini, Tr. 787-88). Moreover, although CARB listed all of the alternatives to RFG that it considered prior to proposing the Phase 2 RFG regulations, Mr. Venturini's option is not even listed among those. (CX 5 at 163-165).

Mr. Venturini's testimony highlights the problem with the deconstruction of CARB's decision that is at the heart of Complaint Counsel's case. It requires this Court to disregard the agency's official explanation for its decision and substitute for it the self-serving speculation of an agency official more than a decade later. Moreover, crediting Mr. Venturini's testimony exposes another problem. If CARB truly would have adopted the federal regulations in spite of concluding

that they were insufficient to meet the applicable legal requirements, it follows that CARB's discretion was wholly unfettered. And if an agency with the unfettered discretion to do as it wishes is not a political institution, it is difficult to conceive of what would be one.

2. Nature of the communication: Unocal's alleged misrepresentations do not meet the criteria for a non-protected communication

The "political" character of the Phase 2 rulemaking under the Commission's test is sufficient by itself to establish Unocal's immunity. Under the Commission's test, moreover, several additional showings must be made regarding the nature of the challenged communications before *Noerr* protection can be lost. First, a misrepresentation or omission must be deliberate, knowing, and willful; second, it must relate to specific, verifiable facts; and, third, it must be "central to the legitimacy of the affected governmental proceeding" in the sense that it must have caused or affected the outcome of the proceeding. (Op. at 36, 42, 43). Complaint Counsel failed to establish that Unocal's alleged misrepresentations meet any of these essential conditions.

a. The alleged misrepresentations are not deliberate, knowing and willful

The Commission recognized that "[t]here is no policy ground to impose antitrust punishments on those who make innocent errors in their dealings with governments. Without knowing falsity, moreover, there would not be the 'abuse' of government process that is the key to ousting *Noerr* . . . ." (Op. at 36 (citing I ANTITRUST LAW 203f1, p. 174). Here, there is no factual basis to conclude that Unocal made any misrepresentations, much less that any such statements were deliberate, knowing and willful, as the Commission's standard requires.

(1) Unocal made no false or misleading statements or omissions to CARB or members of Auto/Oil and WSPA

As noted above, the centerpiece of Complaint Counsel's misrepresentation allegation is Mr. Lamb's August 27, 1991 letter to James Boyd at CARB. (CX 29). But every statement in this letter is absolutely true (Lamb, Tr. 2233-36), and Complaint Counsel did not dispute this at trial. (*E.g.*, Venturini, Tr. 723).

Instead of arguing that any part of Mr. Lamb's letter is false, Complaint Counsel appear to be contending the August 27, 1991 letter created "the materially false and misleading impression that Unocal agreed to give up any competitive advantage it may have had relating to its purported invention and arising from its emissions research results." (Complaint ¶ 42). But the letter itself says nothing about any inventions. It does not speak to competitive advantage, royalties, licenses, patents, or patent applications. Just as the letter's topic sentence heralds, each line of this letter speaks to one topic and one topic only: the "PUBLIC AVAILABILITY OF UNOCAL RESEARCH DATA." (CX 29).

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

What should be self-evident from this letter is that the "data" which Unocal is making publicly available in the third paragraph is the "data base" specifically referred in the second paragraph of the letter as having previously been made available to CARB staff. The author of the

letter, Mr. Lamb, testified that word "data base" in that sentence referred to the underlying data base of vehicle data, fuels data and emissions results for the 5/14 project. (Lamb, Tr. 2234-35). This data base had been provided on a disk to CARB by Dr. Jessup some time in late July. (Jessup, Tr. 1537-38; CX 1247). When Mr. Lamb stated that he "agreed to make the data public," the data to which he was referring was the previously described data base. (Lamb, Tr. 2235). Likewise, when Mr. Lamb stated in the last paragraph that Unocal considers the "data to be non-proprietary" he was referring again to this same data base that had previously been provided to CARB. (Lamb, Tr. 2236).

The context in which this data base and letter was given to CARB makes it crystal clear that Unocal's August 1991 letter had nothing to do with inventions or patent rights—and that no one ever thought that it did. CARB wanted to use Unocal's data in the development of the predictive model. (Venturini, Tr. 718). But when the data base had originally been sent to CARB, it was accorded confidential treatment. (Venturini, Tr. 719-20 (testifying that that disk was confidential before Mr. Dennis Lamb sent his August 27, 1991 letter)). CARB could not use confidential information in its rulemakings. (Venturini, Tr. 233; Fletcher, Tr. 6469). So, "in order to insure that the predictive model is as well founded as possible" Unocal decided to "waive its rights to confidentiality of the 514 project data." (CX 266 at 004). And thus, Mr. Lamb sent the letter, telling CARB that the data base that Unocal had previously provided to CARB was now "non-proprietary and available to CARB, environmental interest groups, other members of the petroleum industry, and the general public upon request." (CX 29).

Significantly, there was no competent evidence at trial from the CARB witnesses that they understood Mr. Lamb's letter to mean anything other than that Unocal was allowing CARB to use and publicly share the data disk it had previously sent to CARB. For instance, Mr. Venturini

testified that at the time CARB received the letter, "the thought did not occur" to him that it had anything to do with patent rights. (Venturini, Tr. 821-22). Mr. Boyd, the CARB staff member to whom the letter was addressed, testified that CARB had learned that Unocal had performed a scientific study and was interested in acquiring the data from this study. (Boyd, Tr. 6710-11). Mr. Boyd recalled that Unocal originally had deemed its data to be confidential, but that he learned at some point "that Unocal intended to make that data available, that a letter and the data were coming to the agency. And ultimately I was informed that the letter had arrived." (Boyd, Tr. 671-12). And Ms. Jananne Sharpless—the only CARB Board member to testify in this action—did not even recall reviewing the August 27, 1991 letter. (CX 7063 (Sharpless, Dep. at 25)).

Complaint Counsel have also stated that Unocal's alleged statement to Auto/Oil that its data was "in the public domain" was also misleading. (Complaint ¶ 2(a)). Complaint Counsel's fraud claim with respect to Auto/Oil centers on a statement in the minutes of an Auto/Oil meeting: "Mr. Jessup explained that the data from Unocal's research has been provided to CARB and is in the public domain." (CX 4027 at 010 (referred to in Dr. Jessup's testimony as CX 291 at 010)). The minutes were written by an antitrust lawyer for Auto/Oil and—although Dr. Jessup does not believe he used the phrase "public domain" (Jessup, Tr. 1546)—there is nonetheless nothing false about this statement.

Dr. Jessup's September 1991 presentation to the Auto/Oil Group was similar to the presentations Unocal had previously made to CARB and WSPA regarding Unocal's emissions research. (Jessup, Tr. 1300, 1543-44; CX 4028 (referred to in Dr. Jessup's testimony as CX 248)). At the presentation, Dr. Jessup offered to make Unocal's data disk available. (Jessup, Tr. 1546; Klein, Tr. 2551; Segal, Tr. 5629-30). Mr. Mallett, a former Unocal employee, recorded in his notes

from this meeting that Dr. Jessup had "offered our data to Auto/Oil and to all members." (CX 7055 (Mallett, Dep. at 34-35); CX 293 at 001). Mr. Mallet added that, "Peter will send data disk to those who give him business cards." (CX 7055 (Mallett, Dep. at 34-35)).

The evidence at trial demonstrates that the disclosure of data relating to a research project does not create a duty to disclose that a company has filed for a patent application on any invention relating to that research. Public disclosure of data and research results frequently takes place *after* a patent application is filed without any indication that a patent has been applied for on inventions related to such research results or data. (Linck, Tr. 7783-84; RX1163 at 010). Likewise, Professor Teece testified that it simply is not reasonable to infer anything about the existence of patent rights from a company's agreement to make data available or to publish research results. (Teece, Tr. 7531, RX 1162A at 014, 077-078).

Testimony from the refiners confirmed this common practice. ARCO has filed patent applications, and then published papers on the research without revealing the existence of its patent applications to the public. (CX 7075 (Wood, Dep. at 15-16)). Chevron disclosed to CARB its Driveability Index research, lifted the confidentiality of that research so CARB could discuss it publicly, published an SAE paper regarding the results of that research and never disclosed to anyone that it applied for a patent on what it believed were inventions relating to this research. (*See*, *e.g.*, Ingham, Tr. 2624, 2667-70, 2680-88, 2708; CX 7071 (Welstand, Dep. at 28, 32-39, 43-45, 50-54, 74, 78-85; CX 7042 (Bea, Dep. at 36, 40); CX 7067 (Toman, Dep. at 50)).

Although there was testimony at trial relating to the various potential meanings of the word "non-proprietary,"[28] regardless of whether the word is understood to mean "non-confidential" (as Mr. Lamb intended),[29] or as a relinquishment of ownership rights, Mr. Lamb's statement that the data was non-proprietary was true. Unocal did not patent either its data or its equations, nor could it have, since neither data nor equations can be patented. (Linck Tr., 7752; RX 1163 at 004). Unocal has never charged CARB or any one else for the use of its data. (Lamb, Tr. 2238-39). ARCO's Mr. Clossey admitted that his company had received a data disk from Unocal, that ARCO used the data to do its own evaluation, and that Unocal did not charge ARCO for their use of this data. (Clossey, Tr. 5380-81, 5450, 5458).

Moreover, even if Mr. Lamb's reference to "data" in the August 27, 1991 letter were read to mean something other than the raw data which Unocal had provided to CARB on a diskette in late July 1991, it could not possibly be read so broad as to include patent claims, which Unocal never shared with anyone other than the Patent and Trademark Office. Both the August 27, 1991 letter (CX 29), and the Auto/Oil September 1991 minutes (CX 4027), make it clear that the data, which is being referred to as "non-proprietary" and "in the public domain," is data *that has previously been shared with CARB.*[30] Unocal never shared with CARB (or Auto/Oil or WSPA) any of the combinations of property ranges of motor gasoline that are claimed in Unocal's patents. (Jessup, Tr.

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[28] (*See, e.g.*, Venturini, Tr. 341-43; Boyd, Tr. 6839; Eizember, Tr. 3117-18).

[29] (Lamb, Tr. 2238).

[30] (*See* CX 29 ("We subsequently made *the data base* available to the staff and agreed to make *the data public* if necessary in the development of a predictive model for use in the certification of reformulated gasoline") (emphasis added); CX 4027 at 010 ("Mr. Jessup explained that *the data from Unocal's research has been provided to CARB* and is in the public domain.") (emphasis added)).

1576). There is thus no basis to infer from the truthful statements that Unocal's data was "non-proprietary," "in the public domain," and "publicly available" that Unocal had no inventions or patent applications on those inventions.

Finally, the Complaint alleges that Unocal's statements about the cost-effectiveness and flexibility of the predictive model were misleading because Unocal did not disclose that it had a patent application and might some day charge royalties. (Complaint ¶ 2(b)). This allegation fails for many reasons.

First, statements about the likely cost-effectiveness of a proposed regulation are paradigmatic of *Noerr*-protected statements to the government. Whether a particular regulatory approach is cost-effective is every bit as political a statement as whether a particular tax policy stimulates or fails to stimulate economic growth. As Professor Elhauge observes, statements "that environmental regulation imposes either high or low economic costs" are fundamentally "political statements." Einer Elhauge, *Making Sense of Antitrust Petitioning Immunity*, 80 CAL. L. REV. 1177, 1224 (1992). As CARB's own Final Statement of Reasons for its Phase 3 RFG rulemaking—conducted pursuant to the same statute—states, the economic feasibility of regulations "is more of a policy or political question than a scientific one." (RX 64 at 009). And, as Professors Areeda and Hovenkamp observe in this regard, antitrust courts "should not review the 'truth' of arguments or general statements about the world[,]" such as assertions about "the economic effects" of a regulatory program. I ANTITRUST LAW 203f2, p. 175.

Second, even if such broad opinion statements regarding "cost effectiveness" and "flexibility" could serve as the basis of an actionable misrepresentation in this context, these statements were true when Unocal said them and remained true even after the CARB and the

industry knew that Unocal had a patent and intended to license its patent. (*See*, *e.g.*, Simonson, Tr. 6002; RX 565 at 009; CX 54 at 002, 007, 013; CX 53 at 053).

(2) <u>There is no evidence that Unocal's statements and omissions were a willful and deliberate attempt to mislead CARB or members of Auto/Oil and WSPA</u>

Just as Complaint Counsel failed to proffer any evidence to show that Unocal's statements were untrue or misleading, they also failed to show that any statements or omissions made by Unocal were done so with a knowing, willful or deliberate intent to mislead. The testimony of Unocal witnesses, together with Unocal's own contemporaneous internal documents, confirm that Unocal never intended to mislead any one.

(a) <u>In the August 1991 letter, Unocal intended to waive the confidentiality of its data base for the development of the predictive model</u>

Unocal's contemporaneous memoranda from August 1991 unambiguously show what Unocal intended in the August 27, 1991 letter. A memorandum summarizing an internal strategy meeting that took place five days before the letter states: "In order to ensure that the predictive model is as well-founded as possible, Unocal will send CARB a waiver to release the 514 project emissions data." (CX 266 at 004; Lamb, Tr. 2231-32; Miller, Tr. 1445).

And just one day after he sent the August 27, 1991 letter, Mr. Lamb wrote to Mr. Beach that "[w]e have agreed to make our 5/14 data public in order for CARB to use it at the workshop and in technical justification for the model." (Lamb, Tr. 2263; CX 1755 at 001). These two internal memoranda from August 1991 demonstrate conclusively that all Unocal intended by its August 27, 1991 letter was to release the confidentiality of its data so CARB could use it in the development of a predictive model.

Mr. Lamb testified that when he wrote the August 27, 1991 letter, he had no intent to mislead anyone at CARB. (Lamb, Tr. 2262). The testimony of other Unocal witnesses is consistent with these two internal memoranda. (*See*, *e.g.*, Beach, Tr. 1768-69; Kulakowski, Tr. 4425; Miller, Tr. 1439-40).

(b) Unocal did not intend for CARB to adopt regulations that overlapped with its patent claims

The Complaint alleges that Unocal's alleged misrepresentations "caused CARB to adopt Phase 2 RFG regulations that substantially overlapped with Unocal's concealed patent claims." (Complaint ¶ 45; *see also* ¶ 76). But the overwhelming evidence shows that Unocal did not deliberately, knowingly or willfully intend for CARB to adopt regulations that overlapped with Unocal's patent claims.

Unlike others such as ARCO—who argued that CARB should mandate certain formulations of gasoline with specific properties—Unocal never advocated to CARB any specific set of formulations, much less formulations that fell within any of its patent claims. (Kulakowski, Tr. 4608; Lamb, Tr. 2223-24).

Unocal's Phase 2 CARB advocacy strategy was motivated by a concern for the operations of its refining business. (*See* Beach, Tr. 1761-62). Mr. Lamb and Mr. Beach decided in October 1990 that Unocal would not go to CARB to advocate a fuel formula based on Unocal's 5/14 research. (CX 194, Lamb; Tr. 2188-93; Beach, Tr. 1755-57). As Mr. Beach testified: "That was absolutely something we were not going to do." (Beach, Tr. 1755). The evidence showed that Unocal never wavered from this approach.

In its June 1991 meeting with CARB, Unocal had a three point agenda of what it hoped to convince CARB: "Avoid Rules Overlap," "Adopt Predictive Model," and "Avoid RFG O2 mandate." (Lamb Tr. 2220-22; CX 24 at 001). Unocal did not advocate at that meeting that CARB adopt a T50 specification and regulation, nor did Unocal advocate to CARB that CARB should adopt any specific set of parameters. (Lamb, Tr. 2223-24). Indeed, CARB staff member Mr. Peter Venturini admitted on cross-examination that Unocal's slide presentation to CARB did not include a single reference anywhere indicating that caps or limits on T50 must be put into the regulations as a result of Unocal's research. (Venturini, Tr. 730-31). No CARB staff or board member testified that Unocal ever advocated in favor of any fuel formula or any particular set of specifications.

Former Unocal scientist, Dr. Wayne Miller, confirmed that Unocal's disclosure of research to CARB was not intended to further Unocal's license or patent strategy. (Miller, Tr. 1450). Mr. Michael Kulakowski, a former Unocal employee who now works for Texaco, further admitted that neither the patent application nor licensing was a priority at the time of Unocal's meeting with CARB. (Kulakowski, Tr. 4603). In fact, at no point in time did Unocal ever advocate that CARB adopt a particular set of parameters as its regulation. (Lamb, Tr. 2223-24).

At the November 1991 Board meeting, Unocal opposed the Phase 2 specifications as a whole. (CX 10 at 023-024 (list of commenters supporting regulation does not include Unocal)). Unocal told CARB that the Phase 2 specifications were not necessary, and were not cost effective. (CX 33 at 002, 019-020; Lamb, Tr. 2308-10, 2274; Boyd, Tr. 6786; CX 7065 (Stegemeier, Dep. at 136-37); CX 7063 (Sharpless, Dep. at 93, 99). With respect to the regulations of specific parameters, Unocal opposed or critiqued the CARB's proposed regulation of RVP (CX 33 at 007-009), T90

(CX 33 at 009), sulfur (CX 33 at 009-010), oxygen (CX 33 at 010-011), olefins (CX 33 at 011-012), aromatics (CX 33 at 012-013), benzene (CX 33 at 014), and T50 (CX 33 at 016).

All of these arguments Unocal made were directly against the interest of maximizing the benefit to its potential patent portfolio. This can by shown most dramatically by the following comparison: After several of Unocal's patents issued, the major California refiners began approaching CARB to seek relaxation of the regulations in various ways to make it easier for them to make gasoline outside the Unocal patents. These proposals by the refiners—such as relaxing various caps—are all proposals that Unocal had advocated for *before* the regulations were adopted.

For example, several of the refiners argued to CARB that the cap on olefins should be raised so that they could avoid Unocal's patent claims. (*E.g.*, RX 553 at 001-002; {[redacted]}, *in camera*). But Unocal had told CARB in November 1991 that olefins were a costly parameter to control and that neither the Staff Report nor the Technical Support Document supported the necessity of controlling or reducing olefins. (CX 33 at 011).

Several refiners argued that the cap on T50 should be raised. (*E.g.*, CX 7045 (Cleary, Dep. at 195); CX 7049 (Hochhauser, Dep. at 91-92, 99-100); RX 552 at 006). But in November 1991, Unocal had told CARB that it agreed with WSPA that T50 should be eliminated: (Lamb, Tr. 2304-06; CX 774 at 045; RX 552 at 006) ("There's very limited things you can do to change T50 . . . [w]e don't see the spec for T50 as necessary." (*See also* CX 33 at 016; Lamb, Tr. 2298).

Others argued in favor of relaxing aromatics limits. (*E.g.*, RX 552 at 006; {[redacted]}, *in camera*). In November 1991, Unocal had criticized CARB staff for not looking at Unocal's study, which showed that aromatic content of gasoline does not affect tailpipe emissions. (CX 33 at 012-013).

At least three refiners asked CARB to "flatten" the T50 response curve, to more closely resemble the EPA complex model. (Eizember, Tr. 3280-81; { }, *in camera*). Unocal had argued unsuccessfully to WSPA in favor of the EPA model. (Kulakowski, Tr. 4642).

And, of course, Unocal opposed all caps in the predictive model. Although Unocal was strongly in favor of a predictive model, Unocal opposed a model with caps on fuel parameters. Unocal expressed this concern in June 1991 to CARB staff. (Lamb, Tr. 2222-23 (Unocal told CARB it opposed unnecessary minimums and maximums in the model)). In November 1991, Unocal told the Board that caps in the predictive model "could eliminate the model as a viable alternative." (CX 33 at 006; Lamb, Tr. 2295-96; Beach, Tr. 1775). After the November hearing, Unocal continued to oppose the inclusion of caps in a predictive model. (Lamb, Tr. 2311-14; CX 42 at 005). And even after the '393 patent issued Unocal argued in favor of an unbounded predictive model. (RX 159 at 037; Jessup, Tr. 1485-93).

In addition, Unocal advocated repeatedly to CARB that the regulations should not go into effect until at least four years from the date on which a predictive model was adopted. (RX 774 at 020-022 (Dennis Lamb testifying on behalf of Unocal)). For every month in delaying the development of the model, Unocal requested that the compliance date for the Phase 2 regulations should be deferred by one month. (CX 33 at 002, 006; Lamb, Tr. 2294; Beach, Tr. 1774). CARB's Executive Officer, James Boyd, recalled that Unocal continued to draw attention to the need for delay in the implementation of the Phase 2 regulations until a predictive model was adopted. (Boyd, Tr. 6774, 6787).

Unocal's consistent advocacy in favor of proposals that would have minimized its ability to exploit its potential patent claims conclusively shows that Unocal did not willfully, knowingly, and deliberately seek to mislead CARB into adopting regulations that overlapped with it potential patents.

(c) **Because there was no duty to disclose its patent application, Unocal's omission cannot be a knowing, willful and deliberate intent to mislead**

Well-established fraud principles recognize that a failure to disclose can give rise to liability only where there is a clear duty to disclose. Moreover, if a duty to disclose is in any way unclear or ambiguous, a failure to disclose cannot as a matter of law constitute acting "with deceptive intent." *OddzOn Prods., Inc. v. Just Toys, Inc.*, 122 F.3d 1396, 1404 (Fed. Cir. 1997).

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

Complaint counsel have not established that Unocal had any duty to disclose the fact of its pending application to CARB, Auto/Oil or WSPA. It is undisputed that CARB never asked Unocal about whether it had any pending patent applications. (Venturini, Tr. 395; Lamb, Tr. 2260). CARB

had no regulation, guideline, criterion, bulletin, manual, instruction, order, standard of general application or other rule requiring such disclosure. (Kenny, Tr. 6518, 6592; Boyd, Tr. 6834). There was no place for Unocal to find any written indication that CARB expected disclosure of a patent application. (Boyd, Tr. 6908).

Indeed, Mr. Lamb was not aware of any CARB policies or procedures or rules that required Unocal to disclose information about patents or pending patent applications to CARB. (Lamb, Tr. 2260). In fact, during the entire eight-year period in which Mr. Lamb had direct responsibility for communicating with CARB on behalf of Unocal, Mr. Lamb was never aware of CARB asking anyone about patents or patent applications. (Lamb, Tr. 2260-61).

Unocal, like many other companies,[31] had a policy of treating pending patent applications as confidential. (Beach, Tr. 1769; Miller, Tr. 1433, 1435). Mr. Lamb testified that it simply never occurred to him to tell CARB about Unocal's patent application. (Lamb, Tr. 2242).

CARB's Mr. Boyd admitted that he does not know if he would have expected a patent application to be brought to CARB's attention, if he would have even wanted to know about a patent application at the time, or if he would have kept the patent application confidential if Unocal had told him about it. (Boyd, Tr. 6821-24; 6887). Further, CARB recognized that federal patent law allowed Unocal to keep its application secret (CX 895A at 002; Kenny, Tr. 6599) and, therefore, any requirement or duty Complaint Counsel have identified would conflict with CARB's own understanding of the law.

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[31] (*E.g.*, CX 7056 (Martinez, Dep. at 81); CX 7064 (Sinclair, Dep. at 42-43); (CX 7067 (Toman Dep. at 29-30); CX 7075 (Wood, Dep. at 11-12, 19-20)).

In addition, CARB, Auto/Oil, WSPA, and Unocal all had antitrust compliance policies addressing the discussion of competitively sensitive issues such as patent applications, future business plans, prices and costs. Mr. Simeroth testified that CARB staff was advised to avoid questions about competitiveness between companies, such as their anticipated prices and what mechanisms they would use to set prices. (Simeroth, Tr. 7487-88). WSPA's Gina Grey testified that WSPA had " very strict antitrust counsel guidelines and business strategy is one of the items we typically do not discuss." (CX 7046 (Grey, Dep. at 50-51)). These guidelines "discouraged any discussion of patents or any other pricing or supply issues relating to our companies." (CX 7046 (Grey, Dep. at 55-56)). Likewise, Auto/Oil members were told that they should not discuss commercial plans that their company may have or discuss anything else relating to commercial production, marketing or pricing. (Klein, Tr. 2521; CX 4022 at 002-003; CX 7073 (Wise, Dep. at 26-27); Segal, Tr. 5653). This prohibition against discussing competitively sensitive material was deeply ingrained in the members from working in a competitive environment. (CX 7073 (Wise, Dep. at 26-27)).

Individuals representing Unocal understood that they should not discuss competitively sensitive information such as patent applications or pending business plans with their competitors. Dr. Croudace, for example understood he was prohibited from discussing "[a]nything that would be dealing with how we make our products in the refineries, what our cost structure is, patents, patent pending, anything that is really exclusive to us." (Croudace, Tr. 604-05; *see also* Lamb, Tr. 2264-65; Kulakowski, Tr. 4625-26). Dr. Jessup testified that he didn't tell his competitors about Unocal's pending patent application because in his understanding it would not have been appropriate and

topics such as pending patents were never discussed when competitors met. (Jessup, Tr. 1483). No one at Auto/Oil asked Dr. Jessup about patents or patent applications at any time. (Jessup, Tr. 1595).

In short, CARB never asked about pending patent applications. It had no rules requiring such disclosure. Unocal itself had internal policies that prohibited it from discussing competitively sensitive information (such as patent applications). Auto/Oil and WSPA had similar policies regarding the discussion of competitively sensitive material among their members, and these policies were well understood and vigorously enforced. Since the only "duty" that Unocal could possibly have understood was a duty *not* to disclose, as a matter of law, it did not have the requisite knowing, willful, and deliberate deceptive intent when it did not disclose its patent application to CARB, WSPA, and Auto/Oil.

b. The alleged misrepresentations do not involve "sharply defined facts" and are not "clear and apparent"

The Commission next requires the challenged misrepresentation to be "subject to factual verification." (Op. at 36). To be actionable, the Commission makes clear that "the falsity must be clear and apparent with respect to *particular* and *sharply defined* facts." (*Id.* (citing I ANTITRUST LAW 203f2, p. 175 (emphasis added)). If the misrepresentation is not "clear and apparent" or involves opinion, argument or generalized statements, then there is no basis for depriving a petitioner of *Noerr* protection. Again, such is the case here.

The Complaint alleges that by representing that certain data was "non-proprietary," Unocal implied that it did not have, or did not intend to assert, any patent rights. (Complaint ¶¶ 2, 41, 48, 58, 78, 84). But the August 27, 1991 letter, which Complaint Counsel claims gives rise to the alleged misrepresentation, refers only to a specific, tangible item: a computer disk containing data

from one of Unocal's emissions projects that Unocal had previously given to CARB. Because Unocal had previously told CARB that the data contained on this disk was confidential, Unocal lifted that confidentiality so that CARB could incorporate the data in a large data base it was compiling in conjunction with its development of its predictive model. That is all the letter says, that is all Unocal intended, and that is all CARB understood it to mean.

As noted above, to turn this letter into a fraudulent misrepresentation about the status of patent rights requires that Complaint Counsel completely ignore the plain language of the letter, the context in which it was written and received, and the common and well understood use of non-proprietary to mean non-confidential. Moreover, it requires that Complaint Counsel interpret the words "data" and "data base" (which the letter says was provided to CARB subsequent to the June 20 meeting) to mean any and all of Unocal's inventions relating to its emissions research—inventions which were never disclosed to or even ever discussed with CARB.

Similarly, when Dr. Jessup gave a presentation to Auto/Oil and told members that he would send them a copy of the data if they wanted one, he was referring to a tangible diskette containing a data base. (*See* CX 7055 (Mallett, Dep. at 34-35); CX 293 at 001) ("Peter will send data disk to those who gave him business cards."). Regardless of the precise accuracy of the Auto/Oil attorney's minutes noting that "Mr. Jessup explained that the data from Unocal's research has been provided to CARB and is in the public domain" (CX 4027 at 010), it is clear from all the competent evidence that the references to "data" or "data disk" refers to a specific item that had previously been shared with CARB and that would be sent to Auto/Oil members upon request.

In its Complaint and at trial, Complaint Counsel repeatedly sought to take the verbiage contained in Unocal's letter of August 27, 1991 out of context so as to argue that when Unocal used

the word "data," it referred to not only data, but presentation slides and equations (which Unocal shared with CARB under an agreement of confidentiality) and Unocal's novel compositions of motor gasoline claimed in the patents (which were never disclosed to CARB). Unocal's August 27 letter is straightforward and unambiguous. But to the extent there is any confusion at all about what was meant in the communications between Unocal and CARB in the summer of 1991, this is the result of CARB's failure to follow its own internal procedures on handling confidential information and CARB's own violation of California statutes regarding what an agency must do if it requests a release of confidentiality.

A memorandum from Mr. Dean Simeroth, dated February 13, 1991, sets forth the procedure by which CARB staff were supposed to handle confidential information. (RX 266; Courtis, Tr. 5921). The memo states that each page of the specified material is to be stamped "confidential." (Courtis, Tr. 5922; RX 266). Mr. Courtis knew the entirety of Unocal's June 20, 1991 presentation slides was confidential. (Courtis, Tr. 5922-25). But the word "confidential" was handwritten on only two pages and not stamped or written on any of the remaining pages. (CX 24; Courtis, Tr. 5922-24). The two pages CARB copied for its Technical Support Document were not the two pages bearing a "confidential" designation. Had CARB complied with its own internal policy, it would have necessarily had to deal with physically removing the "confidential" stamp or requesting that Unocal provide them with a copy not stamped "confidential." Either scenario would have necessarily brought evidentiary clarity to what CARB was requesting—the removal of confidentiality of a specific page or pages from the presentation slides. Any lack of evidentiary clarity for what was requested or given thus falls on CARB, not Unocal, because of this lack of compliance with CARB's internal procedures.

But CARB did more than just fail to follow its own internal policy on confidentiality. CARB admittedly failed to follow California law on how a state board must request a release of confidentiality. Section 91011, Title 17, California Code of Regulation (RX 1183) sets forth requirements for disclosure of public records, which Mr. Courtis admitted he was required to follow as a CARB staff member. (Courtis, Tr. 5796-98, 5920; RX 1183 at 007-008). RX 1183 contains "Article 3. Inspection of Public Records," which addresses the treatment of confidential information that is submitted to CARB. (RX 1183 at 008; Courtis, Tr. 5920). That section requires, in pertinent part, that if a state board itself seeks to disclose confidential data, the state board must inform a designated individual by telephone and by mail that disclosure of the data is sought. (RX 1183 at 008 (§ 91022(b))). Mr. Courtis knew that under circumstances where the Air Resources Board itself wanted to disclose confidential data, it had to inform an individual by telephone and by mail. (Courtis, Tr. 5921; RX 1183 at 008).

Mr. Courtis admitted that he did not send Unocal a letter as required by law to declassify the asserted confidential material. (Courtis, Tr. 5933-34). Neither CARB nor Mr. Courtis gave Unocal notice by mail of its desire that Unocal release the confidentiality of any material or information presented at or subsequent to the June 1991 meeting between Unocal and CARB. (Courtis, Tr. 5933-34; RX 1183 at 008). Additionally, neither Mr. Courtis nor CARB sent any letter to Mr. Lamb stating the purpose for which CARB wanted the confidentiality released. (Courtis, Tr. 5939; RX 1183 at 008). Nor did Mr. Courtis send Unocal a letter requesting that Unocal release confidentiality of information presented at the June 20, 1991 meeting between Unocal and CARB. (Courtis, Tr. 5769-70).

As admitted by Mr. Courtis, had he sent the required letter setting forth what information CARB wanted to use, the letter would have shown exactly what words were actually used in requesting the release of confidentiality, rather than having Mr. Courtis depend upon his memory many years after the events took place. (Courtis, Tr. 5939). To the extent there is any evidentiary vagaries regarding what Unocal's August 27, 1991 letter refers to, such lack of clarity is the direct result of CARB's failure to follow state law. Attempting to transform a telephone conversation from 14 years ago into the sharply defined facts required to establish fraud—when it is the complaining agency that has failed to follow its own procedures and has violated state law—cannot be countenanced.

On these facts, Complaint Counsel did not establish actionable misrepresentation. They failed to show the requisite "clear and apparent" fraud with respect to a "clear and sharply defined fact" necessary to vitiate Unocal's *Noerr* protection.

The Complaint also asserts that Unocal's contention that a "predictive model" is "cost-effective" and "flexible" is false because of the failure to disclose that Unocal would charge a royalty if a patent issued. (Complaint ¶¶ 2(b), 2(c), 37, 46, 48, 57, 79). But Unocal's statements about the comparative cost-effectiveness and flexibility of a pure predictive model are unquestionably opinions or arguments as well as incontestably true and correct. They are not misstatements regarding "particular and sharply defined facts," as the Commission's opinion requires. And, as shown above, the opinion expressed by Unocal was one with which CARB expressed agreement in its official capacity with full knowledge of Unocal's patents.

c. **<u>The alleged Unocal misrepresentation was not central to the legitimacy of the Phase 2 regulations</u>**

The final element relating to the nature of the relevant communication is described by the Commission as its centrality to the very legitimacy of the governmental action involved. (Op. at 36). By this, the Commission makes clear that the misrepresentation or omission must be a material cause of the governmental action—the impropriety must affect the outcome before the agency. (Op. at 36, 42-43).

Courts recognizing a misrepresentation exception in the adjudicative context similarly hold that only deliberate fraud which is so significant and material that it deprives the adjudicative proceeding of its legitimacy gives rise to an exception to *Noerr's* protection. *See Kottle*, 146 F.3d at 1063 (holding that vague allegations of misrepresentation to an administrative agency insufficient to overcome *Noerr* immunity); *Baltimore Scrap Corp. v. David Joseph Co., Inc.*, 237 F.3d 394, 402 (4th Cir. 2000) (noting that the Supreme Court has not approved a fraud exception to *Noerr* immunity, but any such fraud exception could extend only to the type of fraud that deprives the governmental action of its legitimacy). Alleged frauds that "do not infect the core" of a case will receive *Noerr* immunity because, regardless of the alleged fraud, the outcome would be the same. *Cheminor Drugs*, 168 F.3d at 123-24.

As an initial matter, the absence of any evidence in the rulemaking record of CARB's reliance on any alleged misrepresentation undercuts any notion that Unocal made a misrepresentation that was central to the legitimacy of the rulemaking. And the testimony of Jim Boyd, CARB's Executive Director at the time of the rulemaking, regarding the agency's reaction upon learning of the issuance of Unocal's '393 patent, leaves no doubt that Unocal did not make a misrepresentation

that was central to the rulemaking's legitimacy. Mr. Boyd testified that the word "dismayed" would be too strong a term to describe the reaction of CARB members upon learning of that patent. (Boyd, Tr. 6821). Similarly, Mr. Boyd testified that "mislead" was too strong a term to describe Unocal's conduct (Boyd, Tr. 6826-27), and that he didn't know whether he would have even wanted to know about the patent application at the time (Boyd, Tr. 6822-23). A "misrepresentation" such as this cannot be deemed central to the legitimacy of the process in which it was made.

The absence of even dismay is understandable given CARB's contemporaneous understanding of the propriety of Unocal's assertion of patent rights. Thus, a March 1995 internal CARB memorandum that examined the background of Unocal's acquisition of the '393 patent does not state anywhere that Unocal had done anything to mislead CARB. (CX 812). This would be a surprising omission if the Unocal action that is the subject of the memorandum had undermined the very legitimacy of CARB's rulemaking.

Other testimony by CARB officials similarly undermines any claim that Unocal's alleged misrepresentation infected the core of the proceeding. CARB officials understood Unocal's August 1991 letter to signify that Unocal's data could be made public and used in the development of a regulation. (Venturini, Tr. 821-22; Boyd, Tr. 6710-11; *see also* Lamb, Tr. 2254-55; CX 266 at 004). In addition, a CARB internal briefing paper from 1997 admits that federal law permits Unocal to keep its patent application, amendments, and issuance confidential. (CX 895A at 002). And upon learning of the issuance of Unocal's '393 patent, Mr. Boyd did not protest that Unocal had duped CARB. (Boyd, Tr. 6818). Instead, he asked Unocal for assurances that it would "not raise patent infringement issues" as to a reformulated gasoline test program that was then being conducted by CARB. (CX 50; Boyd, Tr. 6818). It is unthinkable that Mr. Boyd would have requested this

dispensation had he believed that Unocal had represented that it had no intellectual property rights bearing on RFG and had CARB relied on that representation.

In addition to this testimony, any claim by Complaint Counsel that the alleged misrepresentation was central to the legitimacy to the proceeding is undermined by Complaint Counsel's own theory of competitive harm. Complaint Counsel are not claiming that the representations caused CARB to adopt regulations that are less cost-effective than those that CARB would have adopted absent the alleged misconduct. According to Complaint Counsel's economic expert, Professor Shapiro, the harm in this case is not based on "assuming or concluding necessarily that CARB would have done any particular—that its regulations would have been different in any particular way if not for these representations." (Shapiro, Tr. 7166). Given that the alleged harm is not even predicated on the premise that CARB would have adopted different regulations but for the alleged misrepresentations, it is difficult to see how the alleged misconduct could have been central to the legitimacy of the proceeding.[32]

There is thus no competent evidence that Unocal's alleged misrepresentation was "material" to CARB's action and affected the outcome of the Phase 2 rulemaking as the Commission's decision requires, let alone that it infected the rulemaking's core.

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[32] Professor Shapiro acknowledged that "to talk about cause and even in the colloquial sense, the common-sense use of the word, one has to have a view if they didn't engage in deception, something else happened, some but-for world . . . ." (Shapiro, Tr. 7142). This testimony acknowledged a central failing of Complaint Counsel's case—a failure to demonstrate that "something else happened" because of the alleged deception and that this "something else" made consumers worse off.

(1) **Cost-effectiveness was not a critical determinant of CARB's Phase 2 regulations**

The Complaint alleges only that Unocal's purported misrepresentation affected CARB's assessment of "cost-effectiveness." Cost-effectiveness is only one factor, and not an outcome-determinative factor, that CARB was required to consider in promulgating Phase 2 regulations. The California Clean Air Act, CAL. HEALTH & SAFETY CODE § 43018(a), required CARB "to achieve the maximum degree of emission reduction possible from vehicular and other mobile sources . . . at the earliest practicable date." The focus on "maximum" emissions reduction at the "earliest practicable" date reflected California's immediate and pressing emissions and air quality problem (*see* CX 10 at 178) and the primary mandate of the Act. (Boyd, Tr. 6810; Fletcher, Tr. 6445).

CARB operated under a statutory mandate to enact, not later than January 1, 1992, Phase 2 regulations for reducing emissions from mobile and vehicular sources. CAL. HEALTH & SAFETY CODE § 43018(b). The Act directed CARB to "take whatever actions are necessary, cost-effective and technologically feasible in order to achieve," by December 31, 2000, various percentage reductions in specific emissions.

CARB's understanding of the term "cost-effectiveness" is reflected in a CARB document entitled "California Clean Air Act Cost-Effectiveness Guidance." (RX 195). This was the same document CARB's Jim Aguila relied upon in performing the cost-effectiveness analysis for purposes of CARB's Phase 2 RFG regulations. (CX 7040 (Aguila, Dep. at 15-18)). This document makes clear that CARB has interpreted its statutory mandate to emphasize the need to achieve maximum emissions reductions at the earliest possible date over cost considerations:

> [W]hile cost-effectiveness is given great emphasis in the California Clean Air Act, it is neither the sole nor the dominant criterion for decisionmaking. The primary mandate is to achieve the state air quality standards by the earliest practicable date.

(RX 195 at 004).

The Cost-Effectiveness Guidance document makes clear that CARB may reject cost-effective means of reducing emissions based on essentially political considerations. Thus, even highly cost-effective measures, such as no-drive days, may be "unacceptable to the public" and rejected on that basis. (RX 195 at 015). Accordingly, CARB believes that "there is no requirement that control measures be adopted in the precise order of their respective cost-effectiveness." (CX 10 at 104; *see also* RX 195 at 016). In CARB's view, "Cost-effectiveness is just one of several criteria that must be considered in the planning process." (RX 195 at 015). By contrast, "[t]he primary mandate is to achieve the state air quality standards by the earliest practicable date." (RX 195 at 004). Thus, CARB's goals in the Phase 2 RFG rulemaking were "to get as many emission reductions as we could from the existing motor vehicle fleet as soon as we could" and "to create a fuel that could be used by the automotive manufacturers in the development of lower-emitting vehicles." (Fletcher, Tr. 6445). There is no basis for concluding that, contrary to both CARB's guidelines and the Final Statement of Reasons for the Phase 2 rulemaking, CARB elevated cost-effectiveness above all other considerations in its rulemaking.

The relative lack of importance assigned to cost-effectiveness in the Phase 2 rulemaking process is demonstrated by CARB's actions. As noted earlier, CARB assigned the task of conducting the cost-effectiveness analysis to Mr. Aguila, a junior engineer who had no prior experience in cost analysis. CARB provided him with no training, and did not review his work. (CX 7040 (Aguila, Dep. at 7-8, 14-18)). In conducting this minimal cost analysis, CARB never sent

specific questionnaires to refiners to obtain cost information in a structured manner and did not require any refiner to provide it with cost information. (CX 7040 (Aguila, Dep. at 51-52)). The agency sought cost data from refiners on a voluntary basis almost as an afterthought. (*See* CX 7040 (Aguila, Dep. at 89-91); Fletcher, Tr. 6958-59; CX 7063 (Sharpless, Dep. at 166-67)). CARB made this request on August 14, 1991—only four months before the statutory deadline for promulgating Phase 2 regulations and *after* CARB had already prepared a regulation that prescribed specific limits for various fuel properties, including T50.[33]

Having only belatedly sought cost information on a voluntary basis, CARB ended up relying on limited investment and operating cost data from only two out of the 30 refineries. (CX 7040 (Aguila, Dep. at 160-67, 176-77, 203-06); Fletcher, Tr. 6958-59; CX 52 at 071; CX 5 at 137A). Nevertheless, CARB proclaimed in its Final Statement of Reasons that "[b]ecause the cost data were received from a diverse group of refiners, staff had the ability to assess the impacts of the regulation on all segments of the industry." (CX 10 at 089).

The seriousness of purpose that CARB committed to its cost-effectiveness "analysis" is demonstrated by the way in which it projected the operating costs of compliance with the regulation. Mr. Aguila determined that operating costs would amount to 50 percent of the capital costs of compliance with the Phase 2 regulations, and CARB included this estimate in CARB's Final Statement of Reasons for Rulemaking. Indeed, CARB proclaimed in its Final Statement that "[t]he staff analyzed the operating costs provided by the six refiners and determined that 50 percent

[33] CARB had previously announced it would determine cost-effectiveness through a sophisticated computerized analysis known as linear programming, but it *never* used this announced approach. (CX 7040 (Aguila, Dep. at 30-31, 51-52, 81-83, 87-93); Courtis, Tr. 5803-04; CX 5 at 1488-153; CX 803 (also referenced in transcript as RX 268); CX 492 at 005 (also referenced in transcripts as RX 167); CX 1047 at 016 (also referenced in transcript as RX 182)).

represented an appropriate value." (CX 10 at 088). CARB made this representation even though Mr. Aguila made this determination on the basis of data from only two refiners, one of which had estimated operating costs at 25 percent and the other at 40 percent. (CX 7040 (Aguila, Dep. at 176-77, 203-06)). In spite of the hurried and haphazard quality of its cost "study," CARB rejected proposals to delay promulgating its regulations to allow time to complete more rigorous cost studies. (CX 39 at 004-005; CX 773 at 027-028; CX 774 at 021; CX 10 at 224; CX 315 at 002).

CARB also rejected proposals by various refiners to conduct an incremental analysis of the cost-effectiveness of individual parameters of its fuel regulation, such as an analysis focused on the incremental cost and benefit of a T50 specification. (*E.g.*, CX 10 at 104; Venturini, Tr. 770; Courtis, Tr. 5882; Eizember, Tr. 3226-27, 3231-32; CX 7059 (Moyer, Dep. at 84-85); RX 436 at 002; RX 210 at 003). Indeed, CARB staff was critical of a WSPA study for examining costs and benefits on a property-by-property basis. (Fletcher, Tr. 6960-61). There is thus no basis to believe that CARB would have conducted an incremental analysis of the cost-effectiveness of a T50 specification had it known of Unocal's pending patent application. As CARB stated, "we do not feel it is appropriate to consider the incremental cost-effectiveness of individual properties such as T90." (CX 10 at 105). CARB states that "because all properties are interrelated, all properties needed to be considered together in order to optimize the overall emissions performance of the fuel." (CX 10 at 104; CX 773 at 264 (Sharpless) ("we're looking at the fuel properties as an integrated system").

In short, CARB did not treat the issue of cost-effectiveness with any seriousness of purpose or rigor. It failed to conduct a meaningful analysis of costs and assigned the cost-effectiveness analysis to an inexperienced junior staffer to whom it gave no training. CARB simply did not view cost-effectiveness as a critical factor in its rulemaking.

(2) CARB would not have changed its analysis of cost-effectiveness had it known of Unocal's pending patent application

Unless disclosure of the Unocal patent application would have materially changed CARB's assessment of cost-effectiveness, the failure to disclose the pending patent would have not been material or affected the substantive provisions of the Phase 2 regulations.

As noted earlier, the evidence clearly shows that CARB was indifferent to patents and patent applications. It strains credulity to assert that CARB would have changed its regulations in response to a patent application when CARB turned down refiner requests to alter its regulations in response to the actual patents that resulted from that application. CARB's refusal had nothing to do with its ability to amend the regulations. It had everything to do with its willingness to amend them.

During the relevant period, CARB's Peter Venturini "couldn't understand how a patent like this could be issued to start with." (CX 7042 (Bea, Dep. 133-34)). He had not even considered the possibility that there could be patents related to RFG that could bear on the regulations. (Venturini, Tr. 821-22). CARB officials also approached the Governor's Office, requesting that the State of California join the refiners' lawsuit against Unocal, challenging the validity of the patent. (Kenny, Tr. 6584-86). And even after Unocal won a judgment for infringement of that patent, CARB continued to believe that the patent was too much "in a state of flux" to be taken into account in its regulatory amendment process. (Venturini, Tr. 815). There is no basis for arguing that CARB would have accorded the patent a greater chance of being valid when it was in the form of an application than it did after the patent had issued.[34]

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[34] The implausibility of such an argument is heightened by the fact that November 1991 the patent examiner had rejected all of the pending patent claims. (Linck, Tr. 7764; CX 1788 at (continued...)

In developing the Phase 3 RFG regulations, which it adopted in December 1999, CARB did not alter the existing regulations to ease patent avoidance despite its awareness of the Unocal patent and repeated refiner requests to modify the Phase 2 regulations to make it easier to avoid the Unocal patents. For example, in early 1998, after Unocal had won the jury trial on its patent case, Mobil approached CARB to explore changes in the CARB regulations to add more regulatory flexibility and "to avoid patent problems."[35] (RX 520 at 001). After meeting with CARB staff, Mobil's Chuck Morgan reported that the staff was "more concerned about changes to provide for oxygenate flexibility than addressing relief for the patent coverage." (RX 520 at 001). He further noted:

> Although CARB realizes the loss of flexibility arising from the patents, they are currently more concerned about regulatory flexibility for oxygenates. They are not convinced that supply shortages will arise from the patents and believe any license fee impact will be within the noise of normal price fluctuations.

(RX 520 at 002). The only data on royalty rates available to CARB at the time when it believed that license fees would constitute mere "noise" was the damages award of 5.75 cents per gallon. This amount is several times *higher* than Unocal's license fee under its RFG patent licensing program.

Exxon also approached CARB, arguing that CARB could make a number of changes to its regulations to increase flexibility to avoid the Unocal patents without increasing emissions. (RX 552 at 003, 006; Eizember, Tr. 3278-81). {[redacted]

[redacted]} *in*

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[34] (...continued)
215).

[35] The exhibit, which is an email message, refers erroneously to the meeting as occurring on January 9, 1997. However, the "Received Date" field in the message header gives the date of January 10, 1998. (RX 520 at 001).

camera; {[redacted]}, *in camera*). CARB, however, was unwilling to make changes to ease patent avoidance even when faced with proposals to do so without increasing emission levels.

Even after the adoption of the Phase 3 regulations, refiners continued to ask CARB to make changes in the new Phase 3 regulations to make it easier for refiners to avoid the numerical claim limitations in the Unocal patents. For example, both Exxon and Chevron approached CARB and asked that CARB increase the olefin cap (among other requested changes). (*See*, *e.g.*, CX 2090 at 002 (referenced in transcript as RX 568); RX 751 at 005, 007). Despite the refiners' argument that such a change would provide them with additional flexibility in dealing with the Unocal patent without increasing emissions, CARB did not make any such changes. Because of the opposition of the automobile industry, CARB declined to relax the T50 specification. (Ingham, Tr. 2717; Gyorfi, Tr. 5277-80). The fact that CARB has not changed the regulations in response to Unocal's patent in the decade since it has known of the patent is fatal to any claim that but for Unocal's alleged misrepresentation, CARB would have enacted different regulations.[36]

Finally, even if it had considered Unocal's pending patent application in determining cost-effectiveness, there is no basis for concluding that CARB would have changed its assessment of cost-effectiveness. CARB analyzed cost effectiveness by looking at the costs of an abatement measure in dollars per ton of pollution reduced, and then comparing this cost to that of past expenditures. CARB indicated that it considered anything under the maximum cost of recent measures to be cost effective. (*See* RX 195 at 006). Unocal's economist, Professor Griffin, examined whether the Unocal royalties, if added to the cost effectiveness calculations which CARB did in 1991, would

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[36] It would have been considerably more difficult—indeed, impossible—for CARB to formulate alternative regulations in November 1991 to avoid potential infringement when the scope of the patent claims that would ultimately issue were unknown.

push the cost of the regulation above the threshold which CARB considered to be cost effective. (Griffin, Tr. 8390-91).

In 1991, CARB had determined that the maximum cost of the regulation was $11,000 per ton. (Griffin, Tr. 8391). To determine what effect the Unocal royalties would have on this number, Professor Griffin assumed that 100 percent of the summertime gasoline was subject to a royalty under Unocal's published royalty rate of 1.6 cents per gallon and applied this calculation to CARB's demand projections out to the year 2005. (Griffin, Tr. 8392; RX 1164A at 045, RX 1164 at 185, *in camera*). He then divided that cost by the emissions reductions that correspond to Phase 2 gasoline and came up with a number of approximately $2,000 per ton. (Griffin, Tr. 8392; RX 1164A at 045, RX 1164 at 185, *in camera*). Professor Griffin then followed CARB's methodology for attributing costs to criteria pollutants and divided this number by two. That additional $1,000 was then applied to CARB's high end estimate of $11,000 per ton, for a resulting high end cost estimate of $12,000 per ton, assuming Unocal royalties on 100 percent of CARB summertime gasoline. (Griffin, Tr. 8394; RX 1164A at 078). Since the threshold set by other measures was in excess of $30,000 per ton, the cost of the CARB regulations, even with the Unocal royalties, would be well below the threshold set by other emission abatement methods. (RX 1164A at 046).

(3) CARB Would Have Regulated T50 Regardless of Unocal's Submissions

CARB's primary mandate in promulgating Phase 2 regulations was to maximize emissions reductions. (Boyd, Tr. 6810; Fletcher, Tr. 6445). There is no evidence in the record to suggest anything other than that CARB staff believed that the T50 distillation point was critical enough to emissions reduction to be included as a specification in the regulations.

But to the extent that Complaint Counsel contend that CARB would not have adopted its T50 specification but for CARB staff's interaction with Unocal, the evidence overwhelmingly refutes this allegation. The evidence shows that CARB developed an interest in T50 months before Unocal ever met with CARB, that CARB staff justified its T50 specification not only upon multiple studies, but for multiple reasons, that CARB based its regulations, including the T50 specification, primarily upon ARCO's EC-X fuel, and that several companies (but not Unocal) lobbied for a T50 specification.

Well before having any substantive interaction with Unocal, CARB had become interested in T50. In October 1990, Toyota made a presentation to CARB arguing that low T50 in gasoline reduces hydrocarbons and CO emissions and that the distillation temperature should be controlled. (CX 5 at 030; *see also* CX 482 at 004-005, 014) (discussing Toyota's program). Chevron also informed CARB in the fall of 1990 that T50 was the dominant factor in the Driveability Index; Chevron thus urged CARB to include T50 in the Phase 2 regulations. (CX 7042 (Bea, Dep. at 38-40); RX 254 at 001-003; RX 256).

CARB, in fact, told WSPA by mid-January 1991 that "it is critical for the purposes of the study [a proposed pre-regulation study of the emission effects of fuel properties] and regulation to have lower T50." (RX 677). And, in April 1991, before the first Phase 2 workshop took place, Toyota again lobbied CARB staff to regulate T50. (Venturini, Tr. 346-50) (explaining that Toyota discussed the emissions reductions resulting from T50 changes at the April 1991 meeting); RX 19 at 014).

Because it was interested in learning about T50 independently of and before receiving any substantive information from Unocal, CARB also sought and received from ARCO the T50 value

of ARCO's EC-X fuel formulation. (Fletcher, Tr. 6918-19; RX 180 at 003). CARB staff then prepared two internal drafts of Phase 2 regulations with T50 values identical to those given to the staff by ARCO: 190° F and 200° F. (Venturini, Tr. 362, 366-68; RX 198 at 012 (190°); RX 184 at 028 (200°); RX 180 at 003).

In proposed draft regulations that CARB published on August 1, 1991—*before* Unocal gave CARB permission to make public use of its data and thus before CARB legally could have relied on that information—CARB proposed to set a T50 value of 200° F. (RX 184 at 028). The August 1 proposed regulations had, as CARB's internal document illustrates, a direct comparison to ARCO's EC-X gasoline, whose precise T50 value was 201.° (Fletcher, Tr. 6924-25; RX 268 at 002). Again, this activity with respect to T50 occurred before Unocal ever released its confidentiality on anything.

As CARB stated in its Final Statement of Reasons for Rulemaking, the CARB Phase 2 regulations were similar to the properties of ARCO's EC-X gasoline. (CX 10 at 178). Adoption of the Phase 2 regulations was seen by the industry as a victory for ARCO.[37] (*See* RX 504 at 001, 002, 007; RX 329 (internal CARB circulation of news clippings)).

CARB cited multiple studies in an attempt to justify its T50 specification in the face of industry opposition to the regulation. (CX 52 at 032; CX 5 at 028; CX 10 at 056-058; Venturini, Tr. 743-44, 752; CX 52 at 032 (section 2(b)). These included the work conducted jointly by General Motors, WSPA, and CARB, as well as work by Chevron and Toyota. (*See* CX 5 at 021, 028) Moreover, CARB had many different reasons, other than exhaust emission reductions caused by T50, which it used to justify the specific T50 limit and specification. Staff was concerned that to

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[37] At the November 21 hearing, ARCO, Toyota, and Nissan also argued in favor of a tight control of T50. (CX 10 at 049).

meet a lower T50 limit would increase front-end volatility. (CX 5 at 033; CX 10 at 050; Fletcher Tr. 6483-84; Venturini, Tr. 761). In addition, the limit on T50 was not just based upon exhaust emissions because CARB also sought to minimize evaporative emissions in these regulations. (CX 52 at 033; Venturini, Tr. 748). Nor did CARB's determination of the T50 limits end with benefits to exhaust and evaporative emissions. Aside from the emissions benefits associated with the flat limit, CARB also set a cap limit on T50 because of enforcement reasons. (CX 10 at 049-050; Venturini, Tr. 783-84). CARB wanted to ensure that the regulation would be enforceable at all points in the distribution system. (CX 10 at 028). With a cap limit, CARB could enforce the regulations downstream of the refinery. (CX 10 at 026). Finally, another consideration in setting a T50 specification was the interaction between T50 and the other regulated parameters, including RVP. (Venturini, Tr. 781-83; CX 10 at 049-050).

Once CARB learned of the potential significance of T50, it performed its own analysis to verify the significance of this property. CARB's statistical analysis showed that T50 was one of the largest, if not the single largest, determinants of hydrocarbon emissions.[38] And the Final Statement of Reasons reflects comments from auto manufacturers and ARCO arguing that CARB should

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[38] CARB's Final Statement of Reasons identified Unocal's study as "the only study that evaluated T50 and provided a statistical analysis" and asserts that it is "the results of Unocal's study that form the basis for the T50 specification." (CX 10 at 075). At other places, however, the Final Statement refers to the agency's reliance on Toyota data in support of the T50 specification. (CX 10 at 049; Venturini, Tr. 779-80). As noted earlier, moreover, CARB drafted regulations incorporating T50 limitations before it ever received Unocal's data and published a proposed regulation containing a specified T50 limitation of 200° F before CARB staff had access to Unocal's data through California's Teale Data Center. Indeed, there is no evidence that CARB ever considered the Unocal data before the conclusion of the Phase 2 rulemaking on November 22, 1991. Further, as shown earlier, CARB changed the T50 specification to 210° F in response to ARCO's request. In addition, Unocal's data did not have a significant effect on the results of a subsequent computer run of CARB's data base in which the agency included Unocal's data. (CX 7045 (Cleary, Dep. at 10-11)).

regulate T50 and set a level that was even more stringent than the proposed regulation called for. (Venturini, Tr. 778-83; CX 10 at 049-050; CX 774 at 184-186).

Thus, the evidence clearly shows that CARB viewed a T50 specification as critical, adopting it over Unocal's objection that it was not "necessary." (CX 10 at 047). There is no basis to believe that disclosure of Unocal's patent application would have led CARB to alter its view that a Phase 2 regulation containing a T50 specification was needed.

(4) <u>CARB had no viable alternative to the Phase 2 gasoline regulations that would have resulted in lower infringement rates</u>

CARB was charged by the California Clean Air Act to promulgate regulations to achieve the maximum degree of emissions reduction from vehicular and other possible sources expeditiously. CAL. HEALTH & SAFETY CODE § 43018(a). Although CARB had enormous discretion in how it went about reducing emissions, it was constrained by statutory mandates to achieve emissions reductions by specified deadlines. As a result, CARB rejected various forms of alternatives to the Phase 2 RFG regulations. While the nature of the rejected alternatives underscores the broad discretion that CARB enjoyed as a matter of law, CARB's basis for rejecting the alternatives also underscores the paucity of *practical* alternatives to the Phase 2 RFG regulations.

The Technical Support Document prepared by CARB staff for the Phase 2 RFG rulemaking set out the following alternatives that CARB had the legal authority to implement and explained the basis for their rejection.[39] First, CARB rejected the concept of tighter regulations on vehicles because of the time it would take to develop such technology and the fact that it would take

[39] (*See also* CX 773 at 195) (Chairwoman Sharpless recognizing the limited options available to CARB as a practical matter)).

approximately ten years to replace enough older vehicles before such regulations would attain their full impact. (CX 5 at 165-166). Second, CARB rejected the concept of requiring fuels other than gasoline because "such a specification could not be wisely done on the basis of only emissions." (CX 5 at 166). Further, because existing cars use gasoline, such a regulation would not produce any significant effect until well after 2000. Third, CARB rejected the concept of adopting an emission standard based on toxics because such a regulation would take at least ten years to reach full effect. (CX 5 at 166).[40]

There is no evidence suggesting that any of the foregoing could have been adopted in place of the Phase 2 regulations to avoid Unocal's patents. Nor is there any evidence suggesting that CARB had the alternative of adopting a rule that regulated gasoline properties with a substantially different T50 specification. Significantly, Complaint Counsel's economic expert, Professor Carl Shapiro, did not identify a single regulatory option that was available to CARB at the time of the Phase 2 RFG rulemaking that ceased to be available to CARB after it learned of Unocal's patents. This absence of a "lock-in" is significant. It shows that CARB's failure to act after learning of Unocal's patents is the most likely indicator of what it would have done had it learned of the patent application during the Phase 2 RFG rulemaking.

Yet Complaint Counsel have for all practical purposes abandoned any attempt to prove the Complaint's claim of a "lock-in." This is evident in Professor Shapiro's testimony. Professor Shapiro correctly agreed with the definition of lock-in as "just a little more graphic word for switching costs, significant switching costs, and it has inherent in it the notion that one had choices

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[40] CARB also rejected scrapping older, more heavily polluting vehicles, as publicly unacceptable. (CX 10 at 111; *see also* RX 195 at 015).

ex ante and that one made a choice and now you're stuck with it in the sense that it is hard to switch, in the sense that your options are reduced in comparison to what they were earlier. That is, your options are reduced or less attractive." (Shapiro, Tr. 7345-46). Yet, Professor Shapiro was unable to identify any less costly regulatory alternative that was available at the time of the Phase 2 RFG rulemaking that ceased to be available by the time CARB learned of Unocal's patents, for reasons of stranded costs or otherwise. (Shapiro, Tr. 7390-91). This failure is grounded in the irrefutable fact that nothing that Unocal allegedly did or omitted to do dictated CARB's regulatory choices or deprived CARB of regulatory choices.

The one alternative proffered by Complaint Counsel and sponsored by CARB's Rule 3.33(c) witness, Peter Venturini, would have been for CARB not to promulgate any Phase 2 regulations and rely instead on EPA regulations. (Venturini, Tr. 787-90). This was no choice at all. CARB was statutorily required to enact Phase 2 regulations by January 1, 1992. CAL. HEALTH & SAFETY CODE § 43018(b). It adopted its regulations less than 40 days before this deadline. Moreover, the Final Statement of Reasons for the Phase 2 regulations repeatedly rejected the EPA alternative as insufficient to achieve the necessary emissions reductions. (CX 10 at 094, 178). It emphasized that "[i]mplementation of only the federal gasoline standards would leave the State far short of obtaining the emissions reductions needed to meet either the federal or state ambient air quality standards." (CX 10 at 178).

After CARB learned of Unocal's patents in 1996, CARB reaffirmed the view that reliance on the EPA's regulations would have been insufficient to meet California's Clean Air Act requirements. (RX 202 at 004). It is little wonder that it did. Failure to adopt the Phase 2 regulations would have resulted in the imposition of a draconian Federal Implementation Plan

("FIP") that would have been needed to bring the state into compliance with the Federal Clean Air Act. (Pedersen, Tr. 8016-21; 8032; RX 1186 at 004-005). A study performed by California's Governor office found that the imposition of a FIP would have cost the state at least $8.4 billion in direct costs and $17.2 billion in lost output, and would have resulted in the loss of 165,000 jobs. (RX 334 at 001).

In short, there is no evidence of any alternative that was available to CARB at the time of the Phase 2 rulemaking and that subsequently ceased to be available to CARB that would have reduced the overlap of the regulations with Unocal's patents. CARB's failure to ease refiners' avoidance of the patents after (1) the PTO issued the patents; (2) the precise scope of the patents became clear; (3) Unocal's instituted a licensing program with specified royalty rates; and (4) the cost of avoiding the patents became understood is strong evidence that CARB would not have done anything different in its rulemaking had Unocal disclosed its application at a time when (1) the PTO had preliminarily rejected the patent application; (2) there was no basis for understanding the scope of any patents that might some day issue; (3) no licensing program was in place; and (4) avoidance costs could not be understood in light of the absence of any issued patent.

C. Unocal's Petitioning Activities in Industry Groups Are *Noerr*-Protected

The Complaint make two types of allegations regarding Unocal's conduct vis-à-vis other refiners. The first is that Unocal's alleged misconduct caused the refiners to refrain from advocating against the Phase 2 RFG regulations. This allegation suffers from several defects.

First, as shown earlier in this brief, the refining industry, with the exception of ARCO, lobbied intensively against the Phase 2 RFG regulations. ARCO lobbied for the regulations because it had successfully captured the regulatory agency and persuaded it to mandate the blending of

gasolines that mimic ARCO's EC-X formula. As one ARCO memorandum recognized, ARCO's "successful lobbying efforts . . . led to CARB's adoption of reformulated gasoline specifications essentially identical to EC-X." (RX 83 at ARAN-098409).

Second, inducing trade organizations and their members to alter their advocacy efforts, if it could be established, would be paradigmatic *Noerr*-protected lobbying. In *Noerr* itself, the challenged conduct was a deceptive publicity campaign aimed at third parties, and the Supreme Court held that these efforts were immune, even when deceptive. *See also Manistee Town Center v. City of Glendale*, 227 F.3d 1090, 1092 (9th Cir. 2000); *Livingston Downs Racing Ass'n, Inc. v. Jefferson Downs Corp.*, 192 F. Supp. 2d 519, 531-32 (M.D. La. 2001). The fact that the cause of the refiners' alleged injury is CARB's adoption of the rules and not Unocal's private conduct is the end of the matter under the caselaw.

Third, the notion that Unocal, by altering the manner in which other companies lobbied CARB, actually changed the outcome of the Phase 2 regulations cannot be reconciled with the claim that the rulemaking was not a political proceeding. If the rulemaking was the quest for scientific truth that Complaint Counsel make it out to be, a change in the lobbying position of any party should not have made a shred of difference in the outcome.

Nor is there any legitimacy to the claim that Unocal's participation in WSPA and Auto/Oil led refiners to make investment decisions that they would have altered had they known about Unocal's patent application. There is no evidence that Unocal had any duty to inform anyone of its patent application. Participation in joint lobbying activities has never been shown to trigger an obligation to disclose patent applications, let alone give away intellectual property rights. And the evidence showed that refiners refused to alter their refinery configurations in the face of an issued

patent because they believed the patent to be invalid. Such evidence flies in the face of any claim that refiners would have altered their refineries upon mere knowledge that a patent application had been lodged. Finally, *Noerr* itself held that petitioning conduct was immune from antitrust liability not only insofar as it affected governmental actions but also with respect to its marketplace impact. The Court held that "direct injury [incurred] as an incidental effect of the railroads' campaign to influence governmental action" was outside the reach of the antitrust laws. 365 U.S. at 143.

V. <u>UNOCAL DID NOT ENGAGE IN EXCLUSIONARY CONDUCT</u>

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

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

Preliminarily, your Honor should reject Complaint Counsel's attempt to argue that Counts 4 and 5 are broader than, or create liability apart from, the monopolization and attempted monopolization claims set forth in Counts 1, 2 and 3. *See* Compl. Counsel's Pretrial Br. at 9-10.

The Commission has specifically rejected past attempts such as this to "expand the reach of the prohibition against attempted monopolization in the Sherman Act by condemning less offensive conduct under the purview of the Federal Trade Commission Act." *General Foods Corp.*, 103 F.T.C. 204, 364-66 (1984).

While the FTC theoretically has the authority under Section 5 to define and proscribe unfair competitive practices outside the scope of the antitrust laws, important limitations imposed by the Supreme Court—together with the FTC's own reluctance to exercise the powers granted under Section 5—compel the dismissal of Counts 4 and 5 in this action. These Counts, which rely upon the exact same factual allegations as Counts 1, 2, and 3, cannot be the basis for extending the FTC's authority under Section 5.

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

n.32 (1995) ("[T]he analytical standards for assessing liability [under both Section 7 of the Clayton Act and Section 5 of the FTC Act] are read coextensively.").

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

> While Section 5 may empower the Commission to pursue those activities which offend the 'basic policies' of the antitrust laws, we do not believe that power should be used to reshape those policies when they have been clearly expressed and circumscribed. Senator Cummins, a principal sponsor of the Act, explained the words, 'unfair competition,' to his colleagues as follows:
>
>> It will be the duty of the Commission to apply those words in the sense precisely as it is now the duty of the court to apply the words 'undue restraint of trade' in the sense in which we commonly understand that phrase. 51 Cong. Rec. 13048 (1914).
>
> The record in this case does not offer a rationale for using the Federal Trade Commission Act to graft an extension onto Section 2 of the Sherman Act.

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

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

B. <u>Unocal Cannot Commit an Antitrust Violation by Lawfully Exercising its Patent Rights</u>

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

The Federal Circuit has held that the exercise of a patent holder's rights can serve as the basis for antitrust liability in only very limited circumstances, none of which is applicable here: "In the absence of any indication of illegal tying, fraud in the Patent and Trademark Office, or sham litigation, the patent holder may enforce the statutory right to exclude others from making, using or

selling the claimed invention free from liability under the antitrust laws." *In re Indep. Serv. Orgs. Antitrust Litig.*, 203 F.3d 1322, 1327 (Fed. Cir. 2000) ("*ISO*"). Although the court recognized that "[i]ntellectual property rights do not confer a privilege to violate the antitrust laws," it reasoned that "it is also correct that the antitrust laws do not negate the patentee's right to exclude others from patent property." *Id.* at 1325 (quoting *Intergraph Corp. v. Intel Corp.*, 195 F.3d 1346, 1362 (Fed. Cir. 1999)). Similarly, the Court of Appeals for the Second Circuit held that "where a patent has been lawfully acquired, subsequent conduct permissible under the patent laws cannot trigger any liability under the antitrust laws." *SCM Corp. v. Xerox Corp.*, 645 F.2d 1195, 1206 (2d Cir. 1981).

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

submission of proposed licensing terms with which it was willing to license does not state a violation of the antitrust laws." *Townshend*, 2000 U.S. Dist. LEXIS 5070, at *23.

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

C. Complaint Counsel's Allegations of Exclusionary Conduct Fail Because They Cannot Establish That Unocal Engaged in Fraud

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

¶ 651, at 83-84 (2d ed. 2002). Significantly, the antitrust laws seek to encourage rather than punish acts of a pure competitive nature. Thus:

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

Id. at ¶ 651c, pp. 78-79.

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

In this action, as Complaint Counsel themselves have stated, the alleged competitive harm is "analogous to the harm alleged in *Walker Process*—the private enforcement of monopoly power

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

As discussed in Section IV(B)(2), *supra*, because Complaint Counsel are challenging Unocal's speech to a governmental agency, they must establish that Unocal made a deliberate, knowing and willful misrepresentation with respect to a clear and sharply defined fact, and that such fraud was material to the outcome of the government proceeding. Unocal's analysis of these factors, shows that Unocal made no such misrepresentation which could vitiate *Noerr* immunity, as outlined by the Commission's three-part test.

Moreover, even if this case were not brought in the context of the alleged enforcement of a fraudulently obtained patent monopoly, and even if Complaint Counsel did not need to establish

deliberate, material fraud under the Commission's *Noerr* opinion, Complaint Counsel would still have to demonstrate the impropriety of Unocal's representations with reference to well-established fraud principles. Complaint Counsel's case may be essentially distilled into one of misleading representations to CARB and others.

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

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

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

It would be incongruous to premise antitrust liability on conduct that cannot be condemned under the very same theory phrased in common law terms. If anything, the antitrust laws are directed at a narrower set of conduct than common law, and most violations of common law obligations

cannot support an antitrust violation. In this action, where the alleged wrongdoing involves a fraudulently obtained patent monopoly and where *Noerr* has been raised as a defense, Complaint Counsel must prove each element of fraud to establish exclusionary conduct. Under Federal Circuit law, this requires a showing of each of the following elements of fraud: "(1) a representation of a material fact; (2) the falsity of that representation; (3) the intent to deceive or, at least, a state of mind so reckless as to the consequences that it is held to be the equivalent of intent (scienter); (4) a justifiable reliance upon the misrepresentation by the party deceived which induces him to act thereon, and (5) injury to the party deceived as a result of his reliance on the misrepresentation." *Nobelpharma*, 141 F.3d at 1069-70.

1. <u>Unocal's statements and omissions were neither false nor misleading</u>

As discussed in Section IV(B)(2)(a), *supra,* the statements Unocal made to CARB, Auto/Oil and WSPA were true, and Complaint Counsel cannot contend otherwise without a tortured interpretation of Unocal's words which no party ever intended or understood. Complaint Counsel's attempts to turn this case into one of an allegedly false omission or one based upon actionable "half-truth" are unavailing as well.

a. <u>Unocal's omissions are not fraudulent</u>

First, just as Unocal made no affirmative misrepresentations, Unocal also made no actionable fraudulent omission that could serve as the basis for liability under Section 5 of the FTC Act. There can be no Section 5 antitrust violation based upon a failure to disclose absent proof of a "clear and unambiguous" duty to disclose. *In re Rambus Inc.*, No. 9302, slip op. at 259 (FTC Feb. 23, 2004). Indeed, courts have long recognized that antitrust rules generally, and specifically liability under Section 5, must be based upon clearly defined rules. *Int'l Distribution Ctrs., Inc. v. Walsh Trucking*

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

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

(1) There is no duty to disclose to CARB

There is no support in the case law or in the evidence here for the concept that there is a special confidential or fiduciary relationship between a regulator and one who will be regulated such that a special disclosure duty should be imposed upon Unocal. As Ms. Sharpless, CARB's Chairman noted, CARB understood that the refiners who participated in its rulemaking would not share information they did not want CARB to have because "they were looking very well after their own self interest . . . ." . (CX 7063 (Sharpless, Dep. at 167)). Indeed, the United States Supreme Court has recognized in *Noerr* that it is those with a personal interest in the proposed law that are most likely to have a strong motivation to communicate with their government:

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

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

For all the reasons set forth in Section IV, Unocal had no duty to disclose it patent applications or any potential plans to seek royalties to CARB. Absent such a duty, Unocal's failure to disclose cannot give rise to an actionable misrepresentation sufficient to constitute the exclusionary conduct necessary for a Section 5 violation in this matter.

(2) There was no duty to disclose to WSPA

(a) Unocal and WSPA had no fiduciaty duty

Just as Unocal had no fiduciary relationship with CARB, it also had no such relationship with the members of Auto/Oil and WSPA, most of whom were Unocal's competitors. There was no

"fiduciary" or other relationship between the members of these groups that would have required Unocal to divulge highly confidential information regarding its patent application or potential royalty plans to its competitors. In fact, as noted in Section IV, just the opposite was true—both organizations had explicit guidelines that prohibited such discussions.

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

But Complaint Counsel did not show that Unocal had any such duty to disclose to WSPA members the existence of (much less the content of) Unocal's pending patent application, or any duty to disclose any royalty plans. First, as a matter of law, there is no such fiduciary duty among the competitors who belong to a trade association. WSPA's counsel and its corporate designee under Rule 3.33 (c) have stated WSPA is not aware of any fiduciary relationship existing between and among WSPA and its members.(CX 7070 (Wang, Dep. at 67-68); RX 674; RX 673). Indeed, in *Rambus Inc. v. Infineon Techs. AG* 318 F.3d 1081 (Fed. Cir. 2003), *cert denied*, 124 S. Ct. 227 (2003), the Federal Circuit rejected a duty of disclosure arising from an alleged fiduciary duty between members of trade association:

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

Id. at 1096.

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

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

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

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

> Compelling . . . firms to share the source of their advantage is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities. Enforced sharing also requires antitrust courts to act as central planners, identifying

> the proper price, quantity, and other terms of dealing—a role for which they are ill-suited. Moreover, compelling negotiation between competitors may facilitate the supreme evil of antitrust: collusion.

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

Here, not only is there no fiduciary duty that might require the disclosure of patent applications, but under WSPA's antitrust guidelines, WSPA members were *prohibited* from discussing with one another information relating to pricing, supply, cost, business strategies, and any other competitively sensitive information—including patents. (CX 7070 (Wang, Dep. at 19-22); RX 670 at 007; (CX 7046 (Grey, Dep. at 50-51, 55-56)).

(b) <u>Unocal did not violate WSPA procedures or policies</u>

There is, likewise, no evidence that Unocal violated any WSPA processes or procedures. The only specific WSPA procedures that the Complaint alleges were violated by Unocal relate to a cost study that WSPA commissioned in 1991. (*See* Complaint ¶¶ 56, 57, 87). According to the Complaint, this cost study, which estimated the costs of the proposed regulations on a cents-per-gallon basis, "could have incorporated costs associated with potential royalties flowing from Unocal's pending patent rights." (Complaint ¶ 57).

The cost study referred to in the Complaint was prepared by Turner Mason, who submitted it to CARB in connection with the Phase 2 rulemaking. (Courtis, Tr. 5877-78). The Turner Mason report used refinery linear programs, based on a hypothetical representation of an average refinery, to estimate costs of the Phase 2 regulations. (Courtis, Tr. 5877-78).

First, notwithstanding the Complaint's allegation, WSPA's corporate representative contended that Unocal had not violated any WSPA policies or procedures. (CX 7070 (Wang, Dep.

at 68-70)). Moreover, the policies and procedures of WSPA included specific "antitrust guidelines that discouraged any discussion of patents or any other pricing or supply issues." (CX 7046 (Grey, Dep. at 55-56)).

With respect to the Turner Mason study itself, Unocal's Mr. Kulakowski was involved on behalf of WSPA in working with Turner Mason in this regard. The Turner Mason report did not include any costs from individual refiners. (Kulakowski, Tr. 4623-24). Mr. Kulakowski was unaware of anyone collecting individual refining costs in connection with the Turner Mason study conducted on WSPA's behalf. (Kulakowski, Tr. 4627). Mr. Kulakowski understood that when he participated in his WSPA duties that the exchange of cost information with other members of WSPA was something to be absolutely avoided due to antitrust concerns. (Kulakowski, Tr. 4625-26). Specific to his work on the WSPA Turner Mason study, no one ever instructed Mr. Kulakowski that he had an obligation to disclose Unocal's pending patent application to WSPA and disclosing the pending '393 patent application did not cross his mind. (Kulakowski, Tr. 4629-30).

Importantly, Turner Mason's Mr. Cunningham admitted that there was no agreement between himself and Unocal for the WSPA study (Cunningham, Tr. 4276-77), and that nowhere in Mr. Cunningham's request for proposal for the work was he entitled to demand cost information from WSPA members. (Cunningham, Tr. 4279). Mr. Cunningham admitted that he had previously testified that for this study he did not ask any of the refiners for cost information and did not try to make a survey of what individual refinery costs were, but instead calculated the typical or average cost of the industry independently. (Cunningham, Tr. 4305-06).

When Turner Mason did its work for WSPA in 1991, it used the same linear program model and the same assumptions it had used in the Auto/Oil study completed the previous year. (RX 347

at 001). But in the Auto/Oil study which Mr. Cunningham co-authored, it was stressed that "[p]otential future technology improvements were excluded because they could not be quantified." (RX 343 at 003).

Likewise, nowhere in his WSPA report does Mr. Cunningham state he attempted to quantify potential technology cost or potential intellectual property cost. (Cunningham, Tr. 4321-22; CX 1106). Mr. Cunningham could not even identify any other place in his study (CX 1106) aside from Table I, where the term "royalty" is used, and each of the royalties listed in Table I is for paid up royalties on individual process units. (Cunningham, Tr. 4323; CX 1106 at 099). Moreover, CX 280 is a handout Mr. Cunningham provided to CARB staff, on November 7 or 8, 1991, which warns that industry studies cannot be made with individual refinery costs because of antitrust concerns. (Cunningham, Tr. 4338-39; CX 280 at 038). Mr. Cunningham explicitly informed the CARB Board that no survey was undertaken because of antitrust considerations over individual companies' data. (Cunningham, Tr. 4329-30).

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

(3) **<u>There was no duty to disclose to Auto/Oil</u>**

(a) **<u>Unocal did not have a fiduciary relationship with Auto/Oil</u>**

Auto/Oil was a joint research program of fourteen major oil companies and three auto manufacturers under the National Cooperative Research Act of 1984, 15 U.S.C. § 4301, *et seq.* (CX 4001 at 002, 026-030; CX 7041 (Alley, Dep. at 23)). Complaint Counsel's allegations with respect to Auto/Oil are similar to their allegations relating to WSPA; namely that Unocal breached its "fiduciary duties" to Auto/Oil members and "violated" and "subverted" its processes and procedures. (Complaint ¶ 84). But like WSPA, Auto/Oil members were competitors with one another. By law, there were no such "fiduciary" duties that would have obligated Unocal to disclose its confidential information to its competitors. *See Rambus Inc. v. Infineon Techs. AG*, 318 F.3d 1081, 1096 n.7 (Fed. Cir. 2003).

Moreover, the obligations of the Auto/Oil members are set forth in a written agreement. (CX 4001). Members of Auto/Oil's Research Program Committee understood that the Auto/Oil Agreement controlled the rights and obligations of the various members of the Auto/Oil program. (Kiskis, Tr. 3847; Pahl, Tr. 2778-79). This Agreement makes it clear that Unocal had the right to pursue independent research in the area of reformulated gasoline and that it had no obligation to disclose the fact that such independent research was undertaken, the nature of the Project, or the nature of the results thereof. (CX 4001 at 014-015).

In addition, just as WSPA antitrust policies prohibited members from discussing their competitively sensitive business plans, so too did the Auto/Oil Agreement. (CX 4001 at 008) ("No Member will utilize the Program for . . . [e]xchanging of information among competitors relating

to costs, sales, profitability, prices, marketing, or distribution of any product, process, or service that is not reasonably required to conduct the research and development that is the purpose of such venture.").

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

(b) Unocal's research was independent research—not the work of the Auto/Oil program

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

This argument is specious. First, the Auto/Oil Agreement is an integrated agreement embodying the entire agreement of the Members which "supersed[ed] any other agreements or understandings among the Members." (CX 4001 at 024). The Auto/Oil Agreement specifically provided that "[n]o amendment or modification or waiver of a breach of any term or condition of this Agreement will be valid unless in a writing signed by each and every Member." (CX 4001 at 024). There was no evidence that the Auto/Oil Agreement was modified by any written agreement signed by each and every member of the Auto/Oil program.

Moreover, the Auto/Oil Agreement distinguishes between the "work of the Program" and "Independent Research." (CX 4001 at 007) ("work of the Program"); (CX 4001 at 014-015)

("Independent Research"). The Auto/Oil Agreement gave each member the right to pursue independent research "on any matter, including reformulated gasoline." (CX 4001 at 014).

The "Work of the Program" was work that was conducted, paid for, and published by the Program. (CX 4001 at 009) (noting that the "Program will be managed by the Research Planning Task Force"); (CX 4001 at 011) ("No Member of the Program shall enter into any contract on behalf of the Program . . . except with the approval of the Research Planning Task Force."); (CX 4001 at 012) (describing members' obligations "to contribute such funds as may be necessary to develop and complete all research approved by the Research Planning Task Force"); (CX 4001 at 014) (stating that "all of the research and testing to be carried out in the Phase I Program will be disclosed in the final report"). The work of the Program was the property of the Program to be donated to the public. (CX 4001 at 007).

"Independent research," on the other hand, was work that was conducted, paid for, and published (if at all) by the individual member(s). (CX 4001 at 014-015). Independent research remained the property of that member. (CX 4001 at 014-015) (when a member engages in independent research "the project shall not be deemed to be undertaken by the Program."). The Auto/Oil Agreement does not contain any provision which would convert Independent Research into the work of the Program because of disclosure of such independent research. Rather, the Auto/Oil Agreement simply provides that "[a] Member who has undertaken . . . an independent research project shall not be obligated . . . [to] disclose . . . the fact that such independent research has been or is being undertaken." (CX 4001 at 014). Under the Auto/Oil Agreement, neither the Program nor the other Members gained any rights or obligations to independent research by reason of the Auto/Oil Agreement nor any right to participate in independent research:

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

(CX 4001 at 015).

There is nothing in the Agreement that creates an exception for independent research results which are disclosed to Auto/Oil members. Indeed, if the disclosure of "independent research" converts such research into the "work of the Program," as alleged by Complaint Counsel, then the above provisions would be nonsensical and rendered meaningless. There would be no need to set out in an agreement whether Auto/Oil should pay for independent work, have a right to participate in the project, or have the right to review or approve contracts relating to the project *unless members of Auto/Oil knew* about the independent research project. Disclosure of independent research was therefore contemplated and no provision was made such that disclosure of the independent research would transform it into the "work of the Program."

There is no question but that the Unocal RFG work was "independent research" belonging to Unocal. Unocal, not Auto/Oil, paid for, conducted, directed, and published Unocal's emissions research. (Jessup, Tr. 1548-49). Dr. Harvey Klein, Shell's representative who attended the September 26, 1991 Auto/Oil meeting, testified that he understood that the Unocal RFG work was independent research both before and after Dr. Jessup presented it to Auto/Oil. (Klein, Tr. 2578, 2544, 2501-02). ARCO's representative on the Auto/Oil's Research Program Committee testified that Auto/Oil did not fund any of Unocal's research for the 5/14 project. (Segal, Tr. 5659, 5596). Nor did Auto/Oil or the Research Program Committee do anything to direct Unocal's research.

(Segal, Tr. 5660). Likewise, at the time of the presentation, Ms. Helen Doherty of Sunoco was aware that Dr. Jessup was presenting Unocal's independent research; research that Auto/Oil did not do, did not request, did not commission, did not pay for, did not approve, never published, and never presented to the public. (Doherty, Tr. 2804-05). Chrysler's Auto/Oil representative testified that Unocal's "work was not conducted under Auto/Oil." (Burns, Tr. 2430, 2409).

That Complaint Counsel's allegation is simply an unsupported, litigation-inspired argument is underscored by the testimony of ExxonMobil's corporate designee that the first time the idea that Unocal's work somehow became the work of the Auto/Oil program was "when the Akin Gump lawyers mentioned it." (CX 7073 (Wise, Dep. at 16-18)).

The independent research provision of the Auto/Oil Agreement is susceptible to only one reasonable construction—one that preserves the rights of an Auto/Oil member to conduct independent research and to retain its rights in the results of its work whether or not it discusses the work with the other members of the Program.

The clearly delineated rights in the Auto/Oil Agreement set forth the complete agreement between the parties. There is no legal or factual basis upon which this Court could find that Unocal had a duty to disclose its competitively sensitive information regarding its patent application or potential royalty plans to its competitors in the Auto/Oil Program.

b. <u>Unocal's true statements did not give rise to an additional disclosure duty</u>

Nor have Complaint Counsel established the sort of misleading "half-truth" that can give rise to an actionable fraud claim. "A representation in the nature of a half-truth, plus concealment of the remaining truth, may constitute fraud." (*E.g., Paulsell v. Cohen*, No. CV-00-1175, 2002 U.S. Dist.

LEXIS 20386, at *71 (D. Or. May 22, 2002). Just because a party speaks on a topic, however, does not mean that it must disclose every facet of the subject it discusses. *See Miller v. Champion Enters., Inc.*, 346 F.3d 660, 682 (6th Cir. 2003) ("Just because defendants issued a press release and held a conference call to discuss their second quarter earnings does not mean that they chose to speak on any situation that could possibly affect their financial condition."); *Backman v. Polaroid Corp.*, 910 F.2d 10, 16 (1st Cir. 1990) (requirement that disclosures be "complete and accurate . . . does not mean that by revealing one fact about a product, one must reveal all others that, too, would be interesting, market-wise, but means only such others, if any, that are needed so that what was revealed would not be so incomplete as to mislead.") (internal quotation marks and citation omitted).

As discussed above in Section IV, neither the statement that Unocal's data was "nonproprietary," nor the statement that the data was in the "public domain" were in any way false, inaccurate or incomplete. There is no reasonable basis to impose a duty to disclose a patent application merely because one has made one's data publicly available. Distributing one's data publicly is a common practice that says nothing one way or another about the presence of any patent rights relating to any inventions. For all the reasons set forth above, Complaint Counsel have not established that Unocal's statements and omissions were in any way false or misleading.

2. Unocal did not intend to mislead CARB/Auto Oil or WSPA

Not only is knowing, deliberate and willful intent to mislead a requisite element of the test the Commission outlined for its *Noerr* exception, it is also a necessary component of both common law fraud and *Walker Process* fraud. *Kangaroos U.S.A. v. Caldor, Inc.*, 778 F.2d 1571, 1573 (Fed. Cir. 1985) (citing *J.P. Stevens & Co., Inc. v. Lex Tex Ltd., Inc.*, 747 F.2d 1553, 1559 (Fed. Cir. 1984). This element of fraud requires intent to induce "the particular action taken by the hearer."

Carlson v. Murphy, 8 Cal. App. 2d 607, 611 (Cal. App. 1935) (citation omitted); *see Walker Process*, 382 U.S. at 177 (construed in *Union Oil* slip op. at 36, as requiring knowingly and willfully misrepresenting facts).

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

Here, for all the reasons set forth above in Section IV, *supra*, neither Unocal's affirmative statements nor its omissions were done with a knowing, willful or deliberate intent to mislead.

3. The alleged misrepresentations were not material and neither CARB nor the refiners justifiably relied upon them

Fraud requires that the alleged misstatements of fact be material. *E.g.*, *Charpentier v. Los Angeles Rams Football Co.*, 89 Cal. Rptr. 2d 115, 123 (Cal. Ct. App. 1999); *City of Atascadero v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 80 Cal. Rptr. 2d 329, 354 (Cal. Ct. App. 1999); *see also Fish v. Richfield Oil Corp.*, 178 F. Supp. 750, 756 (S.D. Cal. 1959) ("There can be no fraud unless

the representation relates to a material matter.") (footnote omitted). A representation is not material unless a reasonable person would want to consider the fact in determining whether to enter the transaction in question. *E.g.*, *Roberts v. Lomanto*, 5 Cal. Rptr. 3d 866, 876 (Cal. Ct. App. 2003) ("The test of materiality is objective: whether a reasonable person in the principals's position would have acted differently had he known the undisclosed facts."); *Charpentier*, 89 Cal. Rptr. 2d at 123 (A matter is material if "a reasonable person would attach importance to its existence or nonexistence in determining his choice of action in the transaction in question.") (citation omitted); *see also United States v. Ciba-Geigy Corp.*, 508 F. Supp. 1157, 1170 (D.N.J. 1979) (stating, in the context of *Walker Process* fraud: "A misrepresentation is material if the patent would not have issued 'but for' the omission.").

Some courts have described materiality as an objective standard which focuses upon whether a reasonable person would have found the withheld information significant to the transaction. *Roberts*, 5 Cal. Rptr. 3d at 876; *Charpentier*, 89 Cal. Rptr. 2d at 123. In contrast, the element of reliance is a subjective standard that focuses on whether the allegedly defrauded party would have made the same decision but for the misrepresentation or omission. *E.g.*, *City of Atascadero*, 80 Cal. Rptr. 2d at 354-55 ("It is essential, however, that the person complaining of fraud actually have relied on the alleged fraud, and suffered damages as a result."); *see also*, *e.g.*, *Whiteley v. Philip Morris, Inc.*, 11 Cal. Rptr. 3d 807, 842-43 (Cal. Ct. App. 2004) ("Actual reliance occurs when a misrepresentation is an immediate cause of a plaintiff's conduct, which alters his legal relations, and when, absent such representation, he would not in all reasonable probability, have entered into the contract or other transaction.") (citations omitted); *Acosta v. Synthetic Indus., Inc.*, 106 Cal. Rptr. 2d 361, 377 (Cal. Ct. App. 2001) ("In order to maintain a cause of action for fraud or one based on

alleged misrepresentations, facts establishing actual reliance must be pleaded."); *Gawara v. United States Brass Corp.*, 74 Cal. Rptr. 2d 663, 666 n.8 (Cal. Ct. App. 1998) (recognizing settled law requiring a showing of actual reliance); *Orient Handel v. United States Fid. & Guar. Co.*, 237 Cal. Rptr. 667, 672 (Cal. Ct. App. 1987) ("In order, however, to plead and prove a fraud cause of action, '[it] must [also] be shown that the plaintiff *actually relied* upon the misrepresentation.'") (citing 4 WITKIN SUMMARY OF CALIFORNIA LAW, TORTS § 446, p. 2732 (8th ed. 1974)).[41] Under common law fraud principles, as well as fraud essential to establish an antitrust claim against a patent holder, the reliance must be justifiable. *See Unitherm Food Sys., Inc. v. Swift-Eckrich, Inc.*, 375 F.3d 1341, 1358 (Fed. Cir. 2004).

The common law fraud elements of materiality and justifiable reliance are also elements of any fraud exception to the *Noerr* doctrine. As recognized by the Commission in its July 7 order, the challenged representation must be one which was actually material and relied upon by the governmental body at issue. *See Balt. Scrap Corp. v. David J. Joseph Co.*, 237 F.3d 394, 402 (4th Cir. 2001) ("If a judgment is not procured by fraud or deceit, it cannot fall within any fraud exception to *Noerr-Pennington.*"); *Cheminor Drugs v. Ethyl Corp.*, 168 F.3d 119, 123-24 (3d Cir. 1999) (alleged frauds that "do not infect the core" of a case will receive *Noerr-Pennington* immunity because regardless of the alleged fraud, the outcome would have been the same); *Kottle v. Northwest*

[41] Like common law fraud, defenses to patent infringement claims, such as implied license and equitable estoppel, also require detrimental reliance. As the Federal Circuit explained, equitable estoppel requires that the "accused infringer must show that, in fact, it substantially relied on the misleading conduct of the patentee in connection with taking some action." *A.C. Aukerman Co. v. R.L. Chaides Constr. Co.,* 960 F.2d 1020, 1042-43 (Fed. Cir. 1992). Detrimental reliance is likewise critical under an implied license theory. *Stickle v. Heublein, Inc.*, 716 F.2d 1550, 1559 (Fed. Cir. 1983) ("[A]n implied license cannot arise out of the unilateral expectations or even reasonable hopes of one party. One must have been led to take action by the conduct of the other party.")

Kidney Ctrs., 146 F.3d 1056, 1063 (9th Cir. 1998) (To survive 12(b)(6) motion and overcome *Noerr* immunity, allegations must demonstrate that the defendant "so misrepresented the truth to the Department that the entire CON proceeding was deprived of its legitimacy.") Section IV(B)(2)(c), *supra*, outlines how Unocal's failure to disclose its pending applications was not material to CARB's decision making, and how CARB would have done nothing differently if Unocal had disclosed that it had a pending patent application during the Phase 2 rulemaking. Because Unocal's alleged misrepresentations were not material, they were not "central to the legitimacy" of the proceeding.

Just as CARB would have done nothing different but for Unocal's alleged misrepresentation, neither would the members of Auto/Oil or WSPA. The Complaint alleges three ways in which the members of Auto/Oil and WSPA purportedly relied upon Unocal's alleged fraud. First, the Complaint alleges that but for Unocal's fraud, WSPA and Auto/Oil participants would have advocated that CARB adopt regulations that minimized or avoid infringement. (Complaint ¶ 90(a)). Second, the Complaint alleges that refiners would have advocated that CARB negotiate license terms substantially different than Unocal was later able to obtain. (Complaint ¶ 90(b)). Finally, the Complaint alleges that but for Unocal's fraud, refiners would have been able to incorporate knowledge of Unocal's pending patent rights in their capital investment and refinery reconfiguration decisions to avoid and/or minimize potential infringement. *Id.* ¶ 90(c).

At trial, there was no reliable evidence to show that refiners would have behaved any differently, regardless of whether they had learned of the patent application at some point in the early 1990s, rather than learning of the issue patent in 1994 (as most of them did). Complaint Counsel has failed to prove any of the allegations in Paragraph 90 of the Complaint.

First, as noted above, there is no allegation (nor could there be) that Unocal ever had a duty to describe its pending patent claims to its competitors in the refining industry. Although the Complaint alleges that Unocal misled refiners by not disclosing "that Unocal intended to assert its proprietary interests (as manifested in pending patent claims)" (Complaint ¶ 2), even if Unocal *had* disclosed that it had filed a patent application and intended someday to assert any claims that might issue, the refiners would not have known the contents of the application, what claims were sought, what claims would someday issue, and what claims Unocal might disclaim. Not only was it not possible for Unocal to know what patent claims would ultimately issue (and which Unocal would ultimately pursue), but even if Unocal had known this, it had no duty to share such information with its competitors—even under the theory of fraud alleged in the Complaint. Without ever seeing the application (much less knowing the actual scope of the issued patents), there is no basis upon which the refiners would have been able to advocate for "regulations that minimized or avoided infringement." (Complaint ¶90(a)). And without knowing the claims of Unocal's yet to be issued patents, there would have been nothing that the refiners could have done to change the configuration of their refineries—even had they so desired. (Complaint ¶90(c)).

At trial, Complaint Counsel presented the testimony of Michael Sarna, who opined that there were certain steps that California refiners could have taken to reduce their overlap with the patents, had they considered the patents in their original modification plans. (*See* Sarna, Tr. 6390). But Mr. Sarna admitted that in order for the refiners to have considered the steps he outlined, they would have had to known what the claims were with respect to T50, olefins, T90 and paraffins. (Sarna, Tr. 6393). The testimony of some of the refiner witnesses echoed Mr. Sarna's admission. For example, Valero's Mr. Ibergs testified that in order to have chosen a different refinery reconfiguration Valero

would have had "to know what the claims were." (CX 7050 (Ibergs, Dep. at 109)). Similarly, Texaco's Mr. Hancock noted that simply knowing of the existence of even an issued patent provides very little useful information. (CX 7048 (Hancock, Dep. 272-77)). Texaco needed to know "what does the patent mean, what does it cover, what impact does it have on our business." (CX 7048 (Hancock, Dep. at 272-73)).

Unocal's final patent did not issue until 2000. (JX 3 at 003). Unocal could not possibly know what the claims for T50, T90, olefins and paraffins would be for its ultimate five-patent portfolio in the early 1990s. Even had it been so prescient, Complaint Counsel have alleged no duty that would require Unocal to say anything to its competitors other than that it had filed a patent application and intended to charge royalties if a patent was granted some day. Absent such a duty, Mr. Sarna's entire opinion on this point is irrelevant, unreliable, and an insufficient basis to support any finding in favor of Complaint Counsel.

Second, corporate representatives from some of the major refiners testified that, had they known that Unocal had filed a patent application, they either would have made no investments in their refineries to produce CARB 2 gasoline, or they would have made reduced investments. (*See* CX 7061 (Riley, Dep. at 12, 19-22); Gyorfi, Tr. 5289-90; (CX 7048 (Hancock, Dep. at 258-59, 264)).

Complaint Counsel's experts do not address this testimony, and indeed, it seems highly unreliable, given the questionable economics of such a decision, as well as the real world behavior of the refiners once they learned of Unocal's *issued* patent. But if one or more refiners had made no investments—or even had made substantially reduced investments—to produce CARB gasoline, the amount of gasoline that complied with the CARB regulations would have been much less than what

was needed to fulfill demand in California. (Teece, Tr. 7591-7602; RX 1162A at 068-072). Moreover, the refineries would have made additional quantities of "conventional" gasoline that would need to be exported out of California at a significant cost of approximately 25 cents per gallon. (Teece, Tr. 7592-93; RX 1162A at 069). Professor Teece concluded that had one or more refiners done as their representatives now claim, gasoline prices would have been substantially higher, by an amount dramatically higher than any amount of royalties sought by Unocal. (Teece, Tr. 7602-03; RX 1162A at 070-072; RX 1205 (demonstrative)). Even if this were a realistic but-for scenario (which it is not), it is certainly not a preferable one for California consumers.

Third, the refiners' actual behavior upon learning of Unocal's *issued* patent is very telling. Most of the major refiners learned of the patent shortly after it issued in early to mid 1994. (*See, e.g.*, CX 7076 (Youngblood, Dep. at 40-42); CX 7048 (Hancock, Dep. at 239); CX 7049 (Hochhauser, Dep. at 79-80); CX 7058 (Millar, Dep. at 33); RX 158).

At least three refiners—Exxon, Mobil and Texaco—knew of the patent before their management approved their Phase 2 capital projects. Mobil approved its plan for reconfiguring the Torrance refinery on April 26, 1994—after it learned of the '393 patent. (Eizember, Tr. 3317-18; RX 233 at 001). Likewise, individuals within Exxon knew of the issuance of the '393 patent before Exxon made its recommendation to management about which refinery reconfiguration plan Exxon should adopt. (Eizember, Tr. 3416). And Texaco made its investment decision on the Bakersfield refinery in March 1995 (CX 7048 (Hancock, Dep. at 162-65); RX 531 at 001), nearly a full year after Texaco learned of the issuance of the '393 patent (CX 7048 (Hancock, Dep. at 239-40)). None of these three made any changes in their refinery reconfiguration plans as a result of learning of the '393

patent. {[redacted]

[redacted]}, *in camera*).

Despite the fact that the major refiners knew of Unocal's patent in 1994, none brought the patent to CARB's attention. For example, as Texaco's Mr. Youngblood explained,

> [I]n my mind at that time, the Unocal patent's ability to stand up was in doubt, so if I had felt that the patent would hold, I would have expressed that concern, but I thought at the time that the patent was so ridiculous since it was covering properties that Auto/Oil members and others had been discussing back in 1989, it wouldn't hold.

(CX 7076 (Youngblood, Dep. at 55-56) (conceding that Texaco did not tell CARB of the patent in its letter to CARB or at the June 1994 CARB meeting); *see* RX 418).

Chevron learned of the '393 patent in approximately February 1994, but did not discuss it with CARB until a year later. (Ingham, Tr. 2728-29). Mr. Gyorfi testified that it would have been premature to contact CARB about the '393 patent in April 1994 because Chevron wouldn't have had enough understanding or information to have been able to make a case to CARB or to describe the patent's impact. (Gyorfi, Tr. 5260).

Most significantly, none of the refiners made any serious efforts to avoid the '393 patent for many years, despite the fact that each refiner now claims that as of April 1995 they were in possession of technology that would have enabled them to avoid the claims at essentially no cost. For example, Shell's Bakersfield refinery actually saved two cents per gallon once it made the decision to produce non-infringing oxygenated gasoline. (CX 7043 (Boone, Dep. at 41-42)). Shell's Bakersfield also avoided infringement of the '393 patent by producing 91 octane premium rather than 92 octane at essentially "no cost." (CX 7043 (Boone, Dep. at 44, 49-50); RX 91 at 003-004). The

Bakersfield refinery made the decision to take these steps to avoid infringing after the Supreme Court denied certiorari in the '393 case in March 2001. (CX 7043 (Boone, Dep. at 43-44, 54)).

Similarly, BP/ARCO stated that it can avoid the claims of the '393 patent without incurring any costs. (CX 7078 (Youngman, Dep. at 52)). ARCO has had this ability since April 1995 (RX 92 at 003-004), but did not attempt to begin blending around the '393 patent until 1997 or 1998. (CX 7077 (Youngman, Dep. at 45); Clossey, Tr. 5466; *see also* CX 7048 (Hancock, Dep. at 227-28); RX 215 at 003-004; CX 7058 (Millar, Dep. at 23-24, 37-38); RX 85 at 003-004; {██████████ ███}, *in camera*).

Moreover, Unocal's refining expert, Mr. Stellman, testified that the volume of infringed gasoline has dropped from 25.8 percent in 1996 down to the level of 1/10 of 1 percent by the year 2002 for California gasoline made during the summertime. (Stellman, Tr. 7914-7915).

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

Finally, at trial, Unocal presented the unrebutted testimony of economic expert, James Griffin, who performed an empirical analysis of the effect of the alleged deception on the refiners' reconfiguration plans using a linear programing model designed to model the California refining industry. (Griffin, Tr. 8401). Professor Griffin applied "perfect foresight" to the refiners in his model, that is, he assumed that they knew in the early 1990s the scope of all five patents that would ultimately issue, that they knew the royalty rates Unocal would announce in 2001, that the patents would be held to be valid, and that a matching analysis would be an infringing analysis. (Griffin, Tr. 8398). He chose this "perfect foresight" assumption because it was a conservative one that gave

the refiners the maximum incentive to do something differently in the early 1990s. (Griffin, Tr. 8400).

In attempting to look at what California refineries would have done (given perfect foresight and absent any alleged fraud by Unocal), Professor Griffin first modeled the California refining industry as of January 1993. (Griffin, Tr. 8411). He put in place all of the processing units that California refineries had at the time, then posed two different questions. (Griffin, Tr. 8411-12). In both cases, he asked the model to solve for the optimal capacity investments to meet 1997 marketplace demands for all the various refinery products. (Griffin, Tr. 8411-12). But in one case, he asked the model to assume there are no patents (and hence, zero royalties). (Griffin, Tr. 8411-12). In the second case, Professor Griffin asked the model to assume that the Unocal royalty schedule is in place, such that the model knows that if it intends to make certain matching blends it will need to pay a royalty on those blends. (Griffin, Tr. 8412).

Professor Griffin's analysis showed that the two cases were substantially similar. In the first case (assuming no patents/royalties), the model chose to build capacity in nine different process units, for a total industry cost of approximately $1.7 billion. (Griffin, Tr. 8419). In the second case, assuming that matching gasoline would pay a royalty, the model chose to spend approximately $1.75 billion on those same process unit capacities. (Griffin, Tr. 8419-20; RX 1219 (demonstrative); *see also* RX 1164 at 079 {[redacted]}, *in camera*)). This small difference between the two cases—together with the fact that his analysis showed that California refineries could make that additional investment at a later point in time if they chose—led Professor Griffin to conclude that refiners would have done

very little differently—even with perfect foresight into the full potential scope of Unocal's patents. (Griffin, Tr. 8422-23).

Complaint Counsel's economist, Professor Shapiro, did not dispute Professor Griffin's conclusion that even if refiners had known of Unocal's patents and royalty schedule before investing in refinery upgrades to comply with the Phase 2 RFG regulations, there was little that they would have done differently. (Shapiro, Tr. 7377). Professor Shapiro noted only that he "understand[s] the methodology" of Professor Griffin's analysis, but that he had "not checked the calculations." (Shapiro, Tr. 7377).

As noted above, Complaint Counsel presumably attempted to address the issue of whether the refiners would have done something differently, but for Unocal's alleged fraud, through the testimony of its refining expert, Mr. Michael Sarna. Mr. Sarna outlined a number of steps refiners could have taken to reduce their overlap with the patents if they had considered the patents in their original modification plans. (Sarna, Tr. 6390). But Mr. Sarna was not testifying as to what refiners *would* have done, only what they *could* have done. (Sarna, Tr. 6392). He opined that even had the refiners taken all the steps described in his report, they would have been provided only with "moderate blend around capabilities" and could not have completely avoided the Unocal patents. (Sarna, Tr. 6417-18, 6420; RX 1154A at 011).

Mr. Sarna's testimony is essentially worthless to the question at hand, however, since it is conditioned upon a number of assumptions and conditions that simply are contradicted by the undisputed facts in the record. Most importantly, in order for the refiners to have taken the steps he outlined, Mr. Sarna testified that the refiners would have had to have made the assumption that the patent would be found to be valid and that their gasolines would be found to have infringed. (Sarna,

Tr. 6404-05). And when Mr. Sarna put together this analysis of the various changes that the refiners could have made, Mr. Sarna himself assumed that the refiners would have viewed Unocal's patent as valid. (Sarna, Tr. 6405).

But none of the six major California refiners believed the *issued* '393 patent to be valid and, in fact, each joined in a lawsuit seeking a declaratory judgment of invalidity. (RX 782; *see also, e.g.*, CX 7059 (Moyer, Dep. at 117) (Texaco attorneys believed that "the patent was not valid and that a litigation challenge to it would likely succeed."); Gyorfi, Tr. 5263-64 (Chevron "had strong guidance from Counsel that these patents were invalid."); Eizember, Tr. 3261 ("both Exxon and Mobil took the position that the '393 patent was invalid").

If they didn't believe the actual *issued patent* was valid, it is not credible to assume that the refiners would have believed that a *pending application* would someday mature into a valid patent. For instance, Chevron's Mr. Gyorfi testified that, had Chevron known of the patent application in 1991, Chevron would have conducted a major study with internal and outside counsel to determine the validity of the pending patent claims, just as Chevron did in 1994 when the patent issued. (Gyorfi, Tr. 5291). Mr. Gyorfi testified that he had no reason to believe that the results of that study would have been any different in 1991 than they were in 1994. (Gyorfi, Tr. 5294-95).

In addition to knowing what the claims covered with respect to a number of parameters, Mr. Sarna also stated that for the refiners to have taken the steps he outlined they would have had to have known that CARB would come out with a predictive model. (Sarna, Tr. 6395). And, in order to determine whether they could successfully blend around the patents, a refiner would need to look at the response curves for at least T50, T90, olefins, aromatics, and sulfur—as well as everything else included in the model. (Sarna, Tr. 6389-90).

The CARB Phase 2 predictive model with equations showing the response curves for each parameter, however, was not announced until June 1994—too late for the refiners to have incorporated these steps into their "original" refinery configuration plans, which Mr. Sarna opined needed to be completed within a few months after March 1993. (*See* RX 1154A at 011-012 ("refiners could not have incorporated major scope changes into their refinery revamp plans in less than a three-year time frame," and "[c]hanging the scope of the refinery revamp to incorporate some blend around capabilities would have had to take place no later than a few months into the permitting process in order to meet the deadline for producing CARB gasoline"); Sarna, Tr. 6118 (observing that the deadline is March 1996 to make CARB Phase 2 gasoline)).

Mr. Sarna also testified that in order for the refiners to have done any economic analysis of the steps he outlined, they would have had to have known the royalty rate that Unocal and the refiners would ultimately agree upon. (Sarna, Tr. 6400). The six major refiners have never agreed upon a royalty schedule with Unocal. (Strathman, Tr. 3645-46). Moreover, some refiners testified that no license terms would have been acceptable. (*E.g.*, CX 7061 (Riley, Dep. at 19-20) (anything more than completely negligible consideration would have been too much)). Before Unocal publicly announced its licensing fees in 2001, none of the major California refiners ever asked what Unocal would charge to license. (Strathman, Tr. 3645-46). [42]

Significantly, Mr. Sarna himself did not set forth any quantitative economic analysis to demonstrate whether it would have been economically viable for the refiners to have selected any

[42] Thus Complaint Counsel's second claim in Paragraph 90(b)—that the refiners would have advocated that CARB negotiate license terms substantially different than Unocal was later able to obtain—has no merit whatsoever, since there is no evidence that the refiners would ever have advocated that CARB negotiate license terms, much less that CARB would ever have attempted such a negotiation.

or all of the steps that were outlined in his report. (Sarna, Tr. 6419). And most importantly, although he opined that refiners could have performed these steps in their original modification plans to provide them with moderate blend around capabilities, he did not offer any opinion in his report as to whether the refiners could take these steps today. (Sarna, Tr. 6421).

Complaint Counsel proffered no credible evidence to support the allegations in the Complaint that had refiners known of Unocal's claims before making their Phase 2 investments, they would have been able to have configured their refineries in such a way as to minimize or avoid infringement. (Complaint. ¶¶ 90(c), 93).

D. Complaint Counsel May Not Proceed on a Breach of Contract Theory

Despite the fact that Complaint Counsel have not pled breach of contract, their economic expert witness, Professor Carl Shapiro, relied on an unsupported contract-like theory as the key assumption underpinning his analysis. (Shapiro, Tr. 7241-42). Professor Shapiro assumed that, in order to get its "technology" accepted by CARB, Unocal offered it to CARB for a "royalty rate of zero." (Shapiro, Tr. 7241-42; CX 1720A at 015).

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

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

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

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

Id.; *Kellogg Co.*, 99 F.T.C. 8, 22-23 (1982) (holding that Complaint Counsel violated section 3.15(a)(1) by seeking relief under a theory that was not pled in the Complaint without filing a motion for amendment first and where no order of amendment had issued). Moreover, the law is well settled that claims based on theories that are not pled in the complaint do not fall "reasonably within the scope of the original complaint"; thus, the ALJ may not grant such amendments. *See, e.g.*, *Beatrice Foods Co.*, 101 F.T.C. 733, 825 (1983) (holding that "no potential competition theory of liability was pled in the complaint and that it is therefore inappropriate to consider evidence under this theory"); *Standard Camera Corp.*, 63 F.T.C. 1238, 1267 (1963) (holding that amendment to substitute word altering underlying theory of complaint "was not reasonably within the scope of . . . the original complaint and therefore was beyond the power of the hearing examiner to authorize").[43]

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

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

is, sought by the promisor in exchange for the promise and given by the promisee in exchange for that promise. RESTATEMENT (SECOND) OF CONTRACTS § 71 (1981); *see also* CAL. CIV. CODE § 1605 (2004).

Here, not a single witness has testified that Unocal intended to convey, or that CARB understood Unocal to be conveying, a "zero royalty" offer in any of Unocal's communications with CARB in 1991. The August 27 letter does not speak to patents or "technology" but only the *data base* of emissions data on a computer disk which Unocal had previously sent to CARB on a confidential basis. Mr. Lamb testified unequivocally that he intended his letter to grant permission to CARB to publish and use that data base, (Lamb, Tr. 2238), but in no way to offer CARB or the public a royalty-free license to any Unocal patent that might issue based upon inventions arising out of the 5/14 work. (Lamb, Tr. 2254-55).

Similarly, CARB did not believe Unocal's August 27, 1991 letter offered a royalty-free patent license. CARB's 3.33(c) witness Peter Venturini testified that when he received this letter in 1991, it did not occur to him that the letter had anything to do with patent rights. (Venturini, Tr. 821-22). Mr. Jim Boyd, the CARB staff member to whom the letter was addressed, testified that he was familiar with the subject matter of Mr. Lamb's letter. (Boyd, Tr. 6710-11). Mr. Boyd testified that CARB had learned that Unocal had undertaken extensive scientific study and was interested in acquiring the data from this study. (Boyd, Tr. 6710-12). Mr. Boyd recalled that Unocal originally had deemed its data to be confidential, but that he learned at some point, "that Unocal intended to make that data available, that a letter and the data were coming to the agency. And ultimately I was informed that the letter had arrived." (Boyd, Tr. 6710-12). And in 1995, when Unocal announced that it had received a patent on new compositions of gasoline, Mr. Boyd sought a limited license

from Unocal for CARB's upcoming test program, asking Unocal not to raise any patent infringement issues with respect to CARB's summer test fuel. (Boyd, Tr. 6817-18; CX 50). No such request would have been necessary had CARB believed that it already had accepted a "royalty-free offer" back in 1991. Absent any evidence of mutual assent regarding a patent license for a zero royalty, there is no support for any such breach of contract theory. It is nothing more than a post-hoc creation with no evidentiary basis.

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

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

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

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

VI. UNOCAL HAD LEGITIMATE BUSINESS JUSTIFICATIONS FOR ITS CONDUCT

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

As noted above, to have proved monopolization, Complaint Counsel had to demonstrate that Unocal's conduct was exclusionary within the meaning of the antitrust laws. Under the antitrust laws, exclusionary conduct is "behavior that not only (1) tends to impair the opportunities of rivals but also (2) either does not further competition on the merits or does so in an unnecessarily restrictive way." *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 605 (1985). The key factor courts look to in assessing whether the conduct is or is not competition on the merits is the proffered business justification for the act. *Stearns Airport Equip. Co. v. FMC Corp.*, 170 F.3d 518, 522 (5th Cir. 1999). A legitimate business justification is practically any conduct that has a rational business purpose. *Stearns Airport Equip. Co.*, 170 F.3d at 523 ("Generally, a finding of exclusionary conduct requires some sign that the monopolist engaged in behavior that—examined without reference to its effects on competitors—is economically irrational.").

Legitimate competitive behavior includes a company's efforts to enhance efficiency, reduce costs, enforce intellectual property, and maximize profits. *See, e.g.*, *In re E.I. du Pont de Nemours & Co.*, 96 F.T.C. 653, 738 (1980) (to determine whether conduct has legitimate business justification, courts look to a variety of criteria such as whether the behavior amounted to ordinary marketing practices, whether it was profitable or economically rational or whether it resulted in improved product performance). When there is a business justification, the challenged conduct is not exclusionary even if "one reason for [defendant's conduct] was to disadvantage the competition."

Universal Analytics, Inc. v. MacNeal-Schwendler Corp., 914 F.2d 1256, 1259 (9th Cir. 1990). Once asserted by the defendant, the plaintiff bears the burden of proving the lack of legitimate business justifications. *High Tech. Careers v. San Jose Mercury News*, 996 F.2d 987, 991 (9th Cir. 1993).

The Complaint alleges that as part of its advocacy of the predictive model, Unocal represented that its data was non-proprietary while maintaining the secrecy of its pending patent application. (Complaint ¶¶ 2, 3, 4, 35, 41, 58, 78). It is undisputed that the reason why Unocal gave CARB its data was to convince CARB to adopt a predictive model. (Complaint ¶¶ 2, 37, 47). This much is apparent from the August 27 letter itself (CX 29), the testimony of CARB witnesses (*e.g.*, Venturini, Tr. 822), and Unocal's internal documents from the time (*e.g.*, CX 240). Because a predictive model would allow Unocal—and other refiners—to produce whatever blends of gasoline they wanted so long as predicted emissions benefits were met, Unocal believed that a predictive model would be a more cost-effective and flexible way in which to regulate gasoline. (*E.g.*, CX 774 at 021-022). As noted above, Unocal was not alone in this desire; many others in the industry, including WSPA, also lobbied for a predictive model. (*See*, *e.g.*, CX 54 at 013; Kulakowski, Tr. 4609-10, 4651-52; RX 161 at 001). A predictive model—and in particular the "pure" predictive model for which Unocal advocated—did not in any way mandate that any company use Unocal's technology. In fact, just the opposite was true: a pure predictive model (as opposed to fuel specifications) gave everyone in the industry the opportunity to make whatever compositions of gasoline were most cost-effective for their own company. (RX 1165A at 018; RX 711 at 002). Hence, even if Complaint Counsel could have shown that there was something misleading about the language that Unocal used in attempting to persuade CARB to adopt a predictive model (which they

could not have done and did not do), this would not be *an antitrust claim*[44] because it is undisputed that the reason Unocal was using this language was to persuade CARB to adopt a predictive model—an action based upon Unocal's very legitimate business reasons of trying to improve the cost-effectiveness and efficiency of its refining operations. Seeking a predictive model—something which many of Unocal's competitors also did—was in no way exclusionary or anticompetitive. *See Bell v. Dow Chem. Co.*, 847 F.2d 1179, 1185 (5th Cir. 1988) (citing cost savings, shortage of supplies and more efficient production as examples of legitimate business concerns); *Ocean State Physicians Health Plan, Inc. v. Blue Cross & Blue Shield*, 883 F.2d 1101, 1111 n.11 (1st Cir. 1989) ("The fact remains that achieving lower costs is a legitimate business justification under the antitrust laws.").

Just as its advocacy of the predictive model was done pursuant to a legitimate business justification, so too was Unocal's conduct in maintaining the secrecy of its patent application. As noted above, Unocal was never asked whether it had any patent applications, (*e.g.*, Jessup, Tr. 1595; Lamb, Tr. 2260), nor did CARB, Auto/Oil or WSPA have any policies which required such disclosure. In fact, CARB was (and still is) prohibited by law from requiring disclosure absent a formal, written rule (CX 7029 at 070 (section 11347.5 of title 2 of the California Code of Regulations, which states that: "[n]o state agency shall issue, utilize, enforce or attempt to enforce

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

any guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule . . . unless the guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule has been adopted as a regulation and filed with the secretary of state pursuant to this chapter."); Boyd, Tr. 6830-31). So in the absence of any such formally adopted policy, practice, standard, guideline, or other rule, Unocal simply adhered to its ordinary business practice and did not reveal that it had filed for a patent application.

There was nothing unusual about Unocal's internal practice of not disclosing the existence or details of pending patent applications. Many other companies, including the refiner witnesses in this case, have similar practices. (*See, e.g.*, CX 7052 (Jacober, Dep. at 79-82, 87-88); CX 7056 (Martinez, Dep. at 87-88); CX 7075 (Wood, Dep. at 56)). As noted above, there are a number of reasons why companies such as Unocal have policies that pending patent applications should be kept confidential, such as protecting the trade secret value of the invention if for some reason the invention is determined not to be patentable and avoiding the potential for provoking an interference with the application. (*See* RX 1163 at 009; *see also Plastic & Metal Fabricators, Inc. v. Roy*, 303 A.2d 725, 733-34 (Conn. 1972) (noting that applicant retains trade secret protection contained in patent application because PTO keeps rejected applications secret)).

Protecting the secrecy of one's innovations and trade secrets is a legitimate business justification that prevents the imposition of liability under the antitrust laws. *Technical Res. Servs., Inc. v. Dornier Med. Sys., Inc.*, 134 F.3d 1458, 1467 (11th Cir. 1998); *see also Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 281-82 (2d Cir. 1979) ("a firm may normally keep its innovations secret from its rivals as long as it wishes"); *ILC Peripherals Leasing Corp. v. Int'l Bus. Mach. Corp.*, 458 F. Supp. 423, 436-37 (N.D. Cal. 1978) (IBM's policy of keeping interface

information secret promoted innovation and was not exclusionary under the antitrust laws). As Judge MacGuire held in *Rambus*, not disclosing information about pending or future patent applications is not only "rational and profit maximizing behavior," but also is procompetitive because the ability to control the disclosure of intellectual property preserves incentives to innovate. *Rambus Inc.*, No. 9302, slip op. at 287 (FTC Feb. 23, 2004).

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

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

VII. THE OPINIONS OF COMPLAINT COUNSEL'S ECONOMIC EXPERT ARE INSUFFICIENT TO SUPPORT ANY FINDINGS IN FAVOR OF COMPLAINT COUNSEL

In recognition of the liberal standard governing the admissibility of evidence in these proceedings under Rule 3.43(b), Unocal did not seek the pre-trial exclusion of the proffered opinions of Professor Shapiro. However, even when an admissibility challenge is not made initially, a party

may still challenge the sufficiency of expert testimony. A court "may review the record to determine the sufficiency of the evidence, the defendant's waiver of any challenges to the admissibility of the expert testimony does not preclude such a sufficiency review." *Stevenson v. E.I. du Pont de Nemours and Co.*, 327 F.3d 400, 407 (5th Cir. 2003). *See also In re Joint Eastern & Southern Dist. Asbestos Litig.*, 52 F.3d 1124 (2d Cir. 1995) (noting distinction between admissibility and sufficiency inquiries). Accordingly, even if an expert's opinions are not disregarded entirely, evidence supporting the opinions may be so lacking that it cannot support a finding for the party offering the expert testimony. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 242 (1993).

"When an expert opinion is not supported by sufficient facts to validate it in the eyes of the law, or when indisputable record facts contradict or otherwise render the opinion unreasonable, it cannot support" judgment for the party that proffers it. *Id.* Expert economic testimony is unreliable if it "ignore[s] inconvenient evidence" or fails to incorporate the "economic reality of the (relevant) market." *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1056 (8th Cir. 2000).[45] Moreover, the necessary connection between the data and the expert's opinion cannot be established by speculation on the part of the proffered expert.

A. Professor Shapiro's Opinions Are Not Reliable Because They Are Based upon the Assumption That Unocal Made a "Royalty-free" Offer of its Patents to CARB, Which Is Plainly Contradicted by the Record

There is no competent evidentiary support for Professor Shapiro's assumption that Unocal made a "royalty-free" offer of its patents to CARB. An opinion may be based upon assumed facts,

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[45] Complaint Counsel in *Rambus Inc.*, Docket No. 9302, urged the Commission to adopt this standard for the admission of expert testimony. (*See* Appeal Brief of Counsel Supporting the Complaint at 94 n.88 (filed April 16, 2004)).

but for the opinion to be reliable, the assumed facts must be proved true. *See, e.g., Logsdon v. Baker*, 517 F.2d 174 (D.C.Cir. 1975). The Advisory Committee Notes to the 2000 Amendments to Rule 702 reinforce this rule. "The language 'facts or data' is broad enough to allow an expert to rely on hypothetical facts *that are supported by the evidence.*" Fed. R. Evid. 702 advisory committee's notes (emphasis added). Professor Shapiro expressly agreed that if the assumption upon which he based his opinion was not provided, "then I don't see that there's any anticompetitive behavior or basis for finding that any power Unocal has was acquired through anticompetitive means." (Shapiro, Tr. 7118). He further testified that the assumption that Unocal had made a royalty-free offer was "fundamental" to his analysis. (Shapiro, Tr. 7242).

Complaint Counsel did not prove the facts underlying professor Shapiro's assumption. In fact, Complaint Counsel proffered no evidence of any royalty-free offer. Deprived of the requisite evidentiary support, Professor Shapiro could not state who made the assumed royalty-free offer, how or when the offer was made. (Shapiro, Tr. 7278-83). Because there is no competent evidentiary support for Professor Shapiro's "fundamental" assumption that Unocal made a "royalty-free" offer of its patents to CARB, Professor Shapiro's opinions are not reliable.

B. Professor Shapiro's Opinions Are Unreliable Because They Are Based upon an Insufficient Factual Foundation and Unwarranted Assumptions

A crucial step in Professor Shapiro's analysis was his opinion that Unocal made its alleged "royalty-free" offer of its technology because of its desire to get CARB to "move in the direction of a predictive model" (Shapiro, Tr. 7294) and persuade the agency of the importance of T50. (Shapiro, Tr.7307; CX1720A at 017-018). Of these two, getting CARB to move in the direction of a predictive model was most important to Unocal, according to Professor Shapiro. (Shapiro, Tr.

7294). Professor Shapiro agreed that his evaluation of Unocal's incentives to make the alleged royalty-free offer is a critical step in his analysis inasmuch as, without an incentive to make the offer, Unocal would have been unlikely to give away its patent rights. (Shapiro, Tr. 7290-92).

On cross-examination, Professor Shapiro agreed that these incentives can change over time. (Shapiro, Tr. 7289). He agreed that Unocal's incentive to make the alleged royalty-free offer depended upon what CARB was telling the public and refiners at any particular point in time (Shapiro, Tr. 7289-90), and thus on what alternatives were "on the table" (Shapiro, Tr. 7291, 7293). But Professor Shapiro did not consider evidence of critical relevance to this issue. The evidence that Professor Shapiro did not consider demonstrates that even if Unocal had an incentive to give away its prospective patents in order to accomplish the goals that he identified, Unocal's goals had been attained by August 1, 1991, and the alleged incentive no longer existed at that point.

With respect to the alleged goal of persuading CARB of the existence of T50, a November 1990 Unocal memorandum explicitly stated that the significance of T50 was certain to be discovered by CARB by April 1, 1991, and that CARB intended to regulate T50 in the forthcoming Phase II regulations. (CX 207 at 001). This document demonstrates that long before Unocal allegedly made the assumed "royalty-free offer," the company expected CARB to discover the importance of T50 and regulate it independently of anything that Unocal did. This document completely undermines that basis for the two alleged incentives to persuade CARB of the importance of T50 that Professor Shapiro cited. (*See* CX 7120A at 015-017). Professor Shapiro did not know whether he had received CX 207 before writing his report. (Shapiro, Tr. 7296-97).

Similarly, drafts of proposed regulations issued by CARB on or about August 1, 1991, proposed a T50 specification, and committed CARB to giving serious consideration to the adoption

of a predictive model. (*See* RX 184; RX 198). These documents, never considered by Professor Shapiro (Shapiro, Tr. 7310, 7316), and conceded by him to be important (Shapiro, Tr. 7293-94) and relevant (Shapiro, Tr. 7315), demonstrate that any incentive that Unocal might once have had no longer existed by August 1, 1991. Because he did not have access to this critical evidence, Professor Shapiro failed to perform the necessary analysis required to evaluate Unocal's incentives.

C. Professor Shapiro's Opinion That CARB Phase 2 RFG Rulemaking Proceeding Was a "Technology Competition" Is Unsupported by Any Facts and Therefore Is Not Reliable

Another linchpin to Professor Shapiro's analysis is his opinion that the CARB Phase 2 regulatory proceeding was "technology competition in action." (CX 1720A at 014). It is this opinion that Professor Shapiro uses, together with his assumption that Unocal made a "royalty-free" offer of its patents to CARB, to reach his opinion that the "competitive price" for Unocal's patents is "zero." (CX 1720A at 015). If Professor Shapiro's opinion that the CARB regulatory proceeding was a "technology competition" is unreliable, his entire subsequent analysis is equally unreliable. Notably, Professor Shapiro could not cite to *any* contemporaneous evidence that CARB, the refiners and the public that participated in those proceedings thought it was a "technology competition." (Shapiro, Tr. 7180). He conceded that for a "technology competition" to occur, the participants have to understand that such a competition is taking place. (Shapiro, Tr. 7181). Yet, over the course of more than 40 days of trial, there was no testimony from any witness that he or she participated in a "technology competition" during the CARB Phase 2 RFG rulemaking in 1991 or believed that such competition was taking place.

D. Professor Shapiro's Opinions Are Unreliable Because He Used Flawed Analytical Methods in This Case

Professor Shapiro's opinions are also unreliable because they are the product of flawed analytical methods.

1. Professor Shapiro's flawed model of CARB Decision-Making

In Section 4 and in Appendix E of his Report (CX 1720A at 010-023; 062-66), Professor Shapiro proposed the use of a mathematical model to attempt to demonstrate how Unocal's assumed deception "can harm competition and injure consumers." (CX 1720A at 010). Professor Shapiro asserted that his model is a "standard constrained optimization problem." (CX 1720A at 062). One foundation of the model was that "CARB is seeking to achieve reductions in emissions in the most cost-effective manner possible." (CX 1720A at 062).

Professor Shapiro failed to test this assertion to determine whether his model was based on factually supported assumptions. As a result, this opinion is unreliable.

As to Professor Shapiro's assertion that the marginal costs of each of CARB's regulations is equal, the costs of various emissions abatement regulations have ranged from a low of $1,300 per ton of emissions reductions to a high of $32,500 per ton. (RX 1164A at 044, 078; RX 1162A at 089). Given this enormous difference in average costs, it would seem far fetched that the marginal costs of these regulations would be equal. In any event, it was incumbent to test the hypothesis that CARB attempts to equalize marginal costs. But no such analysis was offered. The use of an economic model that was inconsistent with the facts renders the model unreliable.

2. Professor Shapiro's flawed model of "regulatory lock-in"

Professor Shapiro opined that Unocal has monopoly power in the relevant technology market due to what he calls "regulatory lock-in" at CARB. (CX 1720A at 028-32). He reached this conclusion based on an analysis of "specific investments." (*See* CX 1720A at 012). Professor Shapiro defined the term "specific investments" to encompass investments made by refiners to comply with the Phase 2 RFG regulations that would be "stranded" or "wasted" if CARB now adopted a different regulation. (Shapiro, Tr. 7060-62, 7069). But Professor Shapiro chose to measure these "specific investments" against an alternative—EPA Phase I regulations—that is demonstrably inferior from a cost-effectiveness standpoint to other available options, as CARB itself argued. (*See*, *e.g.*, RX 334 at 002) ("The result is increasing costs per ton over time."). He did not explain why he believed that it is useful to measure "specific investments" against an obviously inferior alternative. He did not explain why he did not examine options that were far less likely to lead to any stranding of costs, such as modifications to the caps on various fuel characteristics mandated by the regulations.

Professor Shapiro's analysis of "Regulatory Lock-In at CARB" suffers from an additional flaw. Professor Shapiro failed to compare CARB's *ex ante* regulatory alternatives with CARB's *ex post* regulatory alternatives. As defined by Professor Shapiro, the proper measure of lock-in is to "take the *ex post* switching costs that CARB would have to bear to modify its RFG regulations after learning of Unocal's patents and compare those costs with the *ex ante* costs of adopting those same alternatives to its RFG regulations." (CX 1799A at 006). This is the operative definition used by Unocal's experts as well. (Teece, Tr. 7566-67). Professor Shapiro further agreed that lock-in is a

temporal element "in the sense that your options are reduced or less attractive in comparison to what they were earlier." (Shapiro, Tr. 7345-46).

However, Professor Shapiro never performed this temporal comparison that his own definition of lock-in requires. He never identified the *ex post* switching costs that CARB would have to bear to modify its RFG regulations after learning of Unocal's patents and compare them with the *ex ante* costs of adopting those same alternatives. (CX 1799A at 006). Indeed, Professor Shapiro was completely unable to rank any of the alternatives available to CARB in 1991, 1995 or today, in terms of cost-effectiveness. (Shapiro, Tr. 7148-7158; RX 1159; RX 1160; RX 1161; Shapiro, Tr. 7224-31). He could not rule out that CARB's best alternative in 1991 to adopting the Phase 2 regulations would have been to adopt the same regulations with knowledge that compliant gasoline would be subject to a 1.7 cents per gallon royalty. (Shapiro, Tr. 7160).

Having failed to perform this comparative analysis, which his definition of lock-in requires, of whether CARB's options were "reduced or less attractive" in 1995 versus 1991, Professor Shapiro's opinion that CARB was "locked-in" to the Phase 2 regulations is unreliable.

The analysis is unreliable for another reason. As shown above, Professor Shaprior defined the term "lock-in" as switching costs. (CX 1799A at 006). At trial, he agreed with the following definition: "'Lock-in' is just a little more graphic word for switching costs, significant switching costs, and it has inherent in it the notion that one had choices *ex ante* and that one made a choice and now you're stuck with it in the sense that it is hard to switch, in the sense that your options are reduced in comparison to what they were earlier. That is, your options are reduced or less attractive." (Shapiro, Tr. 7346-47).

Although Professor Shapiro thus framed the definition of lock-in in terms of switching costs, he performed his analysis of lock-in based on sunk costs and not switching costs. (Shapiro, Tr. 7062).

The flaws described above demonstrate that Professor Shapiro's opinions are not reliable.

VIII. COMPLAINT COUNSEL DID NOT ESTABLISH THAT UNOCAL POSSESSES, OR IS DANGEROUSLY LIKELY TO ATTAIN MONOPOLY POWER

To prevail on their monopolization claim, Complaint Counsel must show that Unocal possesses monopoly power in a relevant market. *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966). Monopoly power is "the power to control prices or exclude competition" within a relevant market. *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 391 (1956). Complaint Counsel's attempted monopolization claim requires proof of a dangerous probability that Unocal will monopolize a relevant market. *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 455 (1993). Complaint Counsel are unable to meet their burden on both the monopolization and attempted monopolization claims.

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

As will be discussed more fully below, the existence of monopoly power or of a dangerous probability that it will be attained must be established by first defining a relevant market and then establishing the power of a firm to exclude competition within that market or threat that it would do so imminently. The Complaint alleges a market for CARB-compliant "summertime" RFG produced and supplied for sale in California. (Complaint ¶ 99). But Unocal exited this alleged relevant market in 1997 when it sold its West Coast refining and marketing operations to Tosco Corporation.

(Complaint ¶ 13). Consequently, Unocal cannot monopolize or dangerously threaten to monopolize this market.

It is black letter law that a company cannot monopolize or attempt to monopolize a market in which it does not compete. As the Court of Appeals for the Eleventh Circuit made clear in *Spanish Broad. Sys. of Fla. v. Clear Channel Communications,* where a defendant "does not participate" in the alleged relevant market, it "cannot attempt to monopolize that market." 376 F.3d 1065, 1075 (11th Cir. 2004); *see also Aquatherm Indus., Inc. v. Fla. Power & Light Co.*, 145 F.3d 1258, 1261 (11th Cir. 1998) (failure to allege that defendant competes in relevant market was fatal to the monopolization complaint); *Goodloe v. Nat'l Wholesale Co.*, No. 03-C-7176, 2004 U.S. Dist. LEXIS 13630, at **14-15 (N.D. Ill. July 16, 2004) (impossible for defendants to monopolize a market in which they do not participate); *Fieldturf, Inc. v. S.W. Recreational Indus., Inc.*, 235 F. Supp. 2d 708, 721 (E.D. Ky. 2002) ("a firm cannot monopolize a market in which it does not compete"), *vacated in part on other grounds*, 357 F.3d 1266 (Fed. Cir. 2004); *Moecker v. Honeywell Int'l, Inc.*, 144 F. Supp. 2d 1291, 1309 (M.D. Fla. 2001) (same).[46] This issue has also been decided in the context of an attempt by the FTC to hold a firm liable for anticompetitive effects in a market in which it did not compete. *See Official Airline Guides, Inc. v. FTC*, 630 F.2d 920, 927 (2d Cir. 1980).

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[46] Even when Unocal was a participant in the California gasoline market many years ago, it had a relatively small share—approximately 15 percent of the market. (Teece, Tr. 7525-26; RX 1162A at 045). This market share is far too small for "monopoly power" or for showing a "dangerous probability of success" of achieving such power. (Teece, Tr. 7525-26; RX 1162A at 045). Moreover, as Professor David Teece testified, it is "extremely unlikely" that Unocal would re-enter the gasoline market by leveraging its patent portfolio against refiners. (Teece, Tr. 7526-27). Such action would be inconsistent with Unocal's business strategy as well as Unocal's licensing practices. (Teece, Tr. 7527, RX 1162A at 045).

Complaint Counsel's gasoline market allegations are also contrary to the Justice Department-Federal Trade Commission *Antitrust Guidelines for the Licensing of Intellectual Property* (1995), *available at* http://www.usdoj.gov/atr/public/guidelines/ipguide.pdf. Under the Guidelines, market shares in goods markets, such as the alleged California RFG market, are measured in the same manner as in section 1 of the agencies' Horizontal Merger Guidelines. *Id.* § 3.2.1. Under that section, in turn, market shares are assigned "based on the total sales or capacity currently devoted to the relevant market together with that which likely would be devoted to the relevant market in response to a 'small but significant and nontransitory' price increase." *Horizontal Merger Guidelines* § 1.41 (1992), *available at* http://www.usdoj.gov/atr/public/guidelines/hmg.pdf. Under this approach, Unocal's share of the gasoline market is zero, and not the fanciful 100 percent share that Complaint Counsel would assign it. (Teece, Tr. 7526; RX 1162A at 044).

Wholly apart from the legal authority, Complaint Counsel will not be able to show that Unocal has monopolized the alleged market for CARB "summer-time" RFG because their economic expert does not support this claim. Complaint Counsel's expert, Professor Shapiro, offered no opinions regarding whether Unocal has obtained or exercised market power in this alleged relevant market. (*See* Shapiro, Tr. 7326; CX 1720A, CX 1799A).

B. Complaint Counsel Has Not Proved That Unocal Has Monopoly Power or Has a Dangerous Probability of Achieving Such Power Even in the Technology Market Described by Their Expert

Complaint Counsel have no evidence that Unocal possesses or dangerously threatens to possess monopoly power in the technology market defined by their economic expert. Complaint Counsel's evidence fails for at least three reasons. First, their claim of monopoly power relies on the report of an expert who conducted no analysis of the structure of the market and Unocal's power

within it and based his opinion, instead, on the assumed wrongfulness of Unocal's *conduct*. Second, Complaint Counsel cannot show that Unocal possesses monopoly power through a standard structural analysis because they have no evidence of Unocal's market share. Third, Complaint Counsel's allegations of monopoly power are dependent on the existence of a "lock-in" that cannot be proved.

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

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

As in most antitrust cases, Complaint Counsel seek to prove its monopoly power allegations through the testimony of an economic expert.[47] But, unlike in most antitrust cases, they seek to do so without evidence of market structure. They base the claim of monopoly power on the assertion that Unocal made a royalty-free offer of its patents. In other words, the evidence Complaint Counsel's expert relies upon as evidence of exclusionary conduct is the same as his evidence of monopoly power. The caselaw, however, makes clear that monopolization may not be established solely by evidence of exclusionary conduct but requires a separate showing that a firm "actually monopolizes or dangerously threatens to do so." *Spectrum Sports*, 506 U.S. at 459.

Complaint Counsel's showing of monopoly power is based on the fallacious claim that "in order to influence CARB and get its technology adopted, Unocal offered its technology [sic] on a non-proprietary basis" or "offered its patents on a royalty-free basis." (Shapiro, Tr. 7241-42, 7245-46; CX 1720A at 015). According to Complaint Counsel's economic expert, Professor Shapiro, this

[47] Professor Shapiro asserted in his report and at trial that Unocal possesses monopoly power. He did not assert in the alternative that it is dangerously threatening to obtain such power. (*See* Shapiro, Tr. 7090-91; CX 1720A at 026-032).

was part of a "technology competition," which he defined as a competition among owners of competing technologies for RFG to get their technology adopted by CARB in the Phase 2 regulatory process. (Shapiro, Tr. 7180-81; CX 1720A at 14, 15). Based on his assumption about the royalty-free offer,[48] Professor Shapiro opined that the competitive price for Unocal's patented technology is zero. (Shapiro, Tr. 7246-47; CX1720A at 015). Then, because Unocal secured a jury verdict of infringement of its '393 patent based on a damages claim expressed as a reasonable royalty that was greater than zero, and because Unocal is seeking royalties from licensing at a rate greater than zero, he concluded that Unocal is charging a monopoly price for the use of its technology. (Shapiro, Tr. 7337; CX 1720A at 024-026). This, according to Professor Shapiro, is "direct evidence of Unocal's market power." (Shapiro, Tr. 7337; CX 1720A at 024-026). None of Complaint Counsel's witnesses has testified, however, to a "technology competition" or a "zero royalty" offer and Professor Shapiro has identified no such evidence.

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

In limited circumstances, monopoly power may be established through "evidence of restricted output and supracompetitive prices. . . ." *Id.* "Because such direct proof is only rarely available,

[48] Any statements in Professor Shapiro's reports to the effect that "Unocal made its technology available on a non-proprietary basis" or "offered its patents on a royalty-free basis" reflect his standing assumption and are not assertions of fact by him. (Shapiro, Tr. 7132-33).

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

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

Professor Shapiro's assessment of monopoly power does not rely on any rigorous tool of economic analysis and does not present reliable evidence that Unocal "commands a substantial share of the market. . . ." *Republic Tobacco*, 2004 U.S. App. LEXIS 18470, at *49. Nor does it present any evidence of reduced output. Instead, Professor Shapiro *assumed* that Unocal's technology has

a value of zero and concluded that the company has monopoly power because it has sought a price higher than zero. His syllogism is (1) Unocal engaged in exclusionary conduct by offering to license its intellectual property for a price of zero; and (2) Unocal won a jury verdict and is seeking license fees that are higher than zero; therefore (3) Unocal is a monopolist.

Professor Shapiro concedes that, if this analysis is not proven, "then I don't see that there's any anticompetitive behavior or basis for finding that any power Unocal has was acquired through anticompetitive means." (Shapiro, Tr. 7118). But even if its factual predicate could be supported, the approach improperly conflates exclusionary conduct and monopoly power and seeks to establish monopoly power based on wrongful conduct, an approach that the Supreme Court rejected in *Spectrum Sports*.[49]

b. Complaint Counsel have not established that the competitive royalty level is zero

Even if Unocal had offered to license its intellectual property for a zero royalty, which it did not, this fact would not prove that it has the ability to charge a price above the competitive level. Indeed, there is no evidence that Unocal is able to charge *any* price for its patents for any consequential amount of CARB summertime RFG. { [redacted]

[redacted]

[redacted] }, *in camera*). { [redacted]

[redacted] }, *in camera*). { [redacted]

[redacted] } *in camera*). { [redacted] }, *in camera*). { [redacted]

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

}, *in camera*). { }, *in camera*).

Moreover, it is clear that the magnitude of the infringement that was the subject of the jury verdict on which Professor Shapiro relies resulted largely from the stubborn determination of the California refiners to take no steps to avoid Unocal's '393 patent, which they claimed to be invalid. (Teece, Tr. 7564; Cunningham, Tr. 4269-70; Simonson, Tr. 5985; Hoffman, Tr. 4982-83; Clossey, Tr. 5473-77; { }; *in camera*; Engibous, Tr. 3892, 3933-35). Once forced to confront a judgment of infringement of the patent, the refiners implemented very low-cost measures that resulted in virtually complete avoidance of the patent. (Stellman, Tr. 7914-15; RX 1165A at 015) (showing a drop in infringement of the '393 Patent from 25.8 percent in 1996 to 1/10 of 1 percent by the year 2002 for California summertime gasoline). Representatives from each of the major California refiners stated that they are able to blend around the claims of the '393 patent at little or no cost, and that they were aware of the means to blend around the '393 patent as of the spring of 1995, although such efforts were not implemented until much later. (RX 215 at 003-004; RX 91 at 003-004; RX 85 at 003-004; RX 92 at 003-004; RX 207A). A claim that Unocal has monopoly power based on this jury award cannot be reconciled with the evidence. (Teece, Tr. 7521-22).[50]

The claim that the competitive royalty rate is zero also cannot be reconciled with evidence that Unocal is charging nearly the same royalty rate for its patents outside of California as it is charging in California. (*See* Shapiro, Tr. 7431-32; { }, in camera; {

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

[REDACTED]} (*in camera*); {[REDACTED]}, *in camera*; {[REDACTED]}; *in camera*; {[REDACTED]}, *in camera*). As Professor Teece testified, even if one assumes that Unocal engaged in the misconduct alleged in the Complaint, the competitive price for Unocal's patents would not be zero (Teece, Tr. 7540-41), but instead would be benchmarked by the rates agreed to in the arm's length transactions between Unocal and its licensees for gasoline outside the state of California where there has been no alleged misconduct. (Teece, Tr. 7540-44, 7547-48).[51] Because the demand for technology to produce clean-burning gasoline is much higher in California than outside of California, this demand implies a higher competitive price for Unocal's patents within California. (Teece, Tr. 7547; Shapiro, Tr. 7433).

c. **<u>There is no evidence of a "technology competition" from which a competitive price could be derived</u>**

Professor Shapiro's "zero royalty" offer scenario requires what he refers to as a "technology competition in action." (Shapiro, Tr. 7180-81; CX 1720A at 014-015). There is no evidence in the record, however, that such a "technology competition" ever occurred—at least not in any economic sense from which a competitive price for technology could be derived.

As Professor Shapiro himself testified, for there to be technology competition going on, the participants must understand that there is competition going on. (Shapiro, Tr. at 7181). Here, not a single fact witness testified to any such understanding or referred to the CARB Phase 2 regulatory process as "technology competition." (Shapiro, Tr. 7180). And there was no testimony or

[51] Professor Shapiro agreed that Unocal is able to charge royalties outside of California ranging from the marginal 1.43 cents per infringing gallon to 3.4 cents per royalty-bearing gallon. (Shapiro, Tr. 7431-32). He also agreed that economists typically prefer to determine the competitive price levels by observing actual market transactions. (Shapiro, Tr. 7432).

documentary evidence at trial that anyone understood the rule-making proceeding to be one that would set a competitive price for technology.

In truth, Professor Shapiro's "technology competition" was nothing more than his attempt to re-cast the regulatory process—where various different entities, each with its own interests, engaged in lobbying in order to influence the CARB regulations—under a different name. (Shapiro, Tr. 7181-83). But the title "technology competition" carries certain requirements if it is to be used in an economic sense where a competitive price is to be determined. (Teece, Tr. 7533-34). Professor Shapiro himself admitted that if the CARB Phase 2 regulatory process were in fact a "technology competition," Professor Shapiro was not sure of how Sierra Club or other entities without a financial interest would fit in. (Shapiro, Tr. 7182-83).

In a true economic competition, one would expect to see the different competitors aware of one another, and one would expect to see the establishment of objective criteria by which the competition was to be mediated and the price was to be determined. (Teece, Tr. 7533-34). Professor Teece saw no such evidence that any of these elements were present in the CARB Phase 2 rulemaking. (Teece, Tr. 7534). In fact, Professor Shapiro conceded that this "technology competition" was as much about which technology to pick rather than about a price. (Shapiro, Tr. 7184). As noted above with the reference to Sierra Club, Professor Shapiro testified that even those participants in the 1991 CARB regulatory process who did not have a financial interest in the outcome of the rulemaking were participants in the asserted technology competition. (Shapiro, Tr. 7183-84).

Absent any evidence that CARB engaged in an economic competition in which a competitive price could be determined, Professor Teece testified that Professor Shapiro's opinion that the CARB

Phase 2 proceedings constituted a "technology competition" was not well-founded. (Teece, Tr. 7534; RX1162A at 074).

d. <u>Complaint Counsel have not shown that Unocal agreed to give away its intellectual property on a royalty-free basis</u>

The factual predicate for Professor Shapiro's analysis of monopoly power lacks any evidentiary basis. The entire determination of monopoly power rests on the assumption that "Unocal offered its technology on a non-proprietary basis." (Shapiro, Tr. 7131, 7241-43; CX 1720A at 015). But Unocal's August 1991 letter to CARB says nothing about patents, inventions, or even "technology." Instead, it refers expressly to a *data base* of emissions data on a computer disk that Unocal had previously provided to CARB on a confidential basis. (CX 29). *All* the competent evidence in the record shows that by this letter, Unocal intended to lift the confidentiality of this disk, so that CARB could incorporate the data on the disk into the larger data base it was developing to support a predictive model. Any contrary interpretation is belied by the language of the letter, by Unocal's contemporaneous memoranda regarding its intent, and by CARB's own statements and conduct.

To summarize the evidence regarding CARB's understanding of the letter, CARB has taken the position that the letter referred to "a diskette containing the data base" that Unocal had provided to that government agency (RX 327). James Boyd, the CARB Executive Director to whom Unocal addressed the letter, testified that he was familiar with the subject matter of Mr. Lamb's letter. (Boyd, Tr. 6710-11). As Mr. Boyd testified, CARB learned that Unocal had undertaken an extensive scientific study and was interested in acquiring the data from this study. (Boyd, Tr. 6710-11). Mr. Boyd recalled that Unocal originally had deemed its data to be confidential, but that he learned at

some point "that Unocal intended to make that data available, that a letter and the data were coming to the agency. And ultimately I was informed that the letter had arrived." (Boyd, Tr. 6711-12). A few years after receiving the letter, Mr. Boyd asked Unocal for a very limited royalty-free license (or covenant not to sue) in connection with an emissions test program that CARB conducted in 1995. (CX 50). Similarly, in 1995 after Unocal announced the '393 Patent, CARB's Jim Ryden suggested that it might be nice for Unocal to place its patented RFG formulations into the public domain and maybe it would do so if met with "a formidable and very costly legal assault on the RFG patent by it[s] competitors." (CX 812 at 003). This evidence cannot be reconciled with the argument that Unocal had *already* given its patented inventions to CARB or granted a royalty-free license.

Just as significantly, CARB's Rule 3.33(c) witness, Peter Venturini, testified that when he received Unocal's letter in 1991, it did not occur to him that the letter had anything to do with patent rights. (Venturini, Tr. 821-22). Certainly, no one from CARB ever told Mr. Lamb that Unocal had given its patent rights away, (Lamb, Tr. 2324), or that they believed Mr. Lamb's August 27, 1991 letter conveyed a royalty-free license to any potential RFG patents that Unocal might receive. (Lamb, Tr. 2256).

Professor Teece testified that for a number of reasons Professor Shapiro's assumption that Unocal's August 27, 1991 letter was the economic equivalent of royalty-free license lacked any support in the record. (Teece, Tr. 7529-30). First, Professor Teece has read hundreds of technology transfer agreements over the years. (Teece, Tr. 7530.) He testified that in his opinion the August 27, 1991 (CX 29) letter simply does not resemble an agreement to license or transfer technology. (Teece, Tr. 7530). Second, Professor Teece noted that the record does not support an assumption that Unocal was granting a royalty free license to its patents, since there is no evidence that either

Unocal or CARB believed that there had been a royalty free grant of Unocal's patent rights. (Teece, Tr. 7530-31). Third, Professor Shapiro's assumption that the designation of research data as "non-proprietary" is the equivalent of a royalty free offer of patent rights is contrary to a practice that is "quite common for researchers," which is for the researchers to publish research data while their patent applications are still pending for the same research, "often without disclosing that a patent application has been filed." (RX 1162A at 014, 077-078).

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

e. Professor Shapiro's royalty-free offer theory is contrary to Complaint Counsel's fundamental allegations of fraud

Professor Shapiro's analysis of this case was based on an assumption that Complaint Counsel not only did not share but attempted to refute. Professor Shapiro's analysis was based on an assumption that Unocal had made a good faith offer to license its future patents on a royalty-free basis, whereas Complaint Counsel attempted to prove the diametric opposite—that Unocal had made knowing and deliberate misrepresentations. There was no evidence adduced at trial that Unocal intended to make a royalty-free offer, that it made such an offer, or that anyone understood Unocal to have made such an offer. Complaint Counsel's entire case was based upon assertions that Unocal had misled CARB and California refiners by concealing its patent application. Even if Complaint Counsel had proved this deception case, which they have woefully failed to do, the deception alleged by Complaint Counsel would not support Professor Shapiro's analysis.

Professor Shapiro based his entire analysis on the "working assumption" that Unocal "represent[ed] that they will not be charging for [its RFG] technology or that it will be available on a royalty-free basis." (Shapiro, T r. 7073). (*See also* Shapiro, Tr. 7242 (assumption that Unocal represented "that its technology would be in the public domain or therefore that's the economic equivalent to a royalty-free offer"); Shapiro, Tr. 7246-47) (same); Shapiro, Tr. 7250 ("I'm assuming Unocal represented its technology would be available on a nonproprietary basis in the public domain. To me, that's economically equivalent to saying that there would be no royalties, so I use the term 'royalty-free offer'")). The assumption that Unocal had made an of fer to license its intellectual property for a royalty of zero was "a fundamental basis" of Professor Shapiro's analysis in this case. (Shapiro, Tr. 7242). It was on that basis that he concluded that the competitive price for Unocal's patents is zero and, in turn, that Unocal's attempt to obtain a non-zero price for its patents was anticompetitive.

On the facts of this case, this choice of assumptions was highly unorthodox. Professor Shapiro admitted that no competition existed as to the economic terms under which firms would make technology available for licensing. He testified that "[t]he competition here was certainly as much about which technologies to pick or which specs and therefore implied technologies rather than more explicitly here's a royalty rate." (Shapiro, Tr. 7184). And he acknowledged that "what was going on in front of CARB was lobbying." (Shapiro, Tr. 7182). Complaint Counsel certainly attempted to put on no evidence of a technology competition or a good-faith Unocal offer. They attempted to prove deception. The dissonance between the assumption and Complaint Counsel's own theory of the case is so great that Professor Shapiro's analysis would be of no use to Complaint Counsel even if they had proved a case of deception.

Central to Professor Shapiro's analysis was the notion that Unocal had made the royalty-free offer in good faith. In his report, Professor Shapiro put forth a theory of why it made economic sense for Unocal to give up the benefits associated with its potential future patents in return for CARB's agreement to consider the adoption of a predictive model. Recognizing that"[w]ith such a strategy Unocal presumably could not collect royalties if it did indeed obtain a patent," Professor Shapiro argued that giving up this potential future benefit made sense as a means of"influenc[ing] the CARB regulations in a way that was otherwise favorable to Unocal." (CX 1720A at 15). He offered an economic model to "explain why a royalty-free offer can be economically rational" (CX 1720A at 15), which purported to show why such an offer was the "optimal *non-deceptive strategy*." (CX 1720A at 059-061) (emphasis added). (*See also* CX 1799A at 015) (Shapiro rebuttal report).

Professor Shapiro's entire analysis of market power and competitive harm is thus predicated on the assumption that Unocal made a good faith offer to license its patents for a royalty of zero. He offered no analysis in his report based on an assumption that Unocal misled regulators to believe that it had no relevant intellectual property rights. At trial, Professor Shapiro acknowledged that "the economic logic works most precisely in that case as opposed to the case where it was bad faith." (Shapiro, Tr. 7273).

It is apparent that Professor Shapiro's logic for assuming that the alleged royalty-free offer established the competitive price falls apart when it is assumed instead that Unocal lied to regulators. The logic underlying Professor Shapiro's royalty-free offer is that "the price represented when—in a competitive situation is—is a good measure of the competitive price in a situation where we've got opportunism and then later market power." (Shapiro, Tr. 7274). This logic cannot support an assumption that the competitive price is zero, however, in a case involving deception.

Assume, for example, that a company has a patent that it has licensed in market transactions for $100,000 but believes that it can obtain $1 million per license by having regulators mandate product specifications that result in infringement of its patent. It is obvious from observing market transactions that the competitive price for this company's patents is $100,000. If the company subsequently lies by telling regulators that it has no patents and succeeds in having the regulations adopted, the competitive price for the patents is still $100,000, not zero.

In other words, it does not follow from the fact that a company misrepresented the status or existence of its intellectual property rights that the competitive price for its patents is zero. One cannot draw any inference about the price from the mere fact of misrepresentation. And since Professor Shapiro rested his entire analysis on the assumption that Unocal had made a royalty-free offer, once the company's actions are deemed deceptive, the entire basis for the analysis crumbles.

On cross-examination, Professor Shapiro admitted that the existence of deceptive conduct does not permit the assumption of a royalty free offer. He was asked to assume that a company with a patent that it is able to license for $100,0000 misrepresents to regulators that it has no patents and thereby causes regulators to adopt regulations that elevate the value of a license to $1 million per year. (Shapiro, Tr. 7164). Professor Shapiro agreed that under these circumstances, it would not be correct to conclude that the competitive price was zero simply because the patent holder made the misrepresentation. (Shapiro, Tr. 7264-66). When asked to confirm the answer he had given to that effect over a lengthy colloquy, Professor Shapiro showed no hesitancy in doing so:

> Q. Professor Shapiro, if I understood the longer answer you gave, the answer to my question that under this hypothetical would you say that the competitive price for the patents at the time of the misrepresentation was zero would have been no; is that correct?

A. I think I said no in my last answer, didn't I?

(Shapiro, Tr. 7266). Professor Shapiro similarly testified that under the same assumed facts regarding the license fees for the patents prior to the deceptive conduct, a failure to disclose patents when there was a duty to do so would not cause the competitive price at the time of the failure to disclose to zero. (Shapiro, Tr. 7267).

Professor Shapiro subsequently stated that "I have to change some of my early answer[s]," because "if a company lies and says its technology will be available on a royalty-free basis, even if it's been charging for that, maybe it's doing that to sell other products or for other commercial reasons, and I think that does change the competitive price." (Shapiro, Tr. 7268-69). But it is clear that he attempted to withdraw his the answer on normative, and not economic, grounds. He explained that "if the company, for example, was—really wanted to get this regulation passed not just to get the million dollars instead of a hundred thousand but to gain other commercial advantages . . . then I'm concerned that there could be benefits to the company of that lying that would persist even if we were to hold that company to the hundred-thousand-dollar fees because it had represented zero." (Shapiro, Tr. 7271). This answer had nothing to do with what the competitive price was, which Professor Shapiro had defined as the price represented in competitive situations, such as the assumed transactions with willing licensees before the misrepresentation occurred.

Even after attempting to withdraw his answers regarding deception, however, Professor Shapiro acknowledged that a bad faith offer to sell something of value for less than its market price does not establish that the offer price is the competitive price. Thus, he testified that a fraudulent offer to sell the Brooklyn Bridge for $1 million would not establish that the competitive price for the bridge is $1 million. (Shapiro, Tr. 7274). Professor Shapiro also stated in response to one question

on cross-examination that his analysis would be similar in the case of deception rather than a good faith royalty-free offer. (Shapiro, Tr. 7171). Although he stated in that colloquy that the model that he had used in his report to measure the alleged increase in Unocal's market power flowing from its conduct, which was based on a good faith offer, would be similar in the case of deception, he did not identify any of the alleged similarities. (Shapiro, Tr. 7171).[52]

Professor Shapiro, however, offered nothing to undercut the logic that underlay his original answer, which is that the price offered in a market transaction that occurs before the misrepresentation represents the competitive price. Because this logic is unassailable, the conclusions that Professor Shapiro drew from his assumption of a royalty-free offer are useless in a case involving deception. No inferences about the competitive price can be drawn from a misrepresentation, as Professor Shapiro acknowledged in his initial answer to the patent question and effectively conceded in his "final answer" to the Brooklyn Bridge question.

In short, Professor Shapiro's testimony was based on a "fundamental" assumption that Unocal had made a royalty-free offer for its RFG patents (Shapiro, Tr. 7242), based on which he concluded that the competitive price for a license to its RFG patents is zero. His entire analysis was

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[52] Professor Shapiro's model was based on the assumption that the variable R_1 which Professor Shapiro used to represent the expected royalty associated with the Phase 2 RFG regulations, would be zero. (Shapiro, Tr. 7170). He testified that the model would work in the case of deception and that "[r]ather than simply R1 equals zero, the calculations would be a bit different, but the basic analysis along the lines of what I talked about in my direct testimony would be the same." (Shapiro, Tr. 7171). However, in his report, Professor Shapiro stated: "If we in fact observe a level of R_1, that observation reflects *ex ante* or technology competition." (CX 1720A at 012). Thus, Professor Shapiro's conclusion that the competitive royalty level is zero was dependent on the assumption that R_1 was equal to zero. Once R_1 does not equal zero, as Professor Shapiro testified would be true in the case of deception, the assumption of a competitive price of zero cannot stand.

dependent on the existence of a good faith offer, and he acknowledged that a misrepresentation cannot be the basis for concluding that what the misrepresenting party is selling has a value of zero

2. "Matching" or "coverage" rate is not a valid proxy for market share

Complaint Counsel's experts rely heavily on the value of a so-called "coverage" or "matching" rate between Unocal's patent claims and CARB summer-time RFG produced by major California refiners.[53] Professor Shapiro analogized "coverage" rates to market share and opined that the high coverage rate of gasoline produced by the refiners—while not as important as the "direct evidence"—is an indication of Unocal's alleged monopoly power. (CX 1720A at 027; CX 1799A at 024-027). Professor Shapiro opined that coverage or "matching" rates are a good proxy for infringement rates. (Shapiro, Tr. 7330-31).

This approach is inherently unreliable, as it ignores claims limitations in Unocal's patents that have not been construed by the courts and which the California refiners construe as placing virtually all California RFG outside the patents' reach. It also completely disregards alternative technologies that could be brought to bear to avoid the patents in the event that the patents were construed as reaching the refiners' gasoline.

To establish monopoly power, all technologies and goods that compete with Unocal's patented technology must be examined.[54] Once these technologies and goods are identified,

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

[54] The relevant technology market must include both competing technologies and competing goods because "the owner of a process for producing a particular good may be constrained in its conduct with respect to that process not only by other processes for making that good, but also by other goods that compete with the downstream good and by the processes used to produce those other goods." U.S. Federal Trade Commission and Department of Justice, *Antitrust*
(continued...)

Unocal's share of the relevant market must be determined. As a matter of law, a share below two-thirds of the market is insufficient to establish monopolization of a market. *See Colo. Interstate Gas Co. v. Natural Gas Pipeline Co.*, 885 F.2d 683, 694 n.18 (10th Cir. 1989) ("courts generally require a minimum market share of between 70% to 80%"); *Holleb & Co. v. Produce Terminal Cold Storage Co.*, 532 F.2d 29, 33 (7th Cir. 1976) (60% insufficient); *Fineman v. Armstrong World Indus., Inc.*, 980 F.2d 171, 201-02 (3d Cir. 1992) (55% insufficient); *Blue Cross & Blue Shield United of Wisc. v. Marshfield Clinic*, 65 F.3d 1406, 1411 (7th Cir. 1995) (50% insufficient); *Twin City Sportservice, Inc. v. Charles O. Finley & Co.*, 512 F.2d 1264, 1274 (9th Cir. 1975) (50% insufficient).[55]

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

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[54] (...continued)
Guidelines for the Licensing of Intellectual Property ¶ 3.2.2, n.18 & Example 2.

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

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

There is no way to establish Unocal's market share without determining (1) the percentage of CARB summertime RFG that infringe Unocal's patents (which necessarily requires the Court to construe the claims of the four patents which have never been litigated); (2) the alternate technologies used to produce the non-infringing gasolines that account for the remainder of the market; and (3) the substitutability of the alternatives for Unocal's patents. Because California refiners are neither paying for the use of Unocal's patents nor making significant efforts to avoid Unocal's patents,[56] even a proper infringement analysis, standing alone, will not reveal the alternative technologies that are reasonably interchangeable with the technologies claimed by Unocal's patents. Rather, it is necessary to examine the technologies that would be used to avoid Unocal's patents if California's refiners faced the choice of either paying Unocal royalties or investing to avoid the patent, as is the case with the '393 patent. The so-called "coverage rate" computed by Complaint Counsel's expert, Blake Eskew, did not even purport to be an infringement analysis; it did not attempt to determine the applicability of important claims limitations in Unocal's patent, and did not even identify the gasolines that purportedly infringe the claims of Unocal's patents. (Eskew, Tr. 2887-89; CX 1709A at 020-021).

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[56] The major refiners in California consider the patents to be invalid and, with the exception of ExxonMobil, they have not tried to avoid "matching" the numerical limitations of Unocal's patent claims, except for those of the one patent that they have been adjudged to infringe—the '393 patent. (Simonson, Tr. 6064; *see also* Simonson, Tr. 6045, *in camera*; Gyorfi, Tr. 5283-84, 5268-69; Engibous, Tr. 4060-61; CX 7078C (Youngman, Dep. at 52, 83); CX 7048 (Hancock, Dep. at 248-49); CX 7051 (Irion, Dep. at 83-84).

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

Unocal owns five patents related to reformulated gasoline. The 41 claims of the first patent, the '393 patent, are directed solely to certain compositions of motor gasoline with properties meeting specific "numerical requirements," *e.g.*,

> 117. [An unleaded gasoline fuel, suitable for combustion in an automotive engine, said fuel having a Reid Vapor pressure no greater than 7/0 psi, and a 50% D-86 distillation point no greater than 200° F., and a 90% D-86 distillation point no greater than 300° F., and a paraffin content greater than 85 volume percent, and an olefin content less than 4 volume percent] wherein the maximum 10% distillation point is 158° F (70° C.).

(RX 793 at 025). The courts have construed the claims of the '393 patent to require that the infringing gasoline (1) meet the requirement of the preamble to the claim which they have construed as requiring the gasoline to be a composition of traditional motor gasoline; and also (2) meet the stated numerical property limitations for the claim. *See Union Oil Co. Of Cal. v. Atlantic Richfield Co.*, 208 F.3d 989, 996 (Fed. Cir. 2000); *see also* ((Linck, Tr. 7772; Wirzbicki, Tr. 1086-76; RX 1163 at 007).

The fourth patent, the '126 patent, contains 40 compositional claims. (CX 620). The remaining 26 claims of the '126 patent claims and all of the claims of the '567 patent (40 claims), '866 patent (58 claims) and '521 patent (58 claims) are directed to methods and processes for making or using certain, specified compositions of gasoline. (CX 618, CX 619, CX 620, CX 621). In other words, the method and process claims also involve compositions of gasoline, but are further limited by requirements for how the gasolines are made, used or distributed. The claims of these other four patents have not been construed by a court.

A patentee's rights are highly circumscribed by the claims of the patent, which must be read in light of the specification and the patent prosecution history. *See Burke, Inc. v. Bruno Ind. Living Aids, Inc.*, 183 F.3d 1334, 1340 (Fed. Cir. 1999) (patent claim "provides the metes and bounds of the right which the patent confers on the patentee to exclude others from making, using or selling the protected invention") (citation omitted); *Jones v. Hardy*, 727 F.2d 1524, 1528 (Fed. Cir. 1984) (the claims of a patent "measure and define the invention"); *Amazon.com, Inc. v. Barnesandnoble.com, Inc.*, 239 F.3d 1343, 1351 (Fed.Cir. 2001) (same). Here, Unocal's "right to exclude" under the patents extends only to those compositions, methods and processes that are proved to actually infringe a claim of its patents.

Determining infringement is a two-step process: first, the claims must be construed in light of the claim language, the specification and the prosecution history of the patent to determine its scope and meaning; second, they must be compared, as construed, to the accused device or process. *See Tate Access Floors, Inc. v. Interface Architectural Res., Inc.*, 279 F.3d 1357, 1365 (Fed. Cir. 2002); *Eaton Corp. v. Rockwell Int'l Corp.*, 323 F.3d 1332, 1337 (Fed. Cir. 2003). To prove infringement, each and every limitation of the claim must be present in the accused device, method, or process. *See Tate Access Floors*, 279 F.3d at 1365; *see also Southwall Techs., Inc. v. Cardinal IG Co.*, 54 F.3d 1570, 1575 (Fed. Cir. 1995). Both infringement and validity must be examined on a claim-by-claim basis. *See Amazon.com*, 239 F.3d at 1351. No claim limitation may be ignored as insignificant or immaterial. *Techsearch, L.L.C. v. Intel Corp.*, 286 F.3d 1360, 1373 (Fed. Cir. 2002); *Lockheed Martin Corp. v. Space Systems, Loral, Inc.*, 324 F.3d 1308, 1319 (Fed. Cir. 2003) (explaining that claims may not be improperly broadened by ignoring the clear limitations contained in the claim language).

Complaint Counsel have made no attempt to prove that any of the gasoline infringes Unocal's patents. Mr. Eskew compared the numerical property limitations of Unocal's patents to the numerical properties of gasoline batches made by major California refiners and concluded that 93% of gasoline produced by major California refiners to comply with the summer-time RFG "overlapped" certain limitations in Unocal's patent claims. (CX 1709A at 021). Mr. Eskew admitted that proof of infringement requires more than simply matching numerical property limitations and that he did not perform an infringement analysis. (Eskew, Tr. 2887-89). Professor Shapiro nevertheless relied on Mr. Eskew's analysis as a proxy for market share. (CX 1720A at 026). Professor Shapiro admitted that infringement rates would be a more significant indicator of market power, but that he has used Eskew's matching rates as a proxy because no one has shown him that the two are materially different. (Shapiro, Tr. 7331). Their analysis impermissibly ignored all claim limitations except numerical values of gasoline properties. The only reasonable conclusion that can be reached on the record is an utter failure of proof on infringement.

(2) Examining the market under a "likelihood of infringement" standard still requires full infringement analysis including construction of the claims

In its July 6, 2004, decision in this action, the Commission holds that it may conclude there is market power by finding that certain technologies are "likely to infringe" instead of requiring proof of infringement. Commission Opinion at 54 ("We may conclude that certain technologies are likely to infringe and therefore may not provide a significant competitive check on whatever market power Unocal may possess, but this does not find infringement"). Unocal respectfully disagrees. Even if that were the case, however, the standard requires resolution of substantial questions of patent law.

Moreover, even under the "likely to infringe" standard, Complaint Counsel has failed to offer any evidence to support its case.

Courts frequently deal with the question of "likelihood of infringement" when determining motions for preliminary injunction in patent infringement cases. The law is well-settled that even there—when only a preliminary injunction is at stake—a full (albeit tentative) claim construction and infringement analysis is required:

> An assessment of the likelihood of infringement, like a determination of patent infringement, requires a two-step analysis. "First, the court determines the scope and meaning of the patent claims asserted . . . [Secondly,] the properly construed claims are compared to the allegedly infringing device." Step one, claim construction, is an issue of law. Step two, comparison of the claim to the accused device, requires a determination that every claim limitation or its equivalent be found in the accused device. Those determinations are questions of fact.

Oakley, Inc. v. Sunglass Hut International, 316 F.3d 1331, 1339 (Fed. Cir. 2003) (citing *Cybor Corp. v. FAS Techs., Inc.*, 138 F.3d 1448, 1454 (Fed. Cir. 1998); *see also Jack Guttman, Inc. v. Kopykake Enterprises, Inc.*, 302 F.3d 1352, 1361-62 (Fed. Cir. 2002) (reversing denial of preliminary injunction on grounds that the district court misconstrued the claims and therefore improperly found a failure of proof as to likelihood of infringement). "Only when a claim is properly understood" can judgments be made about the likelihood of infringement. *Amazon.com, Inc.*, 239 F.3d at 1351 (construing disputed claim terms on appeal from grant of a motion for preliminary injunction).

Here, there was a complete failure of proof to show what any of the method or process claims mean or that they are likely to have been infringed. For example, claim 41 of the '126 patent, as dependent on claim 1, requires:

41. A method comprising:

(1) blending at least two hydrocarbon-containing streams together to produce at least 50,000 gallons of an unleaded gasoline as defined in claim 1[:

An unleaded gasoline, suitable for combustion in an automotive engine, having the following properties:

(a) a Reid Vapor Pressure less than 7.5 psi;
(b) a 10% D-86 distillation point no greater than 158° F.;
(c) a 50% D-86 distillation point less than 203° F.;
(d) a 90% D-86 distillation point less than 300° F.;
(e) a paraffin content greater than 65 volume percent;
(f) an olefin content less than 8 volume percent;
(g) an aromatics content of at least 4.5 volume percent; and
(h) an octane value of at least 87;]

and

(2) commencing delivery of unleaded gasoline produced in step (1) to gasoline service stations.

(CX 620 at 027-028). Complaint Counsel elicited some testimony about blending at least two hydrocarbon streams together, batches of 50,000 gallons and whether the gasoline is or is intended to be used in gasoline service stations, but nothing at all about what these terms mean. (*See*, *e.g.*, Engibous, Tr. 3957-58, *in camera*; Hepper, Tr. 4079-80, *in camera*; Lieder, Tr. 4793-94, *in camera*; Hoffman, Tr. 5034, 5036, *in camera*; Eizember, Tr. 3334, *in camera*; Doherty, Tr. 2930-31, *in camera*.) Complaint Counsel elicited nothing at all about terms such as "commencing delivery" or what that term means to one of ordinary skill in the art based on the claim language, specification and prosecution history.

Complaint Counsel may argue that these are simple terms that are common in the industry or that they are insignificant to the questions before this Court because a refiner whose gasoline meets the numerical property limitations of a claim is likely to infringe. Many patent cases, however, are fought at the Federal Circuit and Supreme Court levels based on a dispute over

seemingly-simple terms. *See, e.g., Amazon.com*, 239 F.3d at 1352 ("single action"); *Middleton, Inc. v. Minnesota Mining and Mfg. Co.*, 311 F.3d 1384, 1387 (Fed. Cir. 2002) ("uniform"); *Talbert Fuel Sys. Patents Co. v. Unocal Corp.*, 275 F.3d 1371 (Fed. Cir. 2002) and *Talbert Fuel Sys. Patents Co. v. Unocal Corp.*, 347 F.3d 1355 (Fed.Cir. 2003) ("having" and "consisting essentially of"). Moreover, as mentioned above, no claim limitation may be ignored as insignificant or immaterial.

With the example of claim 41 from the '126 patent, the term "commencing delivery" raises a number of questions as to (1) what "commencing delivery" means; and (2) where and when the measurement of gasoline properties (*e.g.*, reid vapor pressure, distillation points, paraffins, olefins, etc.) takes place for purposes of meeting the "commencing delivery" language. Even if one assumed the other claim limitations of claim 41 were met, there is no showing that the gasoline batches as measured at the refinery would meet the claim language – because there is no evidence as to whether commencing delivery of the gasoline takes place at the refinery or after the gasoline has been blended with ethanol.[57] And, as Mr. Eskew testified, blending the product with ethanol changes its numerical property values. (Eskew, Tr. 2905-09).

Here, as to the method claims in this case, Mssrs. Eskew and Stellman conducted a "matching" analysis based on refiners' batch data; there is no evidence in the record as to whether the measurement used by Mssrs. Eskew or Stellman took place before or after blending with ethanol. If "commencing delivery" of the gasoline is construed to require that the gasoline be measured after blending, then there is a complete failure of proof because the final properties after ethanol blending

[57] Complaint Counsel attempted to side-step the inquiry by phrasing their questions in terms of what percent of product was "ultimately" delivered to service stations, ultimately shipped to service stations or "ultimately intended to wind up at retail service stations." (*See, e.g.*, Lieder, Tr. 4794, *in camera*; Hoffman, Tr. 5036, *in camera*; Doherty, Tr. 2931, *in camera*; Eizember, Tr. 3334, *in camera*). There is no evidence that one of skill in the art, in light of the pertinent file histories, specification and claims, would construe "commencing" to mean "ultimately."

have not been provided in this action. (*See, e.g.*, Eskew, Tr. 2905-09 (for CARBOB batches, Mr. Eskew estimated what the property measurements would be after blending with ethanol – he did not look at the actual final properties).[58]

Claim 41 of the '126 patent is one of 182 method and process claims in Unocal's RFG patents. It is a relatively simple method claim. An example of one of the many more complicated claims among Unocal's patents is claim 2 of the '866 patent:

> 2. A method for aiding in minimizing air pollution caused at least in part by exhaust emissions from gasoline-powered automobiles equipped with catalytic converters and operating within a geographical area defined by a city and its contiguous area populated by at least 500,000 persons, the geographical area also encompassing a plurality of automotive gasoline service stations,
>
> the operation of said automobiles contributing to air pollution in said geographical area,
>
> the method, performed by a gasoline supplier delivering at least 100,000 gallons per day of unleaded gasoline as defined below for automotive combustion in the geographical area during a one week time period, comprising:
>
> delivering to at least 25% of the automotive gasoline service stations supplied by said supplier in said geographical area during said one week time period unleaded gasoline yielding, upon combustion, a reduced amount of NOx, CO, and unburned hydrocarbons as compared to Fuel A/O AVE, said unleaded gasoline being suitable for combustion in an automotive engine and having a Reid Vapor Pressure less than 7.5 psi, an octane value of at least 87, a 10% D-86 distillation point no greater than 158° F., a 50% D-86 distillation point no greater than 210° F., and an olefin content less than 10 volume percent.

(CX 619 at 027). In this claim as in many others, there are any number of variables, each of which brings import to the scope of the claim and proof of infringement or even "likelihood of infringement." Complaint Counsel offered no evidence as to what any of the terms of this claim

58 This is particularly significant to injunctive relief because virtually all summertime gasoline in California has been made in CARBOB batches and then blended with ethanol. (Eskew, Tr. 2889).

mean or to show that any of the method or process steps have been met, much less in connection with the specified properties.

(3) Complaint Counsel's matching analysis is meaningless in light of the unresolved ethanol dispute

Professor Shapiro admitted that infringement rates would be a better indicator of market power than "matching," but used Eskew's matching rates as a proxy because no one has shown him that the two are materially different. (Shapiro, Tr. 7331). Such an analysis impermissibly attempts to shift the burden of proof of market power to respondent to show infringement is different than matching. (Shapiro, Tr. 7331). But even so, the record suggests a significant difference.

Counsel for Unocal questioned representatives for each of the refiners about infringement of the RFG patents during depositions in this case. Not a single refiner witness was willing to testify—either to infringement or means of avoiding infringement. Each witness was instructed by refiners' counsel not to answer, on the grounds that the questions called for a legal conclusion. (*See* Engibous, Tr. 3928-29; {[redacted]}, *in camera*; CX 7047 (Hancock, Dep. at 43-44); CX 7048 (Hancock, Dep. at 198-99, 204-05, 252-53); CX 7050 (Ibergs, Dep. at 62-63, 64-65, 70, 92-93, 93-94); CX 7078 (Youngman, Dep. at 81, 93-94, 108)). Had the refiners answered these questions, they would have had to testify that the infringement rate, from their perspective, is close to zero if they continue to assert that ethanol blended gasoline does not meet the limitation of an unleaded gasoline suitable for combustion in an automotive engine.

Since the phaseout of MTBE in California, nearly all of the CARB summertime gasoline in California is now blended with ethanol. (Eskew, Tr. 2889; *see also* Venturini, Tr. 399-400; Sarna, Tr. 6153). In the pending patent litigation, the refiners have taken the position that gasolines made

with ethanol do not infringe Unocal's patents, and their expert, Robert Cunningham, has testified that the question is a matter of claim construction. (*See* Cunningham, Tr. 4356, 4358-59; Strathman, Tr. 3659-60; Eskew, Tr. 2890; Shapiro, Tr. 7332; CX 1579 at 007). The judge in the district court has not decided the issue. (Strathman, Tr. 3660).

As Complaint Counsel's expert admits, a decision that gasolines made with ethanol do not infringe would cause Unocal's alleged market power to be "greatly reduced." (Shapiro, Tr. 7332-33). Even if the gasoline met all numerical property limitations, if gasoline blended with ethanol does not infringe as a matter of law, the matching analysis means nothing at all.[59] More specifically addressing the Commission's concerns, there would be no question that refiners' technologies are not "likely to infringe" and no competitive check on Unocal's market power would be required.

(4) **Unocal's licenses do not evidence market power**

{[redacted] } (*See* {[redacted]}, *in camera*; {[redacted]}, *in camera*; {[redacted]}, *in camera*; {[redacted]}, *in camera*). They have chosen to use this method as a matter of administrative convenience. *Cf. Zenith Radio Corp. v. Hazeltine Research,* 395 U.S. 100, 138 (1969) (royalty structure may be set for convenience of parties). The collective royalties paid to Unocal under the licenses represent a very small portion of the California market for summertime gasoline.

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

Complaint Counsel urge the Court to extend the "matching" analysis outside of the licensing context. According to Complaint Counsel, the licenses show that "matching" is a good proxy for infringement and thus for determining market power.

Complaint Counsel is in error. Infringement must be determined by first construing the claims of a patent in light of the claim language, the specification and the prosecution history. *See Interactive Gift Express, Inc. v. Compuserve, Inc.*, 256 F.3d 1323, 1331 (Fed. Cir. 2001) (*citing Vitronics Corp. v. Conceptronic, Inc.*, 90 F.3d 1576, 1582 (Fed. Cir. 1996)). These are the intrinsic evidence of what the claims mean. *Id.* Extrinsic evidence may not be used to alter any claim meaning discernible from the intrinsic evidence. *See Intel Corp. v. VIA Techs., Inc.*, 319 F.3d 1357, 1367 (Fed. Cir. 2003). Here, Complaint Counsel has not presented a claim construction based on an intrinsic analysis and, therefore, has no grounds to urge this Court to resort to extrinsic evidence.

Licenses, moreover, present unique issues. A patent license is governed by the laws of contract. *See Jazz Photo Corp. v. International Trade Commission*, 264 F.3d 1094, 1107-08 (Fed. Cir. 2001). With specific regard to licenses, the court in *Cardiac Pacemakers, Inc. v. St. Jude Pacemakers, Inc.* offered sound reasoning for why patent licenses are not useful to the claim construction process:

> First, under *Markman*, it is clear that evidence relevant to claim construction should be publicly available evidence. Other inventors are entitled to know the scope of the claims and may try to design around those claims. If evidence of licensing agreements and royalty payments (which are often confidential) were deemed relevant to claim construction, the scope of claims could not be known without access to private, often highly confidential information from multiple sources in an industry. Second, as the evidence in this case suggests, an industry may operate on the basis of a complex web of cross-licensing agreements negotiated on the basis of a complicated matrix of business considerations and legal risks.

Cardiac Pacemakers, Inc. v. St. Jude Pacemakers, Inc., No. IP 96-1718-C H/G, 2000 U.S. Dist. LEXIS 17352, *23, n. 5 (S.D. Ind. Nov. 29, 2000), *aff'd in part, reversed in part and remanded—all on other grounds*, 381 F.3d 1371 (Fed. Cir. 2004) (internal citations omitted). For these reasons, the court there found that , "[t]he fact that licenses have been negotiated and royalties paid offers little or nothing of probative value as to how claim language should be construed when a court is finally called upon to provide a definitive construction." *Id.*; *see also*, 2 W. Robinson, Law of Patents § 732, pp. 481-83 (1890) ("But in the actual interpretation of the patent the court proceeds upon its own responsibility, as an arbiter of the law, giving to the patent its true and final character and force").

Here, the licenses between Unocal and its licensees offer nothing by way of determining the meaning of the patent claims at issue and providing public notice of that meaning. Unocal and its licensees willingly entered into licenses, the terms of which are confidential. The parties could have structured the licenses and fees in any number of ways, including a one time paid-up fee, an annual lump sum, or a royalty on every gallon of gasoline made by the licensee. They chose to structure their licenses in a manner that would simplify the royalty determination and reporting process for the convenience of the parties. In the event of a dispute, the remedy is in an action for breach of contract rather than one for patent infringement.[60]

These licenses as a matter of law cannot provide input as to as to how Unocal would have to prove for patent infringement in an action for damages and/or an injunction. In patent

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

infringement litigation, it is neither the right nor the responsibility of the parties to construe the claims in their confidential transactions; it is a matter reserved wholly to the court to construe the claims based on the intrinsic public evidence of record. *Markman v. Westview Instruments*, 52 F.3d 967, 970-71 (Fed. Cir. 1995) ("[T]he interpretation and construction of patent claims, which define the scope of the patentee's rights under the patent, is a matter of law exclusively for the court.").

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

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

There is another significant reason why Dr. Eskew's matching analysis is not a valid proxy for infringement, let alone Unocal's market power. Even if this matching percentage could show the extent to which refiners have infringed Unocal's patents to produce CARB-compliant gasoline, simply analyzing the amount of infringing gasoline made by refiners that are *not paying for Unocal's patents* reveals nothing in this context about whether and to what extent the refiners would elect to use Unocal's technology if they were required to pay the competitive price.

The proper measure of Unocal's share of the technology market is the usage of Unocal's technology that is paid for or would be made if the refiners were paying for it. (RX 1162A at 055). It is an elementary economic principle that demand at a price of zero is not representative of what

demand would be at a positive price. This economic truth is not merely of theoretical interest. In the case of Unocal's '393 patent, the infringement rate dropped from 29 percent during the pre-trial period, when the refiners did not attempt to avoid the patent, based on their belief that it was invalid, to 0.1 percent once they instituted their low-cost technologies to avoid it. (RX 1165A at 014-015).[61] Significantly, none of the major California refiners has licensed Unocal's patents.

Complaint Counsel are asking this Court to presume that there are no substitute technologies based on the "matching rate" analysis. The evidence shows that this analysis is factually unfounded. {[redacted]} (Simonson, Tr. 6064; see also Simonson, Tr. 6045, in camera; Gyorfi, Tr. 5283-84, 5268-69; Engibous, Tr. 4060-61, in camera; Eizember, Tr. 3573-74, in camera; CX 7078C (Youngman, Dep. at 52, in camera); CX 7048 (Hancock, Dep. at 248-49); CX 7051 (Irion, Dep. at 83-84); (CX 7052 (Jacober Dep. at 54-56)); (CX 7058 (Millar, Dep. at 56; (CX 7050 (Ibergs, Dep. at 74-78).

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[61] The refiners did not take action to avoid the '393 patent for several years (*see* Clossey, Tr. 5466-67; CX 7077 (Youngman, Dep. at 45); {[redacted]}, *in camera*; CX 7047 (Hancock, Dep. at 245-46); CX 7052 (Jacober, Dep. at 23); CX 7058 (Millar, Dep. at 37-38); CX 7061 (Riley, Dep. at 12-15); CX 7051 (Irion, Dep. at 27-28L; {[redacted]}, *in camera*), even though all of them had the ability to, and ultimately did, avoid it for a very low cost. (*See, e.g.*, RX 85; RX 92; RX 207A; RX 215; RX 224). The refiners followed this path because they were confident the Unocal patent was invalid and unenforceable.

(6) <u>There is no evidence of market power without a claim-by-claim analysis</u>

Alternate technologies and the substitutability of those alternatives is a necessary part of the market power analysis. It is impossible to identify available alternates, however, without a claim-by-claim analysis of the five Unocal patents. No evidence of such an analysis was ever offered in this case.

As stated several times throughout this brief, it is the claims of a patent that define the scope of the patentee's rights under the patent. *See Markman v. Westview Instruments*, 52 F.3d 967, 970-71 (Fed.Cir. 1995); *see also Jones v. Hardy*, 727 F.2d 1524, 1528 (Fed.Cir. 1984) ("'[I]deas' are not patentable; claimed structures and methods are . . . . Analysis properly begins with the claims, for they measure and define the invention"). Each claim must be considered as a separate, patented invention. *See Jones v. Hardy*, 727 F.2d 1524, 1528 (Fed.Cir. 1984). Infringement and validity analyses, therefore, must be performed on a claim-by-claim basis. *See Amazon.com, Inc. v. BarnesandNoble.Com, Inc.*, 239 F3d 1343, 1351 (Fed.Cir. 2001).

Professor Teece demonstrated how the analysis of separate claims affects a market analysis. (Teece, Tr. 7556-65; RX 1207 (demonstrative)). He presented a hypothetical situation with an analysis of five patent claims. The "matching" rates for the hypothetical claims was high. He showed what happened when a hypothetical claim with a "matching" rate of 80 percent was found invalid; from that point forward, the infringement rate with respect to that claim was zero. He then showed what happened when another hypothetical claim, with a matching rate of 40 percent, was construed narrowly in an invalidity or infringement analysis; matching on that claim dropped to 5

percent. (Teece, Tr. 7558-60 (explaining that the district court holding that fuels with ethanol do not infringe is one example of a claim construction that could dramatically affect the infringement rate).

"Matching" Is Not A Good Proxy For Infringement/Market Share

Illustrative Example: Hypothetical World With Five Patent Claims

Claim	Matching Rate ([illegible])	Factor Affecting Infringement Rate	Infringement Rate (On Going-Forward Basis)
A	80%	Claim is found invalid	0%
B	40%	Claim is construed narrowly	5%
C	29%	Refiners implement ability to blend around at low cost (even with no change in regulations)	1%
D	50%	CARB makes minor change in regulations, which allows refiners to blend around at low cost	3%
E	5%	None	5%
Overall	[illegible]		[illegible]

(RX 1207) (demonstrative).

With respect to a third hypothetical claim, CARB decided to change the regulations in a respect that made it easier for refiners to work around the claim. With a fourth hypothetical claim,

refiners learned to blend around the claim, as they did with the '393 patent after litigation. Each decision affected both infringement on the individual claim and opened up available alternatives that dramatically affected the rate of hypothetical matching overall, reducing the hypothetical matching rate from 93 percent to 8 percent. (Teece, Tr. 7556-65; RX 1207). Professor Teece described this—the effect of the claim-by-claim analysis—as driving a "wedge" between the matching rate and the infringement rate. (Teece, Tr. 7557).

This is, in fact, how refiners operate. For example, when Texaco learned of the '393 patent, it conducted a claim-by-claim validity analysis and prior art search for art that would invalidate the claims that existed in the issued patent at that time. (RX 537 at 001). According to then confidential, internal reports as early as September 19, 1994 (before the patent was even announced publicly), Texaco had amassed "prior art samples which covered 201 out of the 211 claims in the Unocal patent." (*Id.*). Significantly, the reports stated that "The search of additional samples is continuing and *impacts of the uncovered claims are being evaluated*." In other words, Texaco would analyze validity challenges for those claims that it believed it could invalidate with prior art, and it would analyze the impact and alternatives for avoiding claims that it believed it could not invalidate.

{[redacted]}, *in camera*).

There are a total of 263 claims in the five Unocal patents. {[redacted]

[redacted]} (Simonson, Tr. 6064; *see also* Simonson, Tr. 6045, *in camera*; Gyorfi, Tr. 5283-84, 5268-69; Engibous, Tr. 4060-61; CX 7078C (Youngman, Dep. at 52, 83); CX 7048 (Hancock, Dep. at 248-49); CX 7051 (Irion, Dep. at 83-84). {[redacted]

[redacted]

[redacted]} Engibous, Tr. 4069, *in camera*; CX 7078C (Youngman, Dep. at 79, 81), *in camera*. Without this analysis, Complaint Counsel fail to establish that the matching rate identified by Mr. Eskew and Mr. Stellman is any indication of actual market power where there is potential that infringing amounts on the hundreds of claims at issue could be reduced through a combination of work-around solutions, court determinations of claim validity or narrow claim construction, and/or regulatory relief from CARB. Complaint Counsel have thus failed to establish that Unocal has monopoly power in the relevant technology market, and Professor Shapiro's opinions with respect to indirect evidence of market power should therefore be disregarded.

IX. COMPLAINT COUNSEL DID NOT ESTABLISH THAT UNOCAL'S CONDUCT CAUSED ANY ANTICOMPETITIVE EFFECTS

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

To establish a claim for either monopolization or attempted monopolization, an antitrust claimant must establish (1) a causal link between the challenged conduct and the attainment; or (2) maintenance of monopoly power or the dangerous threat that it would be attained. The prohibition against monopolization or attempts to monopolize is directed "against conduct which unfairly tends to destroy competition itself." *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 458 (1993). This

legal standard "is plainly not met by inquiring only whether the defendant has engaged in 'unfair' or 'predatory' tactics." *Id.* at 459. "Even an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws." *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 225 (1993); *see also Nynex Corp. v. Discon, Inc.*, 525 U.S. 128, 137 (1998). Rather, monopolizing conduct must "cause or threaten harm to consumers from lower market output, higher prices, reduced innovation, or some other indicator of diminished competitiveness." III PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 651d, at 79 (2d ed. 2002).

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

determination of the impact of the conduct on competition." Timothy J. Muris, *The FTC and the Law of Monopolization*, 67 ANTITRUST L.J. 693, 697 (2000); *see also Heary Bros. Lightning Prot. Co. V. Lightning Prot. Inst.*, 287 F. Supp. 2d 1038, 1049 (D. Ariz. 2003) (plaintiff "must show that Defendants' improper actions were the but-for cause of the antitrust injury").

Judge McGuire's holding in *Rambus* makes clear that the causal link between the alleged exclusionary conduct and competitive harm or dangerous threat thereof must also be established in the context of FTC cases alleging monopolization or attempted monopolization. *Rambus Inc.*, No. 9302, slip op. at 300-02 (FTC Feb. 23, 2004) (Initial Decision). The same need to establish a causal link also applies to actions for unfair methods of competition in violation of Section 5 of the FTC Act. *Id.* at 309-10; *see also E.I. du Pont de Nemours & Co. v. FTC*, 729 F.2d 128, 141 (2d Cir. 1984) (requiring a "causal connection between the challenged practices and market prices"). The Commission has made clear that Section 2 monopolization standards apply to cases brought under Section 5 of the FTC Act, as Section 5 may not be used to reshape the policies of the Sherman Act "when they have been clearly expressed and circumscribed." *General Foods Corp.*, 103 F.T.C. 204, 365 (1984).

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

"[T]he plaintiff, on whom the burden of proof of course rests, must demonstrate that the monopolist's conduct indeed has the requisite anticompetitive effect." *Microsoft*, 253 F.3d at 58-59; *see also Rambus*, slip op. at 311. In the context of a claim of misrepresentations involving patents, the antitrust claimant must establish that the alleged competitive harm would not have occurred but for the alleged misconduct. But for causation evidence is essential to show that the conduct had an

adverse impact on the market. Absent proof of such causal link, what remains is merely proof of "unfair" conduct, which *Spectrum Sports* underscores as insufficient to sustain a monopolization or attempted monopolization case.

Accordingly, every antitrust tribunal to examine allegations of misrepresentations regarding patent rights to a standard-setting organization has recognized this causation requirement.[62] The antitrust claimant must establish "a causal link between the standard-setting conduct and the adoption of a standard that infringed the wrongdoer's patent." *Rambus,* slip op. at 301; *see also Heary Bros. Lightning Prot.*, 287 F. Supp. 2d at 1050 ("to find liability for Defendants' actions lobbying the [standards organization], a fact-finder must be able to conclude that the alleged restraint imposed by the third party, the [standards organization] was imposed *because of* the improper lobbying efforts of Defendant") (emphasis in original); *Townshend v. Rockwell Int'l Corp.*, No. C 99-0400, 2000 U.S. Dist. Lexis 5070, at *33 (N.D. Cal. Mar. 28, 2000) (rejecting monopolization claim where plaintiff had "not asserted that the [standards organization] could have adopted a V.90 standard which did not encompass [defendant's] technology"); *Dell Computer Corp.*, 121 F.T.C. 616, 624 n.2 (1996) (knowledge of Dell patent would have led standards body to choose "an equally effective, non-proprietary standard"); 2 HERBERT HOVENKAMP, MARK G. JANIS, & MARK A. LEMLEY, IP AND ANTITRUST § 35.5, at 35-41 (2003 ed.) ("failure to disclose the existence of a patent to a standard-setting organization will not affect the competitive marketplace if the standard-setting organization would have approved the standard even if it had known about the patent").

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

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

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

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

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

The cases thus require a showing of but for causation to link the challenged conduct with harm to consumers. Evidence that an antitrust defendant engaged in "improper" conduct is not sufficient. Thus, in *Brunswick,* the antitrust claimant was required to show that the challenged conduct harmed consumers because the defendant's "power over price" was "greater than it

otherwise would be" if the wrongful conduct had not occurred. *Id.* In the *Walker Process* context, this same principle mandates proof that a patent that confers monopoly power would not have issued but for the fraud. And in the context of alleged misrepresentations to a standard-setting body, the same principle requires a showing that a competitively preferable standard would have been chosen in place of the actual standard had the alleged misconduct not occurred. *See Dell*, 121 F.T.C. at 624 n.2. Consistent with the case law, Judge McGuire determined in *Rambus* that Complaint Counsel must prove that, absent the alleged misrepresentation, the standard-setting body could have or would have chosen a different standard that did not implicate Rambus's patents. *Rambus*, slip op. at 310.

In this case, to establish but-for causation, Complaint Counsel were required to show that CARB had credible alternatives to its Phase 2 RFG regulations that it could have enacted absent deception by Unocal. Unless CARB could have chosen a competitively preferable regulatory solution that did not implicate Unocal's patents or, alternatively, negotiated a license agreement with Unocal to provide for lower royalties than Unocal has actually obtained, there can be no consumer harm. In the absence of credible alternatives to the Phase 2 RFG regulations, even wrongful conduct by Unocal could have caused no harm to competition and consumers.

Complaint Counsel argued at the pre-trial stage that "[t]here need not be detailed proof of the world as it would have existed 'but for' deception, for such a requirement would eviscerate the ban on exclusionary monopolization [sic] and allow monopolists to profit by their wrongdoing." (Compl. Counsel's Pretrial Br. at 7). This attempt to dispense with but for causation requirement flies in the face of the Supreme Court's repeated admonitions that monopolization law does not seek to penalize "wrongful" conduct but focuses solely on *monopolizing* conduct. Complaint Counsel wrongly assume that the application of a causation requirement will allow a monopolist to profit

from wrongdoing. But the absence of causation necessarily means that the "wrongdoing" had no competitive consequence. This is precisely why the Supreme Court has emphasized that "it is wrong categorically to condemn" as antitrust violations even tortious practices that *"could anticompetitively create or sustain a monopoly"* without examining their actual impact on competition. *Nynex*, 525 U.S. at 137 (quoting III PHILLIP E. AREEDA, & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 651d, at 80 (1996)) (emphasis added, internal quotations omitted). That is why the Court requires proof of the challenged conduct's "impact on consumers." *Aspen Skiing*, 472 U.S. at 605.

Complaint Counsel's argument is further belied by the allegations of their own Complaint, which clearly recognize the need to prove but-for causation. The Complaint repeatedly alleges that but for the alleged fraud, CARB would not have adopted regulations that "overlap" Unocal's patents and refiners would have taken measures to avoid those patents. (Complaint ¶¶ 5, 80, 89). The Complaint also alleges that Unocal's conduct "harm[ed] consumers in the downstream product market for 'summertime' reformulated gasoline in California." (Complaint ¶ 5). Allegations of harm to California consumers pervade the entire Complaint. (Complaint ¶¶ 1, 5, 7, 90, 97, 98, 102, 103). The Complaint also repeatedly alleges that the asserted harms would have been avoided had Unocal not committed its alleged fraud. (Complaint ¶¶ 80, 90). The Complaint thus presumes that CARB had credible regulatory alternatives, and that those alternatives were rejected because of the alleged fraud. The allegations that the asserted harm would have been avoided but for the fraud necessarily encompasses the notion that the harm would have been avoided had Unocal told CARB, Auto/Oil, and WSPA about its patent application. There is no other way to make sense of these allegations.

Neither the Complaint's "but for" allegations nor its allegations of harm that would have been avoided thus can be proved without evidence of but for causation. Unless CARB could have chosen an equally effective regulatory solution that did not implicate Unocal's patents or would have brokered a license agreement providing for lower royalties than Unocal has actually obtained, there can be no consumer harm. Complaint Counsel have no evidence of any such regulatory alternative and no evidence of any possibility of license negotiations during the Phase 2 RFG rulemaking, and thus no means of proving the Complaint's allegations.

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

Complaint Counsel have not merely failed to prove that Unocal's alleged misconduct caused an anticompetitive effect, they did not even attempt to proffer such proof. They offered no evidence that CARB even plausibly would have adopted a competitively superior regulation but for the alleged fraud. And there was no evidence that, but for the alleged fraud, the refiners would have invested in refinery configurations that would have produced an outcome that is competitively superior to the current state of affairs. Complaint Counsel's economic expert did not examine whether, and did not assert that, CARB would (or even could) have adopted any regulatory scheme that is more cost-effective than the current one, taking Unocal's patents into account, that it is not able to adopt today. And he did not examine whether, and did not assert that, the refiners might have invested in patent-avoiding refinery configurations that they can no longer pursue today. Indeed, he made no attempt to rebut the persuasive evidence that foreknowledge of Unocal's patents would not have enabled refiners to avoid the patents to a greater extent than they can today. (Shapiro, Tr. 7380-81; Griffin, Tr. 8427).

With respect to the Complaint's allegations of fraud against CARB, the uncontroverted evidence shows that CARB did not view the sole alternative regulation proffered by Complaint Counsel—the EPA regulations—as a plausible alternative. If adopted, this alternative would have imposed costs on California consumers that are significantly greater than the maximum royalties that Unocal could collect if its patents are valid and infringed and refiners agree to negotiate with it in good faith.[63]

The evidence shows that the notion that CARB would have adopted the EPA's Phase 1 regulations in place of the CARB Phase 2 RFG regulations is implausible. CARB expressly rejected the suggestion when it adopted its regulations, stating that the proposal "would leave the state *far short of obtaining the emissions reductions needed to meet either the federal or state ambient air quality standards.*" (CX 10 at 178 (emphasis added); RX 1164A at 028). Unocal's expert on environmental regulation and enforcement, William Pedersen, explained in his testimony that the adoption of the EPA regulations was not a plausible alternative for CARB in 1991 because those regulations would have produced insufficient emissions reductions to satisfy California's obligations under the federal Clean Air Act. (Pedersen, Tr. 8061). As Mr. Pedersen explained, the emissions reductions of the Phase 2 RFG regulations were essential to achieve EPA approval for California's proposed State Implementation Plan to come into compliance with federal air quality standards. (Pedersen, Tr. 8031-32). California did not have any practical alternative methods to achieve the

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[63] The claim that CARB would have adopted the EPA approach exposes a fundamental contradiction in Complaint Counsel's case. Its adoption would have violated a key assumption on which Complaint Counsel's economic expert rested his analysis—that CARB is a cost minimizer. {[redacted]}. CARB could not have adopted the EPA regulation if it truly was attempting to minimize costs. And if CARB's objective was not cost minimization, the notion that Unocal's alleged misconduct affected the outcome of the rulemaking becomes even more implausible than it already is.

emissions reductions attainable through the Phase 2 RFG regulations. (Pedersen, Tr. 8063-64; RX 1186 at 033).[64] Consequently, California had no ability to adopt any RFG regulations that would have provided for meaningfully less substantial air quality benefits than the Phase 2 RFG regulations that CARB actually adopted. (Pedersen, Tr. 8062-63; RX 1186 at 005).

There was no testimony at trial to rebut Mr. Pedersen's analysis. No one testified how CARB would have attained the emissions reductions that it concluded were necessary to satisfy federal and state law without enacting the Phase 2 regulations. Indeed, CARB officials provided further foundation for the expert testimony by confirming that the Phase 2 RFG emissions reductions had been essential for satisfying the state's SIP obligations and attaining the federal Clean Air Act's mandate. (Kenny, Tr. 6608-10; CX 7054 (Mahdavi, Dep. at 26-27); *see also* Boyd, Tr. 6809-10; Simeroth, Tr. 7473-74, 7478-79; CX 7044 (Chan, Dep. at 77); CX 7063 (Sharpless, Dep. at 179-80, 183)). CARB's Executive Officer emphasized at a 1995 CARB hearing that "as I've said before, the SIP doesn't work without California cleaner burning gasoline." (RX 331 at 025). Another former Executive Officer testified that the Phase 2 regulations formed a "huge" part of the predicted emissions reductions in California's SIP. (Kenny, Tr. 6609). He agreed that, even with those regulations, the state only satisfied the SIP mandate "by the skin of [its] teeth." (Kenny, Tr. 6608).

Failure to develop a SIP that satisfied the Clean Air Act mandate would have been disastrous for California. A state's failure to adopt a satisfactory SIP on a timely basis triggers an obligation on the part of the U.S. EPA to propose and implement a Federal Implementation Plan ("FIP") to correct the deficiencies. (RX 1186 at 006). The EPA had in fact proposed a FIP even in the face of

[64] For example, additional controls on large stationary sources would not have offered equivalent emissions reductions because California had already imposed tight regulations on such sources and because additional controls would have been very expensive. (Pedersen, Tr. 8048-49).

the Phase 2 RFG regulations because of California's past SIP failures. According to an analysis prepared by the California Governor's Office with the assistance CARB (RX 334; Boyd, Tr. 6807-08), imposition of the proposed FIP would have imposed at least $8 billion in direct costs and $16.3 billion in lost output in the Los Angeles area alone. (RX 334 at 001).

Professor Griffin compared this $24 billion cost of the FIP with a hypothetical world in which *100%* of the summertime CARB gasoline was produced under the royalty schedule under which Unocal is willing to license its patents. Even under this very conservative assumption that all gasoline sold in California would be subject to Unocal royalties, the estimated cost of the royalty payments, $100 million a year, would have been a small fraction of the estimated cost of the threatened FIP. (Griffin, Tr. 8368-69; *see also* {[redacted]}, *in camera*). Accordingly, Professor Griffin concluded that the scenario under which CARB would have adopted the EPA regulations was not economically plausible. (Griffin, Tr. 8369).

Professor Shapiro did not attempt to rebut this analysis. Although he had stated in his report that "Unocal's deception improperly excluded alternative low-emissions RFG technologies" (Shapiro, Tr. 7390; CX 1720A at 032), at trial, he could give only one example of such an excluded technology—the EPA regulations. (Shapiro, Tr. 7391). But Professor Shapiro effectively withdrew that claim by testifying that he neither assumed nor concluded that CARB's "regulations would have been different in any particular way if not for these representations." (Shapiro, Tr. 7166, 7141-42).

Professor Shapiro also did nothing to rebut Professor Griffin's conclusions regarding the economic consequences of the alleged EPA option. He was unable to state whether the EPA regulations would have been more or less costly than the actual CARB RFG regulations, taking Unocal's patent royalties into account. (Shapiro, Tr. 7151-54, 7225-26). Similarly, Professor

Shapiro could not state whether the EPA alternative would have been more or less costly in reducing emissions on a per-unit basis than the Phase 2 RFG regulations, taking Unocal's royalties into account. (Shapiro, Tr. 7729-31). Accordingly, Professor Shapiro could not conclude that the next best alternative to RFG regulations with no patent royalties would have been the same regulations with a royalty of 1.7 cents per gallon. (Shapiro, Tr. 7160). He thus left unrebutted Professor Griffin's persuasive testimony that adoption of the EPA regulations would have made consumers far worse off and that it was economically implausible that CARB would have adopted those regulations in place of the Phase 2 RFG regulations.

The absence of a plausible alternative to the CARB Phase 2 RFG regulations that would have made consumers better off is fatal to Complaint Counsel's case. Complaint Counsel's economic expert simply did not perform any analysis to show that a more cost effective regulation would have been adopted absent the alleged misconduct.[65] Yet he conceded that such an analysis was necessary to establish whether Unocal's conduct caused harm to competition. Specifically, Professor Shapiro testified that "to talk about cause and even in the colloquial sense, the common-sense use of the word, one has to have a view if they didn't engage in deception, something else happened, some but-for world . . . ." (Shapiro, Tr. 7142).

In this regard, Professor Shapiro's view of the appropriate competitive analysis is in complete accord with the case law. Establishing but-for causation, of course, is the requirement of the case law. The record shows that there was no "causal link between the [rulemaking] conduct and the

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[65] Professor Shapiro expressly admitted that "I don't actually know factually one way or another about these specific causation elements as you might call them," and "I mean, you're now talking about the effect of Unocal's deceptive conduct. I don't make particular assumptions about effect in the sense of what would have happened if they'd done something else." (Shapiro, Tr. 7135).

adoption of a [regulation] that infringed the wrongdoer's patent." *Rambus,* slip op. at 301. Even if Complaint Counsel had established all of the other elements of the offense—and they have established none—their case would fail for want of anticompetitive effects resulting from the challenged conduct.

With regard to the Complaint's allegations of fraud against the refiners, the evidence is even more overwhelming. Indeed, Complaint Counsel's own expert does not even provide any support for this claim. As noted earlier, corporate representatives from each of the major refiners testified that had they known about Unocal's patent application, their companies either would have made no refinery investments to produce Phase 2 RFG or would have made reduced investments. On its face, this testimony is not credible given the refiners' failure to take even minimal steps to avoid Unocal's '393 patent upon learning about it, even though they subsequently demonstrated that they were able to avoid it for a trivial cost. But acceptance of this testimony would be even worse for Complaint Counsel's case.

As Professor Teece testified, a decision by one or more refiners to not invest, or to reduce the investment in capital equipment to produce CARB Phase 2 RFG, would have resulted in a substantial reduction in the amount of RFG available for sale in California. (Teece, Tr. 7591-7602; RX 1162A at 068-072). Professor Teece concluded that had one or more refiners eliminated or scaled back the investment in Phase 2 RFG, as the refiners' representatives now claim in unison, gasoline prices in California would have increased by an amount dramatically higher than any amount of royalties sought by Unocal. (Teece, Tr. 7602-03; RX 1162A at 070-072; RX 1205 (demonstrative)). Complaint Counsel's economic expert did not dispute this testimony.

Unocal's other economic expert, Professor Griffin, conducted a detailed analysis, using a sophisticated linear programming simulation, to determine what California refiners could have done to avoid Unocal's patents had they had perfect foresight of the patents and Unocal's royalty rates when they made their original investments. He concluded that such perfect foresight would not have enabled the refiners to avoid Unocal's patents to a greater extent than they can today. (Griffin, Tr. 8427). Professor Shapiro did not dispute this testimony. (Shapiro, Tr. 7381).

The expert testimony completely undermines the Complaint's allegation that but for Unocal's alleged fraud, refiners would have "incorporat[ed] knowledge of Unocal's pending patent rights in their capital investment and refinery reconfiguration decisions to avoid and/or minimize potential infringement" and that as "[a]s a result . . . the harm to competition and consumers, as described in this Complaint, would have been avoided." (Complaint ¶ 90(c)). Whether or not the refiners' implausible testimony is credited, the Complaint's allegations cannot be proved. If, as is most likely, the refiners would have done nothing different, the world would be no different than it is today. But if, as the refiners and Complaint Counsel claim, the refiners would have eliminated or reduced investment in RFG production capability, their incorporation of "knowledge of Unocal's pending patent rights" into their investment strategies would have inflicted substantial harm on consumers. There is no dispute among the economic experts on either score.

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

In their pre-trial brief, Complaint Counsel's sought to recast *United States v. Microsoft* as obviating the need to prove a causal link between the challenged conduct and consumer harm. This is the same misreading of the *Microsoft* decision that Complaint Counsel proffered and Judge

McGuire rejected in *Rambus*. The *Microsoft* court by no means eliminated the causation requirement. To the contrary, it required that an antitrust plaintiff "demonstrate that the monopolist's conduct indeed has the requisite anticompetitive effect." *Microsoft*, 253 F.3d at 58. The court stated that the requisite causal link between conduct and effect may be established without proof that a competitive alternative that a monopolist had eliminated through exclusionary conduct would have prevailed in the marketplace absent that conduct. *Id.* at 79. It did not, however, dispense with the necessity of proving that a competitive alternative even existed, which is what Complaint Counsel seek to do in this case.

The *Microsoft* court addressed causation in the context of Microsoft's assertion that the elimination of nascent competitors was insufficient to establish competitive harm without further evidence that the competitors would have matured into full-fledged competitive threats. The court rejected this position, stating that the relevant questions are "(1) whether as a general matter the exclusion of nascent threats is the type of conduct that is reasonably capable of contributing significantly to a defendant's continued monopoly power; and (2) whether Java and Navigator reasonably constituted nascent threats at the time Microsoft engaged in the anticompetitive conduct at issue." *Microsoft*, 253 F.3d at 79. The court explained that this approach was needed to prevent monopolists from having complete freedom to squash all nascent threats, as the success in the marketplace of a nascent competitor is by definition uncertain. Its approach required proof that the nascent threats could have eroded Microsoft's monopoly over time but for the fact that they had been eviscerated by the monopolist's conduct. In other words, the court required proof that the monopolist's conduct prevented outcomes that were competitively preferable to those that actually

occurred. The court emphasized that there were "ample findings that both Navigator and Java showed potential as middleware platform threats." *Id.*

In this case, the analogous proof to that required by the *Microsoft* court would be proof that, but for the alleged March 5, 2005 fraud, CARB likely would have adopted a different regulatory scheme that is competitively superior to regulations that CARB adopted and to those that it is currently able to adopt. In other words, the proof would be that Unocal's conduct defeated a regulatory alternative that would have been competitively preferable. This is the equivalent to Microsoft's elimination of nascent competitors that threatened to undermine its monopoly.

Complaint Counsel, however, seek to avoid even the proof that a nascent threat existed and has been eliminated by Unocal's alleged conduct. They proffered no proof that knowledge of Unocal's patent application would have enabled CARB to adopt alternative regulations that would have been more cost-effective than its actual regulations and that it could not adopt after learning of Unocal's patents.

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

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

X. NEITHER CARB NOR THE REFINERS ARE LOCKED IN

Complaint Counsel failed to prove the existence of lock-in affecting either CARB or the refiners.[66] No credible evidence of lock-in was presented at the hearing.

The lock-in claim in this case fails for a number of reasons. First, Complaint Counsel did not show that CARB or the refiners are foreclosed today from adopting any competitively superior option that they could have adopted but for the alleged fraud. The concept of lock-in involves the loss of options. As Professors Areeda and Hovenkamp observe, "[o]ne is 'locked-in' by an earlier choice that narrows one's later options." X PHILLIP E. AREEDA, HERBERT HOVENKAMP & EINAR

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[66] Complaint Counsel claim that a "regulatory lock-in" reinforces Unocal's alleged monopoly power by preventing CARB from changing its regulations to enable refiners to avoid Unocal's patents. Recognizing that no meaningful monopoly power may exist if it may be defeated readily by a CARB regulatory change or by refiner actions, the Complaint alleges that CARB is locked into its regulations. (Complaint ¶¶ 6, 94). And Complaint Counsel's economic expert similarly relies on the alleged lock-in to support his monopoly power analysis. (CX 1720A at 027-031; CX 1799A at 007-010). Because Complaint Counsel cannot prove the existence of monopoly power even without reference to the lock-in issue, the existence of a lock-in is ultimately irrelevant to the determination of monopoly power in this case. If monopoly power does not exist, no amount of lock-in can give it life.

ELHAUGE, ANTITRUST LAW ¶ 1740c, at 123 (2d ed. 2004). Similarly, Professor Shapiro defined lock-in as:

> "Lock-in" is just a little more graphic word for switching costs, significant switching costs, and it has inherent in it the notion that one had choices *ex ante* and that one made a choice and now you're stuck with it in the sense that it is hard to switch, in the sense that your options are reduced in comparison to what they were earlier. That is, your options are reduced or less attractive.

(Shapiro, Tr. 7345-46). Both of Unocal's economic experts offered a substantively identical definition. (RX 1162A at 58-59 (Teece); Griffin, Tr. 8424-25). Complaint Counsel's expert failed to show that CARB experienced a reduction or constraint in its regulatory options, as required by his definition.

Second, Complaint Counsel proffered no evidence of another important element of lock-in. Lock-in is a phenomenon involving switching costs. As Judge McGuire stated in *Rambus*, lock-in entails "a situation where switching costs prohibit consumers from changing to another product or technology." *Rambus Inc.*, No. 9302, slip op. at 326 (FTC Feb. 23, 2004). Complaint Counsel failed to establish that "switching costs" prevent CARB from adopting regulations that ease refiners' avoidance of Unocal's patents or refiners from avoiding Unocal's patents within the current regulations. Although Professor Shapiro framed his definition of lock-in in terms of switching costs (Shapiro, Tr. 7345-47), he based his lock-in analysis upon sunk costs and not switching costs. (Shapiro, Tr. 7062, 7173-74).

Finally, Complaint Counsel failed to put forth any reliable evidence from which this Court could determine that the refiners are locked-in as a result of Unocal's conduct. Their economic expert offered no opinion on refiner lock-in. And although Complaint Counsel proffered the testimony of refining expert Mr. Michael Sarna, Mr. Sarna offered no opinion whether it would have

been economically preferable for refiners to have made different investment choices had they known of Unocal's patent application, and he offered no opinion whether it is equally feasible today for the refiners to take the steps that he claims refiners could have taken *ex ante*.

To establish lock-in, Complaint Counsel must prove the existence of forgone options that are competitively superior to those that exist today. Complaint Counsel put forth no such evidence at trial. In their pre-trial brief, Complaint Counsel expressly disclaimed the necessity of offering proof that CARB's or the refiners' options became, to quote Professor Shapiro, "reduced or less attractive" as a result of Unocal's alleged fraud. This is because they have no such proof. Their economic expert did not investigate whether any superior option that CARB or the refiners might plausibly have adopted had Unocal not made the alleged misrepresentation subsequently ceased to be available. Thus, despite his express acknowledgment that lock-in requires a showing that the *ex post* alternative is "reduced or less attractive" than the *ex ante* option(s), Professor Shapiro did not perform an analysis to compare the *ex post* and *ex ante* choices. (Shapiro, Tr. 7148-58, 7224-32; CX 1779A; RX 1159; RX 1160; RX 1161).

A. Complaint Counsel Failed to Show the Existence of Regulatory Lock-In

1. Complaint Counsel failed to show that CARB cannot today adopt regulatory options that would have been preferable *ex ante*

The fundamental problem with the regulatory lock-in claim was Complaint Counsel's inability to proffer a single regulatory option that CARB might have considered at the time of the alleged fraud that would have been more cost-effective than the regulations that CARB actually adopted, taking Unocal's royalties into account. Professor Shapiro's lock-in analysis was based upon the premise that CARB would have adopted Phase 1 EPA regulations rather than the CARB Phase

2 regulations had it known of Unocal's patent application. (Shapiro, Tr. 7366). As noted earlier however, Professor Shapiro could not state whether the EPA alternative would have been a more or less costly means of reducing emissions on a per-unit basis than the CARB regulations plus a 1.7 cent per gallon Unocal royalty. (Shapiro, Tr. 7229-30). Professor Shapiro did not study whether the EPA alternative was superior to any alternative regulations, and conducted no analysis of the viability of the EPA option. (Shapiro, Tr. 7152, 7367; CX 1720A, CX 1799A).

There was no testimony at trial to rebut the overwhelming evidence that the EPA alternative did not present a viable choice to CARB in 1991 and that in fact, had CARB made such a choice, consumers would have been considerably worse off. Unocal's economic expert, Professor Griffin, opined that even if 100 percent of CARB Phase 2 summertime gasoline were to be subject to Unocal royalties, the value of the royalties would have been a small fraction of the estimated cost of a Federal Implementation Plan that likely would have been imposed absent the adoption of the Phase 2 RFG regulations. (Griffin, Tr. 8368-69). Professor Griffin's analysis showed that CARB would have made the same choice *ex ante* assuming no alleged misrepresentation by Unocal, and thus that the first necessary condition for a lock-in was not present. (Griffin, Tr. 8434, 8437). Given the uncontested evidence that the EPA option would have imposed far greater costs on California consumers than the current regulations, with Unocal's patent royalties, Complaint Counsel failed to establish that CARB is locked-in.

The opinions on lock -in presented by Professor Shapiro fail for another fundamental reason as well. For lock-in to exist, switching costs must prevent the affected party from changing to another product or technology. Lock-in exists, as the Supreme Court observed in *Eastman Kodak Co. v. Image Technical Services, Inc.*, where "the cost of switching is high." 504 U.S. 451, 476

(1992); *see also Brokerage Concepts, Inc. v. U.S. Healthcare, Inc.*, 140 F.3d 494, 515 (3d Cir. 1998); *Rambus Inc.*, slip op. at 326. As Professor Shapiro observed in his book INFORMATION RULES, "[s]witching costs measure the extent of a customer's lock-in to a given supplier." CARL SHAPIRO & HAL R. VARIAN, INFORMATION RULES 111 (1999); *see also id.* at 104 ("When the costs of switching from one brand of technology to another are substantial, users face *lock-in.*").

In this case, Professor Shapiro defined lock-in in terms of switching costs, but failed to analyze lock-in in terms of switching costs. Professor Shapiro's definition was clear: "Lock-in is just a little more graphic word for . . . significant switching costs." (Shapiro, Tr. 7346-47). In his rebuttal report, Professor Shapiro stated that the correct way to measure lock-in is to "take the *ex post* switching costs that CARB would have to bear to modify its RFG regulations after learning of Unocal's patents and compare those costs with the *ex ante* costs of adopting those same alternatives to its RFG regulations." (CX 1799A at 006). Both of Unocal's economic experts offered a substantively identical definition. (RX 1162A at 056; Griffin, Tr. 8424-25).

But Professor Shapiro did not perform the analysis he himself had outlined. Rather, he based his analysis on sunk costs and not switching costs. (Shapiro, Tr. 7062, 7173-74). Professor Shapiro performed his lock-in analysis by comparing the investments to comply with the Phase 2 RFG regulations to investments that the refiners would have had to make had CARB elected to adopt the EPA regulations instead. (Shapiro, Tr. 7082-83). He asserted that "specific investments" are equal to the sunk costs that already have been sunk by refiners in order to configure their refineries to comply with the CARB Phase 2 RFG regulations. (CX 1720A at 12-13, 29-30). Professor Shapiro concluded that those costs would be stranded, or wasted, if CARB were to adopt an alternative regulatory scheme. (Shapiro, Tr. 7060-61, 7064).

But what is critical for purposes of lock-in is not what has been already expended but, as Judge McGuire determined, what switching costs must be incurred—what must be spent prospectively—to avoid the patent. *Rambus Inc.*, slip op. at 327-28. If a regulatory change can take place, for example, at little or no cost, it makes eminently good sense to adopt it regardless of what sunk costs were incurred. The question is therefore, as Professor Shapiro stated in his rebuttal report, whether switching costs increases the cost of choices that were available *ex ante*. *See also* Carl Shapiro & David J. Teece, *Systems Competition and Aftermarkets: an Economic Analysis of Kodak* 39 Antitrust Bull., 135, 143 (1994) (lock-in based on "high costs of switching").

As Professor Teece explained, when analyzing lock-in, an economist cannot measure switching costs in the abstract, but rather must consider what one is switching *from* to what one is switching *to*. (Teece, Tr. 7568). An economist should consider what one is switching to by analyzing the next best alternative. (Teece, Tr. 7569). Professor Shapiro did not do this. (Teece, Tr. 7569).

At trial, Complaint Counsel presented no evidence that compares the costs associated with regulatory amendments to facilitate greater avoidance of Unocal's patents to the refiner benefits from such regulations. In his testimony, Professor Teece noted that refiners had made several proposals to CARB for changes to the existing regulations to make it easier to blend outside the scope of the patents, such as RX751 and CX 2090 (referred to in testimony as RX 568). (Teece, Tr. 7581-84). Professor Shapiro did not analyze these alternatives. For example, he did not consider alternatives such as increasing various cap limits in the existing RFG regulations. (Teece, Tr. 7578-79). He did not consider the possibility that CARB could adopt alternative regulations that would allow refiners to make use of the original investments that they had made to comply with the Phase 2 RFG

regulations. (Shapiro, Tr. 7383-84). For example, Professor Shapiro did not analyze what, if any, investment would be stranded if CARB raised the cap of T50 by a few degrees and in fact never measured any investment that was specific to a particular parameter of the Phase 2 RFG regulations. (Shapiro, Tr. 7370-17, 7384). He simply did not analyze alternative regulations with modified parameters. (Shapiro, Tr. 7372-7375).[67]

Because Professor Shapiro based his analysis on an artificial and unrealistic alternative. defaulting to EPA Phase 1, his conclusion that CARB is locked-in is simply an artifact of the fact that he had not looked for the next best alternative in his analysis. (Teece, Tr. 7580-81). Professor Shapiro's analysis of lock-in in terms of sunk costs rather than switching costs is contrary to the case law and to the economic principles that Professor Shapiro has espoused in his writings and in his rebuttal report. Professor Shapiro's failure to analyze the cost of switching to regulatory proposals that the refiners considered to be the next best alternatives to the existing regulations forms an additional independent basis why his lock-in analysis fails.

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[67] The problems with Professor Shapiro's approach is made apparent by a demonstrative exhibit that he used at trial to illustrate lock-in. The exhibit purported to show that a landlord could raise the rent of a tenant by the cost that the tenant incurred to move to the apartment. (Shapiro, Tr. 7056). Professor Shapiro did not consider the possibility that the renter could avoid the rent increase by moving to an apartment located at a closer location to the new apartment than the old one had been. By moving to a new apartment at a closer location, the renter would incur moving costs (or switching costs) that are lower (and potentially significantly lower) than the original cost incurred in moving into the apartment in the first place. For example, a renter who moved from New York to Dallas would incur the cost of moving to a new apartment in Dallas, perhaps even in the same neighborhood, and not the larger costs of moving from New York to Dallas. The analog to the closer apartment is a set of RFG regulations that seek to maximize the use of the refiners' original investments but allow them greater flexibility, such as increasing the cap limits.

2. **Complaint Counsel also failed to establish a regulatory lock-in because CARB never tried to assist refiners in avoiding Unocal's patents**

Complaint Counsel also cannot establish regulatory lock-in because there is no evidence that CARB ever seriously considered any regulatory options to facilitate patent avoidance even though such options existed. The evidence showed that CARB has elected to maintain its regulations for reasons that are wholly unrelated to any supposed "lock-in." Indeed, as CARB's Rule 3.33(c) witness testified, CARB *did not even consider* Unocal's patents when it adopted its Phase 3 regulations and thus could never have found any patent-avoiding option foreclosed because of an alleged "lock-in." (Venturini, Tr. 815). Other key individuals responsible for CARB's staff's analysis of the proposed Phase 3 regulations confirmed that there simply was no consideration given to the effect of the Unocal patents when CARB was preparing its Phase 3 regulations. For example, Mr. Cleary, the principal author of the staff report (Initial Statement of Reasons) for Phase 3, had no knowledge that CARB ever considered the Unocal patents in conjunction with Phase 3. (CX 55 at 003; CX 7045 (Cleary, Dep. at 179-80)). Dr. Mahdavi, a senior economist at CARB who performed economic analysis for the Phase 3 regulations, testified that no one ever discussed with him whether CARB should consider any or all of the Unocal patents. (CX 7054 (Mahdavi, Dep. at 48)).

The reason given by Mr. Venturini for CARB's failure to consider the Unocal patents when it adopted its Phase 3 regulations was because CARB believed the patents to be invalid and in a state of flux—not because CARB believed that it was "locked-in" to the current regulation by virtue of the investments the refiners made to comply with the Phase 2 regulations. (Venturini, Tr. 814-15). In a 1998 memorandum, a Mobil representative described why he believed CARB was simply not interested in "addressing relief for the patent coverage" (RX 520 at 001):

> They are not convinced that supply shortages will arise from the patents and believe any license fee impact will be within the noise of normal price fluctuations.

(RX 520 at 002). Accordingly, in spite of refiners' pleas to CARB to modify the regulations to ease the avoidance of Unocal's patents, and proposals for doing so without increasing pollution, CARB did not amend its regulations to make it easier to blend around the patents. (Gyorfi, Tr. 5276-80; CX 7049 (Hochhauser, Dep. at 53, 124-25)). In fact, there was testimony at trial about the difficulties of blending Phase 3 gasoline. { } (Sarna, Tr. 6312, *in camera*). { }. (Sarna, Tr. 6312-13, *in camera*). There was also testimony that, at least from the refiners' perspectives, CARB actually sought to increase emissions benefits in its Phase 3 regulations. (CX 7049 (Hochhauser, Dep. at 104-05), { }, *in camera*). When WSPA asked CARB to explain its rationale for the proposals,

> Peter Venturini said that they wanted to obtain some additional benefits as part of this exercise, not just preserve current benefits. He also said that non-technical issues were driving them to make the specifications more stringent, especially for sulphur and benzene.

(RX 711 at 001; CX 7049 (Hochhauser, Dep. at 120-21)).

Complaint Counsel's "statutory" lock-in argument fails as well. Complaint Counsel argue that CARB cannot change its regulations in a manner which would increase emissions because a California law (the Sher Bill) enacted in 1999 forbids CARB from doing so. But by the time this legislation was enacted, the public (including, of course, the California legislature) was well aware

that Unocal had been granted a number of patents, and that a jury and federal judge had already upheld the first patent as being valid and had awarded substantial infringement damages to Unocal. California thus made a clear legislative choice to enact a law mandating that there be no change in emissions reductions regardless of whatever impact this might have on the royalties that might someday be paid by the refiners to Unocal. Unocal's economic expert opined that while such a legislative act can place constraints upon CARB, this is not the sort of constraint that economists would call a "lock in" but rather a political choice made by the legislature with full knowledge of Unocal's patents. (RX 1164A at 053). And CARB, of course, had many years in which it could have, but failed to act, before the Sher Bill took effect.

B. Complaint Counsel Failed to Show the Existence of Refiner Lock-In

Similarly, Complaint Counsel presented no reliable evidence of refiner lock-in at trial. Just as CARB did not consider itself to be locked-in, the evidence is clear that the refiners did not consider themselves "locked-in" to the Phase 2 regulations. As noted above, they presented to CARB a number of potential changes to the regulations that they claim would have provided them with additional flexibility to avoid Unocal's patents, all to no avail. (*See*, *e.g.*, Ingham, Tr. 2714; Gyorfi, Tr. 5276-77; RX 751-002; Eizember, Tr. 3298-3300; CX 7049 (Hochhauser, Dep. at 53, 125); CX 2090 at 002-003, 005).

Professor Shapiro did not address the issue of refiner lock-in. (Shapiro, Tr. 7377). Complaint Counsel's refining expert, Mr. Sarna, performed no quantitative economic analysis to demonstrate whether it would have been economically preferable for the refiners to make changes to their refineries *ex ante* in order to achieve "moderate blend around capabilities." The fact that refiners technologically could have made certain refinery upgrades under an analysis that imposed

no cost constraints is meaningless. Absent evidence that such upgrades would have been more economical than paying Unocal's royalties, it would have been irrational for refiners to undertake them.

Moreover, in order to have made the refinery changes that Mr. Sarna said they could have made, refiners would have needed to have known the patent claims, the scope of the predictive model equations and the Unocal royalties—facts which were not known in the early 1990s. *See* Section V(C)(3), *supra*. Additionally, Mr. Sarna conceded that refiners would have needed to have assumed that Unocal's patents would be valid—a fact contrary to the clear evidence in this case. *See* Section V(C)(3), *supra*.

Most significantly, Mr. Sarna did not offer any opinion in his report as to whether refiners can implement today the refinery changes that he claims they could have made had they known about Unocal's patents when they made their original Phase 2 RFG refinery upgrades. (Sarna, Tr. 6421). If refiners can today make the same changes that they could have made at the time of their original investments when the investments are subject to identical constraints, no lock-in can be said to exist. Professors Griffin and Teece accordingly concluded that Mr. Sarna's opinions do not provide any basis for an economist to make any conclusions about lock-in (Griffin, Tr. 8433; RX 1162A at 063).

As discussed above, Professor Griffin performed an empirical analysis of refiner lock-in using a linear program model. Professor Griffin concluded that refiners would have done very little differently *ex ante*, even had they had perfect foresight into the full potential scope of Unocal's patents. (Griffin, Tr. 8422-23). Professor Griffin also determined that *ex post* refiners can make cost-effective investments that would enable them to avoid the Unocal patents to the same extent—indeed, a slightly greater extent—than they would have if they had had perfect foresight as

to the scope of Unocal's patents and royalties when they made their original investments. (Griffin, Tr. 8427-28). Professor Griffin thus concluded that given the Phase 2 regulations, there was no lock-in based on sunk investments that foreclosed refiners from achieving the same matching rate that would have been optimal had they had perfect foresight regarding the Unocal patents at the time that they made their Phase 2 investments. (RX 1164A at 060).

Professor Griffin's testimony on refiner lock-in was not rebutted by any of Complaint Counsel's experts. (Shapiro, Tr. 7377). The undisputed evidence shows that Complaint Counsel has not established that refiners are locked-in.

XI. COMPLAINT COUNSEL MUST ESTABLISH THEIR CLAIMS THROUGH CLEAR AND CONVINCING EVIDENCE

Unocal proposes that the heightened evidentiary standard, clear and convincing evidence, should be applied to this case. Typically, the standard of proof is preponderance of the evidence. *E.g.*, 16 C.F.R. § 3.43(a) ("[c]ounsel representing the Commission . . . shall have the burden of proof."); *In re Adventist Health System/West*, 117 F.T.C. 224, 297 (1994) (establishing burden to be "preponderance of the evidence").[68] But Administrative Law Judges have left open the possibility that a heightened standard of proof should apply in appropriate cases. *See, e.g.*, *Trans Union Corp.*, No. D-9255, 1998 FTC LEXIS 88, at **116-17 (July 31, 1998) (applying preponderance standard, but noting that clear and convincing burden should be applied where the Court considers that a particular type of claim should be disfavored on public policy grounds); *Rambus Inc.*, No. 9302, slip op. at (FTC Feb. 23, 2004) (initial decision).

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[68] Complaint Counsel cite several sources to establish that the general burden is preponderance of the evidence. This is an accurate description of the general rule, but *Walker Process* and *Handgards* provide exceptions to the rule, and those exceptions should apply in this case.

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

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

Second, the Complaint alleges fraud, and courts often require that fraud be proved by clear and convincing evidence, especially where patent rights are implicated. Cases similar to *Walker Process* require clear and convincing evidence to prove fraud necessary to find that a patentee's conduct before the PTO is exclusionary conduct under the antitrust laws. *Nobelpharma AB v. Implant Innovations, Inc.,* 141 F.3d 1059, 1070-71 (Fed. Cir. 1998) (a patentee is not liable under antitrust laws unless fraud can be shown by clear and convincing evidence); *see also SSIH Equip. S.A. v. ITC*, 718 F.2d 365, 380-81 (Fed. Cir. 1983) (additional comments of Nies, J.) (quoting *Addington v. Texas*, 441 U.S. 418, 423-25 (1979)) ("[t]he interests at stake in [fraud] cases are deemed to be more substantial than mere loss of money and some jurisdictions accordingly reduce the risk to the defendant of having his reputation tarnished erroneously by increasing the plaintiff's

burden of proof"); *Inquiry Into Three Mile Island Unit 2 Leak Rate Data Falsification,* 25 N.R.C. 671, 690 (1987) (explaining that an agency finding of dishonesty or fraud can result in "severe reputational injury," which can support the higher standard of proof).

Complaint Counsel attempt to limit *Handgards* to cases in which the alleged defendant engages in "one or more infringement actions initiated in bad faith," Compl. Counsel's Pretrial Br. at 16-17 (citing *Handgards*, 601 F.2d at 996),[69] but it makes no sense to limit *Handgards* in this way. Instead, *Handgards*, was concerned more broadly with creating barriers, which "are necessary to provide reasonable protection for the honest patentee," 601 F.2d at 996, when it is charged with conduct sufficient for antitrust law to strip away its rights granted by the Patent & Trademark Office.[70] This is consistent with the use of clear and convincing evidence to revoke other government-issued benefits. *See Sea Island Broad. Corp. of S.C. v. FCC*, 627 F.2d 240, 244 (D.C. Cir. 1980) ("we stand with the view that revocation of an FCC license is governed, at the agency level, by the 'clear and convincing' standard of proof") (citing *Collins Security Corp. v. S.E.C.*, 562 F.2d 820, 825 (D.C. Cir. 1977)).

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

[70] *See also Golan v. Pingel Enter., Inc.*, 310 F.3d 1360, 1371 (Fed. Cir. 2002) (requiring clear and convincing evidence that patentee engaged in bad faith in attempting to enforce an expired patent); *Loctite Corp. v. Ultraseal Ltd.*, 781 F.2d 861, 876-77 (Fed. Cir. 1985) (rejecting the preponderance of the evidence standard and affirming use of clear and convincing standard for an antitrust claim grounded in patent misuse vis-à-vis bad faith litigation), *overruled on other grounds by Nobelpharma*, 141 F.3d at 1067; *Lockformer Co. v. PPG Indus., Inc.*, 264 F. Supp. 2d 622, 627 (E.D. Ill. 2003) (adopting clear and convincing standard for patent misuse claim); *Conceptual Eng'g Assocs., Inc. v. Aelectronic Bonding, Inc.*, 714 F. Supp. 1262, 1266-67 (D.R.I. 1989) (requiring clear and convincing evidence of patent misuse for antitrust violation).

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

Indeed, given the potential chilling effect of a finding of antitrust liability based upon efforts to seek redress from the government, some courts have held that exceptions to *Noerr* immunity must be shown by clear and convincing evidence. *See, e.g., MCI Communication Corp. v. Am. Tel. & Tel. Co.*, 708 F.2d 1081, 1155-56 (7th Cir. 1983) (approving jury instructions, in the context of communication tariffs, that required the jury to find sham exception to *Noerr* by clear and convincing evidence); *see also Christianson v. Colt Indus. Operating Corp.*, 766 F. Supp 670, 683 (C.D. Ill. 1991) (applying the clear and convincing standard to sham litigation exception); *Illinois ex rel. Hartigan v. Panhandle E. Pipe Line Co.*, 730 F. Supp. 826, 937-939 (C.D. Ill. 1990) (same holding for intervention before the FERC); *cf. Kottle v. Northwest Kidney Centers*, 146 F.3d 1056, 1059 (9th Cir. 1998) (holding that the heightened pleading standard applies when alleging an exception to *Noerr* based on fraud: "when a plaintiff seeks damages . . . for conduct which is *prima facie* protected by the First Amendment, the danger that the mere pendency of the action will chill the exercise of First Amendment rights requires more specific allegations than would otherwise be required") (quoting *Franchise Realty Interstate Corp. v. San Francisco Local Joint Exec. Bd. of Culinary Workers*, 542 F.2d 1076, 1083 (9th Cir. 1976)). *Contra Litton Sys., Inc. v. Am. Tel. & Tel. Co.*, 700 F.2d 785, 813-814 (2d Cir. 1983).

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

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

XII. THE STATUTE OF LIMITATIONS BARS THIS PROCEEDING

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

Title 28, section 2462 governs this proceeding and provides in relevant part that "any action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued . . . ." 28 U.S.C. § 2462; *see also United States v. Ancorp Nat'l Servs., Inc.*, 516 F.2d 198, 201 (2d Cir. 1975) (FTC administrative enforcement action seeking civil monetary penalties and

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

In this case, Complaint Counsel seek to divest Unocal of specific patent rights without compensation. In particular, Complaint Counsel seek, in effect, to prevent Unocal from enforcing its patents related to RFG in California. (Complaint at ¶¶ 17-18 (Notice of Contemplated Relief)). This effectuates a "forfeiture" of Unocal's patents, in other words "a divestiture of specific property without compensation." *City of Philadelphia v. Nam*, 273 F.3d 281, 286 (3d Cir. 2001); *see also Hickman v. Texas*, 260 F.3d 400, 402 (5th Cir. 2001) (same) (citation omitted). "That a patent is property, protected against appropriation by individuals and the government, has long been settled."

Hartford-Empire Co. v. United States, 323 U.S. 386, 415 (1943) (footnote omitted). Thus, because the contemplated relief sought by the FTC would require Unocal to forfeit its patent rights, § 2462 is applicable to this case.

B. Unocal's Alleged Violation Occurred Outside the Limitations' Period

A cause of action accrues within the meaning of § 2462 "when the factual and legal prerequisites for filing suit are in place." *3M*, 17 F.3d at 1460. In making that determination, "courts have generally looked to the substantive elements of the cause of action on which the suit is based." *3M*, 17 F.3d at 1460. As Complaint Counsel have acknowledged, "the offense of monopolization is *complete* with the acquisition of monopoly power," whether or not that power has been exercised.[71] Similarly, the offense of attempted monopolization is complete once the three elements of the offense—specific intent, anticompetitive conduct, and dangerous probability of success—have been satisfied. *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 454-55 (1993). For purposes of 28 U.S.C. § 2462, the running of the limitations period is measured from the date of the violation. *3M*, 17 F.3d at 1462.

The FTC chose to not file this action until after Unocal's competitors spent eight years litigating against one of Unocal's RFG patents. (*See* JX 7 at 001; *Union Oil Co. of Cal. v. Atlantic Richfield Co.*, 208 F.3d 989 (Fed. Cir. 2000)). Even under the Complaint, Unocal's alleged misrepresentations are said to have stopped in the early 1990s.[72] In January 1995, Unocal announced

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

[72] The final alleged misrepresentation was in June 1994 (Complaint at ¶ 78c), though the Complaint and discovery focused almost exclusively on Unocal's statements in 1991 before (continued...)

its plan to license its RFG technology (CX 599) (Unocal's press release regarding the '393 patent), and thus no longer could "perpetuate the [allegedly] false and misleading impression that it did not possess, or would not enforce, any proprietary interests relating to RFG." (Complaint ¶ 4; *see also* Complaint ¶¶ 2c, 3, 79, 83, 88). One year later, Unocal's competitors requested that the FTC investigate the enforcement of Unocal's '393 patent based on allegedly fraudulent conduct in connection with CARB consideration of Phase 2 regulations. (JX 7 at 001). Seven years later, on March 4, 2003, the FTC initiated administrative proceedings against Unocal. Based on 28 U.S.C. § 2462, this proceeding is at least two years too late. *See United States v. Meyer*, 808 F.2d 912, 920 (1st Cir. 1987) ("Were the statute of limitations to run against, say, an F.T.C. action, the Commission would have only its own indecision to blame.").

As a backdoor attempt to satisfy the limitations provision of § 2462, the Complaint states that Unocal's illegal conduct "continues even today" (Complaint at ¶¶ 99-103), and will continue as long as Unocal licenses its RFG technology or otherwise asserts any of its legal rights or remedies relating to its lawfully obtained patents. In other words, the FTC's view is that there is *no statute of limitations period in this case*. Not surprisingly, courts are loath to interpret statutes of limitations in a manner that renders them superfluous. *See, e.g., Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1051 (8th Cir. 2000) (in merger case, court declines to adopt view of statute of limitations which would subject the merger to "continual challenge" under the Clayton Act);) *Aurora Enter. v. N.B.C.*, 688 F.2d 689, 694 (9th Cir. 1982) (in antitrust tying case, court declines to interpret statute of limitations in manner that "would destroy the function of the statute, since the parties may continue indefinitely to receive some benefit as a result of an illegal act performed in the distant

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[72] (...continued)
CARB and industry groups.

past"); *Crotty v. Niagara Mohawk Power Corp.*, 263 F. Supp. 2d 650, 661 (W.D.N.Y. 2003) (in environmental action governed by § 2462, court declines to adopt position that "taken to its logical end, suggests a *de facto* elimination of any statute of limitation . . . ."). Complaint Counsel appear not to recognize that a limitations defense in itself serves a public interest, because "even if one has a just claim, it is unjust not to put the adversary on notice to defend within the period of limitations and that the right to be free of stale claims in time comes to prevail over the right to prosecute them." *Order of R.R. Telegraphers v. Ry. Express Agency, Inc.*, 321 U.S. 342, 348-49 (1944); *see also Am. Pipe & Constr. Co. v. Utah*, 414 U.S. 538, 554 (1974) ("the policies of ensuring essential fairness to defendants [includes] . . . barring a plaintiff who has slept on his rights.") (internal quotation marks and citation omitted). In addition, when an enforcement action is brought to promote a public interest, as Complaint Counsel contend, the statute period encourages timely challenges, thus minimizing the potential cost to society of the alleged offense. It would be "strange to provide an unusually long basic limitations period that could only have the effect of postponing whatever public benefit" might result from an action. *Rotella v. Wood*, 528 U.S. 549, 558 (2000).

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

Complaint Counsel's characterization of the conduct at issue wrongly blurs an important distinction. Continuing violations in antitrust cases almost exclusively arise in the conspiracy context. *Concord Boat*, 207 F.3d at 1052; *see also* II PHILLIP E. AREEDA, HERBERT HOVENKAMP & ROGER D. BLAIR, ANTITRUST LAW ¶ 320c3, p. 217 (2d ed. 2002) (noting that courts are "significantly more likely to restart the statute when the action complained of is conspiratorial rather than unilateral"). A so-called unilateral continuing violation is actionable only if there are "continual

unlawful acts" within the statute period, as distinguished from the "continual ill effects from a single violation" outside the limitations period. *Crotty*, 263 F. Supp. 2d at 660-661; *see also* II PHILLIP E. AREEDA, HERBERT HOVENKAMP & ROGER D. BLAIR, ANTITRUST LAW ¶ 320c4, p. 221 (2d ed. 2002) (distinguishing "independent predicate acts" that are wrongful in themselves and are sufficient to keep a claim alive, from actions that are mere reaffirmations of the initial act, which are not sufficient to restart the statute period).

The Complaint contains no allegations of wrongful conduct by Unocal subsequent to March 4, 1998 (five years prior to the filing of this action). It includes no contentions, for example, that Unocal made ongoing misrepresentations or engaged in other misconduct in connection with its licensing efforts, the infringement litigation, or the prosecution of its patents before the PTO. Accordingly, the statute of limitations period had passed and this matter should be dismissed under 28 U.S.C. § 2462.

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

Complaint Counsel's proposed remedy aims to strip Unocal of its property right to claim infringement in California of any of Unocal's five patents. (Complaint, Notice of Contemplated Relief ¶¶ 1-3); *see also, e.g., Richardson v. Suzuki Motor Co.*, 868 F.2d 1226, 1246-47 (Fed. Cir. 1989) ("the right to exclude recognized in a patent is but the essence of the concept of property") (citations omitted). Specifically, the first paragraph of the requested relief asks this Court to end all of Unocal's current efforts to assert infringement by any means (for any present or future patents that claim priority back to the '393 patent application) based on the manufacture, sale, distribution, or other use of gasoline to be sold in California. (Complaint, Notice of Contemplated Relief ¶ 1). The

second paragraph asks this Court to prohibit any new or future efforts by Unocal to assert infringement by any means (for any present or future patents that claim priority back to the '393 patent application) based on the manufacture, sale, distribution, or other use of gasoline to be sold in California. (Complaint, Notice of Contemplated Relief ¶ 2). The third portion of the requested relief is identical to the first, except that it relates to the import or export of gasoline, asking this Court to end all of Unocal's current efforts to assert infringement by any means (for any present or future patents that claim priority back to the '393 patent application) based on the manufacture, sale, distribution, or other use of gasoline for import or export to or from California. (Complaint, Notice of Contemplated Relief ¶¶ 3). The Complaint additionally asserts that Unocal should be forced to use, at its own cost, a Commission-approved compliance officer as its sole representative for the purpose of communicating Unocal's patent rights relating to any standard or regulations under consideration by any standard-setting organization of which Unocal is a member, or any state or federal governmental entity that conducts rulemaking proceedings in which Unocal participates. (Complaint, Notice of Contemplated Relief ¶ 4).

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

A. <u>The Commission Has No Authority to Force Forfeiture of Patent Rights</u>

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

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

Unocal is not aware of any reported, precedential decisions in which the FTC issued an order preventing a respondent from enforcing its patents against those who infringe them.[73] Indeed the only court to squarely address this issue appears to be the Sixth Circuit, in *Am. Cyanamid Co. v.*

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

FTC, 363 F.2d 757, 772 (6th Cir. 1966). There, the Sixth Circuit explicitly stated that "[w]e do not hold that the Commission has jurisdiction either directly or indirectly to invalidate or destroy a patent, *nor do we hold that the Commission could order compulsory licensing without payment of reasonable royalties*." *Am. Cyanamid Co.*, 363 F.2d at 772 (emphasis added).

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

Likewise, in *Roberts Co.*, the Commission noted that when drafting an order proscribing the abuse of a patent, it must be careful to strike a balance that preserves the reward of the inventor as much as is possible while protecting the public interest. 56 F.T.C. 1569, 1610 (1960) ("In drafting an order proscribing the abuse or misuse of a patent a careful balance must be struck between the private inventor's legitimate reward and the public interest in the elimination of undue restraints upon competition.") The Commission in *Roberts* thus limited the remedy to prohibiting the unlawful conduct. 56 F.T.C. at 1610; *see also FTC v. Royal Milling Co.*, 288 U.S. 212, 217 (1933) (holding trade names constitute valuable business assets and FTC should not order their destruction if less

drastic means will accomplish the same result: "The orders should go no further than is reasonably necessary to correct the evil and preserve the rights of competitors and public.").

Though framed as a "cease and desist" remedy, there can be no question that the essence and effect of the relief sought here is a confiscation and disgorgement of Unocal's patent rights in California. Not only does the remedy as framed purport to prohibit Unocal from ceasing to file infringement suits (as in *Grand Caillou Packing*), but it presumably further intends to prohibit Unocal from collecting the up to $280 million in additional damages and prejudgment interest, which the district court set at 8.24 percent in the initial September 1998 order and judgment (RX 814 at 004-005; RX 816 at 002) awarded for infringement through some point in 2000. (Strathman, Tr. 3659). Complaint Counsel should not be allowed to expand the power of the Commission by attempting to achieve punitive, forfeiture remedies under the guise of "cease and desist" language.

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

In addition to the Commission's lack of authority to confiscate Unocal's patent rights or to compel royalty free licensing under the guise of its cease and desist authority, there are multiple additional reasons why the proposed remedies must be rejected. Here, the requested relief improperly attempts to sweep in, without distinction, all five of Unocal's patents, without regard for the judiciary's decisions with respect to the '393 patent, and notwithstanding the minuscule market share represented by the '393 patent technology. (Teece, Tr. 7513, 7552-53).

Unocal received the first of its five RFG patents, the '393 patent, in 1994. (RX 793at 001). This patent was the only one at issue in the 1997 jury trial, and the only one subsequently upheld as valid and infringed by the Federal Circuit. *Union Oil Co. of Cal. v. Atlantic Richfield Co.*, 208 F.3d

989 (Fed. Cir. 2000), *cert. denied* 531 U.S. 1183 (2001). The jury in the 1997 trial found that on average approximately 29 percent of the CARB summertime gasoline infringed, based upon the refiners' production from March through July 1996 (the only time period for which the refiners had supplied production records). (Strathman, Tr. 3656; RX 1165A at 014). The damages award for these five months totaled $69 million. (*See* RX 814 at 004-005; RX 816 at 002). Following the Federal Circuit's decision, the defendant refiners paid this amount to Unocal, together with $27 million in prejudgment interest, (*See* RX 814 at 004-005; RX 816 at 002).

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

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

(RX 814 at 005).

At the refiners' request, the court stayed this accounting of additional damages pending appeal. (Strathman, Tr. 3658). Once Unocal had prevailed on appeal, Unocal moved forward with the accounting earlier ordered by the court. After receiving updated information on refiners' motor gasoline production, Unocal moved for an additional award of damages totaling $209 million for infringement of the '393 patent for the period from August 1, 1996 through September 30, 2000 (the date through which refiners had provided production records). (Strathman, Tr. 3658-59; CX 1579 at 001-009). Unocal also sought prejudgment interest bringing the outstanding total to around $280

million. (Strathman, Tr. 3659 at 001-009). The accounting is currently not proceeding, however, because the case is "on hold" pending reexamination of the '393 patent. (Strathman, Tr. 3660-64).

The demand that Unocal must "cease and desist all efforts it has undertaken by any means . . . through or in which Respondent has asserted that any person or entity . . . infringes any of Respondent's [RFG patents]" (Complaint, Notice of Contemplated Relief ¶ 1) appears to be an attempt to preclude Unocal from collecting the outstanding damages for infringement which is part of its accounting decree. As a creation of the legislative and executive branch, the Commission lacks constitutional authority to order relief that would conflict with or ignore a binding decision of an Article III court.

The constitutional problems raised here were carefully analyzed by the Second Circuit in *Deerfield v. FCC*, 992 F.2d 420 (2d Cir. 1993). That appeal presented the question of whether an FCC agency action should be set aside as contrary to law or the constitutional power of the agency, in accordance with 5 U.S.C. § 706(2).[74] The court of appeals set forth in strong language the limits of an administrative agency's authority in relation to a court judgment:

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

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[74] 5 U.S.C. § 706(2) provides that the reviewing court shall "hold unlawful and set aside agency action, findings, and conclusions found to be (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; (B) contrary to constitutional right, power, privilege, or immunity; [or] (C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right . . . ."

Deerfield, 992 F.2d at 428 (citations omitted) (emphasis added).

The same constitutional principles apply here. The district court entered its decision in favor of Unocal and specifically ordered the terms under which an accounting is to proceed. (RX 814). The Commission cannot circumvent this binding decision by seeking a remedy that would preclude the court-ordered accounting from going forward or otherwise render such decision a nullity.

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

The relief sought here would be overly broad and inappropriate with respect to Unocal's patents, even were the Commission somehow vested with the power to force forfeitures of patent rights. Remedies imposed by the Commission must bear a "reasonable relation" to the unlawful practices found to exist. *FTC v. Colgate-Palmolive Co.*, 380 U.S. 374, 394-95 (1965); *see also Standard Oil Co. of Cal. v. FTC*, 577 F.2d 653, 662 (9th Cir. 1978); *Spiegel, Inc. v. FTC*, 411 F.2d 481, 484-85 (7th Cir. 1969); *FTC v. National Lead Co.*, 352 U.S. 419, 429 (1957). A remedy—especially one that seeks to impinge upon valuable property rights—should be tailored narrowly to avoid affecting conduct that was not determined to violate Section 5. *See La Peyre v. FTC,* 366 F.2d 117, 122 (5th Cir. 1966) (setting aside portion of cease and desist order because Court found no probable adverse effect on competition with respect to certain conduct).

Here, it must be remembered that the proposed remedy seeks a forfeiture of Unocal's right to enforce any of its five patents in California, even though nothing in the Complaint asserts that Unocal did anything wrong in obtaining these patents. To the contrary, claims of inequitable conduct not only were dismissed by the judiciary, but the refiners bringing those claims incurred sanctions for the vexatious, unsupported nature of their arguments. *Union Oil Co. of Cal. v. Chevron USA,*

Inc., 34 F. Supp. 2d 1222, 1224-25 (C.D. Cal. 1998). This, in and of itself, demonstrates that stripping Unocal of its patents as a remedy lacks a reasonable relationship to the alleged conduct.

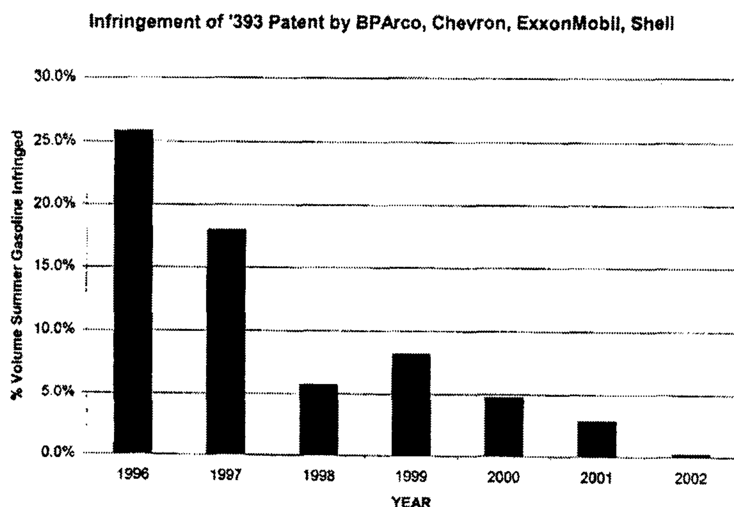
The attempt to impose such a drastic measure is especially inappropriate and unfair given that Unocal's actions, as shown by Your Honor's Initial Decision, objectively appeared to be immune under antitrust law both in 1991, as well as at the time of the complaint in 2003. *In re Union Oil Co. of Cal.*, No. 9305, slip. op. at 1-2 (FTC Nov. 23, 2003) (Initial Decision). This weighs heavily against any remedy involving forfeiture of patent rights. For example, in *In re Abbott Labs.*, No. 3945 (FTC May 26, 2000) (Consent Order), and *In re Geneva Pharms., Inc.*, No. 3946 (FTC May 26, 2000) (Consent Order), the Commission explained that it was not seeking disgorgement because, *inter alia*, "the behavior occurred in the context of the complicated provisions of the Hatch-Waxman Act, and because this is the first government antitrust enforcement action in this area." Combined Statement of Commission with Analysis to Aid Public Comment, *available at* http://www.ftc.gov/os/2000/05/abbottgenevastatement.htm; *see also In re Hoechst Marion Roussel, Inc.*, Docket No. 9293 (FTC May 8, 2001) (Consent Order).

Complaint Counsel's proposed remedy should be denied for additional reasons, as well.

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

Relief that restricts or prohibits enforcement of the '393 patent does not bear a reasonable relation to the alleged conduct and should be rejected because, wholly apart from the issue of whether Complaint Counsel demonstrated that Unocal has monopoly power with respect to Unocal's other four patents, there can be no argument that the '393 patent conferred *any* market power upon Unocal.

Significantly, once the refiners decided to implement steps to avoid infringement of the '393 patent, representatives of each refiner testified that they were able to do so for little to no cost (or even a cost savings)—and that the technology to do so has been in existence since 1995. (RX 1162A at 050; RX 85 at 003-004; RX 91 at 003-004; RX 92 at 003-004; RX 200A at 003-008; RX 207A at 003-008; RX 215 at 003-004; RX 224 at 003-008). As might be expected, infringement of the '393 patent has rapidly declined.



(RX 1165A at 015), *in camera*). In recent years, less than one percent of the summertime CARB gasoline falls within the claims of Unocal's '393 patent. (Sarna, Tr. 6367-68; Teece, Tr. 7513). Professor Teece cited this as "real-world evidence" in support of his conclusion that Unocal has no monopoly power in connection with the '393 patent. (Teece, Tr. 7551-52).

Accordingly, any remedy meant to stop enforcement of the '393 patent—and thereby prevent Unocal from collecting the more than $280 million owed to it under the accounting action pursuant

to the Court's September 28, 1998 Order (Strathman, Tr. 3658-59; CX 1579), does not bear a reasonable relationship to any conduct resulting in a monopoly or attempted monopoly.

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

The Complaint asserts that Unocal's "nondisclosure" of potential patent rights led CARB to adopt regulations in 1991, and because of these regulations Unocal acquired an illegal monopoly. But no one produces gasoline under the Phase 2 regulations. Rather, current production occurs within the confines of regulations adopted after Unocal's patents began to issue. Mr. Venturini of CARB testified regarding when and how the Phase 3 regulations came about:

> [I]t was in the '99 time frame, the governor basically issued a directive after all this work had been done basically directing us to modify the Phase 2 regulations, to basically phase out MTBE, to basically preserve the emission benefits associated with the Phase 2 program. And I think there were some other things, but those were the significant ones that I took, took out of it. . . . Senator Sher's legislation also directed us to seek additional benefits if we could. We also made some other adjustments that eke out a few more tons of reductions.

(Venturini, Tr. 128-29). The new regulation took effect in December 1999. (Venturini, Tr. 129).

Complaint Counsel introduced no evidence that Unocal misled CARB or the industry with respect to these later adopted regulations. The Phase 3 regulations were passed with knowledge by CARB and the industry that Unocal had received patents, that a jury upheld one of Unocal's patents, and that the jury had awarded damages for infringement. (Eskew, Tr. 3010; Eizember, Tr. 3280 (testifying that Exxon and Mobil approached CARB to discuss Unocal's patents during the Phase 3 process)). CARB's Mr. Kenny agreed CARB certainly could have raised the issue of Unocal's patents with Senator Sher, in the California legislature, but to his knowledge, CARB did not do so. (Kenny, Tr. 6605-07). Nor did CARB ever have a written policy during Mr. Kenny's tenure, which

lasted until January 2003 (Kenny, Tr. 6496) requiring participants in the CARB regulatory process to disclose all pending patents (Kenny, Tr. 6518).

Accordingly, it is overly broad to tie a remedy to gasoline made now or in the future under California's after-the-fact regulations. Furthermore, the proposed remedy would implicate all gasoline, whether imported to or exported out of California, without regard to whether the gasoline is made pursuant to any CARB regulation. For example, refiners in California produce gasoline for use in Arizona. (Eskew, Tr. 3010-11). There is no basis for encompassing such gasoline within the scope of a remedy for alleged wrongs associated narrowly with California Phase 2 gasoline.

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

Complaint Counsel fails to articulate a "reasonable means of calculating the gains or benefits" from the alleged violation, as support for any potential disgorgement remedy.[75] It is axiomatic that the amount of the disgorgement or forfeiture should not exceed the illegitimate profits (if any) earned by the defendant and attributable to the antitrust violation. *See, e.g., C.F.T.C. v. Sidoti*, 178 F.3d 1132, 1138 (11th Cir. 1999) (reversing order to disgorge all profits from 1990 to 1997 where no evidence of fraud after 1994). Such a desegregation is necessary because disgorgement is designed to only extract the unjust enrichment from the offender; it is intended to be remedial and not punitive.[76] Any remedy that calls for the forfeiture of gains resulting from efficiencies would punish (and deter) procompetitive conduct and thus would be inimical to the

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

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

policies underlying the antitrust laws. (Shapiro, Tr. 7131) (agreeing that a monopoly may, if a technology is superior, be preferable). Thus, courts consistently have rejected royalty-free licenses as a remedy in antitrust cases and instead have required that patent holders who have violated the antitrust laws license their patents at a reasonable royalty rate.[77]

Instead of articulating a "reasonable basis" for the monetary remedy sought in this case, tied to the concept of antitrust injury, Complaint Counsel propose a remedy that assumes all revenues from the patent are monopoly profits (i.e., the competitive value of Unocal's patents is zero). Such an assumption may simplify the calculation, but it is demonstrably incorrect, as evidenced by the fact Unocal's patents have been licensed to refiners outside California in arms length transactions untainted by any allegations of wrongdoing. (Teece, Tr. 7540-41). An appropriate remedy that would bear a reasonable relationship with the alleged conduct in this case would require Unocal to charge the same royalty rate per gallon in California as it has outside of California. (Teece, Tr. 7546).

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

Likewise, the proposed remedy forcing Unocal to communicate its patent rights with other standard-setting bodies or regulators through an approved third party is an impermissible restraint not only on Unocal's speech, but an overly broad intrusion into private and public standard-setting or regulation making. The remedy impliedly assumes that such bodies impose a duty to disclose patents, when no such showing was made or even alleged in this case. Indeed, with respect to CARB's rulemaking, Mr. Boyd testified that he was not even sure he would have wanted to know

[77] *See United States v. Glaxo Group Ltd.*, 410 U.S. 52, 59 (1973); *United States v. Nat'l Lead Co.*, 332 U.S. 319, 338-39 (1947); *Hartford-Empire Co. v. United States*, 324 U.S. 570, 572 (1945); *Am. Cyanamid Co.*, 363 F.2d at 770.

that Unocal had a patent application. (Boyd, Tr. 6823). And Professor Teece testified that, with respect to standard-setting bodies, disclosure rules can undermine their function and impose unwelcome costs. (Teece, Tr. 7609-11; RX 1162A at 026). In a survey of standard-setting bodies studied by Professor Teece, less than ten percent required disclosure of all patent applications. (Teece, Tr. 7606-07; RX 1162A at 031). If government agencies and private standard-setting bodies conclude that patent information is relevant, they are free to make such inquiry or conduct their own investigations into the potential impact of patent rights. But there is no precedent for forcing a company to comment on its "patent rights" much less for thrusting a "compliance" officer into such a role, especially when four of the five patents have not yet been litigated or construed by the courts.

XIV. JURISDICTION

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

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

any civil action arising under any Act of Congress relating to patents"). Unocal, accordingly, submits this jurisdiction argument to continue to preserve the issue.

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

A case arises under the patent laws when a complaint facially discloses "either that federal patent law creates the cause of action or that the plaintiff's right to relief necessarily depends on resolution of a substantial question of federal patent law, in that patent law is a necessary element of one of the well-pleaded claims." *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 808-09 (1988). This inquiry asks whether patent law "is a necessary element of one of the well-pleaded [antitrust] claims." *Christianson*, 486 U.S. at 809 (citing *Merrell Dow Pharms. Inc. v. Thompson*, 478 U.S. 804, 813 (1986)).

The Complaint against Unocal expressly invokes the burden of resolving substantial questions of patent law. The Complaint makes nine different allegations dependant on an alleged overlap between Unocal's patent claims and CARB's regulations. (Complaint ¶¶ 5, 33, 45, 76, 79, 80, 83, 88, 92).[78] In a scenario like this, where the truth or falsity of such allegations requires determining the scope and infringement of a patent, a complaint arises under the patent laws. *Additive Controls & Measurement Sys., Inc. v. Flowdata*, 986 F.2d 476, 478 (Fed. Cir. 1993) (finding substantial patent question in a business disparagement action where alleged falsity required proof of noninfringement); *Datapoint Corp. v. VTel Corp.*, No. 97 CIV. 642, 1997 WL 220306, at *2 (S.D.N.Y. Apr. 29, 1997) (claim that required resolution of alleged fraud's impact on patent

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

royalties made it "necessary to determine the scope and validity of the underlying patent infringement claims" and thus to "determine substantial questions of patent law").

In addition, the proof of harm alleged here also depends upon the resolution of substantial issues of patent law. The Complaint alleges that, but for Unocal's fraud, members of two private organizations would have taken actions including, but not limited to, "advocating that CARB adopt regulations that *minimized* or *avoided infringement* on Unocal's patent claims" and "incorporating knowledge of Unocal's pending patent rights in their capital investment and refinery reconfiguration decisions to *avoid and/or minimize potential infringement*." (Complaint ¶ 90(a), (c) (emphasis added)). The Complaint further alleges that refiners cannot avoid infringement but are locked-in to current refinery configurations. (Complaint ¶ 92 ("extensive overlap between CARB RFG regulations and the Unocal patent claims makes avoidance of the Unocal patent claims technically and/or economically infeasible"); Complaint ¶ 93 ("refiners cannot produce significant volumes of *non-infringing* CARB-compliant gasoline without incurring substantial additional costs") (emphasis added)). These allegations require a determination of substantial patent questions, including the construction and scope of Unocal's patent claims, the existence of noninfringing alternatives, and the ability of refiners to avoid infringement.

These are not abstract propositions. The refiners have taken the position that any gasoline composition that contains ethanol is outside the scope of Unocal's patent claims. (*See* Cunningham, Tr. 4358-59; Strathman, Tr. 3659-60; Eskew, Tr. 2890; Shapiro, Tr. 7332; CX 1579 at 007). If this construction, which Unocal vigorously disputes, is correct, virtually no RFG produced or sold in California infringes any of Unocal's patents, and Complaint Counsel's claim of monopoly power withers away. (*See* Teece, Tr. 7558-60; Shapriro, Tr. 7332-33). There is no way to resolve this issue

without construing Unocal's patents, as refiners' expert in the previous litigation admitted. (Cunningham, Tr. 4358-59 ("And whether the ethanol-containing gasolines are covered is a matter of claim construction, I believe.").

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

The Opinion of the Commission rejected Your Honor's ruling that the FTC lacks jurisdiction because this case depends on resolution of substantial questions of patent law.[79] In so doing, the Commission relied, *inter alia*, on *Christianson* for the proposition that "a claim supported by alternative theories in the complaint may not form the basis for § 1338(a) jurisdiction unless patent law is essential to each of those theories." *Union Oil Co. of Cal.*, slip op. at 52-53. The Commission cited alternative theories, such as misrepresentation, which it concluded do not require resolution

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

of "issues regarding patent construction or infringement." *Union Oil Co. of Cal.*, slip op. at 53. It speculated that misrepresentation could be established by "comparing Unocal's conduct in creating the allegedly false and misleading impression that it would not enforce any patent rights with its subsequent enforcement activities." *Union Oil Co. of Cal.*, slip op. at 53. Even if this case was strictly limited to an enforcement theory, Complaint Counsel would still have needed to prove, based upon the face of the Complaint, illegal monopoly power, which still involves the extent of infringement under the patents.

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

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

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

the United States generally. Congress, however, *expressly* articulated the court's jurisdiction over patent claims separately in 28 U.S.C. § 1498(a).

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

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

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

Frischer & Co., 17 C.C.P.A. at 509 (emphasis added). The *Frischer* Court also noted that there was no indication in the legislative history that Congress intended to confer this power upon the Tariff Commission. *Frischer & Co.*, 17 C.C.P.A. at 509-10.

In 1974, Congress added language to § 1337 allowing the ITC to consider "[a]ll legal and equitable defenses . . . ." *Lannom Mfg. Co., Inc. v. United States Int'l Trade Comm'n*, 799 F.2d

1572, 1576 (Fed. Cir. 1986). The legislative history reveals that Congress intended, by this language, to allow the ITC to "review the validity and enforceability of patents." *Lannom Mfg. Co.*, 799 F.2d at 1577 (citing S. Rep. No. 1298, 93 Cong., 2d Sess. at 196 (1974)); *see also* H.R. Rep. No. 571, 93d Cong., 1st Sess. at 78 (1973). The statute on its face, without looking at this legislative history, was ambiguous as to whether the ITC could address patent infringement issues. Congress eliminated any lingering doubt regarding the ITC's patent jurisdiction, when it passed the Omnibus Trade and Competitiveness Act in 1988. *See* Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, 102 Stat. 1107. The Act added to the statute, *inter alia*, 19 U.S.C. § 1337(a)(1)(B)(i)-(ii), expressly permitting the ITC to determine whether an imported article "infringe[s] a valid and enforceable United States patent." 19 U.S.C. § 1337(a)(1)(B)(i)-(ii); *see generally Texas Instruments, Inc. v. Tessera, Inc.*, 231 F.3d 1325, 1330 (Fed. Cir. 2000) ("In section 337 proceedings relevant to patent infringement, the ITC follows Title 35 of the United States Code and the case law of this court."). In stark contrast, the FTC is neither expressly nor impliedly granted such authorization.

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

Unlike the statutes cited above, the FTC Act says nothing about jurisdiction over patent questions, and the Act's legislative history evinces no Congressional intent to confer such jurisdiction. Meanwhile, the Supreme Court has stated that, "the Commission may exercise only the powers granted it by the Act." *FTC v. Nat'l Lead Co.*, 352 U.S. 419, 428 (1957). These powers do not include the right to determine substantial questions of patent law. *See Decker v. FTC*, 176 F.2d 461, 463 (D.C. Cir. 1949) ("The proceedings before the [FTC] related only to advertising. They did not draw into question the validity of the patent grant. Hence the case is not one arising under the

patent laws, cognizable only in a federal district court."); *Chas. Pfizer & Co., Inc. v. Columbia Pharm. Corp.*, 142 U.S.P.Q. 493, 494 (E.D.N.Y. 1964) ("The Federal Trade Commission has neither the right nor the power to pass on the patent's validity."); *Am. Cyanamid Co. v. FTC*, 363 F.2d 757, 772 (6th Cir. 1966) ("We do not hold that the Commission has jurisdiction either directly or indirectly to invalidate or destroy a patent, nor do we hold that the Commission could order compulsory licensing without payment of reasonable royalties.").[80]

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

After ninety years of existence without venturing into the patent law realm, the FTC only recently began to assert what it now supposes to be its authority to investigate methods of competition rooted in patent infringement contentions. "[W]ant of assertion of power by those who presumably would be alert to exercise it, is . . . significant in determining whether such power was

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

actually conferred." *FTC v. Bunte Bros., Inc.*, 312 U.S. 349, 352 (1941). As the Supreme Court wrote in *Federal Power Comm'n v. Panhandle E. Pipe Line Co.*, 337 U.S. 498 (1949), "[f]ailure to use such an important power for so long a time indicates to us that the Commission did not believe the power existed." 337 U.S. at 513; *see also Bankamerica Corp. v. United States*, 462 U.S. 122, 131 (1983) (stating that "[g]overnment's failure for over 60 years to exercise the power it now claims" under the Clayton Act "strongly suggests that it did not read [the statute] as granting such power"). The FTC's attempt to assert jurisdiction over matters arising under the patent laws, specifically the current Complaint against Unocal, is an analogous and likewise improper exercise of authority, which Your Honor properly dismissed.

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

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

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

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

Congress reinforced its strong interest in consistent and uniform patent jurisprudence when it passed the Federal Courts Improvement Act of 1982, which established the Court of Appeals for the Federal Circuit. Under 28 U.S.C. § 1295(a)(1), the Federal Circuit has exclusive jurisdiction over appeals from district court decisions where the district court's jurisdiction over patent matters was based, in whole or in part, on § 1338. Congress's express purpose was to promote predictability, uniformity, and the efficient administration of patent law. *Markman v. Westview Instruments, Inc.*, 517 U.S. 370, 390 (1996) (for the sake of "desirable uniformity . . . Congress created the Court of Appeals for the Federal Circuit as an exclusive appellate court for patent cases"); *see also* S. Rep. No. 275, 97th Cong., 1st Sess. at 5-6 (1981). Thus, appeal from the decisions of other agencies and courts that have express jurisdiction over patent law issues, such as the ITC and the Court of Claims, must be taken to the Federal Circuit. 28 U.S.C. § 1295. The same is true for appeals from PTO proceedings (35 U.S.C. § 141) and appeals from the bankruptcy courts when substantial patent issues are raised. *See In re Cambridge Biotech Corp.*, 186 F.3d 1356, 1369-70 (Fed. Cir. 1999).

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

Recognition that the FTC lacks jurisdiction to hear cases that turn on the resolution of substantial questions of patent law would not mean the FTC is powerless to challenge unfair methods of competition that raise patent issues. Section 13(b) of the FTC Act permits the

Commission to bring actions for equitable relief in district court. *See* 15 U.S.C. § 53(b). Were a well-pleaded complaint arising under the patent laws brought by the FTC in district court, where original jurisdiction is vested, on appeal the matter would come before the Federal Circuit under § 1295, consistent with the goal of patent law uniformity.

Dated: March 14, 2005.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on March 15, 2005, I caused the original and two paper copies of the public version of Union Oil Company of California's Post-Trial Brief, together with an electronic copy on CD, to be delivered for filing via Federal Express and also caused an electronic copy to be delivered for filing via e-mail to:

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