

FEDERAL CIVIL ENFORCEMENT COMMITTEE NEWSLETTER

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EDITOR'S NOTE

Dear Committee Member:

In this issue, we focus on recent litigation by the Federal Trade Commission. In our first article, Ben Labow analyzes the FTC's recent unsuccessful attempt to enjoin the proposed acquisition of Giant Industries, Inc. by Western Refining, Inc. The Commission had alleged that the merger would reduce the bulk supply of light petroleum products to northern New Mexico. Mr. Labow argues that the Commission's willingness to challenge the transaction demonstrates that proposals for legislation that would require stricter application of the antitrust laws to the petroleum industry are misguided.

The second article, written by Logan Breed, analyzes the FTC's administrative liability and remedy decisions in the *Rambus* case. The Commission ruled that Rambus had engaged in unlawful monopolization when it allegedly deceived members of a standing-setting body about patents that it owned that related to standards for a type of computer memory. In a separate decision, the Commission ordered Rambus to license its patents at a specified royalty rate. Mr. Breed analyzes the Commission's liability and remedy opinions and concludes that the Commission's remedy is likely inconsistent with the factual findings that the Commission made in the liability opinion.

In the third article, author Carla Hine provides an overview of the “Unilateral Effects Analysis and Litigation” workshop that the FTC conducted on Feb. 12, 2008. Featuring insights from a distinguished group of government officials, federal judges, antitrust practitioners, and economists, the conference provided an excellent opportunity to examine what arguably has been the most important substantive issue in recent merger litigation.

Christine Wilson, Editor

FTC V. FOSTER: THE PETROLEUM INDUSTRY UNDER FIRE

By Ben Labow¹

According to a recent Federal Trade Commission ("FTC" or "Commission") publication, the "national average price of gasoline [rose] from approximately \$2.20 per gallon in February [2007] to over \$3.22 per gallon as of May 21, 2007, which was the highest recorded current dollar price since the Energy Information Administration ("EIA") began its reporting."² Given these price increases, it is unsurprising that consumers have turned to their legislators for relief. It is similarly unsurprising that legislators have attempted to stem the tide of rising gas prices through calls for stricter application of the antitrust laws to the petroleum industry. Such proposals for modifications to the antitrust laws are misguided. As the FTC's recent loss in *FTC v. Foster*³ proves, the federal agencies are perfectly capable of rigorous and aggressive enforcement of the federal antitrust laws in the petroleum industry. Indeed, the district court's opinion suggests that the FTC may have been overly aggressive in its prosecution of the *Foster* case.

The Facts in Foster

In *FTC v. Foster*, the FTC sought a preliminary injunction to enjoin the proposed acquisition of Giant Industries, Inc. by Western Refining, Inc., alleging that the merger would reduce the bulk supply of light petroleum products to northern New Mexico. At the time of the complaint, Western owned and operated a refinery in El Paso, Texas, and sold most of its gasoline (35-40%) in El Paso and west Texas. Western also supplied light petroleum products to Albuquerque, New Mexico; Tucson and Phoenix, Arizona; and Juarez, Mexico. Western did not operate any terminals in New Mexico. Giant owned and operated two refineries in New Mexico and a single refinery in Virginia. Additionally, Giant operated several terminals in New Mexico, including one located in Albuquerque. Because of declining local crude oil production in the Four Corners area, Giant had not been operating its New Mexico refineries at full capacity. To increase its New Mexico refineries' utilization rates and productivity, Giant acquired an idle crude oil pipeline system in August 2005. Giant projected that its new pipeline would become operational in the second quarter of 2007, at which time it would be able to operate its New Mexico refineries at full capacity.

Market Definition

The FTC alleged, and the court and parties agreed, that the relevant product market was the bulk supply of light petroleum products. The FTC further alleged that the geographic market consisted of eleven counties in northern New Mexico. However, the court found that FTC had failed to prove its alleged geographic market. The FTC's many problems in establishing the relevant geographic market included that its own experts appeared to disagree in court with the geographic market that the FTC alleged in its complaint. The FTC's economic expert testified that the geographic market was the Albuquerque MSA (four counties), while the FTC's industry expert testified that the geographic market consisted of those northern New Mexico counties "served from Giant's refineries and pipeline-supplied Albuquerque area terminals," which covered nineteen counties.⁴ The court found that "[n]o witness explained why the borders of either the FTC's relevant geographic market or the experts' markets were appropriate"⁵ and that "[c]ustomers in the northern New Mexico market purchase gasoline from supply sources not included in the FTC's relevant geographic market."⁶

Despite the FTC's failure to allege a proper geographic market, the court nonetheless found that "[t]he FTC has demonstrated sufficiently high market shares and increases in market concentration to trigger the presumption that the Western/Giant merger will likely have anti-competitive effects."⁷ The court stated that "the FTC . . . made a *prima facie* case under the *Merger Guidelines*," thus successfully shifting the burden to the defendants.⁸ The FTC nonetheless lost the case because the defendants "rebutted this presumption with proof of ease of entry, cognizable efficiencies, or other recognized defenses."⁹

Alleged Anticompetitive Effects

The FTC's primary theory of competitive harm focused on the anticipated future capacity generated by Giant's new pipeline. The FTC alleged that, absent the merger, Giant would increase supply to Albuquerque or northern New Mexico on the order of 900 barrels per day. The FTC hypothesized that this additional capacity would lead to lower prices and that, if the parties consummated the transaction, Western would divert this volume away from Albuquerque. The court disagreed and found that the evidence did not support the FTC's theory for three reasons.

First, the court held that the FTC had underestimated the number of actual or potential competitors in the market. The FTC's economic expert testified that the merger would reduce the number of competitors in the relevant market from seven to six. The FTC alleged that Giant and Western competed with ConocoPhillips, Valero, Holly, Chevron, and Shell in supplying bulk quantities of gasoline to northern New Mexico. However, the court found that the FTC had incorrectly excluded Alon from the relevant market.¹⁰ The court found that Alon had supplied the Albuquerque market with product shipped from the Gulf Coast to El Paso and then on to Albuquerque.¹¹ Additionally, the court found that Alon had sought to become a new shipper on one of the primary pipelines to New Mexico, the Plains pipeline, by taking advantage of the pipeline's new shipper policy.¹²

The court also found that gasoline from Gulf Coast refiners was an alternative supply source for shippers on the Plains pipeline. Indeed, "Western ha[d] sourced Gulf Coast supply to Alon, which took product in El Paso and delivered it to Albuquerque."¹³ The court noted that Western executives viewed Gulf Coast refiners as competitors for northern New Mexico customers. Additional evidence presented during the hearing revealed that Gulf Coast suppliers affected price negotiations for gasoline in northern New Mexico. For example, "[s]ome contracts and other long-term sales arrangements in Albuquerque include[d] options for the buyer to elect Gulf Coast-based pricing, rather than the prices based on Albuquerque or El Paso pricing."¹⁴ Ultimately, the court found that "with [a] small but significant price increase, it is almost always profitable to ship gasoline from the Gulf Coast to Albuquerque."¹⁵

In addition to Alon and Gulf Coast refiners, the court found that trucking from Texas into northern New Mexico had a disciplining effect on prices. The court found that "[c]ommon carriers — including Flying J — trucking from Longhorn's El Paso terminal to Albuquerque provide another alternative source of supply."¹⁶ Indeed, the court, quoting the expert for the defense, stated that the "evidence continues to grow, that, in fact, [Flying J's trucking] is quite consistent, routine, and [of] substantial volume" and that "[t]he volume of trucking into New Mexico has been rising over time."¹⁷ Despite the apparent impact of trucking on the market, the FTC's expert had not asked for, and the Commission did not provide him with, data on trucking from Texas or trucking by Flying J.¹⁸

Second, the court found that the reduction in output of 900 barrels a day — that the FTC alleged would occur if the merger went through — would not have a material effect on prices. Indeed, the court found that "[t]he amount of gasoline that the FTC alleges would be diverted from Albuquerque is small and would have little or no significant impact on post-merger prices. Nine hundred barrels is less than one percent of Western's total daily production and less than half of one percent of the anticipated Western/Giant total expected daily production."¹⁹

Furthermore, the court found that "[t]here [was] ample supply of gasoline available to the northern New Mexico market" and that other suppliers, including ConocoPhillips, Valero, Holly, and Alon, could easily replace the lost capacity. For example, Valero was unable to produce any gasoline from its McKee refinery (located in the Texas panhandle) for a period of time due to a fire that shut down the refinery. Nonetheless, "[d]uring the time period when McKee was unable to produce any gasoline or other refined products, Valero was 'absolutely' able to purchase product from other area bulk suppliers to make up for its lost production."²⁰ The court also noted that "Flying J's purchase of the Longhorn pipeline in August of 2006 ha[d] introduced substantial additional capacity for the bulk supply of gasoline to northern New Mexico" and that "[t]he Plains pipeline is considering an expansion of its line from El Paso to Albuquerque and has conducted a detailed engineering analysis to expand the pipeline."²¹

Additionally, the court noted that prices had not risen during the period of time when Giant's crude oil supply was dwindling. Giant's utilization rates at its New Mexico refineries had declined from seventy-two percent in 2002 to sixty percent in 2006.²² The Court explained that "Giant's declining crude oil supply ha[d] not resulted in higher prices in Albuquerque. . . . There is no evidence in the data 'of a sustained elevation of price' coinciding with Giant's declining crude oil supply and declining output."²³ Indeed, the court found that other suppliers responded effectively to Giant's reduction in output. The court found that this evidence undermined the FTC's argument that the diversion of 900 barrels per day (the equivalent of 4-5 truckloads) from Albuquerque would enable Western/Giant to influence prices in northern New Mexico.²⁴

Third, the court found that Western/Giant's customers could discipline any unilateral attempt to

reduce output. The Court explained that “Chevron has substantial buyer-power and leverage with Western, and Chevron receives a favorable price. Because Chevron has substantial flexibility on the sources of its supply to northern New Mexico, Chevron has frequently sought to obtain more favorable terms from Western.”²⁵ Indeed, the FTC’s expert acknowledged during the hearing “that Chevron could buy from Flying J in El Paso and ship to Albuquerque over Chevron’s line time.” The FTC’s expert also acknowledged that “Chevron could buy on the Gulf Coast and ship up the Longhorn pipeline to El Paso and then over the Plains pipeline to Albuquerque.”²⁶

A Misguided Prosecution?

The facts of *Foster* raise questions about why the FTC brought the case in the first instance. The evidence cited by the court in its opinion appears to favor overwhelmingly the defendants. Nonetheless, the Commissioners voted unanimously to file suit. Even more peculiar is the fact that the FTC sought to appeal the decision to the Court of Appeals for the Tenth Circuit and filed a motion for an injunction pending appeal with the district court. In its motion, the FTC claimed that there were “important questions [to be] resolved by the Court of Appeals.”²⁷ These questions included whether

the elasticity of demand for gasoline in the Albuquerque market is such that an additional 1400 barrels per day will depress prices paid by consumers by approximately ten cents per gallon; [whether] Flying J is a potential bulk supplier to the market; the amount of bulk gasoline transported by truck to the Albuquerque market; whether the Plains pipeline will be expanded and, if it is, if the expansion can be completed in a relatively short time frame, and if there are any potential bulk gasoline suppliers to the Albuquerque market who do not currently have access to any of the three pipelines that serve the Albuquerque market.²⁸

The problem with the FTC’s argument is that all of these questions are questions of fact, which either were, or should have been, raised before the district court. The FTC failed to allege that the district court had abused its discretion with respect to its findings of fact. Indeed, in denying the FTC’s motion, the district court stated: “The Court dealt with these issues extensively in its order yesterday, and the FTC does not point out how the Court is in error.”²⁹

On October 3, 2007, following a 3-2 vote, the FTC announced that it was withdrawing its appeal in *Foster*. Despite its belief that the district court had “made a number of questionable findings,” the Commission nonetheless determined that pursuing an appeal in the case would not be in the public interest under Commission Rule 3.26(d).³⁰ Notably, the Commission recognized in its statement that new evidence developed during the course of the preliminary injunction proceedings “mitigates against continuing in administrative litigation.”³¹ The Commission explained that the “new information suggests that the Plains Pipeline, which runs from El Paso, Texas to Albuquerque, New Mexico, may begin work on a capacity expansion project more quickly than previously thought” and that such an expansion likely would lead to “more competition and lower gasoline prices in Northern New Mexico, notwithstanding the merger.”³²

Commissioners Harbour and Rosch filed a dissenting statement in which they stated that the district court had committed a number of legal errors.³³ They explained that a full trial was necessary, “regardless of how that trial could come out.” The dissent also noted: “[W]e have pledged vigorous merger enforcement in this area of the economy generally and with respect to refinery mergers specifically. We do not consider a preliminary injunction hearing to be any substitute for a plenary trial in this respect.”³⁴

The Commission’s loss in *Foster* raises an issue as to whether the Commission was willing to pursue a relatively weak case with such fervor at least in part because it involved consolidation in the petroleum industry. Indeed, the Commission’s statement in *Foster* begins with the following language: “As the Commission has stated repeatedly, no other industry’s performance is more deeply felt than that of the petroleum sector, and no other industry is more carefully scrutinized by the FTC.”³⁵ Additionally, as discussed above, the dissent in *Foster* appears to suggest that the FTC should evaluate refinery mergers using more rigorous standards than mergers in other industries and that preliminary injunction hearings may be less likely to resolve the issues raised by these mergers. Indeed, it is hard to imagine the FTC would have brought suit in a different industry in the first place based on facts analogous to those present in *Foster* (e.g., numerous actual and potential competitors), let alone filed an appeal after such a harsh loss. If nothing else, *Foster* stands for the proposition that the last thing we need are stricter laws and regulations applied to the petroleum industry; the FTC appears quite

capable of providing intense scrutiny there on its own.

- ¹ Ben Labow is an attorney at O'Melveny & Myers LLP.
- ² FTC Gasoline Column, *What is Driving Higher Gas Prices?* (June 7, 2007).
- ³ No. CIV 07-532 JB/ACT, 2007 WL 1793441 (D. N.M. May 29, 2007).
- ⁴ *Id.* ¶ 164, at *18.
- ⁵ *Id.* ¶ 165, at *18.
- ⁶ *Id.* ¶ 166, at *18.
- ⁷ *Id.* ¶ 245, at *26.
- ⁸ *Id.* ¶ 264, at *28.
- ⁹ *Id.* ¶ 245, at *26.
- ¹⁰ *Id.* ¶ 202, at *22.
- ¹¹ *Id.* ¶ 204, at *22.
- ¹² *Id.* ¶ 205, at *22.
- ¹³ *Id.* ¶ 210, at *23.
- ¹⁴ *Id.* ¶ 221, at *24.
- ¹⁵ *Id.* ¶ 259, at *27.
- ¹⁶ *Id.* ¶ 215, at *23.
- ¹⁷ *Id.* ¶¶ 215, 217, at *23.
- ¹⁸ *Id.* ¶ 220, at *24.
- ¹⁹ *Id.* ¶ 286, at *31.
- ²⁰ *Id.* ¶ 320, at *34.
- ²¹ *Id.* ¶¶ 336, 341, at *36.
- ²² *Id.* ¶ 34, at *4.
- ²³ *Id.* ¶ 376, at *38.
- ²⁴ *Id.* ¶ 286, at *31.
- ²⁵ *Id.* ¶ 361, at *37.
- ²⁶ *Id.* ¶ 369, at *38.
- ²⁷ Motion of the Federal Trade Commission for an Injunction Pending Appeal at 4, *FTC v. Western Refining, Inc.*, No. CIV 07-532 JB/ACT (D. N.M. May 29, 2007), available at <http://www.ftc.gov/os/caselist/0610259/070530motion.pdf>.
- ²⁸ *Id.* at 4.
- ²⁹ Memorandum and Order Denying the Motion of the Federal Trade Commission for an Injunction Pending Appeal at 4, *FTC v. Foster*, No. CIV 07-532 JB/ACT (D. N.M. May 30, 2007).
- ³⁰ Statement of the Commission Concerning Dismissal of the Administrative Compliant at 1, *In re Paul L. Foster, Western Refining, Inc., and Giant Industries, Inc.*, Docket No. 9323 (Oct. 3, 2007), available at <http://www.ftc.gov/os/adjpro/d9323/071003statement.pdf>. Title 16 C.F.R. § 3.26(d) states that further litigation should not be pursued following the denial of a preliminary injunction unless it would be in the public interest.
- ³¹ *Id.* at 3.
- ³² *Id.*
- ³³ Dissenting Statement of Commissioner Pamela Jones Harbour and Commissioner J. Thomas Rosch, *In re Western Refining, Inc.*, Docket No. 9323 / File No. 061-0259 (Oct. 3, 2007), available at <http://www.ftc.gov/os/adjpro/d9323/071003dissenting.pdf>.
- ³⁴ *Id.* at 3.
- ³⁵ Statement of the Commission Concerning Dismissal of the Administrative Compliant at 1, *In re Paul L. Foster, Western Refining, Inc., and Giant Industries, Inc.*, Docket No. 9323 (Oct. 3, 2007), available at <http://www.ftc.gov/os/adjpro/d9323/071003statement.pdf>.

FTC V. RAMBUS: DID THE COMMISSION GET THE REMEDY RIGHT?

By Logan Breed¹

As technology becomes an increasingly ubiquitous part of our everyday lives, the companies that design and manufacture that technology have often turned to standard setting organizations ("SSOs") to ensure

compatibility between their products. Done properly, these endeavors are undeniably procompetitive – they can reduce costs, facilitate interoperability, increase consumer choice, and enable economies of scale.² However, standard setting also creates opportunities for anticompetitive behavior of many stripes, including price-fixing, reductions in non-price competition, and other coordination between competitors.³ The Federal Trade Commission ("FTC" or "Commission") has found that a participant in a SSO may have a unique opening to deceive the other members of the SSO by withholding or hiding information about its intellectual property portfolio. When the deception is effective and the SSO unknowingly incorporates the offender's technology into its standard, the SSO has in effect unwittingly awarded the deceptive firm with a monopoly over that piece of the standard (and potentially the entire standard if there is no other royalty bearing IP involved). Such deception is often referred to as anticompetitive "patent hold-up."

The anticompetitive effect of such deception and the increasing importance of effective standard setting practices in technology industries led the FTC to pursue several investigations of deceptive conduct in the standard-setting process over the last decade under Section 5 of the FTC Act⁴ in an effort to dissuade "bad actors" from taking advantage of the standard setting process.⁵ First, in 1996 the FTC sought and obtained a consent order against Dell Computer Corp. because it told an SSO that it did not own any patent rights regarding a proposed standard for the personal computer VL-bus – a mechanism to transfer instructions between the computer's central processing unit and peripherals, such as a disk drive – and then tried to enforce its patent rights against companies that practiced the standard after the SSO incorporated its technology into the standard.⁶ Second, in 2003 the FTC brought an administrative enforcement action against the Union Oil Company of California ("Unocal") for misrepresenting information about its patent rights regarding the production of its low-emissions fuel to the California Air Resources Board ("CARB"), a state regulatory agency that was creating industry standards for the development of reformulated gasoline.⁷

Then, in June 2002, the FTC brought an administrative action against Rambus, Inc. for allegedly deceiving the JEDEC Solid State Technology Association ("JEDEC") SSO into incorporating Rambus's technology in its standards for synchronous dynamic random access memory chips

("SDRAM").⁸ As a JEDEC member, Rambus participated in the standard-setting process for various technologies associated with dynamic random access memory ("DRAM") for computers. JEDEC had several policies and practices designed to prevent anticompetitive holdup, including that JEDEC's members were expected to reveal the existence of patents and patent applications that could later be enforced against those who practice the standard. The FTC determined that Rambus had disregarded these policies and expectations, refusing to disclose its relevant patents and patent applications.⁹ Moreover, the FTC found that Rambus had used the information that it gained about the pending standard to amend its patent applications in order to ensure that the final standard would incorporate its technology.¹⁰

Rambus and *Unocal* were originally parallel cases; the former involved a claimed deception of a private SSO and the latter involved a claimed deception of a public SSO. However, the *Unocal* case settled when Chevron acquired Unocal and agreed as part of the merger settlement not to enforce the patent in question.¹¹ Consequently, *Rambus* is the first case involving monopolization by deception of an SSO that the FTC has fully litigated.

The *Rambus* case was so complex that the FTC divided its analysis into two stages. In August 2006, it issued a decision on liability, unanimously holding that Rambus had engaged in monopolization by withholding and concealing information regarding relevant patents and patent applications that were highly material to the SDRAM standard-setting process.¹² In February 2007, following briefing and argument on the subject of remedy, the FTC ordered compulsory licensing by Rambus of its technology at Commission-determined maximum rates for a period of three years, after which the maximum rate drops to zero.¹³ Two Commissioners, J. Thomas Rosch and Pamela Jones Harbour, filed concurring opinions in which they argued for broader remedies.¹⁴

The majority opinion on the remedy issue, authored by Chairman Deborah Platt Majoras, defended the FTC's authority to order compulsory licensing at a royalty rate determined by the FTC based on the conditions that would have occurred but for the defendant's deception (*i.e.*, the *ex ante* bargaining position of the parties) – even if the result was a compulsory royalty-free license. However, a majority of the Commissioners ultimately chose to impose a less severe remedy despite significant evidence that JEDEC would have adopted alternative

technologies in the "but for" world, which would have resulted in Rambus's receiving no royalties. Moreover, the compulsory licensing remedy did not cover Rambus's patents as applied in the most recent (and commercially significant) iteration of the relevant standard, called "DDR2 SDRAM."

Given (1) Rambus's clearly anticompetitive conduct as determined by the Commission, (2) the strong factual predicate found by the Commission for the premise that JEDEC would not have adopted Rambus's technology but for its deception, and (3) the majority opinion's strong position regarding its "broad discretion to restore competition,"¹⁵ it is somewhat surprising that the FTC chose to impose a more modest remedy than Complaint Counsel sought in this case. This article explores the difference between the FTC's statements about the scope of its remedial power and its actual use of that asserted power in the *Rambus* case, and suggests that the majority's attempt to craft an economically viable remedy may have missed the forest for the trees in this particular case.

Commission's Liability Decision

The FTC issued an administrative complaint against Rambus on June 18, 2002, alleging that Rambus's failure to disclose its intellectual property caused JEDEC members to believe that Rambus had no relevant patent rights or pending patent applications, and therefore that JEDEC had involuntarily adopted standards that infringed Rambus's patents.¹⁶ The complaint contained three substantive alleged violations of Section 5: (1) Rambus monopolized SDRAM technology markets; (2) Rambus attempted to monopolize those markets; (3) Rambus unreasonably restrained trade in the SDRAM technology markets and engaged in unfair methods of competition.¹⁷ The complaint alleged that Rambus actively concealed its efforts to develop relevant patents "in violation of JEDEC's own operating rules and procedures."¹⁸ Moreover, it alleged that Rambus made false and misleading statements to JEDEC that created the "materially false and misleading impression that [Rambus] possessed no relevant intellectual property rights" and had no plans to enforce any future intellectual property rights against the standard.¹⁹

Rambus decisively won the first round of the battle. The Administrative Law Judge ("ALJ") dismissed the complaint, finding that Rambus's monopoly power was the product of its superior technology and market preferences rather than deception.²⁰ The ALJ

found no basis for Complaint Counsel's inference that Rambus had intended to deceive JEDEC.²¹ He determined that JEDEC (and the DRAM industry generally) was aware of Rambus's patent portfolio before it adopted the relevant standards, so JEDEC could not have reasonably relied on any omissions or affirmative misrepresentations by Rambus in the standard setting process.²² Furthermore, he found that Complaint Counsel had failed to prove that JEDEC had viable alternatives to Rambus's technology, so the challenged conduct had no anticompetitive effect even if Rambus did deceive the SSO.²³ Finally, the ALJ concluded there was insufficient evidence that the prior deception led to the adoption of Rambus's technology in standards adopted after its departure, i.e., JEDEC was not "locked in" to Rambus's technology when it created subsequent versions of the relevant standard.²⁴

Complaint Counsel appealed the Initial Decision to the Commission for review. In a unanimous opinion authored by Commissioner Pamela Jones Harbour, the Commission reversed the ALJ's Initial Decision, finding that Rambus had "violated Section 5 of the FTC Act by engaging in exclusionary conduct that contributed significantly to the acquisition of monopoly power in four relevant and related markets."²⁵ In particular, the Commission found that Rambus "capitalized on JEDEC's policy and practice – and also on the expectations of the JEDEC members" – by (1) refusing to disclose its patents and applications, and (2) actively misleading JEDEC about its efforts to seek patents that would cover implementations of the JEDEC standards.²⁶ The Commission authoritatively stated that "there is little room for dispute about what Rambus did" because there was overwhelming evidence of Rambus's misconduct from Rambus's own documents and witnesses.²⁷

Notably, the Commission based its determination of deception on evidence of what the JEDEC members understood the rules to be rather than on a strict legal analysis of the texts that governed JEDEC members' obligations to the organization. Instead of focusing solely on JEDEC's written policies, the Commission considered "the totality of the circumstances in which [Rambus's] conduct occurred"²⁸ – including evidence related to Rambus's understanding of JEDEC's policies, other JEDEC members' testimony concerning their understanding of JEDEC's policy objectives, and the behavior of JEDEC when members attempted to enforce their patents after Rambus failed to disclose them. The Commission determined that the JEDEC members'

reasonable expectations were the dispositive factual predicate for a finding of liability – and that Rambus had "played on these expectations" to achieve an anticompetitive result.²⁹ This focus on what those involved in the standard-setting process expected, rather than on an analysis of their obligations under the rules of the standard-setting organization, is somewhat novel in an antitrust case based on a monopolization theory, although there are analogous principles in the "good faith" requirements of consumer protection law.³⁰

Once the deception element was established, it was relatively easy for the Commission to find a monopolization violation. First, it found a sufficient causal link between Rambus's conduct and JEDEC's decision to incorporate Rambus's technology into its standards. Again, the Commission relied on documentary evidence of Rambus's intentions, the testimony of JEDEC members, and the behavior of JEDEC members to find causation. Second, the Commission held that the incorporation of Rambus's technology into the JEDEC DRAM standards gave Rambus monopoly power over those standards as "a natural consequence of DRAM industry attributes."³¹ Finally, the Commission found sufficient "lock-in" to give Rambus durable monopoly power. In other words, switching costs were high enough that JEDEC had no choice but to continue using Rambus's technology even after the deception was revealed. However, the Commission found that the evidence did not support an inference that this lock-in effect extended to DDR2 SDRAM, the most recent relevant JEDEC standard, because it was adopted after Rambus's misconduct had been uncovered³² and the record contained insufficient evidence to establish that backward compatibility concerns "substantially contributed" to lock-in.³³

While the Commission reached a unanimous consensus that the ALJ's Initial Decision was wrong on almost every point, the Commissioners decided that they could not determine the proper remedy without additional information, and, consequently, ordered the parties to brief and argue the remedy issue separately. Perhaps tipping its hand on the nature of the internal disagreement among the Commissioners on the remedy issue, the Commission specifically requested that the parties propose means to determine "reasonable royalty rates" based on the existing record, "qualitative characteristics descriptive of appropriate relief," and "appropriate injunctive and other provisions that should be incorporated into the Final Order."³⁴

Remedy Decision

The Commissioners' unanimity disintegrated on the remedy issue, although no Commissioner was persuaded by Rambus's argument that the only proper remedy was a "cease and desist" order regarding future anticompetitive conduct.³⁵ Chairman Majoras, writing for herself, Commissioner Kovacic, and Commissioner Leibowitz, held that Rambus must accept Commission-established maximum royalty rates on Rambus's patented technology as applied to JEDEC's SDRAM and DDR SDRAM standards for a three-year period, after which the royalty rate will drop to zero.³⁶ The opinion based its calculations on an effort to determine the rate that most likely would have resulted from negotiations between the parties before JEDEC unwittingly adopted Rambus's technology (*i.e.*, when the industry had not yet invested in Rambus's technology and JEDEC had more bargaining power). Commissioner Rosch issued a separate opinion in which he stated that he believed there was sufficient evidence to order royalty-free compulsory licenses on Rambus's patented technology as applied to JEDEC's SDRAM and DDR SDRAM standards. Commissioner Harbour, the author of the Commission's Liability Decision, also issued a separate remedy opinion. She agreed with Commissioner Rosch that a zero-royalty license was appropriate in this case, but she also argued that the remedy espoused by the majority was insufficiently broad to restore the "but for" world because it did not include the DDR2 SDRAM standard.

As these concurring opinions suggest, the two key remedy issues (from both a legal and a practical perspective) were (1) whether the Commission should impose royalty-free licenses and (2) whether the remedy should cover Rambus's technology as applied to DDR2.

Issue #1: The Commission declined to require royalty-free licenses

The majority opinion acknowledged that the fundamental question at issue was the proper scope of the FTC's remedial power: "The Supreme Court has not yet addressed the scope of the Commission's remedial authority where, as here, the Commission has applied the legal standards of Section 2 of the Sherman Act."³⁷ Despite (or perhaps because of) this uncertainty, the Commission asserted that it has broad power "to create a forward-looking remedy" that "restor[es], to the extent possible, the competitive conditions that would have been present

absent Rambus's unlawful conduct."³⁸ Moreover, the majority opinion added that the Commission has "wide latitude for judgment" on the proper remedy as long as it bears a "reasonable relationship to the unlawful practices that the Commission has found."³⁹ The Commission affirmed that its remedial authority extends to compulsory licenses, citing its own forty year-old dicta to support the proposition that it has the authority to order royalty-free compulsory licenses.⁴⁰ However, the majority opinion declined to require royalty-free licensing in *Rambus* because "Complaint Counsel have not met the burden of demonstrating that restoring the competition that would have existed in the 'but for' world requires that Rambus license its technology with no compensation."⁴¹

This result is somewhat notable because it is clear from the Liability Decision that the Commission believed that Rambus intentionally hid its intellectual property in order to get JEDEC to adopt its technology without a commitment to license the technology on reasonable and non-discriminatory ("RAND") terms.⁴² The Commission found that: (1) Rambus's conduct was "calculated" to mislead; (2) Rambus failed to disclose its patent applications despite repeatedly being advised by its own counsel that it faced equitable estoppel if it did not make such disclosure; (3) Rambus avoided disclosing its patent position for the "very reason" that it understood such information would be material to JEDEC; and (4) Rambus "intentionally and willfully engaged in deceptive conduct."⁴³ The majority opinion even went so far as to state that "Rambus's intentional and willful deception ... is sufficient, without more, to justify broad fencing-in relief."⁴⁴

As noted above, the Commission called upon on the standard for "deception" articulated in its consumer protection jurisprudence - *i.e.*, strong evidence of what the JEDEC members understood the SSO's disclosure rules to be in practice - to determine that JEDEC had detrimentally relied on Rambus's deception to its detriment.⁴⁵ The Commission found that JEDEC "could have turned to unpatented alternative technologies in each of the relevant product markets."⁴⁶ It also found that "the evidence does not establish that Rambus's technologies were superior to all alternatives on a cost/performance basis"⁴⁷ and that "[w]ith regard to cost, Rambus failed to demonstrate that alternatives would have been more expensive."⁴⁸ Finally, and of particular significance, the Commission determined that Rambus's misconduct - *not* the superiority of Rambus's technology - caused JEDEC to adopt

Rambus's technology instead of one of those alternatives.⁴⁹ In addition to these findings, the record contained evidence that Rambus had clearly demonstrated at least twice that it would not commit to RAND terms.⁵⁰ In short, the Liability Decision laid the factual groundwork to conclude that JEDEC would have adopted a different technology in the "but for" world – leaving Rambus out in the cold with no royalties.

On the other side of the ledger, the Liability Decision found no factual evidence to support Rambus's proposition that it would have agreed to RAND terms in the "but for" world rather than allowing JEDEC to incorporate a competing technology. The only record evidence that Rambus proffered in support of this contention was testimony from its expert economist, who stated that it would have been in Rambus's economic interest to do so. However, even if that were true, the record provided ample evidence that Rambus was willing to act against its short-term self-interest in licensing RDRAM and would not have been likely to accept RAND royalty rates.⁵¹ As the majority opinion noted, "Rambus was so desperate to avoid having to license on RAND terms that it chose to deceive JEDEC rather than to succumb."⁵²

Nevertheless, the Commission ultimately determined that Complaint Counsel did not sufficiently demonstrate that a royalty-free license was "require[d]" to restore the competition that would have existed in the "but for" world.⁵³ The Commission was particularly concerned that its remedy should extend only so far as absolutely necessary to restore the competitive conditions that would have existed absent the anticompetitive conduct.⁵⁴ The majority of the Commissioners believed this mandate compelled them to determine the cost to JEDEC members if JEDEC had adopted non-Rambus technology, rather than the amount of royalties that Rambus would have received if JEDEC had adopted some other technology (i.e., zero). In other words, for the Commission to impose a royalty-free remedy, it "must conclude on the basis of the record that in the 'but for world' ... Rambus would not have obtained any royalties."⁵⁵

Of course, as the Commission noted,⁵⁶ it is difficult to ascertain with any certainty what would have happened if Rambus had not violated the law. While the Commission believed that it had the power to impose royalty-free licenses, it also believed that power was subject to "important limits" and may require "special proof."⁵⁷ The key question is where

those limits lie. How much proof is necessary to impose royalty-free licensing? Complaint Counsel argued that because the Liability Decision provided the requisite link between Rambus's misconduct and its acquisition of monopoly power, Rambus should bear the risk of the uncertain consequences of its conduct – and therefore "any doubts regarding the remedy are resolved against the wrongdoer."⁵⁸ The Commission did not address this argument directly, but apparently it disagreed – it refused to order royalty-free licensing because it was not sufficiently certain that Rambus would have been shut out of JEDEC in the "but for" world. The majority opinion stated Complaint Counsel failed to prove that "absent Rambus's deception, JEDEC would not have standardized Rambus' technologies, thus leaving Rambus with no royalties,"⁵⁹ despite the fact that the Commission had already determined that Rambus's misconduct was the reason that JEDEC adopted its technology.⁶⁰

The majority relied heavily on the fact that JEDEC's policies did not absolutely prohibit the incorporation of patented technologies on RAND terms, noting that JEDEC had incorporated such technologies in the past.⁶¹ Apparently, the "special proof" required by the Commission was proof that JEDEC had never incorporated – and would never incorporate – a patented technology with a RAND commitment. Given the difficulty in reconstructing the "but for" world with any degree of certainty, it appears likely that Complaint Counsel will find it difficult to meet this high standard in future cases.

Issue #2: The Commission's Remedy Excludes DDR2

The second significant issue for the Commission to resolve was the proper scope of the remedy. In particular, Complaint Counsel advocated that, although the Liability Decision did not find Rambus liable with respect to monopolizing the DDR2 SDRAM standard, the Commission's remedy should extend to that standard because Rambus's monopoly power in DDR2 "bears a reasonable relation to the unlawful practices found to exist"⁶² and it was necessary to cure the "hang-over of the long-existing pattern of [anticompetitive conduct]" (i.e., it was necessary to restore competitive conditions).⁶³ The Commission disagreed, rejecting Complaint Counsel's theory that deception on earlier technologies locked the JEDEC members into DDR2 (which was adopted after Rambus had resigned from the organization) – even though the majority opinion conceded that "there is no doubt that some relationship exists between

Rambus's deceptive conduct and its position in the DDR2 SDRAM market."⁶⁴

From a practical perspective, limiting the remedy to SDRAM and DDR SDRAM severely curtails its effectiveness. Wall Street treated the remedy decision as a clear victory for Rambus – on the day that the Commission issued its Final Order, the value of Rambus's stock increased 24 percent.⁶⁵ This is because most major computer manufacturers now use primarily DDR2, even in their entry-level products.⁶⁶ Moreover, industry analysts predict that DDR2 products will comprise over 77 percent of DRAM revenues in 2007, and over 84 percent in 2008.⁶⁷ By excluding the commercially dominant standard, the Commission's decision will only have a relatively marginal impact on the victims of Rambus's misconduct. The Commission recognized that its decision "will have declining impact as the market progressively shifts to DDR2," but it refused to apply any remedy to DDR2.⁶⁸ Because the Commission found the existence of "some relationship" between Rambus's misconduct and DDR2, there is reason to doubt that this result is correct.

Commissioner Harbour filed a concurring statement in which she argued that the remedy should extend to DDR2. According to Commissioner Harbour, perhaps the central problem with the majority opinion's approach to the DDR2 issue is that it focused on the *feasibility* of designing around Rambus's patents rather than the *prejudice* of requiring industry participants to choose between totally redesigning their standard or paying royalties that Rambus impliedly assured them they would never have to pay.⁶⁹ This raises a valid question: If the Commission found a relationship between Rambus' misconduct and the DDR2 standard, as it did, why should the industry bear the burden of designing around Rambus's patents in DDR2? The Commission based its ruling on the fact that JEDEC members could have feasibly designed around Rambus's patented technologies when the DDR2 standard was adopted.⁷⁰ Of course, that finding is much different from a conclusion that JEDEC members would not have been prejudiced by being forced to design around those patents at that point in time.

Commissioner Harbour argued that the remedy should cover the DDR2 standard under the Commission's "fencing-in" authority to "require relief that prohibits otherwise lawful conduct, if such relief is necessary to prevent ongoing harm to

competition."⁷¹ When the SDRAM and DDR standards were adopted, it was feasible for JEDEC members to adopt alternative technologies that were neither more costly nor less efficient than those actually adopted.⁷² It can be assumed that designing around Rambus's patents would have been virtually costless at those times. On the other hand, forcing the industry to design around those same patents years later is far from costless. First, the recoupment period on the time and money spent designing, developing, testing, optimizing and establishing the value of the standardized technologies would be truncated, and the experience gained in using those technologies would be lost. Second, a new round of otherwise unnecessary investment would have to be incurred to replace those technologies with others that offer no perceived advantages. The entire industry – DRAM manufacturers, OEMs and component makers – is arguably prejudiced if they must abandon tried, true and proven technologies and work to perfect unproven technologies that offer no potential efficiencies, particularly when they were led to believe that they would not ever be forced to choose between paying royalties to Rambus or having to design around Rambus's patents.⁷³

Moreover, based on the facts found by the Commission in the Liability Decision – which, as noted above, laid the factual groundwork to conclude that JEDEC would have adopted a different technology in the "but for" world – it would arguably distort the standard setting process to require JEDEC to replace its tried, true and proven technologies with alternative, unproven technologies that offer no apparent cost or performance advantages. It seems flawed to impose such a requirement simply because a SSO member who spent years baiting a "pernicious"⁷⁴ trap for its fellow members finally decided to reveal its deception by springing that trap.

Conclusion

The Commission's liability decision condemns Rambus's conduct in no uncertain terms, and the Commission strongly asserted that it has "wide latitude for judgment in selecting a remedy"⁷⁵ – but the remedy imposed in this case was much narrower than the relief requested by Complaint Counsel because (1) it did not require royalty-free licensing and (2) it did not apply any remedy to DDR2, the most commercially relevant standard. Based on the Commission's unanimous findings of fact, there was significant support for the proposition that Rambus would have received no royalties in the "but for"

world – and Rambus provided scant evidence to the contrary.

Despite the relatively minor economic effect of the Commission's remedy on Rambus's business, the Commission's commitment to this case – which has lasted five years – underscores its belief that effective enforcement and deterrence is crucial to encouraging participation in SSOs.⁷⁶ The fairly minimal financial impact of the remedy suggests that, this time, the Commission was primarily interested in providing guidance for the future conduct of SSOs. However, the high burden of proof assigned to Complaint Counsel on the scope and nature of the remedy in this case may make it difficult for the Commission to compel more severe remedies in future cases.

Of course, the Commission is not the only source of antitrust enforcement. Private litigants may take advantage of the Commission's findings and pursue an equitable estoppel theory in future private litigation that would bar Rambus from enforcing its SDRAM patents against those litigants with respect to the DDR2 standard. These private litigations may shed some more light on whether the Commission should have imposed a zero-royalty remedy and whether it should have extended that remedy to cover DDR2. Further, the FTC case is still not over – Rambus has indicated that it intends to appeal the Commission's decision. On March 16, 2007, the Commission stayed the enforcement of the maximum royalty rate provisions of the Final Order pending Rambus's appeal.⁷⁷

Finally, the European Commission ("EC") has also entered the fray. On July 30, 2007, it issued a Statement of Objections challenging Rambus's conduct, alleging that Rambus engaged in "patent ambush" demanding unreasonably high royalty rates for patents fraudulently accepted as JEDEC standard. If it finds that Rambus violated Article 82 (which prohibits "abuse of a dominant position"), the EC could impose a fine of up to 10 percent of Rambus's global turnover for each year it broke the law. (And, as the EC's recent record €497 fine against Microsoft for unilateral conduct violations demonstrates, it is not afraid to invoke this power.) Alternatively, the EC could require Rambus to license its technology on RAND terms. The EC ostensibly brought its own action because the Commission's remedy does not cover royalties on non-US patents relating to goods that are not imported into or out of the United States,⁷⁸ but it will be interesting to see whether the relief sought by the EC extends farther than the

Federal Trade Commission was willing to go.

¹ Logan Breed is an attorney at Hogan & Hartson LLP.

² See, e.g., *Rambus, Inc. v. Infineon Techs. AG*, 330 F. Supp. 2d 679, 696 (E.D. Va. 2004) ("[F]ar from being anticompetitive or merely benign, SSOs generally have beneficial effects on competition.") (citing David A. Balto, "Standard Setting in the 21st Century Network Economy," 18 NO. 6 COMPUTER & INTERNET L. 5, 7 (2001)).

³ See, e.g., *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 500 (1988) ("Agreement on a product standard is, after all, implicitly an agreement not to manufacture, distribute, or purchase certain types of products. Accordingly, private standard-setting associations have traditionally been objects of antitrust scrutiny."); *American Soc'y of Mech. Eng'rs v. Hydrolevel Corp.*, 456 U.S. 556, 571 (1982) ("[A] standard-setting organization ... can be rife with opportunities for anticompetitive activity.")

⁴ 15 U.S.C. § 45(a)(2) (2006).

⁵ See, e.g., Susan Creighton, "Ranking Exclusionary Conduct," at 10 (Nov. 25, 2005), available at <http://www.ftc.gov/speeches/creighton/051115conduct.pdf> ("Looking for anticompetitive opportunism in standard-setting organizations ... can yield significant bang for the enforcement buck.")

⁶ *In the Matter of Dell Computer Corp.*, 121 F.T.C. 616 (1996).

⁷ *In the Matter of Union Oil Co. of Cal.*, F.T.C. Docket No. 9305.

⁸ JEDEC is the semiconductor engineering standardization body of the Electronic Industries Alliance ("EIA"), a trade association that represents all areas of the electronics industry. It has approximately 290 member companies, including both manufacturers and users of semiconductor components. See <http://www.jedec.org/>.

⁹ *In the Matter of Rambus, Inc.*, Docket No. 9302, Opinion of the Commission, 2006 WL 2330117 (F.T.C.), 2006-2 Trade Cases ¶ 75,364 at 4 ("Liability Decision").

¹⁰ *Id.*

¹¹ *In the Matter of Union Oil Co. of Cal.*, Docket No. 9305, Decision and Order, 2005 WL 2003365 (F.T.C.) (Aug. 2, 2005). An FTC Administrative Law Judge ("ALJ") initially granted Unocal's motion to dismiss the complaint in its entirety on November 25, 2003. *In the Matter of Union Oil Co. of Cal.*, Docket No. 9305, Initial Decision, 2003 WL 22977696 (F.T.C.) (Nov. 25, 2003). That ALJ held that *Noerr-Pennington* immunity applied to efforts, including alleged misrepresentations, to influence the standard setting functions of a governmental entity. Moreover, the ALJ ruled the FTC did not have jurisdiction over allegations that depend on the resolution of "substantial questions" of federal patent law. The Commission reviewed the ALJ's decision, disagreed on both points and reversed the Initial Decision on July 7, 2004. *In the Matter of Union Oil Co. of Calif.*, Docket No. 9305, Opinion of the Commission (July 7, 2004), available at <http://www.ftc.gov/os/adjpro/d9305/index.htm>. It refused to extend *Noerr-Pennington* protection to Unocal's alleged activity, and also held that the ALJ misinterpreted the scope of the FTC's jurisdiction, stating that "the ALJ and Unocal err through an unduly narrow reading of the FTC Act; an overly broad reading of the statute that confers patent law jurisdiction upon the federal courts; and a fundamental misinterpretation of the nature of the Commission's inquiry when patents are among the relevant assets of firms alleged to have unlawfully created or exercised monopoly power." *Id.* at 42-43.

¹² *In the Matter of Rambus, Inc.*, Docket No. 9302, 2006 WL 2330117 (F.T.C.) (Aug. 2, 2006).

¹³ *In the Matter of Rambus, Inc.*, Docket No. 9302, Opinion of the Commission on Remedy, 2007 WL 431524 (F.T.C.) (Feb. 5, 2007).

14 In the Matter of Rambus, Inc., Statement of Commissioner J. Thomas Rosch, Concurring in Part and Dissenting in Part, 2007 WL 431525 (F.T.C.) (Feb. 5, 2007) (“Rosch Concurring Opinion”); In the Matter of Rambus, Inc., Remedy Statement of Commissioner Pamela Jones Harbour Concurring in Part and Dissenting in Part, 2007 WL 431523 (F.T.C.) (Feb. 5, 2007) (“Harbour Concurring Opinion”).

15 *Id.* at 8.

16 In the Matter of Rambus, Inc., Docket No. 9302, Administrative Complaint (June 18, 2002), available at <http://www.ftc.gov/os/adjpro/d9302/020618admindcmp.pdf> (“Complaint”).

17 Complaint ¶¶ 122-24.

18 *Id.* ¶¶ 2, 70-78.

19 *Id.* ¶¶ 70-78.

20 In the Matter of Rambus, Inc., Docket No. 9302, Initial Decision, 2004 WL 390647 (F.T.C.) at 300-04 (Feb. 23, 2004) (“Initial Decision”).

21 See *Id.* at 295-300, 331-32.

22 See *Id.* at 304-09.

23 See *Id.* at 312-16.

24 See *Id.* at 326-29.

25 Liability Decision at 5.

26 *Id.* at 4.

27 *Id.* at 37.

28 *Id.* at 51.

29 *Id.* at 66.

30 See, e.g., *Murray Space Shoe Corp. v. FTC*, 304 F.2d 270, 272 (2d Cir. 1962) (holding that, in the context of a deceptive advertising claim under Section 5, the FTC should assess the general impression the advertisement creates rather than engaging in a “hyper-technical” assessment of “the meaning of each word and phrase”); Federal Trade Commission Policy Statement on Deception, 4 Trade Reg. Rep (CCH) ¶ 13,205, at 20,911-12 (FTC Oct. 14, 1983).

31 *Id.* at 78.

32 Rambus filed its first infringement suit against a producer of JEDEC-compliant DRAMs in early 2000, and JEDEC published the DDR2 standard to its members in 2002. See *Id.* at 111.

33 *Id.* at 113.

34 *Id.* at 120.

35 In its filings and at oral argument on the remedy issue, Rambus argued that (1) the Commission was empowered only to seek prospective “cease and desist” orders, (2) Rambus’s current royalty rates under the JEDEC standards were competitive and reasonable compared to its rates for other comparable licenses, and (3) therefore, the remedy should be limited to an order directing Rambus not to engage in deceptive conduct in future standard-setting. On the other hand, Complaint Counsel argued that the Commission should impose a compulsory, royalty-free license on all of Rambus’s patents that had been incorporated into JEDEC standards because, had Rambus properly disclosed its patents, JEDEC would have approved a standard that did not infringe those patents or required a royalty-free license. Amici additionally argued that the Commission should consider the deterrence aspect of its remedy – if Rambus received a windfall (or any positive return) for its misconduct, future SSO participants would have an incentive to engage in similar conduct.

36 In the Matter of Rambus, Inc., Docket No. 9302, Opinion of the Commission on Remedy, 2007 WL 431524 (F.T.C.) at (Feb. 5, 2007) (“Majority Remedy Opinion”).

37 *Id.* at 2. The Commission applied the legal standards of § 2 because FTC Act § 5 reaches conduct that violates the Sherman Act. See, e.g., *FTC v. Cement Inst.*, 333 U.S. 683, 694-95 (1948); *Fashion Originators’ Guild of America v. FTC*, 312 U.S. 457, 463 (1941).

38 *Id.* at 2, 6.

39 *Id.* at 6.

40 “[W]here the circumstances justify such relief, the Commission has the authority to require royalty-free licensing.” *Id.* at 10 (quoting *American Cyanamid Co. v. FTC*, 63 F.T.C. 1747, n.46 (1963)).

41 Majority Remedy Opinion at 16.

42 See, e.g., In the Matter of Rambus, Inc., Docket No. 9302, Concurring Opinion of Commissioner Jon Leibowitz, 2006 WL 2330118 (F.T.C.) at 21 (Aug. 2, 2006) (“Rambus’s abuse of JEDEC’s standard-setting process was intentional, inappropriate, and injurious to competition and consumers alike.”).

43 Liability Decision at 67, 44, 68.

44 *Id.* at 26. This concept was also discussed in detail at oral argument. In particular, Complaint Counsel advocated that the Commission’s “fencing in” authority under cases such as *FTC v. National Lead*, 352 U.S. 419 (1957) was a separate theory under which the Commission could defensibly extend the remedy to include DDR2. See Oral Argument Relating to Remedy: Transcript of the Proceedings at 24-26, 85 (Nov. 15, 2006), available at <http://www.ftc.gov/os/adjpro/d9302/061115remedyoralargumenttranscript.pdf>.

45 See *supra* n.29 and accompanying text.

46 Liability Decision at 97.

47 *Id.* at 82.

48 *Id.* at 94.

49 See *id.* at 71 (“The record establishes that the purpose and effect of Rambus’s deceptive conduct was to manipulate the standard-setting process at JEDEC and gain market power.”) (emphasis added).

50 See Rosch Concurring Opinion at 7.

51 See *id.* at 5-6.

52 Majority Remedy Opinion at 13.

53 *Id.* at 16.

54 See *id.* at 10.

55 See Rosch Concurring Opinion at 2.

56 Majority Remedy Opinion at 12.

57 *Id.* at 10.

58 In the Matter of Rambus, Inc., Docket No. 9302, Reply Brief of Counsel Supporting the Complaint on the Issue of Remedy at 5 (Sept. 29, 2006) (“Complaint Counsel Remedy Reply Brief”).

59 Majority Remedy Opinion at 12.

60 Commissioner Rosch’s concurring opinion pointed out the strength of Complaint Counsel’s position, stating that “JEDEC’s rules, the expectations of its membership, and the market’s concerns with costs generally and the cost of Rambus’s technologies in particular all strongly support a finding that a fully informed JEDEC would have adopted standards that did not read on Rambus’s patents.” Rosch Concurring Opinion at 4.

61 Majority Remedy Opinion at 15-16.

62 Complaint Counsel Remedy Brief at 16-17 (quoting *Toys R Us v. FTC*, 221 F.3d 928, 940 (7th Cir. 2000)); see also *ES Development, Inc. v. RWM Enterprises, Inc.*, 939 F.2d 547, 557 (8th Cir. 1991) (proper antitrust remedy should account for the “continuing effects of past illegal conduct”) (citing *Willk v. American Medical Ass’n*, 671 F. Supp. 1465, 1485 (N.D. Ill. 1987); *In re Multidistrict Vehicle Air Pollution*, 538 F.2d 231, 236 (9th Cir. 1976).

63 In the Matter of Rambus, Inc., Docket No. 9302, Brief of Counsel Supporting the Complaint on the Issue of Remedy, 2006 WL 2790237 (F.T.C.) at 18 (Sept. 18, 2006) (“Complaint Counsel Remedy Brief”) (quoting *National Lead*, 352 U.S. at 425).

64 Majority Remedy Opinion at 30.

65 See Nicole Ridgway, “Investors Bid Up Rambus on FTC Royalty Ruling,” Feb. 5, 2007, available at <http://www.smartmoney.com/onedaywonder/index.cfm?story=20070205>.

66 See Harbour Concurring Opinion at 9.

67 See *id.*

68 Majority Remedy Opinion at 30.

69 See Harbour Concurring Opinion at 4 (“A DDR2 remedy would more completely and effectively mitigate the likely and foreseeable effects of Rambus’s exclusionary conduct and would create an opportunity for the market to establish a competitive equilibrium.”).

70 See Liability Decision at 113.

71 Harbour Concurring Opinion at 5.

⁷² See Liability Decision at 82, 94, 97.

⁷³ As the Commission found, "JEDEC's members expected disclosure of both patents and patent applications that might be applicable to work JEDEC was undertaking, if the patents ever were going to be enforced against JEDEC compliant products." Liability Decision at 66 (emphasis added).

⁷⁴ *Id.* at 35.

⁷⁵ Majority Remedy Opinion at 26 (quoting *Jacob Siegel Co. v. FTC*, 327 U.S. 608, 613 (1946)).

⁷⁶ The Department of Justice Antitrust Division ("DOJ") has also provided important guidance to SSOs and their participants regarding patent disclosure requirements and the proper scope of *ex ante* patent licensing commitments in two recent business review letters. See Letter from Thomas O. Barnett, Assistant Attorney Gen., U.S. Dep't of Justice to Michael A. Lindsay, Dorsey & Whitney LLP (April 30, 2007) ("IEEE Business Review Letter"), available at

<http://www.usdoj.gov/atr/public/busreview/222978.htm>; Letter from Thomas O. Barnett, Assistant Attorney Gen., U.S. Dep't of Justice to Robert A. Skitol, Drinker, Biddle & Reath, LLP (Oct. 30, 2006) ("VITA Business Review Letter"), available at <http://www.usdoj.gov/atr/public/busreview/219380.htm>.

⁷⁷ *In the Matter of Rambus, Inc.*, Docket No. 9302, Order Granting in Part and Denying in Part Respondent's Motion for Stay of Final Order Pending Appeal, 2007 WL 901600 (F.T.C.) (March 16, 2007).

⁷⁸ See European Commission, DG Competition, "Commission Confirms Sending a Statement of Objections to Rambus," Aug. 23, 2007, available at

<http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/07/330&format=HTML&aged=0&language=EN&guiLanguage=en>.

FTC HOSTS "UNILATERAL EFFECTS AND LITIGATION" WORKSHOP

By Carla Hine¹

On February 12, 2008, the Federal Trade Commission ("FTC") hosted a workshop on unilateral effects analysis. The FTC organized this workshop, titled "Unilateral Effects Analysis and Litigation," to gain critical insight into how unilateral effects theories should be applied to mergers of firms selling competing but differentiated products.² The workshop was prompted in part by the mixed results that the FTC and the Antitrust Division of the Department of Justice ("DOJ") (collectively, "Agencies") have experienced in litigating unilateral effects cases. The workshop focused on unilateral effects cases involving mergers between firms producing or selling differentiated products competing locally instead of generally. Such cases often produce small, narrow markets and have been the most challenging for the Agencies to litigate.

In her opening remarks, Chairman Majoras noted that the Agencies "have a great responsibility to ensure that we're basing [unilateral effects] decisions, most of which reside in consent decrees, on solid analysis, which would be supportable in the courts if litigation were necessary." Chairman

Majoras also outlined some of the key issues that she hoped the workshop would address, including: (1) whether market definition has become an ends rather than a means to determine whether a merged firm will be able to exercise market power; (2) how to make defined markets in unilateral cases look less gerrymandered and more intuitive and consistent with consumers' views; (3) whether defining markets is necessary when the Agencies can present direct evidence of competitive effects, and (4) the most probative types of evidence in unilateral effects cases, and the best ways to present such evidence in court.

The panelists, including government officials, antitrust practitioners, federal judges, and economists, tackled these topics throughout the workshop's five panels. We address each of these topics in turn.

Has Market Definition Become an Ends Rather Than a Means to Determine a Combined Firm's Ability to Exercise Market Power Post-Merger?

Throughout the workshop, the panelists debated the appropriate role of market definition in unilateral effects cases as a tool to gauge the effect on competition when one firm is removed from the industry. In the analytical framework established by the Horizontal Merger Guidelines,³ market definition serves as a proxy for determining whether a merger between competitors will result in a substantial lessening of competition. Over time, however, unilateral effects analysis has emerged as a powerful tool for directly measuring the competitive harm from a prospective merger; the agencies have increasingly turned to unilateral effects in their analysis of mergers. Indeed, Susan Creighton of Wilson Sonsini Goodrich & Rosati stated that when she served first as Deputy Director and then as Director of the FTC's Bureau of Competition, the staff primarily were concerned about competitive effects in determining whether a proposed merger would harm competition. She observed that it was only "very late in the game" that staff would begin defining relevant product and geographic markets.

Joseph Simons of Paul Weiss noted that much of the current difficulty faced by the agencies stems from the drafting of the Merger Guidelines. When the Merger Guidelines were amended to include unilateral effects, the language on market definition went unchanged. Mr. Simons argued that when the concept of unilateral effects was "shoehorned in," the Merger Guidelines lost their cohesiveness as a whole.

Kathryn Fenton of Jones Day, currently chair of the Antitrust Section of the American Bar Association, noted that the Commission's decision in *Evanston*⁴ held that if it was possible to show harm through direct evidence in a geographic market, the resulting market defined by the harm constitutes a relevant market, but observed that avoiding the more conventional and direct exercise of market definition is likely a "hard sell" to courts, as they are skeptical of economic evidence.

One of the panels consisted of simulated closing arguments in a trial regarding the merger of two ice cream manufacturers, and neatly illustrated the concern that market definition has become an end rather than a means in unilateral effects analysis. Michael Bloom, Director of Litigation for the FTC's Bureau of Competition, argued the government's case, maintaining that because the merging parties competed within a narrow, concentrated market for super-premium ice cream and had correspondingly high market shares, the merger should be blocked. The Honorable Diane Wood of the United States Court of Appeals for the Seventh Circuit quickly questioned whether by defining the relevant market so narrowly, the government summarily assumed "the most important question before the court," namely, whether there was in fact a market for super-premium ice cream, and further questioned whether the government had a case at all if the market were broader than super-premium ice cream. By attempting to present a unilateral effects analysis within the framework of traditional market definition analysis, the government risks making proof of a narrow market the linchpin of its case.

How Should the FTC and DOJ Define Relevant Markets So They Look Less Gerrymandered and More Intuitive?

Many panelists agreed that some of the Agencies' recent cases suffer from the perception that the relevant market definitions look gerrymandered to fit a particular theory and do not match actual data or economic reality. Rich Parker of O'Melveny & Myers observed that the Agencies have been unduly focused on defining a narrow market in an attempt to obtain a presumption of illegality under *Philadelphia National Bank*.⁵ Mr. Parker noted that an agency's credibility is critical to winning a case and stated that the most important question isn't what market the agency defines, but rather what is intuitive in explaining unilateral effects to a judge. Mr. Parker suggested that a far more effective litigation strategy for an agency would be to state

that it doesn't need the *Philadelphia National Bank* presumption because it has solid evidence that the merging parties drive prices. Mr. Parker further suggested that the Agencies should be willing to simply cede a broad market definition to the defendants and then argue the existence of a sub-market based on unilateral effects evidence.

Dan Wall of Latham & Watkins, who served as lead counsel for Oracle in the DOJ's 2004 suit to block Oracle's acquisition of PeopleSoft, offered a defendants' perspective of the Agencies' recent litigation efforts. First, Mr. Wall asserted that market definition should correspond with common sense intuition about the marketplace. Second, he observed that the Agencies should not take unwarranted litigation risks by arguing for narrower markets than necessary to demonstrate that a proposed merger will result in anticompetitive effects. Third, he explained that the Agencies should not provide defendants the opportunity to make the government's proffered market definition the linchpin of the defendants' case. Strategically, Mr. Wall suggested, the Agencies should avoid providing defendants with excess ammunition by making concessions with respect to market definition while preserving their case to the extent possible.

Although some panelists exhibited resistance to narrow markets based on localized competition, Robert Willig, Professor of Economics at Princeton University, argued that the antitrust bar should accept the notion that markets can be localized, and that the best characterization of the relevant market is obtained by deducing the market from competitive effects. Professor Willig conceded that the resulting market characterizations may not be "completely intuitive," but noted that a lack of initial intuitiveness is not a good reason for rejecting competitive effects and does not diminish the fact that competitive effects provide the best available evidence of the relevant market definition.

Is Market Definition Necessary Where the FTC and DOJ Can Present Evidence of Competitive Effects?

Throughout the workshop, the panelists debated whether market definition or competitive effects should be the focus of unilateral effects cases. Ms. Fenton asserted that the language of Clayton Act Section 7 requires the agencies to define relevant markets. Specifically, by prohibiting transactions "where in any line of commerce . . . , the effect of such acquisition may be substantially to lessen

competition,"⁶ the statutory language requires an examination of competitive effects in each potentially affected "line of commerce," which necessitates defining relevant markets.

In contrast, several panelists supported circumventing market definition and concentrating on competitive effects. Arguably, where the Agencies can show competitive effects, there is no need to define a market or assess market concentration because market definition serves as a mere surrogate for proving actual anticompetitive effects. Jonathan Baker, Professor of Law at American University, observed that if the government could prove some likely harm, there must be a market in which that harm would occur; might that inference be enough to satisfy the language of the Clayton Act? Carl Shapiro, Transamerica Professor of Business Strategy at University of California at Berkeley and Senior Consultant at CRA International, suggested a more direct approach: get rid of the market definition exercise altogether.

In his discussion regarding the pros and cons of using market definition in unilateral effects cases, Professor Baker noted that both narrow and broad market definitions have certain strategic drawbacks. For example, narrow markets may look gerrymandered, or may be focused on the wrong issue (*i.e.*, the extent of buyer substitution to third parties outside the narrowly defined market instead of the amount of substitution between the merging firms). Conversely, while a broad market definition places the focus on competitive effects and how the merger will allow the combined entity to change the competitive response of a certain rival or recapture lost profits, it may also force the government to concede that there are several rivals and that the competitive effects are limited to a small portion of the market, which are "bad optics" for the case. Professor Baker noted that while the Agencies seemingly could avoid these issues by focusing on competitive effects and simply not defining a market at all, any benefit from such a strategy would be illusory as the Agencies would need to respond to a broad market definition proffered by defendants.

Looking ahead, Dan Wall asserted that the Agencies are obliged to address market definition unless they amend the Merger Guidelines to eradicate reliance on market definition in merger analysis. Ms. Creighton observed, however, that the Merger Guidelines are unlikely to be reformed because the DOJ does not see a need for amendments. As a

practical matter, noted Constance Robinson of Kilpatrick Stockton, the FTC and DOJ do not necessarily need to approach the analysis in the same lock-step fashion outlined in the Merger Guidelines.

Probative Evidence in Unilateral Effects Cases

The panelists generally agreed that the most effective unilateral effects cases are those in which the economic evidence complements the parties' internal strategic planning documents, customer views, industry views, and recent entry – in other words, where both the economic and qualitative evidence point toward the same conclusions.

There was less consensus among the panelists regarding the emphasis that parties should place on economic and econometric evidence. Some panelists focused on the drawbacks of relying too heavily on economic evidence. For example, using imperfect data (while it may be the only data available) or data that measures the wrong level of competition (*e.g.*, scanner data in a branded food product merger, measuring prices set by retailers instead of wholesale prices) may lead to skewed, unreliable results. Additionally, there are challenges associated with educating judges and jury members who are not well-versed in various economic analytical tools.

Professor Shapiro discussed his forthcoming paper with Joseph Farrell, Professor of Economics at University of California at Berkeley. This paper presents an alternative to traditional market definition in unilateral effects cases using data that arguably should be available in any case. Focusing on readily accessible data that can be explained easily to a court, Professors Shapiro and Farrell suggest measuring the pressure on prices that would result from a proposed merger by multiplying the diversion ratio (*i.e.*, the fraction of the sales coming at the expense of the target company) by the profit margin (*i.e.*, price minus cost) on each unit sale at the target company. If the resulting product is larger than the efficiencies created by the merger, the paper asserts that the merger would produce upward pricing pressure. This approach arguably addresses the dual concerns of (1) procuring robust data by using easily accessible data and (2) presenting simplified economic analysis to the court.

Several panelists advocated the primary use of more conventional types of evidence, such as the parties' internal business documents indicating who the parties view as their competitors and against which

competitors they are pricing or otherwise reacting, customer testimony and evidence of entry — provided, however, that these various evidentiary sources offer a consistent view of the marketplace. Other panelists were less enthusiastic about using customer testimony or surveys. Dennis Carlton, Professor of Economics at the University of Chicago School of Business and Senior Managing Director of Compass Lexecon, made the point that as an economist he is skeptical of what consumers *say* and prefers instead to look at what consumers *do*. Professor Carlton further noted that defining who the relevant consumer is for the purpose of such studies is often problematic. Richard Rapp of NERA Economic Consulting stated that customer testimony and other individual testimony involves “cherry picking” in the sampling process and produces outcomes in a manner that offers less protection than *Daubert*⁷ provides for economic analysis. Ms. Robinson added that customer testimony can often be unpredictable and one can never be sure what a customer will say under cross-examination.

The Future of Unilateral Effects Analysis

The panelists suggested a variety of ways in which the FTC can enhance the value of unilateral effects analysis in the courtroom, although there was no general consensus on how this could be accomplished. Suggestions included amending the Horizontal Merger Guidelines and using Part III decisions to educate courts on unilateral effects theory and analysis. There was general agreement, however, that the FTC could take steps to strengthen its unilateral effects cases under the current legal framework. Specifically, participants tended to agree that the FTC should focus on trial strategy earlier and should define a market and use economic evidence so as to reinforce the narrative of other, non-economic, forms of evidence and create a more intuitive case.

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More information regarding the workshop, including web casts and transcripts, can be found at <http://www.ftc.gov/bc/unilateral/index.shtm>.

- ¹ Carla Hine is an attorney at McDermott Will & Emery.
- ² More information regarding the workshop, including information regarding the panels, web casts, and transcripts, can be found at <http://www.ftc.gov/bc/unilateral/index.shtm>.
- ³ U.S. DEPARTMENT OF JUSTICE AND FEDERAL TRADE COMMISSION, HORIZONTAL MERGER GUIDELINES (1992), available at <http://www.usdoj.gov/atr/public/guidelines/hmg.pdf>.
- ⁴ *In the Matter of Evanston Northwestern Healthcare Corp. and ENH Medical Group, Inc.*, FTC Docket No. 9315, Aug. 2, 2007, available at <http://www.ftc.gov/os/adjpro/d9315/070806opinion.pdf>.
- ⁵ *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 363 (1963).
- ⁶ 15 U.S.C. § 18.
- ⁷ *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579 (1993).

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