



FTC turns back challenge on patent coverage

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..... The US Federal Trade Commission (FTC) has overturned a decision by one of its administrative law judges, which held that the agency lacked power to stop patent owners from deceptively inducing state regulatory agencies to adopt standards subject to patent protection. The charge in controversy was that the Union Oil Company of California (Unocal) violated antitrust laws by deceiving the California Air Resources Board (CARB). This alleged misconduct occurred in regulatory proceedings for setting a gasoline content standard to lessen air pollution. The FTC's administrative law judge had ruled the FTC had no regulatory power over conduct occurring in such government proceedings, and dismissed the charges without a factual trial of the allegations. This led to an appeal to the five-commissioner FTC, which unanimously reversed the initial decision. The effect of the reversal is to reinstate the proceeding against Unocal for a determination as to whether it had committed the alleged fraud on CARB concerning patents.

Background

In 2003, the FTC charged Unocal with illegally acquiring monopoly power in the technology market for producing so-called *Phase 2 summer-time CARB gasoline*—a formulation of low-emissions gasoline that the State of California required distributors to sell during smog-prone months. In Los Angeles, that can be up to eight months a year. The FTC charged that Unocal induced CARB to set a standard that refineries could meet only by using technology cov-

ered in substantial part by Unocal patent applications. At the time, Unocal falsely represented to CARB that the technology was nonproprietary and in the public domain. Meanwhile, Unocal successfully pursued its patent applications. Once the patents were issued, the company began demanding hundreds of millions of dollars in royalties from companies selling gasoline that met the California legal standard. In 1995, a patent infringement battle began between Unocal and its competitors: Exxon, Mobil, Chevron, Texaco, and Shell. Unocal eventually won a judgment for more than \$90 million and a requirement that about six cents per gallon was a proper royalty. Unocal has announced

that it expects to collect up to \$150 million a year from license fees.

Unocal persuaded the administrative law judge to dismiss the case on several grounds. First, Unocal's conduct was protected First Amendment activity, under that amendment's clause making inviolate the right to petition to the government for redress of grievances. Second, the FTC has no authority or jurisdiction to consider the case because it involves determination of issues of patent law.

Noerr-Pennington doctrine

The legal principle that political activity—such as persuading the US Congress

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or a state legislature to pass a law that puts the persuader's competitors at a disadvantage—is protected under the First Amendment stems from two US Supreme Court decisions. In one case, the Noerr Trucking Co. sued a group of railroads under the antitrust laws for lobbying together to persuade the Pennsylvania legislature to pass laws disadvantageous to truckers. Noerr alleged that the railroads misrepresented facts about the harm trucks did to highways. In the other case, a group of coal mine owners and a union persuaded the US Labor Department and the Tennessee Valley Authority, a utility supplier, to adopt regulations that kept small-mine owners (such as Pennington Mining Co.) from competing in the market to sell coal to TVA. In both cases, the Supreme Court held that the antitrust laws do not address such conduct because it is protected petitioning activity. Hence, the legal principle is known as the *Noerr-Pennington* doctrine.

The FTC overturned the administrative law judge's ruling that this doctrine protected Unocal from prosecution by the agency. The scope of the doctrine varies with its context. It is most sweeping where it involves contact with the federal government or a state legislature. It might have less sweep when it involves an administrative or executive agency, and it has still less scope in adjudication (that is, the dispute is before a court). Thus, in one case, the Supreme Court explained, "Misrepresentations condoned in the political arena are not immunized when used in the adjudicatory process." Moreover, the Supreme Court even more severely regarded misrepresentations to nongovernmental standards-setting bodies, such as the American Society of Mechanical Engineers or IEEE. In a case involving the ASME, the Supreme Court observed that "the applicability of Noerr immunity varies with the context and nature of the activity." Some lower court decisions have held that Noerr-Pennington did not protect misrepresentations to state or federal administrative agencies.

Unocal argued for—and the adminis-

trative law judge's initial decision accepted—a distinction based on whether the misrepresentation occurred in a context of abusing the administrative process to harm competitors or to accomplish an outcome, by the agency's decision, that harmed competitors. This theory was that Noerr-Pennington protected the second category, but not the first. The FTC rejected this theory, stating: "If the petitioner desires a governmental outcome, then building a monopoly through blatant lying would be protected." It makes no sense to apply such a theory to misrepresentations because the whole point of lying to an agency is to induce it to take action and reach an outcome based on the lie; otherwise, why lie?

In short, the FTC insisted that

Unocal's Noerr-Pennington motion rests on the proposition that a private business may lie to a government rule maker, misrepresent its intentions regarding the enforcement of its patent rights, and then swing the trap shut after the government has enacted regulations that overlap with the patents. According to Unocal, a firm may thereby amass market power and enforce patent rights buttressed by a government mandate in ways never understood nor intended by the government agency, with absolute impunity from antitrust review. [Yet] virtually all recent cases hold that in some circumstances false petitioning does not enjoy protection [and the FTC now] joins this consensus.

FTC's standard for loss of immunity

The FTC now faced the problem of defining a standard for distinguishing which misrepresentations could create liability and which could not. First, the FTC distinguished between political and non-political activity. Several criteria helped in making this distinction.

One factor to consider was whether there was a governmental expectation of

truthful representation. Apparently, the FTC thought that the Pennsylvania legislature couldn't have expected the railroads to be truthful when seeking antitrust legislation, but California's CARB expected oil companies to be truthful when giving advice about how to formulate gasoline to lessen pollution.

Another factor was the degree of governmental discretion. Perhaps the Pennsylvania legislature in the Noerr case, and the Department of Labor and TVA in the Pennington case, had vast or almost unfettered discretion in making a determination. On the other hand, CARB clearly expected to base its prescription of gasoline standards on factual evidence. Normally, government agencies base such action on substantial evidence, or at least evidence that is not arbitrary and capricious. That is a requirement of both federal and California law in administrative agency proceedings. The FTC considered these constraints on CARB's discretion to be "significant indicia" that its proceeding "fell outside the political arena."

A third important factor is the extent to which the agency must depend on the party making representations. A legislature probably takes anything a lobbyist says with a grain of salt, and if it does not want to rely on representations it can usually hold hearings or investigate. An agency like CARB, and certainly one like the US Patent and Trademark Office, usually lacks the capability for independent, factual inquiries into technology. As far as the issue of patent coverage went, only Unocal could know what type of patent claims it had pending.

Finally, the FTC said that it should consider how well it could determine the causal relationship between the agency action and the misrepresentation. That is, did Unocal actually influence CARB to take the anticompetitive action? Perhaps, also, any determination should consider whether CARB had no alternatives, so that the misrepresentation did not affect the ultimate outcome. A fact of importance here was that CARB's final order stated that it relied heavily on Unocal's presentations.

Issues arise also, the FTC opined, as to the nature of the representation. (However, these factors appear to cover much the same ground as the preceding ones, although under a different label.) Is it a deliberate misrepresentation or an innocent, untrue statement? Is it a failure to disclose information where it is not clear that a duty exists to make disclosure? Also, is the challenged assertion a statement as to facts or a mere expression of opinion? Presumably, the agency should not reasonably rely on the latter. Finally, how important and central to the issues is the assertion? The FTC conceded that “to vitiate Noerr-Pennington protection a misrepresentation must be of central significance, such that it undermines the very legitimacy of the government proceeding.” To measure this “central significance” the FTC said it would ask whether the misrepresentation *caused* the agency action in question—or whether “the agency would not have acted the way it did *but for* the impropriety.” The allegations of the FTC’s formal charges against Unocal were of intentional, bad-faith deceptive conduct, that

- concerned factual matters known in large part only by Unocal; and
- the misrepresentations caused CARB to adopt regulations that “substantially overlapped Unocal’s patent claims.”

Based on this analysis, the FTC explained, it rejected Unocal’s position that the Noerr-Pennington doctrine prevented the FTC from seeking to order Unocal not to enforce its patents against refiners and sellers operating under the CARB regulations.

Patent issues

The FTC then turned to the patent issues. It rejected Unocal’s contention that “this matter may only be brought, if at all, in a federal district court, which has original jurisdiction over patent questions” and it reversed the administrative law judge’s conclusion that the FTC lacked jurisdiction in this case. Rather, the FTC insisted, that it is “a fundamental misinterpretation of

the nature of the Commission’s inquiry when patents are among the relevant assets of firms alleged to have unlawfully created or exercised market power.”

First, Congress delegated to the agency broad power to prevent unfair methods of competition when it passed the FTC Act in 1914. That Congress did mention abuse of patent power does not mean that it intended to limit the FTC’s role. The FTC pointed to legislative history, which stated that “there is no limit to human inventiveness” in the field of thinking up new, unfair practices. Being more specific than directing the FTC to generally suppress “unfair” practices would simply invite evasion of whatever the act specified. Furthermore, in the past, the FTC has remedied patent abuses, such as enforcement of patents procured through fraud on the patent office. Although federal law gives US district courts exclusive jurisdiction over civil actions arising under the patent laws, an FTC proceeding is not a civil action. It is an administrative proceeding and does not arise under the patent laws; it arises under the FTC Act.

Finally, the Commission noted, this decision is not one based on the merits of the charges. That still has to be resolved. This decision simply holds that the administrative law judge erred in dismissing the case on the ground that it did not belong at the FTC.

Ruling’s significance

As just indicated, this is not a ruling that Unocal in fact committed the wrongs alleged in the FTC’s complaint. It is simply a ruling that, if the FTC judges the facts to correspond to what the complaint alleged, then Unocal committed unfair competition. The administrative law judge whose knuckles the FTC rapped for dismissing the charges as beyond the FTC’s jurisdiction could now still regroup and hold that the alleged facts remain unproved. Certainly, that is what Unocal will urge him to hold.

But the decision does indicate that the similar arguments against FTC jurisdiction, made in other proceedings, are not likely to fare well before the FTC. In fact, in the

pending appeal of the *Rambus* decision to the full FTC, for example, the focus of the arguments are now whether Rambus in fact deceived the standard setters and whether there was no effective alternative technology that JEDEC could or would have adopted, but for the alleged misrepresentations about patent coverage. Rambus now is not even arguing that the FTC is powerless to address the alleged misconduct. It simply denies that misconduct in fact occurred, given the facts.

Thus, defendants now seem to accept the principle that if a company deceives a standard-setting body into adopting a standard whose implementation requires use of the company’s patented technology, by causing the body to believe that the technology is not patented, then there *can* be a violation of antitrust or unfair competition law. The italicized “can” means that a complaint must meet other requirements—such as that of the standard creating market power, actual intent to deceive, and perhaps a showing that, but for the deception, the body would have been able to implement a standard with different technology.

Interestingly, other domestic and foreign tribunals are now addressing alleged patent abuse in standards setting. The privately adopted “Orange Book” technical standard for compact discs, using in large part patented technology from Philips, has been challenged successfully, so far, in the US and Taiwan. The US International Trade Commission (ITC) and the Taiwanese Fair Trade Commission have each held that Philips improperly required would-be licensees to accept licenses under unwanted and unnecessary “pooled” patents to gain licenses under necessary patents (that is, necessary to meet the technical standard specified in the Orange Book). The alleged result was increased license fees and thus higher total costs for CDs. Philips is now appealing from the ITC decision to the US Court of Appeals for the US Federal Circuit, but it will be facing an uphill battle since the courts must uphold ITC decisions (like FTC decisions) on appeal if the record contains “substantial evidence” to support the agency’s findings.