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14 UNITED STATES DISTRICT COURT
15 NORTHERN DISTRICT OF CALIFORNIA
16 SAN FRANCISCO DIVISION

17 UNITED STATES OF AMERICA,)
18)
19 Plaintiff,)
20)
21 v.)
22)
23 JDS UNIPHASE CORPORATION)
24 and E-TEK DYNAMICS, INC.,)
25)
26 Defendants.)
27)
28)

Civil Action No. C 00-2227 TEH
Filed: June 30, 2000

29 **COMPETITIVE IMPACT STATEMENT**

30 The United States of America, pursuant to Section 2(b) of the Antitrust Procedures and
31 Penalties Act (“APPA”), 15 U.S.C. § 16(b) - (h), files this Competitive Impact Statement relating to
32 the proposed Final Judgment submitted for entry in this civil antitrust proceeding.

33 **I.**

34 **NATURE AND PURPOSE OF THE PROCEEDING**

35 On June 22, 2000, the United States filed a civil antitrust Complaint alleging that the proposed
36 acquisition of E-TEK Dynamics, Inc. (“E-TEK”) by JDS Uniphase Corporation (“JDS”) would
37 violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18. The Complaint alleges that JDS
38 and E-TEK are two of the leading manufacturers of components for fiber optic communication

1 systems. JDS competes against E-TEK in the production and sale of dense wavelength division
2 multiplexer and demultiplexer modules of 16 or fewer channels (“DWDMs”). DWDMs are
3 important components that increase the transmission capacity of fiber optic networks. These two
4 manufacturers are each other’s primary competitor in the production and sale of DWDMs.

5 Competition between JDS and E-TEK has benefited customers through higher output, lower
6 prices, increased quality, and faster delivery time. The acquisition of E-TEK by JDS will substantially
7 lessen competition in the production and sale of DWDMs in violation of Section 7 of the Clayton Act.
8 The proposed acquisition will substantially increase the incentive and likelihood for the combined
9 company to engage unilaterally in anticompetitive behavior, such as suppressing output and increasing
10 prices of DWDMs.

11 The request for relief in the Complaint seeks: (1) a judgment that the proposed acquisition
12 would violate Section 7 of the Clayton Act; (2) a permanent injunction preventing JDS and E-TEK
13 from merging; (3) an award to the United States of its costs in bringing the lawsuit; and (4) such
14 other relief that the Court deems proper.

15 When the Complaint was filed, the United States also filed a proposed Final Judgment that
16 would permit JDS and E-TEK to merge, but would require the modification of certain supply
17 agreements the merged entity will hold with several thin film filter suppliers.

18 The United States and the defendants have stipulated that the proposed Final Judgment may
19 be entered after compliance with the APPA. Entry of the proposed Final Judgment would terminate
20 the action, except that the Court would retain jurisdiction to construe, modify or enforce the
21 provisions of the proposed Final Judgment and to punish violations thereof.

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28 **II.**

1 packaged with other parts into a DWDM, each thin film filter will transmit a certain wavelength of
2 light and reflect or absorb other wavelengths. The packaged filters are then assembled into modules
3 of up to 16 channels, depending on a customer's desired channel count.

4 Because dense wavelength division multiplexers and demultiplexers are typically priced on a
5 per channel basis -- the higher the channel count, the greater the price of the module -- a customer
6 will only purchase the number of channels needed for its network design. A customer desiring a 16
7 channel multiplexer, for example, would not find it cost effective to substitute a 40 channel
8 multiplexer. A small but significant increase in the price of DWDMs would not cause a significant
9 number of customers to substitute multiplexers and demultiplexers which can achieve channel counts
10 higher than 16 channels. Because there are no good substitutes for DWDMs, the production and sale
11 of DWDMs, whether based on thin film filter or some other technology, is a relevant product market,
12 or "line of commerce," within the meaning of Section 7 of the Clayton Act.

13 JDS and E-TEK produce and ship DWDMs to customers throughout the United States and
14 the world. The world constitutes a relevant geographic market within the meaning of Section 7 of the
15 Clayton Act.

16 **C. Harm to Competition as a Result of the Proposed Transaction**

17 Upon consummation, the proposed acquisition will substantially lessen competition in the
18 manufacturing and sale of DWDMs in the world market. JDS and E-TEK are the two most
19 significant manufacturers and sellers of DWDMs, with market shares of 41% and 27% respectively.
20 Their combined market share of 68% represents a substantial increase in concentration in the market.
21 As measured by the commonly used *Herfindahl-Hirschman Index (HHI)*, concentration in DWDMs
22 will rise by about 2100 points to an HHI of about 4700 after the acquisition.

23 Customers view JDS and E-TEK as next best alternatives for DWDMs. During individual
24 purchase negotiations, customers compare product offerings from one company with offerings from
25 the other to ensure that they are obtaining competitive prices, product specifications, and timely
26 delivery. After the acquisition, customers will be left with inferior alternatives to the merged entity,
27 with the result that JDS will have greater incentive and ability to reduce output below and raise prices
28 above the levels they would have been had JDS been competing against E-TEK. JDS will also have

1 reduced incentives to meet customer product specifications and delivery requirements without the
2 competitive presence of E-TEK.

3 Competing firms are unlikely to constrain anticompetitive behavior -- a price increase, for
4 example -- by the merged firm in a timely manner. The DWDM market is characterized by increasing
5 demand and supply shortages. Competing firms are currently operating at or near capacity. To
6 expand output quickly enough to discipline a price increase by JDS would require overcoming time-
7 consuming obstacles. One major obstacle faced by an existing firm or a new entrant is the availability
8 of a sufficient supply of thin film filters. JDS has obtained virtually all of its supply of thin film filters
9 from Optical Coating Laboratories, Inc. ("OCLI"), with which JDS established a strategic alliance in
10 1997 and which it acquired in February of 2000. E-TEK has obtained its supply of thin film filters
11 primarily through supply agreements that have included the acquisition of rights of first refusal over
12 thin film filter coating chambers located on the premises of merchant suppliers. E-TEK has also
13 supplied itself with thin film filters produced at coating chambers located on company premises.
14 Together, JDS and E-TEK in 1999 controlled approximately 80% of the world's thin film filter
15 output.

16 It is a difficult and time consuming process to develop the capability of producing thin film
17 filters cost effectively. Vacuum coating chambers and sophisticated optical monitoring systems to
18 control the thin film deposition process must either be designed and constructed internally or be
19 acquired from commercial vendors of such equipment. Once coating chambers are installed, a
20 potentially lengthy trial and error development process is needed to approach the manufacturing
21 yields of the leading incumbents.

22 In addition to these limitations on the supply of thin film filters, there are further obstacles to
23 timely and sufficient new entry as a supplier of DWDMs. These obstacles include the need to design
24 a DWDM that can be produced cost effectively in commercial volume and that meets specifications
25 and is acceptable to customers for use in fiber optic communications networks. Customers
26 commonly require rigorous and extensive testing over a substantial period of time before previously
27 untested DWDMs are qualified and accepted for use in such networks. These obstacles are less
28 significant for fringe firms already producing DWDMs.

1 In the world market for DWDMs, the proposed acquisition threatens substantial and serious
2 harm to purchasers of DWDMs. By significantly increasing the market share of JDS in DWDMs, the
3 proposed acquisition will provide the combined company with substantially enhanced control over the
4 output and price of DWDMs. Furthermore, customers of DWDMs will lose the competition
5 between JDS and E-TEK which has resulted in faster product delivery times and improvement in
6 product specifications.

7 III.

8 **EXPLANATION OF THE PROPOSED FINAL JUDGMENT**

9 The proposed Final Judgment will preserve competition in the market for DWDMs by
10 requiring defendants to eliminate control over the supply of thin film filters by four merchant filter
11 vendors. The proposed Final Judgment effectively eliminates such control by prohibiting the merged
12 firm from enforcing E-TEK's rights of first refusal over coating chambers used by four merchant
13 vendors to produce thin film filters. The elimination of control is intended to ensure that firms other
14 than the merged firm have access to a supply of thin film filters and thereby are able to serve as
15 competitive alternatives to the merged firm in the supply of DWDMs.

16 **A. Modification of Thin Film Filter Supply Agreements**

17 E-TEK currently holds contractual rights of first refusal over a significant portion of the
18 output of the four major merchant vendors of thin film filters. After a 90-day transition period that
19 starts with the filing of the Complaint in this matter, Section IV.A. of the proposed Final Judgment
20 directly requires the merged firm to cease enforcing these contractual rights. The 90-day transition is
21 necessary for the merged firm to readjust settled commercial relationships. The effect of the
22 cancellation of the rights of first refusal is an elimination of E-TEK's control over the supply of filters
23 from the merchant vendors.

24 JDS, and its current subsidiary OCLI, in 1999 produced over 50% of the 100 GHz and 200
25 GHz world output of thin film filters. E-TEK produced about 5% of the world output in coating
26 chambers located on company premises. E-TEK controlled an additional estimated 23% of the 1999
27 world output through rights of first refusal over chambers located on the premises of the four
28 merchant vendors. Under the relief provisions of the proposed Final Judgment, this 23% of the 1999

1 world output of thin film filters will be released from control by the merged entity and available to
2 other firms and new entrants. Control over this production will transfer to the established merchant
3 vendors, who will be free to use the filters internally or to sell them to new entrants or established
4 producers of DWDMs.

5 **B. Transition Period**

6 During the 90-day transition period specified in Section IV.B. of the proposed Final
7 Judgment, the merged firm's reliance on its contractual control of coating machines at the four filter
8 vendors is gradually phased out. After 30 days, 30% of the rights of first refusal at each filter vendor
9 become unenforceable. After 60 days, 60% of the rights of first refusal become unenforceable. After
10 90 days, the transition period expires and all of the rights of first refusal are unenforceable.

11 The transition period will provide an opportunity for the merged firm to begin expansion of its
12 internal supply of thin film filters, thus facilitating an uninterrupted flow of thin film filters to the
13 merged firm for production of DWDMs. OCLI is a long established supplier of optical coatings that
14 the merging parties believe has significantly superior technology and significantly superior
15 manufacturing yields in the production of thin film filters for use in DWDMs. Upon consummation
16 of their merger, JDS and E-TEK expect they will be able to expand internal thin film filter capacity at
17 the merged firm by transferring OCLI technology to E-TEK.

18 The 90-day transition period also provides an opportunity for the merged firm to compete
19 with other potential purchasers for short term purchases of thin film filters from the merchant
20 vendors. Thus, although the merged firm's rights of first refusal are gradually phased out during the
21 transition period, its right to purchase in competition with others for short term purchase orders is not
22 eliminated. Market forces, including competition from the merged firm, will determine the price of,
23 and the customer receiving delivery of, each merchant vendor's thin film filters that are no longer
24 controlled by rights of first refusal.

25 During the transition period, and under the terms of the proposed Final Judgment, defendants
26 do not have unlimited rights to substitute long term purchase arrangements with the merchant filter
27 vendors in replacement of their abrogated rights of first refusal. There is a 30-day limitation on the
28 length of the period during which the merged firm can receive thin film filter deliveries under a

1 purchase order. Thirty days is a commercially common length of time for thin film filter purchase
2 orders and is the period expressly contemplated for the length of purchase orders under certain of E-
3 TEK's existing supply agreements for thin film filters. The 30-day limitation on purchase orders
4 during the transition period is intended to facilitate implementation of the relief by providing
5 competitors and potential competitors of the merged firm with improved and unrestricted access to
6 thin film filters.

7 **C. Rights of Repayment**

8 To reduce the incentive for the merged firm to purchase from these merchant filter vendors,
9 rather than expand internal capacity, Section IV.C. of the proposed Final Judgment prohibits the
10 merged firm from enforcing its contractual rights of repayment for money E-TEK advanced to the
11 merchant filter vendors and prohibits the merged firm from enforcing its security interests in the
12 coating chambers. The prohibition is effective immediately upon filing of the Complaint.

13 The rights of first refusal over coating chambers on the premises of the four merchant filter
14 vendors commonly arose in connection with advance payments by E-TEK to a filter vendor that were
15 to be repaid over a period of time by means of discounts of up to 20% off the market price the filter
16 vendor otherwise would charge for the filters. The security interests were to secure the repayment of
17 the advances. As of the date of the filing of the Complaint in this matter, the aggregate balance of the
18 amounts advanced or currently due to be advanced to the four filter vendors was under \$4 million.
19 The effect of the merged firm having the right to obtain thin film filters from the merchant suppliers at
20 this discounted price would be an incentive to continue to purchase from the merchant suppliers.

21 The provision of the proposed Final Judgment eliminating the merged firm's right to obtain
22 filters at the discounted price will increase the incentive for the merged firm to expand its own
23 production capacity, rather than rely on purchase from the merchant filter vendors. Increased
24 production capacity for thin film filters at the merged firm will increase total industry thin film filter
25 capacity and will lower prices for DWDMs. The increased thin film filter capacity will have this effect
26 because the supply of DWDMs is currently limited by capacity constraints in the total industry supply
27 of thin film filters.

28 **D. Notification to Competitors and Potential Competitors**

1 Section IV.D. of the proposed Final Judgment requires the merged firm to notify a set of firms
2 of the opportunity the Final Judgment will provide for improved and unrestricted access to the supply
3 of thin film filters to be available from the merchant filter vendors. The firms to be notified are
4 competitors and potential competitors of JDS and E-TEK who the merging parties have identified to
5 the Antitrust Division.

6 **E. No Reacquisition**

7 For a period of three years from the date the defendants relinquish all rights of first refusal,
8 the merged firm, in accordance with Section VII. of the proposed Final Judgment, cannot reacquire
9 any right of first refusal over any coating chamber located on the premises or owned by the merchant
10 filter vendors as of the date the Complaint was filed. The purpose of the bar on reacquisition is to
11 protect the integrity of the intended elimination of control by preventing evasion of the required relief.
12 This proposed Final Judgment seeks to prevent possible evasion by broadly defining rights of first
13 refusal in Section II. and by specifying in Section VII. that the bar extends to acquisition of rights of
14 first refusal over any coating chambers on the premises or owned by any of the four merchant filter
15 vendors. Such acquisition would be a prohibited reacquisition under the terms of the proposed Final
16 Judgment.

17 The bar on reacquisition by the merged firm of long term control over the four filter vendors'
18 coating machines is not intended to foreclose the commercial opportunity for the merged firm to
19 compete with other DWDM producers to purchase thin film filters from these four filter vendors on a
20 spot market basis, with purchase orders of a duration for delivery of 60 or fewer days. A safe harbor
21 provision in Section VII. of the proposed Final Judgment makes clear that nothing in the decree is
22 intended to preclude such purchases.

23 The bar on reacquisition extends for three years. In this case, the evidence indicated that this
24 time period would be sufficient to protect competition.

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28 **F. Other Provisions**

1 In order to monitor and ensure compliance with the Final Judgment, Section V. requires
2 periodic affidavits on the fact and manner of defendants' compliance with the Final Judgment.
3 Section VI. gives the United States various rights, including the ability to inspect defendants' records,
4 to conduct interviews and to take sworn testimony of defendants' officers, directors, employees and
5 agents, and to require defendants to submit written reports. These rights are subject to legally
6 recognized privileges, and any information the United States obtains using these powers is protected
7 by specified confidentiality obligations.

8 The Court retains jurisdiction under Section VIII., and Section IX. provides that the proposed
9 Final Judgment will expire on the tenth anniversary of the date of its entry, unless extended by the
10 Court.

11 Through the modification of the supply agreements with merchant vendors of thin film filters,
12 the proposed Final Judgment's prohibitions will lower obstacles to entry and expansion by new and
13 fringe DWDM suppliers and thereby improve, enhance and preserve competitive alternatives to the
14 merged firm in the world DWDM market. Absent these prohibitions, the likely result of a combined
15 JDS and E-TEK would be higher prices and lower output than there otherwise would be for
16 DWDMs.

17 **IV.**

18 **REMEDIES AVAILABLE TO POTENTIAL PRIVATE LITIGANTS**

19 Section 4 of the Clayton Act, 15. U.S.C. § 15, provides that any person who has been injured
20 as a result of conduct prohibited by the antitrust laws may bring suit in federal courts to recover three
21 times the damages a person has suffered, as well as costs and reasonable attorney's fees. Entry of the
22 proposed Final Judgment will neither impair nor assist the bringing of any private antitrust damage
23 action. Under the provisions of Section 5(a) of the Clayton Act, 15 U.S.C. § 16(a), the proposed
24 Final Judgment has no *prima facie* effect in any subsequent private lawsuit that may be brought
25 against the defendants.

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28 **V.**

1 contained in the proposed Final Judgment will preserve competition in the market for DWDMs. This
2 proposed Final Judgment will also avoid the substantial costs and uncertainty of a full trial on the
3 merits on the violations alleged in the complaint. Therefore, the United States believes that there is
4 no reason under the antitrust laws to proceed with further litigation if the supply agreements are
5 modified in the manner required by the proposed Final Judgment.

6 **VII.**

7 **STANDARD OF REVIEW UNDER THE APPA**
8 **FOR PROPOSED FINAL JUDGMENT**

9 The APPA requires that proposed consent judgments in antitrust cases brought by the United
10 States be subject to a sixty (60) day comment period, after which the court shall determine whether
11 entry of the proposed Final Judgment "is in the public interest." In making that determination, the
12 court *may* consider:

13 (1) the competitive impact of such judgment, including termination of alleged
14 violations, provisions for enforcement and modification, duration or relief sought, anticipated
15 effects of alternative remedies actually considered, and any other considerations bearing upon
16 the adequacy of such judgment;

17 (2) the impact of entry of such judgment upon the public generally and
18 individuals alleging specific injury from the violations set forth in the complaint
19 including consideration of the public benefit, if any, to be derived from a determination
20 of the issues at trial.

21 15 U.S.C. § 16(e) (emphasis added). As the United States Court of Appeals for the D.C. Circuit
22 held, this statute permits a court to consider, among other things, the relationship between the remedy
23 secured and the specific allegations set forth in the government's complaint, whether the decree is
24 sufficiently clear, whether enforcement mechanisms are sufficient, and whether the decree may
25 positively harm third parties. *See United States v. Microsoft*, 56 F.3d 1448, 1461-62 (D.C. Cir.
26 1995).

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In conducting this inquiry, "[t]he Court is nowhere compelled to go to trial or to engage in

1 extended proceedings which might have the effect of vitiating the benefits of prompt and less costly
2 settlement through the consent decree process."¹ Rather,

3 [a]bsent a showing of corrupt failure of the government to discharge its duty, the
4 Court, in making its public interest finding, should . . . carefully consider the
5 explanations of the government in the competitive impact statement and its responses
6 to comments in order to determine whether those explanations are reasonable under
7 the circumstances.

8 *United States v. Mid-America Dairymen, Inc.*, 1977-1 Trade Cas. (CCH) ¶ 61,508, at 71,980 (W.D.
9 Mo. 1977).

10 Accordingly, with respect to the adequacy of the relief secured by the decree, a court may not
11 "engage in an unrestricted evaluation of what relief would best serve the public." *United States v.*
12 *BNS, Inc.*, 858 F.2d 456, 462 (9th Cir. 1988) (citing *United States v. Bechtel Corp.*, 648 F.2d 660,
13 666 (9th Cir. 1981); *see also Microsoft*, 56 F.3d at 1460-62. Precedent requires that

14 the balancing of competing social and political interests affected by a proposed
15 antitrust consent decree must be left, in the first instance, to the discretion of the
16 Attorney General. The court's role in protecting the public interest is one of insuring
17 that the government has not breached its duty to the public in consenting to the
18 decree. The court is required to determine not whether a particular decree is the one
19 that will best serve society, but whether the settlement is "*within the reaches of the*
20 *public interest.*" More elaborate requirements might undermine the effectiveness of
21 antitrust enforcement by consent decree.²

22 The proposed Final Judgment, therefore, should not be reviewed under a standard of whether
23 it is certain to eliminate every anticompetitive effect of a particular practice or whether it mandates
24 certainty of free competition in the future. Court approval of a final judgment requires a standard
25 more flexible and less strict than the standard required for a finding of liability. "[A] proposed decree

26 ¹ 119 Cong. Rec. 24598 (1973). *See United States v. Gillette Co.*, 406 F. Supp. 713, 715 (D.
27 Mass. 1975). A "public interest" determination can be made properly on the basis of the Competitive
28 Impact Statement and Response to Comments filed pursuant to the APPA. Although the APPA
authorizes the use of additional procedures, 15 U.S.C. § 16(f), those procedures are discretionary. A
court need not invoke any of them unless it believes that the comments have raised significant issues
and that further proceedings would aid the court in resolving those issues. *See* H.R. Rep. 93-1463,
93d Cong. 2d Sess. 8-9 (1974), *reprinted in* U.S.C.C.A.N. 6535, 6538.

² *Bechtel*, 648 F.2d at 666 (emphasis added); *see BNS*, 858 F.2d at 463; *United States v.*
National Broadcasting Co., 449 F. Supp. 1127, 1143 (C.D. Cal. 1978); *Gillette*, 406 F. Supp. at 716.
See also Microsoft, 56 F.3d at 1461 (whether "the remedies [obtained in the decree are] so
inconsonant with the allegations charged as to fall outside of the 'reaches of the public interest'").

1 must be approved even if it falls short of the remedy the court would impose on its own, as long as it
2 falls within the range of acceptability or is 'within the reaches of public interest.'" *United States v.*
3 *American Tel. & Tel Co.*, 552 F. Supp. 131, 151 (D.D.C. 1982), *aff'd sub nom.*, *Maryland v. United*
4 *States*, 460 U.S. 1001 (1983) (quoting *Gillette Co.*, 406 F. Supp. at 716); *United States v. Alcan*
5 *Aluminum, Ltd.*, 605 F. Supp. 619, 622 (W.D. Ky. 1985).

6 Moreover, the court's role under the Tunney Act is limited to reviewing the remedy in
7 relationship to the violations that the United States has alleged in its Complaint, and does not
8 authorize the court to "construct [its] own hypothetical case and then evaluate the decree against that
9 case." *Microsoft*, 56 F.3d at 1459. Since "[t]he court's authority to review the decree depends
10 entirely on the government's exercising its prosecutorial discretion by bringing a case in the first
11 place," it follows that the court "is only authorized to review the decree itself," and not to "effectively
12 redraft the complaint" to inquire into other matters that the United States might have but did not
13 pursue. *Id.*

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28 **VIII.**

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DETERMINATIVE DOCUMENTS

There are no determinative materials or documents within the meaning of the APPA that were considered by the United States in formulating the proposed Final Judgment. Consequently, the United States has not attached any such materials to the proposed Final Judgment.

Dated this 30th day of June 2000.

Respectfully submitted,

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