A New Test for Anticompetitive Litigation

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Abstract

This paper aims at shedding some light on a very controversial topic in Competition Policy or Antitrust. The anticompetitive litigation – commonly called sham litigation – has been broadly discussed in the legal literature but there is no consensus on how antitrust authorities should handle those cases. Our intention is to offer a new test for evaluating the potential anticompetitive behavior associated with abusing the right of petition. Our challenging objective is to provide a screening device capable of guiding competition authorities around the globe when dealing with the practice of initiating one or a series of lawsuits or administrative procedures having as main purpose the intention to increase a rival’s cost or squeezing her margin. We review the evidence showing some lack of knowledge on the topic and doubtlessly an extremely reduced number of cases and an almost complete absence of convictions and precedents around the globe. This is a clear indication that type-II errors are common in the topic, with dramatic consequences for the market place. Our new test – an evidence-based one – shall contribute improving the standards for dealing with anticompetitive litigation, or sham litigation.

"You can’t just assume that because someone has a patent, he has some deep moral right to exclude everyone else." Judge Richard Posner, 2012

I – Introduction

There is no doubt that Courts and Administrative authorities have always relied on economic tests – more or less sophisticated – to enforce antitrust law. Objective evidence as well as solid criteria are necessary – although not sufficient – for a high-quality antitrust enforcement.

We argue in the present paper that the non-definition of a simple and objective test for assessing sham litigation is at the origin of the low enforcement of antitrust regarding this important issue. Following the nowadays commonly used formal and stringent criteria, competition authorities and courts worldwide

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3 Several false negative cases, which means a tendency of underenforcement of competition law.
may be dismissing a significant number of (true) cases, which is especially sensitive in the global economy of the XXIst Century, the so-called knowledge economy.

In the following section we review some of the tests used for antitrust enforcement. Section 3 focuses on establishing the grounds for the treatment of sham litigation, by presenting the anticompetitive practice in question, as well as its treatment in the literature and in antitrust practice historically. In Section 4 we review the evidence available attesting the current low enforcement records worldwide. Section 5 presents an antitrust effects-based test on the occurrence of sham litigation, while Section 6 concludes this paper.

II – Antitrust Tests

For decades economic analysis has helped competition law enforcers to develop thresholds in order to screen unlawful practices from lawful practices (Kovacic and Shapiro, 1999). The use of indicators enables antitrust enforcement to show objectivity, while offering also a roadmap to private parties. Both in litigation cases and in merger control, economic concepts, reasoning and evidence are central to antitrust analysis and decisions.

Beginning from structural indicators, in this section we review very briefly the most frequent tests that, by helping to deal properly with the screening problem, have permitted antitrust to be enforced. Our main focus is on the screening of predatory practices, since this is closely related to sham litigation, as we shall see later in this paper.

a. Market Power, Market Definition and Concentration

To assess market power, Courts and Administrative Authorities worldwide have been relying on market share, an indicator remaining from the long tradition of structure and conduct line of analysis. The share calculations are based on the assumption that quantity or revenue (q) is a proxy for the competitive pressure by a substitute producer. In a market of firms x, y, and z:

\[ S_x = \frac{q_x}{q_x + q_y + q_z} \]

Market shares are the basis for developing simple tests, like the concentration rate tests. Accordingly, K firm concentration ratio involves calculation and then summation of the market shares of the largest k firms in the market.

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5 Baker and Bresnahan (2010).
The hypothetical monopolist test, introduced in 1982 by US DoJ⁶ (SSNIP test, i.e. small but significant increase in prices, generally taken to mean at least 5%). The test has been providing some rigor to the decisions on where to draw the market boundaries. It relies mostly in the economic concept of substitutability, concerning – on the demand side – how products are interchangeable for having high cross-elasticity of demand and – from the supply side – how firms can easily switch production in order to offer substitutable products.⁷

Another structural measure used in tests was introduced in 1992 by the joint DoJ⁸ and FTC⁹’s guidelines, the Helfinger-Hirshman test. The HHI is calculated using the sum of squares of market shares:

\[ \text{HHI}= \sum_{i=1}^{N} S_i^2 \]

Where \( S_i \) is the ith firm’s market share expressed as a percentage so that the HHI will take values between 0 and 10,000.

Structural indicators are widely used to infer profitability, as a consequence of market power¹⁰. Under the assumption that a Cournot game captures the nature of the competition in an industry, a firm’s margin is equal to the individual market share divided by the market demand elasticity:

\[ \frac{P(Q) - C_i(q_i)}{\eta_D} = \frac{S_i}{\eta_D} \]

where again \( S_i \) is the market share of the firm and \( \eta_D \) is the market demand elasticity. Furthermore, under Cournot, the weighted average industry margin is equal to the sum of the squared individual market share divided by the market demand elasticity.

\[ \sum_{i=1}^{N} \left[\frac{P(q) - C_i'(q_i)}{P(Q)}\right] = \sum_{i=1}^{N} S_i^2 \frac{1}{\eta_D} \]

In the Cournot model, the HHI is proportional to industry profitability and can therefore be related to firm’s market power.

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⁶ 1982 Department of Justice Merger Guidelines, US.
⁷ The current and important discussion on the limits of this method, as well as the alternative tests proposed, either to define properly market boundaries or to assess directly market power is beyond the objective of this paper. This section intends only to highlight the contribution of economic measures and tests to antitrust analysis. The methodology discussion just mentioned is well described in Evans (2011) and Russo et al (2010).
⁸ Department of Justice of the United States,
⁹ Federal Trade Commission, US.
¹⁰ Russo et al (op. cit.)
b. Cartel Inquiries

The antitrust enforcement against cartel also deserves a lot to economic analysis enhancement. Stigler (1964) set the basis for assessing the conditions of monitoring and enforcing agreements turning viable the coordination among firms\textsuperscript{11}. Basically, the colluders must reach some form of understanding about what exactly it means to coordinate; later, they must be able to monitor behaviour in order that “cheaters” from the coordinated prices or practices can be detected. Additionally, there must be the threat of a credible direct punishment to deviating firms, which means that the collusion can be enforced. These steps have been followed by virtually all cartel investigation, helping to avoid false positive cases, i.e. distinguishing explicit cartel cases from oligopolistic results or tacit collusion\textsuperscript{12}.

c. Predatory Pricing

One of the classic exclusion conducts dealt with by the antitrust theory consists of the practice of predatory pricing, where the prices are low to the point of influencing negatively the competitive process. Considering that low prices are also a positive consequence of the competitive process, the antitrust authorities face the difficult task of defining what is to be considered predatory instead of healthy competition. The elimination of inefficient firms is the result of the competitive process, but this process can be harmful, if efficient rival firms are also expelled from the market through the excessive lowering of prices by the dominant firms\textsuperscript{13}.

Traditionally, the predation problem has been identified through the observation whether the dominant firm has incurred losses in the short run in a particular market forcing the exit (or not allowing the entry) of a rival firm, expecting that its profits above normal could be obtained in the future markets. The more specific test to gauge the screening between competitive and non-competitive pricing was introduced by Areeda and Turner (1975). According to the

\textsuperscript{11}The categories Agreement, Monitoring and Enforcement are also presented in the literature as Consensus, Detection and Punition.

\textsuperscript{12}Belleflame, Paul, Peitz (2010)

\textsuperscript{13}The question of a monopoly reached through a strategy of predatory pricing is present in the history of antitrust since its beginning. Sherer and Ross (1990) thought that the emergency of the rule of reason coincided with the trial through the US Supreme Court of the cases involving Standard Oil and American Tobacco, both in 1911. In the first case that required the use of the rule of reason, Standard Oil was accused of maintaining a control over 90% of the industry of oil derivatives (at the time kerosene and burning oil), status that was obtained through the acquisition of more than 120 rivals, the discriminatory use of pricing in rail transportation, preventing access to oil supply sources through the acquisition of Oil Pipes, industrial espionage and finally through the use of pricing wars to exclude rivals of the market or force them to sell their businesses. The authors noticed it is a controversial fact if Standard Oil truly reduced prices in a profound way to destroy rivals or to teach them a lesson. It is their understanding that the firm used a sophisticated limit-pricing strategy region-by-region. (p. 450). In the case of American Tobacco, the Supreme Court accused the firm of monopolizing the cigarettes market and other tobacco products acting unreasonably by excluding rivals from accessing distributors, buying out 250 competitors and adopting predatory pricing.
authors, prices below cost should be considered definitely illegal. Considering that it is rare to find adequate documentation of statistics of production costs, the authors suggest the use of the average cost as evidence for the test.

It has been almost 30 years since Areeda and Turner proposed how to address the predatory pricing issue. The test raised controversy for years and the debate was particularly enriched with the use of concepts of the new literature developed from the 80s on, based on Game Theory and strategic behaviour in oligopoly markets. The central question in these models is the asymmetry of information between the agents in the market. The dominant firm is better informed than its competitors in models where the predator induces market exit of the smaller rivals.

In spite of such academic advances, the assessment of predatory practices continues to rely on the Areeda and Turner test in US and other jurisdictions. The American Supreme Court endorses a test of predatory pricing requiring that the predator prices below its costs and that it has either a reasonable prospect or probability of recouping the losses from so doing.

The European Union Court of Justice, in the first European predatory pricing case - ECS/Akzo Chemie Commission decision in 1985, when it supported European Commission reasoning - discussed the Areeda and Turner test, but did not consider it as a generally valid rule to establish the predatory nature of pricing policies. The decision stressed what is now the criterion for assessing predation in Europe: prices above average costs are also predatory if the intention to eliminate competitors is demonstrated.

Baumol (1996), after Posner (1973), come to favour an average variable cost test, not as an approximation, as stated by Areeda and Turner, but as the right test at all. Both authors see monopolization intent in predation, where a challenged practice is likely to exclude from the defendant’s market an equally or more efficient competitor – this is the equally efficient competitor standard. Following this reasoning, prices that exclude an equally efficient competitor are predatory.

Edlin (2011) proposes an alternative test to screen predatory practices. In his own terms:

“[C]hallenged [predatory] practices is likely in the circumstances to exclude from the defendant’s market a competitor who would provide consumers a better deal than they get from the monopoly.” This is the consumer betterment standard.

This standard to distinguish between anticompetitive and procompetitive exclusion is derived from Edlin and Farrell (2011), a work we intend to follow closely to propose a new test for anticompetitive litigation.

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14 This literature is reviewed in Ordover and Saloner (1990).
15 Some recent cases in Brazil were dismissed by CADE, the Brazilian Competition Authority, explicitly for not reaching the criterion stated by Areeda and Turner (1975).
16 Russo et al (op. cit.).
In relation to predatory litigation, as we discuss in the next section, no economic test, so far, is handled either by Courts or Administrative Authorities. This seems to be the reason for the underenforcement of Competition Law in relation to this conduct, spite of its anticompetitive effects. This status quo implies excluding or delaying the entrance of new competitors in the marketplace.

III – Sham or Anticompetitive Litigation

A discussion on a test for sham or anticompetitive litigation must begin with the understanding of the historical and legal treatment of the right of petition and bad faith litigation.

The First Amendment of the US Constitution expresses one of the fundamental freedoms of all Americans, namely the right to petition government for redress of grievances. Similarly, the Brazilian Constitution of 1988 in its Article 5 establishes as entrenchment clause the right to petition the Government in defense of rights or against illegal acts or abuse of power to all, regardless of the payment of fees (section XXXIV, a). The Constitution then emphasizes that no injury or threat to right can be excluded from consideration by the Judiciary (XXXV), the so-called substantiation of the principle of no ditching of judicial control.

It happens, however, that this right of petition - just like any other right - has its limits, and certain parameters must be respected for its (legal and legitimate) exercise. Rights historically even more fundamental such as liberty and property also have their limitations. The freedom of an individual ends when it reaches or threatens the freedom of others, being limited by it, and can be curtailed by society through the imposition of imprisonment. In the same line of argument, any property (intellectual or material) can be enjoyed freely, but must meet its intended social function and should not impose obstacles to others' property. The easements of Civil Law, the compulsory licensing of a patent and the application of the essential facilities doctrine in the antitrust sphere are examples.

The Noerr-Pendington Doctrine emerged in the 60s in the United States and aims at defining the limits for exercising the right of petition. More specifically, the Doctrine was responsible for creating what in the literature has been called the antitrust immunity of the activity of petition, guaranteed in principle by the 1st Amendment of the U.S. Constitution and its famous Bill of Rights, which includes in particular the right to petition.

In 1961, there was a complaint by the Noerr Motor Freight against 24 rail companies for developing a public campaign towards the responsible public agencies and the public in search of state laws beneficial to rail transportation. That is, the railway companies were jointly engaged in a campaign whose purpose was to impose extra charges on road transportation, which was exerting
competitive pressure on the rail. The Supreme Court held that this activity (conspiracy to restrain and monopolize the business of long distance freight) could not be challenged under the Sherman Act (the main U.S. antitrust legal diploma) regardless of any resulting trade restrictions.

In 1965, there was Pennington's complaint against the United Mine Workers because of pressure by the union of miners and large mining companies for higher minimum wages for miners, which would harm small miners. This case extended antitrust immunity to attempts to persuade executive officials, and not only legislators.

In both cases, there was no conviction under antitrust law as it was considered a legitimate right to exert pressure to influence legislative activity and / or executive officials, although their results might have harmful effects on the desired state of competition. By the Noerr-Pennington Doctrine, thus, private entities are immune from antitrust liability because of attempts to influence the approval or enforcement of laws, even when the laws they advocate have anticompetitive effects.

The decision in the Noerr case itself, however, delineated the boundaries of such antitrust immunity, the so-called “sham exception to Noerr-Pennington doctrine”. The Noerr 1961 decision says that the antitrust immunity does not extend to cases where the acts are “a mere sham to cover what is actually nothing more than an attempt to interfere directly with the business relationships of a competitor and the application of the Sherman Act would be justified.” The term sham litigation came from this citation.

The case involving California Motor (1972), which dealt with the opening of judicial and administrative procedures to hinder access of intra-state carriers to interstate transportation, was the first in which a company was condemned for the practice of anticompetitive or sham litigation, meaning it had abused its antitrust immunity by incurring in the sham exception.

IV – Sham Litigation Current Treatment

The US treatment of sham litigation is nowadays still guided by the so-called Noer-Pennington doctrine presented in the previous section. The Noerr-Pennington doctrine is broad and frequently invoked, and not limited to contexts that involve intellectual property rights. Balancing these interests, the court held that a patentee's infringement suit is presumptively in good faith and that this

17 This section follows closely Salgado et al (2011). This recent research has shown the need for deepening the international debate around the identification criteria of anticompetitive use of intellectual property.
presumption could only be rebutted with clear and convincing evidence that the patentee acted in bad faith.

The U.S. Noerr-Pennington doctrine provides antitrust immunity for persons petitioning for government action. Though, The doctrine's immunity does not extend to sham litigation. Where intellectual property rights are at issue, the PREI decision provides clear guidance on how to determine whether an intellectual property infringement suit constitutes sham litigation. As stated recently by US authorities in competition policy: The PREI test is a strict one, requiring that the intellectual property litigation be both “objectively baseless” and subjectively without merit, concealing “an attempt to interfere directly with a competitor's business through the use [of] the governmental process” in order to qualify as sham. This standard is difficult to meet, and very few cases have met the stringent test for this exception.18"

The United States has some paradigmatic cases. The case Handgards would be properly a case of predatory litigation in the strict sense, since it is based on knowingly invalid patent. It would therefore be unsupported (i.e. baseless) Handgards’ argument that her competitor was violating its patent by producing products encompassing such patent, knowingly invalid. On the other hand, the Walker Process case would be fraudulent litigation. It involved a fraud the Food Machinery Company, which initiated a process to stop or slow the entry of competitors through the use of a patent obtained by fraud.

Latest American cases have brought some precious clarification. The Professional Real State 1993 case stated a two-stage test establishing a sham exception to the Noerr-Pennington antitrust immunity. The two conditions of sham litigation would be: (i) firstly, the claims should be objectively baseless; (ii) secondly, there should be a subjective intent of squeezing the competitor's margin through the litigation.

The USS POSCO 1994 case, for example, although not involving IP, stressed the prospective character of the analysis of predatory litigation. It deals with some practice to avoid the participation of competing bids in public procurement auctions – a very similar case to a currently investigated one in Brazil involving Amitech and technical specification for pipes in duct procurement (PA 08012.0045752/2007-15). The US case dealt with the lobby of the union (sponsored by USS POSCO) in the sense of demanding from competitors more commitments than initially expected (with respect to the disposal of toxic waste) and the campaign to have customers protesting against inexistent security violations, and a further series of procedures in the same sense. Besides squeezing the margin of competitor BE & K, the demands “caused such delay and cost to the projects that future project owners would only hire union-affiliated companies.”

On the one hand, the decision USS POSCO states that the two-stage analysis set up in the Professional Real State case (the so-called PRE test) is retrospective when it accounts for a single action. When the practice under scrutiny involves multiple claims, citing the California Motor case, the decision here states the prospective character: "When there are a number of actions, the question is not

18 Transcript from US Report apud Salgado et al (op cit)
whether any of them has merit - some may have, a simple matter of luck - but if they were filed as a policy of starting legal proceedings without worrying about the merits and with the purpose of injuring a rival in the market. Analysis in these cases is prospective: Were the lawsuits started, not because of genuine right to undo the damage, but as part of a pattern or practice of proposing successive actions essentially with the purpose of harassment?” The decision emphasizes that “litigation is invariably costly, takes the focus and is time consuming, having to defend a series of such procedures can inflict a crushing burden on a business.” A final lesson is the following blunt: “The fact that a small number in a series of processes is not frivolous is not fatal in a case of the California Motor Transport type: even a broken clock is right twice a day.”

In the USS POSCO, the court examined whether each lawsuit had an objective basis. Indicating that the party accusing the other of sham litigation has the burden of proof, it concluded that the representative could not satisfy this burden from the rate of success presented: 15 out of 29 cases were in favor of the complainant. The Kottler 1998 case has further emphasized the issue: “The fact that a small number in a series of actions is not frivolous is not fatal ... but an average of victory greater than 50% can not sustain” a case of sham litigation.

This is certainly not an absolute criterion, and that was the subject of discussion in the process involving the Kaiser Foundation Health Plan and Abbott, decided on 13/01/2009. In this case, it was examined whether a potential series of lawsuits against manufacturers of generic drugs would be a case of sham litigation. The court noted that Abbott had opened 17 cases and won only 7 of them. However, it was pointed that in each of the 10 cases in which the company had lost there was a plausible argument that could possibly have prevailed, and that each case was about a different issue that had not been previously interpreted. It was noted further that the number of cases was high because of the number of generic manufacturers, something beyond the control of Abbott.

The only case in Europe that dealt explicitly with sham litigation was ITT Promedia (1996), and there was no conviction. Despite the effort made by the European Commission in scrutinizing the pharmaceutical sector through the Pharmaceutical Sector Inquiry (PSI), what one has in Europe in this sector at the interface with intellectual property rights boils down by now to the case Astra Zeneca case at the European Commission and the newly judged Gaviscon British case. Although extremely interesting, those cases do not deal with litigation itself as an anticompetitive conduct.

In the aforementioned ITT Promedia case, the Commission in its 21/06/1996 decision rejected the plea of sham litigation as follows: “In principle, to bring an action in court, which is the fundamental right of expression of access to the judiciary, cannot be characterized as an abuse” unless “a dominant firm filed an action (i) which cannot be reasonably considered an attempt to establish their rights, and can therefore only serve to reach the other party and (ii) that is conceived within a framework of a plan aimed at eliminating competition.”

The European Court of Justice did not question the criteria adopted by the Commission, expressing only two caveats with regard to point (i). The first was to
clear that the factual situation relevant to the criterion is the situation existing at the time the lawsuit was filed. The second caveat was that this was not about inferring whether or not the rights existed at the time the suit was filed, but "whether such lawsuit was aimed at determining what the plaintiff could, at that moment, reasonably regard as her rights."

Note that in sham litigation, EU and US doctrines are singularly close. The tests developed under Noerr-Pennington are very similar to the EU test developed in and ITT Promedia cases. Under Noerr-Pennington the first question to be answered is whether, according to an objective standard (a average player would so act) speaking, the firm initiating the legal action reasonably could be held to believe believe it had rights to protect, which is more or less the same as the test proposed by the Commission in ITT Promedia. Here, only objective factors are taken into consideration, and it is what the firm initiating the proceeding reasonably could not believe at the time the lawsuit was initiated that is relevant, later events having no bearing on that finding. Second, both tests propose that if one can find that there was no merit to the case the court will have to decide whether the lawsuit was conceived in a plan whose goal was to eliminate competition, the last inquiry being an inquiry into the subjective intent of the dominant undertaking.

Another similar treatment is found in the case law dealing with use of Government processes for anticompetitive purposes: the utilization by a player of a unwarranted multiplicity of Government remedies, where the unreasonable behavior should be sought not in any single petition, but in the reiteration of such process. When dealing with a series of lawsuits, the question is not whether any one of them has merit--some may turn out to, just as a matter of chance--but whether they are brought pursuant to a policy of starting legal proceedings without regard to the merits and for the purpose of injuring a market rival. The inquiry in such cases is prospective: Were the legal filings made, not out of a genuine interest in redressing grievances, but as part of a pattern or practice of successive filings undertaken essentially for purposes of harassment? Therefore, a second but related set of criteria is required whenever the possible misuse of Government processes for anticompetitive purposes occurs by proliferating petitions even though a number of them may be found rightful, but the multiplicity itself cannot be shown as reasonable under an objective standard.

In order to evaluate the current stage of predatory litigation involving mainly intellectual property rights, a survey was recently elaborated\(^\text{19}\) with the collaboration of competition authorities and intellectual property registration entities from a wide range of countries\(^\text{20}\). The following countries were selected to the elaboration of the comparative study: South Africa, German, Saudi Arabia, Argentina, Austrália, Brazil, Canada, Chile, China, South Korean, Egipt, Spain, USA,

\(^{19}\) The study on the anti-competitive enforcement of IP rights was commanded from WIPO, World Intellectual Property Organization to IPEA, the Brazilian Institute of Applied Economic Research, and is here refered as Salgado et al (2011).

\(^{20}\) The entities answered the questionary sent by IPEA from December 2010 till July 2011, some of them delivering deeply detailed reports.
France, India, Italy, Japan, Mexico, Russian, Turkey, European Union, United Kingdom and Peru. The research result has shown the need for deepening the international debate around the identification criteria of anticompetitive use of intellectual property.

The request for information from the various foreign authorities recited the following filters to clarify what such agencies were supposed to inform:

"The administrative or judicial procedures concerning any of the rights covered by Article 1.1 of TRIPs, brought to the attention of Intellectual Property authorities or antitrust agencies, where at least one of the following aspects is conspicuously present:

(a) procedures where the final favorable prospects for plaintiff (or requiring party) is evidently improbable, but the initiation or continuation of the procedure by itself is liable to have anticompetitive effects OR

(b) procedures multiplied on the same or closely related causes of action where such reiteration of actions or requests (even though each one action or request by itself would be procedurally reasonable) also is liable to have anticompetitive effects OR

(c) other actions, initiatives of requests where the benefit to plaintiff or requesting party could result from the initiation or continuation of the procedure itself rather than the final result of the exercise, and such initiation or continuance by itself is liable to have anticompetitive effects; OR

(d) any actions, initiatives of requests, which under domestic law is classifiable as abuse of right or abuse of process, and such abuse is liable to have anticompetitive effects."

Such filter (a) does not limit itself to the initiation of the procedure: the continuation of a process that had shown to be evidently improbable is also covered; (b) exceeds the simple PREI standard (but follows POSCO) by covering a multiplicity of claims, even though any one of them could be held as rightfully initiated or continued, when such proliferation of petitions by itself may be evidently unneeded to attain the petitioner's rights; (c) stresses that the issue at stake is the use of the governmental process - as opposed to the outcome of that process – that is the source of an anticompetitive effect; (d) looks for a player's behavior that under the pertinent law is deemed to be an abuse of a substantive right or a procedural abuse, and also is liable to have an anticompetitive effect.

The grid did not mention any subjective assessment of intention of anticompetitive effects nor required that a specific anticompetitive effect had actually occurred. A small but significant number of answers were received in pursuance of the study. Some illustrative answers are described below. The European Commission reported us that under the EU law, one case only (the mentioned ITT Promedia Case) would satisfy the grid. The Public Health Institute
of Chile and the Russian Patent and Trademark agency (Rospatent) refrained from mentioning any case that could satisfy the inquiry as submitted.

The US Government Report, joint signed by competition and intellectual properties offices, stated that: "(...)Subsequent U.S. case law [After the Court’s definition of PREI test] demonstrates that the two-part PREI test is difficult to meet. Courts “have generally rejected claims of anticompetitive sham litigation.” Some sham litigation claimants have survived motions to dismiss or motions for summary judgment58 predicated on the PREI test. In one case, for example, purchasers and competitors brought antitrust actions alleging that drug companies impeded market entry of the generic version of a brand name drug through patent infringement actions that the antitrust claimants alleged were sham litigation. Based on the plaintiffs’ evidence, the court found genuine issues of fact as to whether drug companies’ suits against competitors were objectively baseless, denying defendants’ motion for summary judgment58 This case, and others in which sham litigation claims were allowed to go forward, settled before trial. There are no litigated decisions in the U.S. courts holding that an IP plaintiff has engaged in sham litigation.

It is important to note that “[a] finding that a lawsuit is a sham merely means that Noerr-Pennington immunity does not apply to that lawsuit. An antitrust plaintiff must still show all the substantive elements of an antitrust violation.” Therefore, establishing that a lawsuit is a sham is merely the first step for an antitrust claimant.

(...) The U.S. Noerr-Pennington doctrine provides antitrust immunity for persons petitioning for government action. The doctrine’s immunity does not extend to sham litigation. Where intellectual property rights are at issue, the PREI decision, discussed above, provides clear guidance on how to determine whether an IP infringement suit constitutes sham litigation. The PREI test is a strict one, requiring that the IP litigation be both “objectively baseless” and subjectively without merit, concealing “an attempt to interfere directly with a competitor’s business through the use [of] the governmental process” in order to qualify as sham. This standard is difficult to meet, and very few cases have met the stringent test for this exception. “

The Korean Federal Trade and Competition Authority (KFTC) reported that even if litigation is brought with unlawful intention, if the lawsuit is not considered to result in anticompetitive effect, it does not constitute antitrust violation. Patent infringement litigation is considered to be in violation of antitrust law only when it has anticompetitive effect such as competitors exiting the market due to business difficulties caused by the litigation. Moreover, there should be
a reasonable cause/effect relation between the litigation and anticompetitive effect.

In 2006, the KFTC received a complaint regarding sham litigation. But at the time, as a lawsuit regarding the case was pending in the court, the KFTC had difficulty proving accuracy of factual evidence regarding the litigation. So, the KFTC decided to drop the case to avoid a situation where a decision by the competition authority on litigation abuse contradicts the court’s decision on patent infringement.

After the patentee who instituted the litigation lost, the Commission reconsidered the case, but decided not to launch the case officially, because 1) even if the patentee lost the suit, the litigation was not deemed to be objectively baseless and 2) despite the litigation, the competitor of the patentee did not suffer significant anticompetitive effect and successfully entered the relevant market.

The KFTC does not have much experience of handling cases regarding abuse of patent litigation, because conditions on assessing illegality are even stricter for litigation abuse. The KFTC views that a competition authority should be mindful of overly aggressive law enforcement in an alleged litigation abuse case in that a patentee should be able to enjoy the full rights to seek court proceedings enshrined in the constitution.

The Spanish Report documented that the doctrine maintained by the TDC in these cases stems from its interpretation of the alleged infringement (distortion of competition through unfair acts). According to the TDC, unless the two cumulative conditions of Article 7 (the act of unfair competition seriously distort competition within the market and that serious distortion affecting the public interest) are met, the TDC should not act, irrespective of the extent in which the act might be unfair. The jurisdiction in such cases belongs to a civil court under the Unfair Competition Act, and such court should resolve the matter. The TDC would only be competent to sanction acts of unfair competition that distorts the competitive market conditions and also affects the public interest, while the civil jurisdiction in a proceeding between the parties shall be in charge of the unfair anti-competitive acts that do not have the relevant designated Article 7 of the LDC.

In all cases detected in copyright or industrial property rights, TDC closed the case on the grounds that - while the acts may be unfair -, they affected only the parties, since they were not significant enough to distort the market in question. This doctrine has been applied consistently by the TDC in multiple resolutions for different markets (TDC resolution of April 16, 1993, A Textbook 47/ 93 Valladolid TDC resolution of February 17, 1993, A 40/ 92, Booksellers Valencia TDC resolution of October 7, 1993, R 61/ 93 Driving from Valencia, among others).

The Mexican agency responding to the inquiry (COFEPRIS), even not confirming to the proposed grid, listed a series of procedures related to IP rights, which in its feeling would regard anticompetitive purposes. Suits were directed to extend the term of pharmaceutical patents.
According to such agency, even though the Mexican law limited the duration of some patents granted under a transitory provision to the remaining term of the foreign patent, but not to exceed twenty from the Mexican filing, a number of patent holders started court actions to extend the Mexican patents to a further term of protection accorded to the related foreign patent.

This foreign extension was due, for instance, to a Special Protection Certificate, a legal device to compensate patent holders for the delay imposed by the administrative review of the sanitary licenses needed to commercialize the pharmaceutical products. In some cases, the court has issued preliminary orders to maintain the patent in force until the merits of the case is judged, and therefore the generic alternatives were delayed. In specific cases, the preliminary orders were confirmed by the final judgment.

The Mexican authority did not inform whether anticompetitive claims were raised in those cases. It would however be noted that the first prong of the Promedia test would not be possibly satisfied in the mentioned cases, considering that the right sought in court was duly recognized.

A number of court actions were filed against COFEPRI, alleging that by granting licenses for commercialization to beneficiaries that are not the patent holders of the licensed products; the agency would be violating such patents. Non-active elements included in the listings.

The same agency also gave notice of a series of writs of mandamus against it, where court orders were issued to include in the Official Listing of Patents in Force as published in the Official Gazette, even though the included patents were not active product inventions, but combination or formula ones. COFEPRIS mentions that the criterion of inclusion in the official listing was accepted by the Mexican Supreme Court, but the orders would contravene such understanding.

Finally the agency also reports that the innovating pharmaceutical companies have requested the change of some regulatory legislation in order to ensure a broader linkage between patents and sanitary licenses. All those episodes are classified by the agency as “monopolist practices” or “excessive exercise” of Intellectual Property.

Further to the official responses from the indicated jurisdictions, a number of cases corresponding to the grid were found by the staff researchers. We selected some examples from the quoted Report.

In Chile, in the case Imatinib, the Chilean Competition Authority decided an alleged abuse of judicial and administrative procedures by Novartis in regard of the mentioned pharmaceutical. The majority vote found that the industry was adequately exercising its patent rights even though a subsequent technical study demonstrated that no infringement had in fact occurred.
Most cases filed in court regarding Imatinib were dismissed, and in consequence of such exercises, it was alleged that the competing firm suffered a delay of 14 months to enter the market. A dissident vote in the Authority decision found undue utilization of court and administrative means with anticompetitive purposes in other 1993 case, a vexatious use of preliminary orders in a patent issue caused considered competitive damage to the Chilean economy.

A non-IP case indicated the Chilean legal theories acceptable in dealing with misuse of the right to petition for anticompetitive purposes. In the case Punta Lobos the Authority dealt with a series of administrative and judicial cases deemed to delay the entry of competitors in the market of salt. The issue was the exercise of Constitutional rights to access of judicial or administrative redress; the Authority indicated that these rights were not free from a competitive limitation.

The index that there was present an anticompetitive purpose was the cumulating of distinct procedures where the interests were contradictory. Considering the series of procedures thus entertained, the Authority found an illegal action to be punished.

The Peruvian competition authority (Indecopi) has dealt recently with one case where a vexatious/sham litigation issue was raised, even though extraneous to the IP Field, in which it reviewed its case law on the matter. The decision indicated that not only the PRE standard (applicable to an isolated misuse of procedure) but also the accumulation of various individual meritless cases should be considered. Indecopi referred to the Constitutional aspects of the matter, examined Chilean and Brazilian precedents and ended by holding the defendant guilty of abuse of judicial procedures for noncompetitive purposes.

In a very significant aspect of the decision, the Authority discarded the argument that the intervention on competition grounds on sham cases should wait for the termination of the judicial procedure, as such delay could render the intervention innocuous. Other important issue decided was the need of a statutory

In Brazil, since 2000, the Competition Authority has been receiving allegations of vexatious litigation for anticompetitive purposes. The number of cases where this issue is alleged has been growing. The Brazilian Competition Authorities have been struggling in recent years in initiating preliminary investigations and administrative proceedings to investigate conduct of companies that affect competition through the abuse of the right to petition, i.e., companies using the administrative and judicial procedures with the aim of harming its competitor in the market. Some cases have come to final judgement and five SDE procedures are nowadays open to investigate anticompetitive litigation in the pharmaceutical industry.

Among the cases of greatest impact is the one that has recently assessed conducts by Siemens Brazil, renamed Continental, the dominant firm in the Brazilian market for tachographs (PA 08012.004484/2005-51) and the one that
dealt with the anticompetitive abuse of copyrights in sales TV channels, the Shop Tour case (PA 08012.004283/2000-40).

The Tacographs case, decided 18/8/2011 is the leading precedent A series of judicial and administrative procedures concerning a local manufacturer was held by the instructing authority as to be prima facie anticompetitive. Respondent, a multinational corporation, had 85% of the market for analogic equipment.

The competitor filing the claim before the Authority entered the market with a digital version of the product. Even after losing a writ of mandamus and a civil action on procedural basis, the Respondent continued to try to oppose the new entrant by a series of other procedures. Some members of the judgment body (CADE) refused to utilize the expression “sham litigation” to classify the facts, as characterizing a specific analysis idiomatic to the US Law, indicating that a separate ground could be found directly in the domestic Antitrust Law. This reaction seems to have dominated the various votes cast on the case, as only passingly the US precedents were cited.

On the other hand, when administering the PREI Test the instructing lower authority (SDE) had manifested its conclusion that

"Nevertheless, a preliminary victory on the merits does not necessarily preclude the [Competition] authority to conclude that it is without foundation"

SDE also noted that the Respondent has sold its products without homologation from the relevant Federal authorities, what would indicate a conflict of interest that appointed to an anticompetitive purpose of the writ of mandamus and the other suit that questioned the action of the competitor. Some votes cast by the judging body dismissed this fact as grounds for the application of what would be comparable to the objective prong of the PREI Test.

CADE did find the Respondent guilty not of vexatious litigation, but of cartelizeing behavior. The important precedent on the issue under study was the confluence in the various votes that there was no Constitutional barrier to find a conduct as being anticompetitive just because it is enveloped within the exercise of a right to redress.

An extended analysis of the civil procedure and administrative procedure aspects of the case noted that in both codes there are provisions whereby the abuse of procedure is refused; the analysis also noted that the Supreme Court has indicated that the right to redress is not an unmitigated principle.

There was also a majority understating that once a firm has attained dominance in the relevant market, his elephantine behavior would render its exercise of the right to redress in face of competitors particularly sensible. But according to the leading vote, in the case there was no clear purpose of damaging the competitor, by filing the administrative and judicial procedures.
Even when not citing directly the PREI Test, the objective standard was used by some judges, by testing the judicial procedures under a filter of "no reasonable grounds to be found".

The instructing Authority decision

The instructing Authority found that no violation was to be pointed out in the case; even though an abusive acquisition of IP rights is generally had as anticompetitive device to be examined by the competition authorities130, in this circumstance no such abuse was even alleged.

The lower decision found that IP rights not necessarily create market power and even in those cases where this occur, and higher prices to consumer is verified, a pro-competitive stream may be identified in terms of dynamic competition and incentive to investment; at the case under analysis, the use of court actions to exert IP rights was not found to be contrary to competition rules, considering inter alia, that the suits have been successful in court.

Some commentators noted that by requesting here that the procedure to be anticompetitive should be utterly baseless, SDE would be proposing a self-defeating mechanism, which would nullify the efficiency of objective branch of the two- pronged test provided under the precedent of the US Supreme Court. It was felt that by acknowledging such stringent standard the judging authority had established a difficult precedent.

SDE remarked furthermore that the eventual change in the IP laws to adjust the local legislation to foreign standards that prevent the reposition market from the effects of industrial designs would be the province of the Legislative Power.

The Judging Authority Decision

The finding by the instructing authority that no vexatious litigation has occurred was subjected to an automatic appeal to the Judging Authority; the opinion of the Federal Prosecutor´s office attached to the Authority was in favor of the representing party for a number or grounds.

The decision of the Judging Authority even though refusing the argument of vexatious/sham litigation, indicated that both the acquisition of IP rights by registration and its exercise could be subject to examination under competition rules. Such rights could be substantively assessed as to its actual balance of benefits and anticompetitive effects in the material circumstances of the cases.

Considering the Constitutional provision that subject the Industrial Property rights to the social interest and the purposes of economic and technological development the decision failed to find such objectives fulfilled in the exercise of industrial design rights in the reposition market. Considering the balance of rights and obligations, the decision identified a disproportion between the exclusion rights
and the competition and consumer interests, and recognized a possible violation of the antitrust law.

The decision refused the thesis that no refusal of exercise could be imposed to the industrial design in the lack of compulsory license under the relevant treaties; if an abuse were to be found, the Authority could prevent the automakers from exercising exclusionary rights in the reposition market. There is no antitrust immunity for industrial designs and albeit the PTO is not empowered to examine such issues, the Authority is. The case was resent to the instructing authority to examine the possible abuse of dominant position.

Although dismissing the sham/ vexatious litigation argument, the decision seems to inaugurate a trend whereby, even considering the potential pro-competitive effects of IP, the analysis should not be shy of assessing the efficiency of its exercise in the facts of the specific case.

Shop Tour Case dealt with a TV producer of programs pushing consumer products to viewers. Initially broadcasting late in the night, eventually it obtained an UHF channel in São Paulo.

In a series of court actions where copyright exclusivity was alleged over any TV sales format, Shop Tour obtained preliminary orders to prevent competitors from exploiting its market niche. However, in most cases final adjudication was adverse, as the alleged copyright grounds were not convincing to the trial or appellate courts. After nine successive losses, a member of the Federal lower chamber represented to the Authority arguing abuse of right to petition with anticompetitive purposes.

The instructing authority in Brazil, SDE, indicated as the pertinent criteria to assess the illicit content of the acts that irrespectively of intent has as purpose or is liable to produce any effect that is a violation to the Brazilian Antitrust laws. But it excluded violation as the represented party only has used the judicial means at its disposal, and in some lower instances the result was not adverse.

Furthermore, Shop Tour’s clients were not contractually prevented from hiring other purveyors of the same service. The Prosecutor offices attached to the Authority followed such understanding.

The judging authority, CADE, however, took other direction. After stating that the right of petition is solidly ingrained in the Brazilian Constitution, Judge Ragazzo cites the Noerr doctrine and both the PREI Test and the Posco standards for multiple petitions; the Schein case on negotiated relinquishment of rights by defendants; and the AstraZeneca European case.

As to the Brazilian precedents, the precedent mentioning “inconsistent” behavior as grounds for determining abuse of right to petition was cited as well as the
Baterias Moura case where it was stated that an abuse of petition case could fly at the presence of a series of indexes, namely, (a) the plausibility of the grounds offered; (b) the truthfulness of the information offered (c) the adequacy and reasonableness of the means utilized and (d) the probability of success of the petition.

Both instances where the abuse of petition was nominated as “sham litigation” and where the expression was expressly rejected were mentioned.

As an initial finding of law, the decision states that using or not the “sham litigation” model, it would seem clear that the right to petition was not immune to antitrust concerns, and that the reasonableness of the grounds offered to exercise the petition was a central aspect of the issue, whenever alleging an Intellectual Property right.

The analysis therefore concentrated on the copyright basis of the case; the respondent in all cases indicated a copyright registration as the fundament of its title. Under domestic law, however, registration is not mandatory and remains unexamined. The utilization of this empty title to base the range of suits was thus held as abusive. The vote also indicates a series of provisions of the copyright law that, according the judge, would be direct violated by the exercise of the petition. A number of court precedents deciding on the inexistence of copyright protection for TV formats was likewise mentioned, to stress that the grounds were “fragile”

In a rather sudden leap, the vote takes from the fragility of the grounds a sign of bad faith. Some judicial precedents on civil procedure abuses were offered as basis; especially a decision of the Superior Court of Justice where it was stated that it is a bad faith litigant whoever petition against literal text of law in order to renew a suit many times already judged. Therefore, by repeating the same petition and hiding from the courts the series of prior adverse judgments, the respondent would have violated the art. 17 of the Code of Civil Procedure, which covers the abuse of procedure.

The vote then differentiates the facts at stake from what occurs with patents and plant varieties, where the exclusivity granted correspond to some social benefit. In the case under analysis, there would be no such bargain and the basic Constitutional balance was therefore frustrated with clear efficiency damages. The alleged exclusivity was not asserted on any expressive form, but on the general idea of utilizing TV programs to sell products. Upon such rogue grounds and by causing steep transaction costs through preliminary orders there was an anticompetitive effect.

Under the current law (vote. P. 1863) this effect may be held illicit: (a) irrespective of intent, where there is an objective risk of violating any of the provisions of art. 20 of the Antitrust Law; or (b) whenever intent of causing such effects is demonstrated. In such case, bad faith was evident from the vast number of litigations filed against relevant players.
Even after dispensing with the objective risk standard by concluding that intent was clearly present, the vote goes on by indicating that not only risk but effective violation occurred. And this happened after a series of what the vote considered (in English) “objective baseless claims”). The vote ends by citing the Tacographs case:

"What is legally unacceptable, and herein lies the distinctive sign of judicial predation, is that the Plaintiff’s efforts are directed not to win the competitor on merits of the case, but to defeat him or harm him in the arena of business by collateral damage stemming from the existence of the process."

The Copyright Collecting Agency Cases

The most visible set of cases of series of procedural bad faith litigation were judged against the Brazilian Central Collecting Society (ECAD)167, which holds by law exclusive rights of collecting some copyright values. ECAD was repeatedly held in abuse of procedure, as well of abuse of its (substantive) monopoly rights by discriminating costumers168. The same entity was recently condemned by CADE in a cartelization inquiry commenced by the inquiring Authority on May 2011, after a lengthy prior inquiry. As the plaintiff in those cases is a monopolist, it would seem adequate to hold those cases as sham/ vexatious litigation.

The Sanofi Aventis patent extension case

In a relevant Federal case170, the plaintiff was a patent holder that at the very last day of the term of its patent filed an action for extending such term. Although the possibility of any extension of term of patents was a much disputed issue, with the majority of decisions of the same court against it, the pertinent theme was not the grounds alleged but the choice of time when the right of petition was exercised, and a preliminary order to extend requested.

On account of such timing, the possibility of bad faith was raised. The leading vote rejected the argument, as no clear bad faith was proven, and any competitive effect (which was not deemed proven) would be indirect and intermediated by a business decision from competitors. A dissident vote affirmed the trial court finding of bad faith, remarking that abuse stems from the use of legal means to achieve illegal ends, and no possible benefit could result to plaintiff from its delay but to discourage competitors to enter the market, what would be possible irrespective of the result of the case in its merits.

An European case not included on EC report, probably because it didn’t fit the authors' research grid, was Astra Zeneca(the AstraZeneca 2011 case).. In that case,
The problem of bad faith was also felt as indicated in a 2011 case. It could be argued that this standpoint derives from the peculiar construction of abuse of rights in the EU Competition system. There is a very outstanding split of approach in the treatment of anticompetitive acts between the US and EU systems.

As noted Rikardsson:

“In 1999, the Commission received a complaint from two generic companies alleging that AZ was abusing its dominant position in several national markets within the EEA by preventing generic firms to bring their equivalent generic products based on omeprazole to the market. AZ was said to be involved with two types of abuses, both relating to AZ’s business strategy within two separate regulatory frameworks. The first, which is relevant for this thesis, consisted of AZ’s alleged deceptive conduct and fraud on several national patent offices to gain SPCs for its patents relating to the product Losec, i.e. abusing the patent law framework to delay generic entry. In that case, evidence of bad faith resulted from internal documents by AstraZeneca...”

The Commission works under the assumption that every decision a dominant firm takes that affects competition in a presumably negative manner is illegal according to article 102 TFEU, given that the firm has the intention to restrict competition.

In AstraZeneca [T-321/05], the Court held:

"In the present case, the Court observes that the submission to the public authorities of misleading information liable to lead them into error and therefore to make possible the grant of an exclusive right to which the undertaking is not entitled... constitutes a practice falling outside the scope of competition on the merits which may be particularly restrictive of competition. Such conduct is not in keeping with the special responsibility of an undertaking in a dominant position not to impair, by conduct falling outside the scope of competition on the merits, genuine undistorted competition in the common market...” [Par. 355]

V – A New Test for Sham Litigation

As discussed in the previous section, the IPEA_WIPO survey revealed that PREI/POSCO/PROMEDIA set of tests is the most common standard to evaluate such cases. Even in jurisdictions where no mention is made to these standards, some complex filtering is carried out. But, as stated by the same US authorities quoted above: the “this standard is difficult to meet, and very few cases have met the stringent test”21.

21 US Report, apud Salgado et al (op cit)
It seems pretty clear that, following formal and stringent criteria, competition authorities and courts worldwide may be dismissing a significant number of (true) cases. Another standard, based on economic perspective should be used instead to assess the effect on competition - and so over consumer welfare - of conducts adopted by firms with market power.

A modern reading of predatory practices suggests a change of focus on predatory behaviour, from profit recovery in the future to damage to the consumer and/or economic efficiency\textsuperscript{22}. Sham litigation, as a special type of predatory practice, should be seem by the same lens. Here the competition law requirements of assuring social welfare through efficient handling of the economic activity, and the purposes of the Intellectual Property Law to stimulate creation and innovation are clearly entangled.

V.1 – Some preliminaries

From an antitrust perspective, one should only mind the cases of bad faith litigation which negatively impact the conditions of competition in the market. That is, if a firm initiates a lawsuit in bad faith, but that does not have affect competition, Competition Law should not interfere, and the judge or court in the case should apply the penalty for litigating in bad faith. And that would be the whole story. A good example would be a sequence of lawsuits brought by a company against a neighboring company only to harm it, regardless of whether they are competitors or not.

However, if the impact of a baseless lawsuit or administrative procedure (or a series of them) go beyond the process itself, impacting the ability of the defendant company to compete in the market, then there should be an antitrust penalty in addition to a fine in the individual lawsuit. It is worth mentioning that it is often difficult to detect the anticompetitive potentiality of an individual action, because in some cases the potential harm of an individual suit may be so small that one might think it does not exist. However, that should not prevent the punishment of an antitrust offense being characterized by the iterated practice, the repetition of lawsuits with little anticompetitive harm. The evidence of such would be the existence of a certain number of groundless and/or fraudulent petitions (administrative and / or judicial).

This explanation has important consequences in terms of antitrust policy to be developed. It implies that the investigatory body should not restrict its scrutiny of the practice of anticompetitive litigation to procedures where there is conviction (by the judge or court) of the author for bad faith. Conviction for bad faith litigation in the individual process is not a necessary nor a sufficient condition for the occurrence of anticompetitive litigation. Not to mention the cases that go unnoticed by the judiciary, in these cases where the offense is evidenced by the repetition of the procedure (including in different spheres, such as judicial and administrative), the judge in a single process cannot screen the anticompetitive

\textsuperscript{22} Following Edlin and Farrell learning, as discussed above.
behaviour. As for non-sufficiency, we shall remember the foregoing example of litigation in bad faith that does not impact on the competitive conditions. Since the application of fines for bad-faith is not necessary nor sufficient for the characterization of anticompetitive litigation, it can be at most be used as a reasonable first approximation, to get an estimate of the size of the problem – but should not bound the antitrust scrutiny.

V.2 – The basis for a new test

Starting from the concept of predatory behaviour developed by the new trends in industrial organization literature, we suggest that it is feasible to develop an analogous rationale to deal with the controversial matter of sham litigation, as it appears in the classic case law as in the judicial and administrative cases analysed in Salgado et al (2011). The idea is to provide a test to screen the “improper exercise of the right of petition with anticompetitive effect”. 23

a. The Predation “New Learning”

The new literature in industrial organization on predatory behaviour, presents three alternative types of models (Tirole, 1990):

i) There are game-theoretical approaches based on the idea of “deep pocket“. In this line, the most recent contributions show how predatory behavior could occur in a balanced way if information is imperfect and the financial resources of the dominating firm are substantially stronger than any present and or future potential competitor;

ii) There are a second set of articles showing how in the presence of imperfect information, an incumbent firm could establish a reputation of toughness and discourage potential new competitors entering the market to go head on with the stronger incumbent firm;

iii) Finally, a third set of works shows that, when the information is not symmetric about costs and demand, a predator can use a lower price to let a competitor know that might be better under the present conditions of demand and cost to exit the market than to face the stronger dominating firm.

This literature deepened the understanding of predatory behaviour. It demonstrated that in the presence of asymmetric information (about market conditions, costs, a particular “taste” for predation or simple strategy of other firms), or imperfect flow of information in the financial markets, predation is theoretically possible, even in the absence of entry barriers that traditionally were thought to be a necessary condition for such behaviour.

23 As defined properly by the Secretary of Economic Law (SDE / MJ) in its report in the recent case involving the tachographs manufacturers Seva and Siemens in Brazil, mentioned earlier.
As noted by Edlin (2012):

“(…)they pointed out that if firms have asymmetric fundamentals – i.e. cost production or financing or discounting, and asymmetric information about these costs, then predation makes perfect sense in that a firm with high costs may cut prices in an effort to convince entrants that is has low costs and that they should therefore exit” (pp. 151)

Edlin (2002) goes further arguing that even if information is symmetric, asymmetric fundamentals, like cost and product quality, allows an incumbent with advantages to predate or disadvantage entrants and drive them from the market (Edlin, 2012, p 152)

As a result of the Industrial Organization’s recent developments, the understanding of predatory pricing has evolved from the ideas of losses incurred by the firm that adopted those practices. A modern reading of the practice of predatory pricing is offered through Edlin and Farrell (2004), to whom:

“Predation occurs when a firm offers consumers favorable deals, usually in the short run, that get rid of the competition and thereby harm consumers in the long run.” (p. 502)

According to the authors and in particularly, as pointed out by Edlin (2001), there is no reason to reduce predatory cases to situations where one can verify pricing below cost, if prices above cost can also hurt the consumer, by limiting the competition.

The definition of predation centered in the conventional thesis of sacrificed profits was offered by Bork, during the trial Neumann v. Reinforced Earth Co. (786 F 2nd 424, 1986):

“Predation involves aggression against business rivals through the use of business practices that would not be considered profit maximizing except for the expectations that 1) actual rivals will be driven from the market, or … 2) rivals will be chastened sufficiently to abandon competitive behaviour the predator finds threatening to its realization of monopoly profits.” (apud Edlin e Farrell, p. 510).

At the same time, the sacrifice of profit in the short run is not always present in predatory pricing. A low-cost monopolist can hurt competition (not only the competitors) using strategically its advantages to exclude competitors with little or no effort, as Edlin (2001) explains. Sacrifice was defined by Bork (1978, p. 145) as an “investment in monopoly profit”. This voluntary sacrifice, having the damage to competition as motivation, could also be associated to other legitimate reasons. Today’s production can generate lower costs in the future in a learning by doing industry or, in a straight forward form, “sacrifice” in a product could be immediately compensated by raising the profits in a complementary product. This way, the profit sacrifice in the short run is neither necessary nor sufficient to create damage and could be distant from both cases.
To get a monopoly position in the marketplace, the sacrifice of profits is not necessary if the dominant firm detains substantial cost advantages (adding the tax and financial advantages). Edlin (op.cit.) shows that sometimes an efficient firm uses its advantages to offer good deals in stable markets, something that is good for consumers and economic efficiency, but occasionally an efficient firm can do just the opposite, charge high prices or offer services and or products of low quality while it faces little or no competition and offer the opposite only when the competition appears.

From a low-cost monopolistic point of view, to offer great deals after the arrival of a new competitor in order to hurt and even provoke the exit of the newcomer does not necessarily imply sacrifice. One should change focus from "sacrifice plus financial recovery" to "exclusion with great damage to the consumer and or efficiency".

Farrell and Edlin (op. cit.) suggest a change of focus on predatory behaviour, from profit recovery in the future to damage to the consumer and or economic efficiency.

It worst mentioning that the literature on predation continues to go further, from the models developed during the 1980s in response to the sceptical Chicago’s view. There are new models and empirical analysis examining the feasibility and effects of this kind of practice we discuss briefly ahead.

Fumagalli e Motta (2009) propose a theory of predatory pricing, based on scale economies and sequential buyers. The entrant needs to reach a critical scale to be successful. The incumbent is ready to make losses on earlier buyers so as to deprive the entrant of the scale it needs, thus making monopoly profits on later buyers. They consider several extensions of the model and the conditions for equilibrium. These conditions are present when the scale economies are sufficiently important and the incumbent is efficient in relation to the entrant.

Fumagalli and Motta show that predation may be rational not only to deter entry, but also to relegate a smaller rival to a niche market, preventing it from expanding it scale.

Shalem, Spiegel and Stahl (2012) discuss that if the dominant reacts to new entry with an aggressive behaviour, it will be unable to even recoup its losses and hence may not engage in predatory conduct from the beginning. Because of that, it would be necessary to analyse the incentives of a dominant firm to engage in predatory behaviour, taking for basis a fully dynamic model, since the dominant firm’s incentive to engage in predatory behaviour in any given period and the potential entrant’s incentive to enter depend in how the game unfolds in future periods.

The authors found that predation is an equilibrium behaviour whenever it is accompanied by the predator’s commitment to also deter future entry. They also found out that predation is facilitated when the entrant has a large capacity and higher average costs, a result similar to Fumagalli and Motta (op. cit.) conclusions.
In relation to empirical investigation, Broadly, Bottom and Riordam (2000) encountered sound elements of the conduct and also Edlin (2012) that observes that if a potential entrant expects the dominant firm to be aggressive and try to drive him out of the market once it enters, then it may opt to stay out of the market from the beginning.

It is worth mentioning that our paper follows also the literature on exclusion, that develops the idea of contracting externalities, as defined by Bernheim and Whinston (1998) and particularly Segal and Whinston (2000), where the authors show that in the condition of multiple buyers and supply-side economies of scale, the incumbent uses exclusive dealing contracts to deter efficient entry. Also, the incumbent enjoy a first mover advantage, i.e., make offers to buyers before the entrant could materialize and make counter-offers, enhancing the exclusion drive.

**Predation and Anticompetitive Litigation**

Christopher Klein (1989), is his seminal work on the theme, defines sham litigation, incorporating the legal perspective, as a anticompetitive litigation without legitimante basis. From the economic perspective, it can be addressed as a predatory or fraudulent litigation with anticompetitive effects involving an improper use of Courts or governmental process against rivals targeting anticompetitive aims. From the economic perspective, sham litigation can be considered a form of predation distinct form the traditional one, that works through price mechanism. This form of predation tends to be more frequent, as the predator may easily impose disproportional costs to rivals using non-price methods. Moreover, barriers to enter are less important to the success of non-price predation.

The article by Klein is still virtually the only relevant reference in the economic analysis of anticompetitive litigation, which opposes the existing vast legal literature on the subject. The subdivision proposed by Klein (op. cit.) within the anticompetitive litigation is here very convenient. Klein focuses primarily on the interface between antitrust and intellectual property – a field by excellence where anticompetitive litigation appears. Klein first distinguishes anticompetitive practices associated with the misuse of (valid) intellectual property from the practices discussed here. The misuse of supposedly valid intellectual property rights is more related to the underlying objective of intellectual property rights to induce innovation, to the issue of social function of all property and to the essential facilities doctrine.

According to Klein, legal actions can be moved not only because of its expected benefits are greater than the litigation costs, but also to impose a favourable result to the litigant. This happens because some legal actions impose unbearable litigation costs to the plaintiff. Than, the litigant has an incentive to move a legal

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action even with little chance of success, only to force the plaintiff to accept an agreement.

This rationale can be expressed as follows:

Let \( L \) be the expected litigation costs and \( B \) the expected gain, in case of success;

The litigator that aims only the expected gains of a favourable court decision will move a legal action if:

\[
\begin{align*}
B - L &> 0 \\
\text{ou} & \quad \Rightarrow \\
B &> L
\end{align*}
\] (1)

Litigators moved by external or collateral gains may decide to move a legal action even if the litigation costs exceed the expected gains.\(^{25}\)

Let \( X \) be the litigation external or collateral gain (discounted), i.e., independent from the action result. They will move a legal action if:

\[
\begin{align*}
X - L &> 0 \\
\text{ou} & \quad \Rightarrow \\
X &> L \\
\text{e} & \quad \Rightarrow \\
B &< L
\end{align*}
\] (2)

In this case, the litigation costs are only justified by the action collateral gains. This constitute a clear case of strategic litigation. Even when both expected gains and collateral gains are, isolatedly, smaller than costs, but jointly they sum up an expected amount superior to the litigation process, we face a case of strategic litigation.

The predatory litigation is a specific type of strategic litigation, which expected collateral gains derive from its anticompetitive effects. The predatory litigation is conducted with the aim of attacking a business rival in order to obtain competitive advantages in the marketplace, independent of the legal action result. The predator has no expectations of profiting from the legal action by its content; their profit expectation relies on the higher price it will be able to impose in the market place after having defying its rival.

Summarizing, the strategic litigation been characterized by \( B<L \), it is motivated by the collateral gain \( X \). If \( X \) derives from de effect on the price the litigator will be able to charge afterwards, than the litigator objective is anticompetitive and the litigation is predatory.

\(^{25}\) One should have in mind this is na ex ante analysis, which takes into account only the expected effects, no matter the final result of the case(s).
This rationale is a cornerstone of the new proposed test, combined with the insights of Edlin (2012) e Edlin e Farrell (2011) mais Fumagalli e Motta (2009).

Predatory litigation is as probable as:

a) the litigator is a dominant firm or a collusion of firms;

b) the plaintiff is a recent competitor that has just entered the market – or a potential competitor;

c) The legal action effect is to prevent or delay the enter or expansion or the plaintiff, or force its exit.

Complementing, the fraudulent anticompetitive litigation is defined as a litigation that gets its target by means of fraud, raising the probability of success of the legal action.

Together, the predatory litigation and the fraudulent litigation give economic content to sham litigation concept. Both cases implies the misleading use of legal process to aim anticompetitive effects.

It is worth noting that this economic definition is wider than the current legal definition, that includes only cases without basis – groundless cases where B=0,

The economic definition here stated is based on B<L.

Note we are dealing with the central problem of antitrust: prevention of entry and exclusion of rivals from the market As, it should be reminded, it was stated by Joseph Farrell in his lecture at Cresse 2012. There Farrell mentioned the practices of pay for delay and sham litigation as the most visible and pervasive examples of this issue. In the freedom of trade perspective proposed in Edlin e Farrell (2011), the antitrust aim is to ask if a conduct or a contract interferes with the competitive process, leading to inefficient results or that hurt consumers.

“...The freedom-to-trade perspective stresses process: the freedom of buyers and sellers to change their trading partners whenever that is mutually beneficial. The aspect of the competitive process that we study here is buyers and sellers exercising this freedom and forming improving coalitions, finding mutual gain in bypassing greedy or incompetent incumbents.

(...)

the competitive process centrally involves the freedom to strike better deals. From this perspective much (...) of antitrust can be seen as prohibiting firms' attempts to restrain or thwart improving trade between their rivals and customers, echoing the Sherman Act’s ban on agreements in "restraint of trade." In this way antitrust protects B's and consumers' freedom to trade to their mutual betterment."(pp. 3)

B may be an innovator entrant or a maverick entrant, which enhances consumers welfare, proposing to them a positive coalition. Antitrust aim means, in Edlin and
Farrell (2011) terms of “freedom to trade” perspective, to protect the competition process, so as firms can fight over customers by offering them “better and better deals”.

V.3 – More on the new test

The main criticism about the commonly used PRE test lies on its first criterion: "no reasonable litigant could realistically expect that their claim was deferred". This is a too restrictive condition, and with adverse effects on competition - despite the fact it is still widely majoritary in the literature and antitrust case law. It can be extracted from condition i above that if the lawsuit has a minimal chance of success, it could no longer characterize anticompetitive litigation. That is, although (on average) the expected benefit of a lawsuit or series of claims of a company may not worth the (sure) cost of litigation, we could not characterize the offense. In these cases - typical of classically named predatory behaviour - the extra revenue that would make the practice a rational behavior would come precisely from the author’s gain derived from limiting the competition conditions because of the practice under scrutiny.

In other words, it would not be rational for the author to petition on that claim and / or administrative procedure if he wondered exclusively for gains and losses in the proceeding at stake (or set of proceedings). It is the externality, the impact on the defendant's capacity to compete, or conditions external to the dispute itself, which make the economically rational behavior. This discussion appears, although superficially, in the Astra Zeneca case decided by the European Commission.

If the requirement to dismiss a claim of anticompetitive litigation was this - to look instead at the expected value of litigation itself – it would not be required the probability of victory in a specific claim to be nil. What would really matter would be a combination of probability and potential earnings - something intrinsic to the very definition of expected value.

The criterion of zero probability of victory, which can be extracted from the idea that "no reasonable litigant could realistically expect that their claim was deferred" is overly restrictive for the control of the antitrust practice of predatory litigation. Some clearly predatory practices which involve some probability of winning the case remain outside of the punishment spectrum. It should be emphasized that analyzing the probability of winning only makes sense in the case of predatory litigation; if the right was obtained through fraud, litigation might have a high probability of winning and still be anticompetitive – exactly because of the fraudulent conduct, just like in Walker Process.

The consequences in the antitrust arena of requiring zero probability of winning in sham litigation cases are immense, and go far beyond the obvious stimulus to an illegal practice that the law does not punish. The presence of a minimum regulatory uncertainty would be enough to potentially avoid any company guilty of abuse of the right of petition. In a country full of regulatory uncertainties and controversies - such as those around the end date of pipeline
patents and the prior consent of the sanitary authorities for the granting of pharmaceutical patents - it becomes almost impossible to prove that a company would be sure to lose a lawsuit.

The problem, however, is even worse. The need to show a zero probability of winning has a serious implication in the processes of investigation of abuse of right of petition. To defend itself against an accusation of sham litigation, a firm will seek to show that her probability of winning was greater than zero. How can she do so? The analysis performed most of the time is unfortunately retrospective – irrespective of international case law previously mentioned. Therefore, a company actually will argue in an antitrust claim that it won in court sometimes and / or at the administrative level. That is, the defense in proceedings for sham uses as counterevidence some victory in any administrative proceeding or judicial claim. A single eventual victory in the merit in court / administrative trial would be enough to distort the null probability of victory and, therefore, any "reasonable litigant could realistically expect that her claim could be accepted - thus relieving him from culpability for anticompetitive litigation. Thus, given an infinitesimal chance of victory, the law of large numbers assures us that every individual will have a huge incentive to increase the number of claims: in fifty cases my chance to win at least one is greater than if starting only ten or twenty cases.

In other words, besides not being restraining an anticompetitive practice - which in itself creates incentives for it to occur more in society as a whole - we are giving additional incentives in the individual case for a company to start more and more (undue) demands because the difficulty of proving the offense is an increasing function of the number of judicial and / or administrative claims.

The Brazilian decision on the Shop Tour case (PA 08012.004283/2000-40) taken on 15/12/2010 is the first conviction in Brazil for sham litigation and brings some light on the above issue. The case dealt with sham litigation concerning bringing lawsuits against competitors in the sales TV channels segment for alleged violations of copyrights on the scripts of those sales opportunity shows. The decision reviewed the history of all lawsuits involved – as the respondent claimed it had won several of them. The decision pointed out that all those victories in first instance were reversed at upper courts when appealed for those already judged. This was enough to dismiss the defense argument and characterize that the respondent could not reasonably expect to win those suits and therefore they were a sham aimed at excluding competitors by abusing its IP. This first decision also emphasizes the difference between predatory and fraudulent litigation – which follows our understanding.

VI - Conclusion

This brief conclusion aims at presenting our achievements with this paper. We started it by introducing the topic of effects-based tests and the basics of the
practice of anticompetitive or sham litigation. We then claimed the need for an objective test for dealing with such anticompetitive behaviour.

In order to base our claim for a new test we presented the undeniable evidence of an extremely low record of cases related to unlawful litigation with antitrust effects and the striking absence of leading cases, or cases at all in most jurisdictions around the world.

Finally we criticized heavily the nowadays mostly used test: the PRE test. The main guidance for policy makers from our research is that such test is totally inadequate and its usage has led to an underenforcement of competition standards in what concerns anticompetitive litigation.

We propose a screening device based on the discounted expected gain from the litigation. According to this new test, litigation is anticompetitive if its present discounted value to the author – usually a dominant firm – is negative in the absence of undue harm to a competitor. The analysis should be a prospective one, although making use of essential information available *ex post*.

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