THE ECONOMICS OF SHAM LITIGATION:

THEORY, CASES, AND POLICY

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CHAPTER ONE

INTRODUCTION

I. The Controversy

Sham litigation as an antitrust law violation has been the subject of much discussion in recent years. Historically, sham litigation has generally been defined legally as anticompetitive litigation that is "baseless" or otherwise without any legitimate foundation. From an economic perspective, this is a very restrictive definition which allows considerable use of the legal and administrative systems for anticompetitive ends. A definition of sham litigation that is more in keeping with economic reasoning would identify sham litigation as predatory or fraudulent litigation with anticompetitive effect, that is, the improper use of the courts and other government adjudicative processes against rivals to achieve anticompetitive ends.

Beyond the proper legal definition of sham litigation, there is considerable disagreement over the frequency of such attacks using the courts and other adjudicative forums, and the implications for social welfare of the various policy options designed to limit such litigation. Some legal commentators believe that sham litigation is a substantial and growing phenomenon in the United States and that it presents a challenge to current antitrust policy.[1] Others perceive the antitrust problem as less severe, or they fear the problems associated with its solution: a constriction of First Amendment rights of access to the government.[2]

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[1] For instance, Bork (1980), p. 348, states "...that this form of predation may be common and that the aggregate annual loss to consumers may be large."

[2] Areeda (1982) is the most prominent proponent of this view. Klein (1986) presents a formal economic model which generates a "chilling effect" on legitimate suits in some situations.

Judicial definitions of sham litigation are also in a state of confusion.[3] The subject of predatory litigation has recently piqued the interest of public antitrust enforcers[4], and in 1985 the Federal Trade Commission issued a complaint based on a

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[3] In the legal community much of the recent concern about predatory litigation surrounds the Seventh Circuit's 1982 opinion in Grip-Pak. Here, Judge Posner utilized a cost-benefit approach to analyze anticompetitive intent and held that even nonbaseless claims could constitute sham litigation. This arose in sharp contrast to other interpretations which required litigation to be "baseless", abusive, frivolous, "access barring", or undertaken solely with anticompetitive intent in order to incur antitrust liability. Two excellent reviews outline the current state of the arguments, although they are critical of Grip-Pak. See Hurwitz (1985) and Handler and De Sevo (1984). In 1987, the Grip-Pak ruling was clarified somewhat in Premier Electric.

The confusion of judicial opinion may reflect the lack of available evidence with which to make informed judgments, as well as the refusal of the Supreme Court to render opinions in cases of this type since Otter Tail Power in 1973 and Vendo in 1977. Neither of these opinions, however, dealt directly with defining sham litigation. The last full expression of Supreme Court majority opinion on sham litigation was California Motor Transport (1972).

[4] James C. Miller III, then Chairman of the Federal Trade Commission, told a 1984 conference at the Hoover Institution: "Another sort of mischief, of course, is the government itself--or, rather, firms' efforts to use the coercive powers of government for their own advantage against their rivals." See Miller and Pautler (1985), p. 500.

Federal Trade Commissioner Terry Calvani made similar remarks before the American Bar Association in 1985. He concluded: "In summary, I believe that non-price predation is an important object of antitrust attention. It is at least as pernicious as its cousin price predation and is probably much more commonplace. I predict that it will become important grist for the mill of antitrust counsel." Calvani (1985), p. 5.

theory of predatory litigation.[5] Despite the obvious importance of evidence on the frequency and implications of anticompetitive behavior in government forums, little empirical research has been attempted in the area.[6] This study is intended to increase our empirical knowledge of this subject.

II. Purpose of the Report

Unfortunately, one cannot easily identify situations involving predatory attacks before a governmental body.[7] It is possible, however, to observe suits brought under the Sherman Act in which one firm alleges "sham litigation", i.e., claims that the actions of one or more of its competitors in an adjudicatory proceeding were intended to impose costs upon it or to exclude or drive it from the market in violation of the antitrust laws. The basic data source for the report is, therefore, the set of published court records

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[5] Amerco et al., Docket No. 9193. The Federal Trade Commission has a history of bringing cases involving non-price predation. The "Coffee Case," General Foods Corp., Docket No. 9085, was partly concerned with predatory use of advertising and other promotional expenditures. See Hilke and Nelson (1984).

[6] This is especially true of predatory litigation, Williamson's (1968) study of the Pennington case being a prominent exception. The situation is less bleak in the case of regulatory predation. See McCormick (1986) for a recent review.

[7] Anyone with experience in defining markets for antitrust purposes knows the difficulties in determining whether two or more firms compete in a significant way. Thus, even if one had access to the records of every national, state, and local government proceeding, the mere determination of which proceedings involved competitors would be a monumental task fraught with opportunities for error.

between 1972 and 1985 on public and private Sherman Act "countersuits" that entail such allegations of sham litigation.[8]

The major question that the report seeks to answer is whether the case law involving Sherman Act countersuits alleging sham litigation has developed in a way that appropriately discourages the use of adjudicative proceedings to produce anticompetitive outcomes.[9] This report examines countersuits alleging predatory use of adjudicative proceedings in order to compare the characteristics of the firms involved in the alleged sham actions to the characteristics that the economics literature suggests are conducive to such predatory strategies. In particular, the report tests whether countersuits that survive motions to dismiss allege sham activities in markets exhibiting economic conditions likely to support predation.

Along the way, the report provides a discussion of the economics of predatory litigation and of strategic litigation more generally. The report also constructs a tentative picture of the seriousness of predatory litigation as a policy problem from statistics on the frequency of lawsuits alleging predatory litigation and from trends in the number, characteristics, and outcomes of these suits. This leads to a discussion of policy options.

Although reliance on countersuits as a source of data solves a major problem in initiating the research, it introduces several complications as well. Sherman Act countersuits are responses to previous or coincident

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[8] Throughout the report, a Sherman Act suit alleging sham litigation is referred to as the "countersuit" and the action which is alleged to be sham is called the "sham suit" or the "sham action."

[9] This is a minimal test in that evidence is not examined to determine whether sufficient conditions for such predation are present. Those countersuits alleging conditions likely to be associated with predation are at least plausibly legitimate; those allegations which do not contain these conditions are more likely to be either sham-sham suits (defined below) or a product of a divergence between the economic and legal definitions of sham.

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litigation and may be brought as strategic attempts to force favorable settlements of the original suits, rather than with any expectation of ultimate success on the merits. In addition, the Sherman Act countersuits may themselves be predatorily inspired, or initiated only to harass the defendant into paying the plaintiff a sum of money in order to avoid a costly defense.[10] These strategic or predatory countersuits have been called "sham-sham suits."[11] In examining the court records, therefore, an attempt is made to distinguish the honest countersuits from the sham countersuits.

Another complication is the effect of changes in the sham litigation case law on the propensity of firms to undertake predatory actions and Sherman Act countersuits alleging sham litigation. Since the Supreme Court's 1972 decision in California Motor Transport[12], the case law has moved toward a wider definition of actions which may constitute sham violations of the antitrust laws.[13] This trend is apt to discourage predatory litigation while encouraging Sherman Act countersuits, including sham countersuits. Moreover, sham suits, sham countersuits, and related litigation are likely to be settled in many cases. Generally such settlements are not reported in standard legal sources. Thus, a sample of reported countersuits is likely to constitute a selected sample of all such allegations (Klein and Priest (1984)). These possible complications require care in analyzing simple trends and other aspects of the countersuits.

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[10] The uncertainty in the case law on sham litigation and the incentive of treble damages have probably exacerbated the use of Sherman Act suits for these purposes.

[11] See Klein (1986). Sham-sham suits are also referred to as "sham countersuits" in the remainder of the report.

[12] 404 U.S. 508 (1972).

[13] The case law has tended to drift away from strict requirements of baseless and repetitive acts, although these concepts are not without force in some circuits today. See Hurwitz (1985) and Handler and DeSevo (1984).

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III. Summary of Results

The report concludes that economic conditions conducive to predatory litigation in Sherman Act countersuits do matter to the courts in their decisions on motions to dismiss, but they may not matter much. While the report finds that allegations concerning characteristics conducive to predation are associated with countersuit outcomes,[14] it also finds that a relatively large proportion of countersuits survive a motion to dismiss in cases where the underlying alleged sham suits lack these characteristics conducive to predation.[15] This suggests a public policy goal of modifying the case law in order to discourage sham countersuits.

Despite this suggestion that the number of countersuits alleging sham litigation may be excessive, the number of countersuits as well as the recent increase in the rate of countersuit cases may be much lower than has been suggested in the legal literature. Beyond this, the data shed little light on the magnitude of the resources at stake in sham litigation cases and countersuits. Hence, though the findings of this report generally suggest a policy goal of modifying the case law, the costs and benefits of such a policy cannot be inferred from the data.

IV. Plan of the Report

Chapter Two reviews the economics of predatory strategies and of litigation in general, and applies this analysis to the case of sham litigation. The conditions likely to support predatory litigation are discussed here. The case law on sham litigation and its economic interpretation are

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[14] In fact, the logit regression analysis of Appendix II suggests that the probability of passing a motion to dismiss may be raised by as much as 33 percent by the presence of predatory characteristics.

[15] These cases may constitute a third of the countersuit sample. In total, over 50% of the countersuits that lack the examined predatory characteristics survive motions to dismiss.

reviewed in Chapter Three. The data and the statistical results concerning countersuits are discussed in Chapter Four. Chapter Five provides a short summary and some comments on the policy implications of the empirical analysis.

There are also two appendices. Appendix I lists the 117 countersuits alleging sham litigation as a violation of the Sherman Act and some characteristics of each countersuit. Appendix II presents a brief regression analysis of the determinants of the probability that a countersuit survives a motion to dismiss.

CHAPTER TWO

THE ECONOMICS OF SHAM LITIGATION

I. Introduction

This chapter applies economic analysis to the problem of defining sham litigation as an antitrust law violation. This analysis implies that most sham suits or countersuits that violate the Sherman Act should display certain characteristics that are associated with successful nonprice predation strategies. This discussion prepares the way for the empirical analysis of countersuits alleging sham litigation in Chapter Four.

From an economic viewpoint, sham litigation strategies either involve fraudulent use of the courts or they are special cases of nonprice predation. Economists believe that nonprice predation is likely to be more common than price predation, primarily because the predator is more likely to be able to impose disproportionate costs on its target using nonprice methods, and also because entry barriers are less important for the success of nonprice predation than for price predation. Section II discusses these factors in more detail, compares price predation to predatory litigation, and derives some simple conditions which make markets susceptible to nonprice predation.

Predatory litigation raises certain concerns peculiar to this method of nonprice predation. The discussion of these concerns requires a brief review of the economics of litigation, especially the theory of strategic behavior in litigation and settlement. Nonstrategic litigation is undertaken if the expected value of the direct effect of the judgment on the merits exceeds the expected cost of litigation.[16] In contrast, strategic (including predatory)

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[16] Throughout this report, the terms "costs" and "benefits" are used to include nonmonetary as well as monetary issues. For instance, reputation damage or freedom to deal with retailers as desired would be relevant costs or

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litigation is undertaken to achieve a goal collateral to winning a judgment on the merits.[17] Strategic behavior complicates the analysis of countersuits alleging sham litigation, because the countersuit itself may be a strategic response to legitimate litigation. All this is the subject of Section III.

Section IV applies the economic analysis of predation and litigation to the case of sham litigation. There are several reasons for litigation to arise among competing firms. The absence of conditions conducive to nonprice predation should help to distinguish cases that are unlikely to involve predatory litigation.

II. Price and Nonprice Predation Strategies

Economists are skeptical of the profitability of predatory pricing strategies, especially in situations characterized by full information.[18] The successful price predator, for example, must impose larger losses on its target than on itself during the predatory pricing period and, following the target's exit, the predator must be protected from entry in

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benefits of litigation, even if no monetary damages were at stake in the case.

[17] Note that winning through fraud or misrepresentation can be a factor in either strategic or non-strategic litigation. In particular, the economic definition of sham cases discussed below includes some nonstrategic cases in which fraud is used to achieve a successful (but anticompetitive) outcome.

[18] Easterbrook (1981) reviews the arguments on both sides and concludes that, in the case of full information -- when entrants and buyers know the incumbent firm is following a predatory strategy -- the predator's rivals and customers can undertake counterstrategies that render price predation unprofitable. Nevertheless, very little empirical work has been done in this area. What evidence there is suggests that price predation is rare. See Koller (1971), but also see Burns (1986).

order to recoup its lost profits through elevated prices. The first condition is unlikely to be met, because a predatory pricing firm must at some point possess a larger market share than its rivals. The target has an incentive to remain on the fringe of the market and minimize its losses during the predatory period, and then to expand when the predator raises prices to recoup its losses.[19]

Even when the target exits, easy entry would prevent the predator from recouping its losses. When the predator attempts to raise prices following the target's exit, entry may be attracted and prices driven down before the predator can recoup. This renders the predatory pricing strategy unprofitable.[20]

Nevertheless, predatory pricing may be profitable when potential entrants have incomplete information about the predator's incentives. In this case, predatory pricing in response to entry may give the predator a reputation for aggressiveness which deters future entry. Potential entrants, lacking the knowledge that a predatory strategy is being used, may believe that the predator's low prices were its short-run profit-maximizing response to entry. This would cause potential entrants to reduce their expected level of post-entry profits for any given pre-entry price level. Thus, the predator may be able to charge higher prices following price predation without attracting entry.[21]

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[19] These and other points are made in Salop (1979) and Dixit (1982). Also, see Salop (1981).

[20] This is similar to the theory of contestable markets, in which ease of entry and exit produces competitive pricing even if the incumbent is a monopolist. See Baumol (1982). For a criticism based on the likelihood of the existence of contestable markets, see Brock (1983).

[21] See Milgrom and Roberts (1982) and Kreps and Wilson (1982). If the predator competes in multiple markets with incomplete information, profitable predatory pricing may be more likely. In this case, the predator may greet entry in one market with prices which yield only a slight loss to the entrant. Potential entrants to the other markets may

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A related strategy is for the predator to make a credible predatory pricing threat that deters entry.[22] This usually requires that, prior to entry by a competitor, the predator make a commitment, perhaps an investment in excess capacity, which makes the predator's profit-maximizing response to entry yield negative profits to the entrant. The predator thus bears the cost of its pre-entry commitment in order to gain profits without attracting entry.

These cases notwithstanding, it is generally argued that nonprice predation will be a profitable strategy more frequently than will price predation. While the benefits of the two strategies to the predator are usually similar, the costs of nonprice predation to the predator may be much lower. In addition, the profitability of nonprice predation does not necessarily require entry barriers against the entrant type of firm.

Nonprice predation strategies can be split into two types. The first is based directly on the theory of raising rivals' costs first mentioned in Salop (1981) and developed formally in Salop and Scheffman (1983). Here, a firm may attempt to raise the costs of some or all of the firms in a market, including itself, if the costs can be made to fall disproportionately on its rivals. The market price then rises by more than the increase in the predator's average cost, and the predator's profits may rise if the increase in the profit margin is not offset by quantity decreases. For example, a capital-intensive firm might try to have the minimum wage increased, because this would increase its more labor-intensive rivals' average costs relative to its

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take this as an indication of their likely post-entry profits and, consequently, may not enter. The predator may be able to sacrifice profits in one market in return for supracompetitive profits in several other markets. See Easley, Masson, and Reynolds (1985). Lescher (1980) argues that this form of predation may be commonplace. See also Saloner (1987) for predation in anticipation of a takeover.

[22] See Salop (1979), and Spence (1977) and (1981).

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own.[23] Furthermore, there is no need for a recoupment period, because costs and prices rise simultaneously, as long as there are entry barriers against capital-intensive firms.

The second type of nonprice predation seeks to prevent, delay, or raise the costs of entry by competitors without affecting post-entry production costs. Although related to entry-deterring strategies generally, this type of predation often depends on imposing greater costs on an entrant than are borne by the predator.[24]

Predatory use of adjudicative processes is an example of nonprice predation. In industries with some entry regulation, for example, an incumbent firm may be able to protest entry before the regulatory body at low cost even when it does not expect a successful litigated outcome, whereas the entrant will be burdened with the cost of justifying its entry. Thus, entry is delayed, the expected entry costs of future entrants may be increased, and the probability of future entry may be reduced.[25]

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[23] This is the situation analyzed by Williamson (1968) in the _Pennington_ case. Other examples of raising rivals' costs can be found in Hilke and Nelson (1984) and Hamilton and Kawahara (1974).

[24] Many legal commentators accept the proposition that the incumbent may find it relatively easy to impose high costs on the entrant at little cost to itself. See Bork (1978), pp. 347-348, and Balmer (1980), pp. 62-63. The only relevant empirical work, Pashigian (1982), generally supports this conclusion. Pashigian finds that legal expenses decline as a proportion of total sales as a firm's total sales increase. This could give a large firm an advantage over a smaller entrant in absorbing litigation costs.

[25] See, for example, FTC Staff Motion for Leave to Intervene before the Federal Energy Regulatory Commission in the Matter of Texas Gas Transmission Corporation, Docket CP87-205-000, July 29, 1987. FTC staff argued that FERC's procedures may allow incumbent pipelines to inefficiently deter the entry of rivals, thereby raising the costs of natural gas to consumers.

Predatory litigation in the courts may have similar effects. The predator may repeatedly file lawsuits of little merit against an entrant to impose costs of defense, delay financing or other contractual arrangements, and ultimately discourage potential entrants from entering.

The profitability of the second type of nonprice predation strategy is higher (for a given market) the larger the market share of the predator relative to the target, because the costs incurred by the predator and imposed on the target are not related to output or sales. Thus, the predator suffers lower costs per dollar of sales relative to the target the greater the disparity in their market shares. Also, the strategy is more likely to be profitable when it prevents or delays entry or expansion, or causes the target to exit.

Therefore, litigation among competitors is more likely to be predatory when:
1) The plaintiff is a dominant firm or conspiracy.
2) The defendant is a recent or potential entrant or a competitor.
3) The effect of the plaintiff's action is to prevent or delay entry or expansion by the defendant, or to cause exit.

These characteristics will be used in the empirical investigation of sham litigation cases. It is now time, however, to examine the economics of litigation and its implications for nonprice predation strategies.

III. The Economics of Litigation

The economic analysis of crime, the court system, and litigation began in earnest approximately twenty years ago.[26] This analysis applied economic principles of optimization to

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[26] One might date the beginning of this modern era in the economic analysis of litigation with Becker's (1968) treatment of the criminal justice system. This was soon followed by Landes (1971) and Posner (1973). These papers began to consider the determinants of settlement and the effect on court outcomes of the actions and reactions of the various participants in the system.

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the participants in the court system in order to generate predictions consistent with casual observation of the courts and, later, to generate hypotheses which could be tested empirically. Eventually, the study of strategic behavior in litigation grew out of the study of the determinants of pre-trial settlements.[27]

The basic premise of this literature is the prediction that a suit is undertaken when the plaintiff's expected benefits outweigh its expected costs. Given the costs of litigation and the option to reach a settlement, if the parties have full information about each other's expectations concerning the outcome of litigation, litigation occurs only as a result of a genuine disagreement between the parties concerning the outcome.[28] If the difference in expectations concerning the outcome of litigation is due to uncertainty over the facts or the law, or differences of opinion as to the applicable facts or law, then settlement may occur during litigation as new information causes the expectations of plaintiffs and defendants to converge. Therefore, litigation is "optimal" in this context, because it arises only when there is a dispute to be resolved.[29]

As in the theory of price predation, however, more interesting situations develop when the parties have limited information. For example, when the parties do not know each other's expectations, litigation may ensue due to

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[27] The important early article on pre-trial settlement is Gould (1973). Outgrowths of his work are discussed below.

[28] When both parties believe they are likely to win, when the gain to one party is a loss to the other, and when litigation costs are equal and not large compared to the size of the award, there is little chance of pre-trial settlement. See Gould (1973), Landes (1971), and Posner (1973). Strategic behavior is an additional reason for pre-trial settlement to fail. See Cooter, Marks and Mnookin (1982), P'ng (1983), and Bebchuk (1984).

[29] Society's resources are not wasted on "unnecessary" trials.

strategic behavior, even when the parties actually agree.[30] The parties may hold out for more favorable settlements, even though this raises the probability that the settlement will fail and trial will follow.[31]

Limited information opens the way for each party to try to affect the other's expectation of the value of litigation to its own advantage.[32] For example, a defendant might act as if it thought the value of the plaintiff's suit was low in order to sway the plaintiff toward accepting a lower settlement amount, even though the defendant's true expectation of the value of the suit is high.

More generally, suits and countersuits may be brought not on their own merit, that is, not because the expected value of a favorable judgment outweighs the costs of litigation, but to force a collateral outcome favorable to the plaintiff.[33] Some lawsuits, for instance, may impose significant litigation costs on the defendant if allowed to go to trial. This may prompt plaintiffs to bring suits with little expectation of success on the merits, in hopes of coercing a

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[30] See, for instance, Samuelson (1983); Cooter, Marks, and Mnookin (1982); Bebchuk (1984); See P'ng (1983).

[31] This is Samuelson's (1983) result. A similar outcome in Bebchuk (1984) is driven by an information asymmetry (i.e., the defendant knows more about the case than does the plaintiff). Nalebuff (1986) suggests that settlement negotiations may fail due to the plaintiff's failure to make a low enough settlement offer, because of the plaintiff's need to perpetuate a credible threat of going to trial.

[32] See Salant (1984) and Fedenberg and Maskin (1986).

[33] An interesting example consistent with this is the behavior of firms threatened with hostile takeover attempts. Jarrell (1985) finds that target firms that litigate the takeovers and then settle are often successful at increasing the purchase price of their stock. In this case, the strategic use of litigation increases stockholders' returns.

settlement from the defendant.[34] Similarly, defendants may file countersuits of little merit in order to raise the plaintiffs' litigation costs, or lower their expectation of success, and force favorable settlement.[35]

A few simple equations are helpful in illustrating these different motivations for litigation.[36] Suppose L represents the expected costs of litigation and B represents the expected gain from success on the merits,[37] properly discounted. Then, plaintiffs motivated only by the expected gains from obtaining a favorable judgment on the merits will bring suit only if:

$$B - L > 0$$
$$\text{or} \qquad (1)$$
$$B > L.$$

That is, "honest" nonstrategic plaintiffs sue only if the

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[34] Rosenberg and Shavell (1985) examine nuisance suits analytically. The plaintiff's cost of filing suit must be low and the defendant's litigation cost must exceed the plaintiff's for the strategy to be credible. Then, the defendant has an incentive to avoid trial by paying the plaintiff a sum less than the defendant's litigation cost and the plaintiff has an incentive to accept. If such suits can be expected to occur repeatedly, however, then the defendant has an incentive to litigate in order to deter future nuisance suits.

[35] Although not discussed explicitly by Samuelson (1983) and Bebchuk (1984), this possibility is consistent with their findings.

[36] This analysis deals with total costs and benefits for simplicity. The more subtle marginal analysis can be found in Klein (1986).

[37] Throughout this discussion, the term "success on the merits" is used to indicate that the evidence is given within the broad range of acceptable legal practice, that is, nonfraudulently.

expected direct benefits of winning in court (B) exceed the costs (L).

Plaintiffs motivated by an external or collateral gain may decide to sue even if the costs of litigating cannot be offset by the expected benefits of winning on the merits.[38] Suppose X represents the discounted expected external or collateral gain from litigation, that is, the gain that is independent of the outcome of the case. Then, plaintiffs will bring some strategically inspired suits for which:

$$X - L > 0$$

or

$$X > L \qquad (2)$$

and

$$B < L.$$

In this case, the costs of litigating can be justified solely by the collateral gain $(X > L)$. This is the clearest case of strategic litigation.

Suppose a plaintiff chooses to bring suit when

$$(B + X) > L$$

and

$$(3)$$

$$X < L, B < L.$$

In this case, litigation is motivated by the sum of meritorious and collateral gains $(B + X)$, but cannot be justified by either type of gain alone. Despite its mixed motivation, no litigation would occur in this case in the absence of a collateral gain $(X = 0)$. This is also a case of strategic litigation. In short, strategic suits are those for which $B < L$, $X > 0$ and $B + X > L$, that is, suits for which a collateral goal is necessary to make the suit worth pursuing.

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[38] It is important to note that this analysis is based on expected benefits and costs of the litigation, that is, on *ex ante* assessments of the likelihood that various outcomes will occur. The fact that a plaintiff actually wins a ruling (despite a low probability of this outcome) does not in and of itself imply that the case was not a sham case under the definition here.

Plaintiffs may also be willing to bring nonstrategic suits that are not justified by the costs and benefits of success on the merits. In particular, such cases may be pursued if fraud or deception creates the expectation of higher direct benefits from litigation. Suppose B_F represents the expected direct benefits of litigation if fraud or deception is used.[39] Then a plaintiff will bring a fraudulent suit if

$$B_F > L$$
and $$(4)$$
$$B < L.$$

Thus, whenever a plaintiff brings suit either $B > L$ (condition 1) and the suit is legitimate, or $B < L$ and the suit is either strategic (conditions 2 and 3) or it is fraudulent (condition 4).

Predatory litigation is brought in order to attack a business rival for competitive gain that is independent of the legal outcome of the action.[40] As defined here, it is a special case of strategic litigation, in which the expected collateral benefits justifying the suit are derived from its anticompetitive effects.[41,42] The predator does not expect

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[39] This expected value is assumed to reflect the probability that the fraud will be successful.

[40] Some predatory or "raising rivals' costs" suits could be indirectly aimed at competitors. For instance, a firm might sue its rival's supplier in order to cripple the rival competitively.

[41] Suits may be predatory on the margin, however, in the sense that the litigation is pursued beyond the point that nonstrategic litigation would be settled, because of the additional competitive benefits to be gained from litigating. See Klein (1986).

[42] More generally, the presence of a collateral gain motivates strategic litigation of all types. As we will see in Chapter Three, the presence of this "ulterior motive" has prompted an analogy between sham litigation and the tort of

to profit from a favorable judgment on the merits alone ($B <
L$), but because of a higher market price caused by the
effect of the suit on its rival's ability to compete ($X > 0$).
Fraudulent anticompetitive litigation is litigation that
achieves its anticompetitive effects through deception that
increases the likelihood of success in the courts ($B < L$ but
$B_F > L$).

Together predatory litigation and fraudulent
anticompetitive litigation provide a more economically
satisfying definition of sham litigation than that given under
a baselessness standard. Both types of cases are misuses of
the legal process for competitive ends. However, this
definition includes more than the "baseless" cases of the legal
definition. In the notation here, "baseless" cases are cases
with $B = 0$, while the economic definition includes all cases
for which $B < L$. The implications of this analysis are
applied directly to litigation among competitors in the next
section.

IV. The Economics of Sham Litigation

Competitors may bring suits against each other for a
number of reasons. The suits may involve legitimate
disputes, fraudulent use of the process, or they may be
strategic. Fraudulent or strategic litigation among
competitors may be motivated by rent-seeking, by the pursuit
of favorable settlements through nuisance suits, or by
anticompetitive effects. Below, the distinguishing
characteristics of the various possible motivations are
examined. In general, this analysis suggests that the
presence of market characteristics conducive to the pursuit
of predatory strategies helps to distinguish economically
meaningful sham suits from other types of litigation.

Rent-seeking, as the term is used here, involves a
dispute over the ownership of returns to a fixed investment

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abuse of process. Whether an economic definition of abuse
of process would encompass all nonpredatory forms of
strategic litigation is not addressed here, although it may be
an interesting area for future research.

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or a unique resource.[43] For example, a firm might challenge the award of a contract to a competitor in order to attempt to win the contract for itself.[44] A successful strategy of this type might not affect the market price, but only shift the distribution of sales among the firms. The firm that gained sales, however, might increase the rents earned by its fixed plant at the current price. This sort of "competition in the courts" may offend against fairness and it may waste the resources of the courts and the competitors. However, unless it raises prices, it does not represent an antitrust problem. In this sense, some rent-seeking litigation, even between competitors, does not constitute sham litigation under this definition.

Nuisance suits border on extortion. The plaintiff knows it can impose costs on the defendant, even though the plaintiff is unlikely to win on the merits. The defendant may be induced to avoid trial by settling with the plaintiff for a sum less than the cost of defending the suit.[45] This may be a profitable strategy for the plaintiff if its litigation costs are less than the defendant's. The only case in which nuisance suits constitute predatory litigation is where the

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[43] This is a fairly strict definition of rent-seeking. In a broader sense, all litigation is a form of rent-seeking. The literature on rent-seeking developed alongside the theory of regulation. See, for instance, Stigler (1971), Posner (1974), and Peltzman (1976).

[44] The plaintiff might claim that the defendant's bid was based on incorrect specifications or would cause environmental damage. The suit is strategic, because the plaintiff seeks to gain not by winning the suit directly -- which might result in the issuance of more environmentally responsible specifications -- but by gaining another chance to acquire the contract.

[45] This is true as long as additional suits are not expected. In the case of expected repetitive litigation or multiple suits, it may pay the defendant to litigate rather than settle.

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settlement constitutes an anticompetitive agreement rather than a simple bribe.[46]

Fraudulent anticompetitive litigation depends primarily on the ability to deceive the courts into granting benefits that have anticompetitive effects. Except in the case where an explicit monopoly position is awarded (as with a fraudulently obtained patent), this type of litigation requires market conditions conducive to anticompetitive outcomes and conditions that make fraud more costly to expose. In the case of litigation among competitors, the analysis of these conditions parallels that for predatory litigation, as discussed next.

Predatory litigation always has an anticompetitive goal. It may be undertaken to cause exit, to deter entry, to raise rivals' costs, or to enforce collusive schemes.[47] The key in every case is the existence of a collateral goal that is expected to yield benefits to the plaintiff through changes in a market price. This outcome is more likely when the market conditions conducive to nonprice predatory activity outlined in Section II are present.

In the language of the equations at the end of Section III, strategic litigation is characterized by the condition $B < L$. External or collateral benefits X motivate the suit. If X derives from an effect on a market price, then the plaintiff's goal is anticompetitive and the litigation is predatory. The existence of an anticompetitive goal where $X > 0$ is unlikely in the absence of market conditions conducive to nonprice predatory behavior by the plaintiff. Therefore, litigation between competitors in markets lacking conditions conducive

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[46] This point was suggested by Reasoner and Atlas (1983) in their study of possible antitrust violations in settlement contracts.

[47] One problem in forming and maintaining cartels is that each individual conspirator has an incentive to cheat on the agreement. To prevent a cartel from breaking down into competition, a device for punishing cheaters or for making cheating unprofitable is needed. See Osborne (1976). Litigation is a possible enforcement device for retaliating against cheaters on a cartel agreement.

to predation is not likely to be sham litigation in an economic sense.

Furthermore, the same conditions can be used to help examine sham countersuits. A sham countersuit is a Sherman Act countersuit motivated by an anticompetitive collateral goal. For example, consider a case in which a firm brings a patent infringement suit against a competitor. The competitor responds by filing a countersuit claiming that the patent suit is a sham. Now, suppose the judge is inclined toward economic analysis and compares the market conditions alleged in the countersuit to those conducive to predatory strategies. If conditions are conducive to predation by the plaintiff in the patent suit, then the patent suit may be sham and the countersuit may be meritorious.

There are, however, problems in distinguishing legitimate from sham countersuits when market conditions are conducive to predation. First, the conditions considered here increase the likelihood of predatory litigation but are not sufficient conditions for predation, so one cannot conclude that the underlying suits necessarily involve sham just because conditions are conducive to predation. Moreover, a sham countersuit could follow a sham suit.

Finally, it should be noted that litigation can be anticompetitive without being sham litigation, even under the economic definition of sham litigation discussed here. For instance, the state action doctrine can create situations where this will occur. This legal doctrine holds that state sanctioned litigation is exempt from antitrust scrutiny. Industries in which entry is regulated, for example, may be governed by laws that allow incumbent firms to protest entry of new competitors in court based on the economic harm they expect to suffer as a result. Thus, an anticompetitive suit could arise for the purpose of excluding entrants and maintaining the status quo price. Nevertheless, if the state clearly articulated its intent to displace competition through its regulatory process and if it actively supervises that process, then the plaintiffs are legally protected from

antitrust liability.[48] A countersuit claiming that this suit is sham would be dismissed under the state action doctrine, in spite of the suit's predatory characteristics.

A review of the case law in Chapter Three will be helpful in further illustrating the difference between the legal and economic views of sham litigation and in laying a groundwork for the empirical work.

V. Summary of the Economics

Litigation among competitors may be legitimate, strategic, or fraudulent. Legitimate litigation is instituted on the basis of expected direct benefits from nonfraudulent success on the merits. In contrast, strategic litigation seeks a collateral goal. The goal may be the capture of competitive rents, a favorable settlement, or an anticompetitive market effect. Fraudulent litigation is pursued because of benefits due to deception.

As defined here, sham litigation is strategic or fraudulent litigation in which the goal is anticompetitive. It may be undertaken to induce exit, to raise rivals' costs, or to prevent or deter entry or expansion by actual or potential competitors. It can serve the strategic goals of monopolization, of entry deterrence, or of disciplining rivals in a collusive group. In any case, sham litigation is initiated not in order to succeed on the merits, but to achieve a collateral or fraudulent anticompetitive goal. It causes a market price to be higher than it would otherwise be for some period of time. Predatory litigation is a special case of nonprice predation.

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[48] In defining a collateral goal X of litigation, recall that X is assumed to be independent of the outcome of the suit. Any anticompetitive effect of the suit that is contingent on the outcome of the litigation is part of the "legitimate" benefits B of the suit. Possibly the laws that allow such anticompetitive effects should be challenged on antitrust grounds where possible, but use of the law for this effect does not constitute sham litigation under the definition here.

In this context, economic reasoning predicts that sham litigation is more likely to occur when:

(1) The plaintiff is a dominant firm or conspiracy.
(2) The defendant is a recent or potential entrant or competitor.
(3) The effect of the plaintiff's action is to prevent or delay entry or expansion by the defendant or to cause exit.

The allegation of sham litigation not possessing these characteristics increases the likelihood that such a countersuit under the Sherman Act is itself a sham countersuit. As a result, if the courts are basing sham decisions on the potential for anticompetitive effect, these characteristics should be correlated with the outcome of such decisions.   -

CHAPTER THREE

THE CASE LAW AND ITS ECONOMIC INTERPRETATION

I. Introduction

The analysis of the case law on sham litigation begins with the Supreme Court's opinion in Noerr (1961). Here, the Court suggested that the First Amendment protects most attempts to influence government, even for anticompetitive ends.[48] It also discussed a possible "sham exception" to this protection for some acts, if the other elements of a Sherman Act monopolization case were present.

Since Otter Tail Power (1973), however, the Supreme Court has been largely silent on sham litigation.[49] This has left the field to the Circuit Courts. One of the more controversial of the lower courts' decisions has been Grip-Pak. Judge Posner wrote this opinion for the Seventh Circuit in 1982 and departed from the usual emphasis on the "baselessness" of the litigation or whether the litigation was "access barring" in determining antitrust liability. Based on an implicit cost-benefit analysis, he states that under certain conditions even colorable claims may carry Sherman Act liability, if the intent is not to win a favorable judgment but to gain a competitive advantage simply by the process of petitioning.

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[48] There is an argument among some legal scholars as to whether the Noerr doctrine gives constitutional protection to anticompetitive petitioning or merely narrows the Sherman Act to exclude this conduct or both.

[49] The Court's decision in Vendo (1977) was based primarily on the federal court's ability to enjoin actions in state court, rather than an interpretation of sham. A more recent decision in Allied Tube (1988) limited Noerr protection for private standard setting activities, even when the standards were routinely adopted by state and local governments, but again, the decision did not further interpret the sham standard.

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Although the lower courts' opinions of this analysis have not been consistent, some legal commentators claim that the Supreme Court's opinion in Bill Johnson's Restaurants, a labor law case, has invalidated the Grip-Pak method in favor of a standard of "frivolousness."[50] These same commentators use the Court's decision in another labor law case, Sure-Tan, to reinforce their view. It will be argued here that, in fact, Sure-Tan and Bill Johnson's Restaurants are not inconsistent with the use of the Grip-Pak implicit cost-benefit analysis.

This case law is discussed in Section II. Section III gives the case law an economic interpretation and applies cost-benefit analysis to the recent Supreme Court decisions in labor law. Section IV discusses some of the legal standards for defining sham litigation and their relationship to the economic definition of Chapter Two. Section V summarizes and concludes.

II. The Case Law

In Eastern Railroad Presidents Conference v. Noerr (1961) a group of truckers alleged that a group of railroads hired a public relations firm to run a publicity campaign designed to influence public opinion in support of legislation favoring railroads at the expense of truckers. The Supreme Court ruled that this activity could not be challenged under the Sherman Act, regardless of any resulting restraint of trade. The Court added, however, that "There may be situations in which a publicity campaign, ostensibly directed toward influencing governmental action, is a mere sham to cover what is actually nothing more than an attempt to interfere with the business relationships of a competitor and the application of the Sherman Act would be justified."

The Court's decision in United Mine Workers v. Pennington (1965) extended antitrust immunity to attempts to persuade officers of the executive branch of government. It was alleged that a conspiracy of UMW officials and large coal producers persuaded the state Secretary of Labor to set a minimum wage for employees of contractors selling coal to TVA. Even though this may have injured smaller coal

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[50] See Hurwitz (1985) and Handler and De Sevo (1984).

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producers,[51] the Court held that it did not violate the Sherman Act because it involved the act of a government official, "who is not claimed to be a coconspirator."

These two decisions established not only the immunity afforded attempts to influence legitimate executive and legislative acts, but two major exceptions to that immunity. This has become known as the Noerr-Pennington doctrine.[52] Sherman Act liability may still follow sham petitioning undertaken for competitive gain, and some conspiracies between citizens and government officials to achieve illegal ends. Only the first of these is considered here.

The first Supreme Court decision to address Sherman Act liability for actions taken in litigation was Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp. (1965). Food Machinery sued Walker for patent infringement, but, following pre-trial discovery, moved to dismiss its complaint because the patent had expired. Walker then claimed that Food Machinery had illegally monopolized commerce by enforcing a patent obtained by fraud on the Patent Office. Upon Food Machinery's motion to dismiss, the Supreme Court held that enforcing a patent obtained by fraud could violate the Sherman Act if the other elements of a Sherman Act monopolization case were present. Essentially, the knowing

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[51] See Williamson (1968) for a discussion of the economic incentives underlying this case. Also of interest is the more general case of union and employer conspiracy analyzed by Maloney, McCormick, and Tollison (1979).

[52] The case law on these points is still developing, and some controversy remains over the extent of the immunity granted by the Noerr-Pennington doctrine. Among legal commentators, controversy also remains about the immunity that should be granted. Thomas Arendt (1981) argues, for example, that state sanctioned restraints on trade should be held to violate the Sherman Act. Similarly, Natalie Abrams (1983) believes that attempts to influence legislative bodies for anticompetitive ends should be illegal.

assertion of baseless claims in court for the purpose of injuring a competitor was the basis of this opinion.[53]

In _California Motor Transport v. Trucking Unlimited_ (1972) the Court confirmed the illegality of pressing claims without regard to the merits in order to stifle competition. Bork describes the case in the following way:[54]

> Plaintiffs were fifteen trucking firms operating in California. Defendants were nineteen of the largest trucking firms in the state. The complaint alleged that defendants, discomfited by the increasing competition of smaller truckers, entered into a conspiracy to inhibit and deter that competition. They banded together to create a joint trust fund to be used in opposing all applications for operating rights for smaller trucking firms. Such opposition was to be pursued before all available courts, as well as before the California Utilities Commission and the Interstate Commerce Commission. Defendants, it was alleged, agreed to pursue their oppositions regardless of the merit of any application and regardless of the absence of any basis for opposition.
>
> To complete the intended terroristic effect of the scheme, defendants warned the smaller truckers that they had put their plan into operation and that smaller truckers could avoid the costs that would be inflicted upon them only by refraining from asking for new operating rights.

The Supreme Court held that the conspirators were not shielded from Sherman Act liability, because _Noerr_ had reserved the possibility of attaching liability to sham acts.

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[53] For a more detailed discussion, see Bork (1978), p. 352, and Balmer (1980), p. 54.

[54] Bork (1978), p. 353.

The Court also indicated that a sham could be found where claims were filed "with or without probable cause."[55]

In Otter Tail Power Co. v. United States (1973), it was alleged that an electric utility, in order to frustrate the issuance of bonds to finance construction, had undertaken lawsuits against some municipalities that desired to build their own generating facilities. The cities were customers of the utility at the time. The Court held that repetitive baseless suits against actual or potential competitors fall within the sham exception to Noerr, regardless of whether those competitors are barred from access to the agencies or the courts.

Subsequent lower court decisions,[56] recalling Walker Process, have generally found that repetitive sham acts are not required for a violation of the Sherman -Act. In the words of one judge, "I am not convinced that the Court intended to give every dog one free bite, thus making it an irrebuttable presumption that the first lawsuit was not a sham regardless of overwhelming evidence indicating otherwise."[57] Nevertheless, multiple claims are generally more likely to support a finding of sham activity than is a single claim.[58]

The trend in the case law toward a broader interpretation of sham activity has, thus far, culminated in Grip-Pak, Inc. v. Illinois Tool Works, Inc. (1982). Grip-Pak claimed that Illinois Tool delayed Grip-Pak's entry into the

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[55] This phrase was not given great weight in lower court decisions until 1982 in Grip-Pak.

[56] The one other Supreme Court decision involving sham litigation is Vendo v. Lectro-Vend (1977), but it centered on the propriety of enjoining an on-going state lawsuit and did not address the sham question directly.

[57] See Colorado Petroleum Marketers v. Southland Corp. (1979). Similar opinions were voiced in Associated Radio Service Co. v. Page Airways, Inc. (1976), and MCI v. AT&T (1982).

[58] See Fischel (1977), pp. 109-110.

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manufacture and sale of plastic holders for "six-packs" of canned beverages, in which Illinois Tool allegedly possessed a patent monopoly, by suing Grip-Pak for theft of trade secrets. The Seventh Circuit drew an analogy to abuse of process in finding that Sherman Act liability could attach to court claims which were successful on the merits.[59] As Judge Posner wrote:

> We think it is premature to hold that litigation, unless malicious in the tort sense, can never be actionable under the antitrust laws. The existence of a tort of abuse of process shows that it has long been thought that litigation could be used for an improper purpose, even when there is probable cause for the litigation; and if the improper purpose is to use litigation as a tool for suppressing competition in its antitrust sense...it becomes a matter for antitrust concern.

The unusual nature of this opinion, however, is in its implied use of cost-benefit analysis to illuminate the intent of the litigation brought by the alleged predator. For instance, Judge Posner states that:

> Many claims not wholly groundless would never be sued on for their own sake; the stakes, discounted by the probability of winning, would be too low to repay the investment in litigation.

And, after relating some examples, he continues:

> In these examples the plaintiff wants to hurt a competitor not by getting a judgment against him, which would be a proper objective, but just by maintenance of the suit, regardless of outcome.

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[59] Analogies to abuse of process have been drawn in Associated Radio Service (1976), and by Balmer (1980), p. 66. The tort of abuse of process consists of using a legitimate suit as a threat or club to obtain a collateral end not directly sought in the proceeding.

This leads to the conclusion that:

> The line is crossed when his (the predator's) purpose
> is not to win a favorable judgment against a
> competitor but to harass him, and deter others, by
> the process itself -- regardless of outcome -- of
> litigating.

Thus, Judge Posner seems to advocate a position which is
very similar to the economic approach to sham litigation: a
firm's bringing suit for which the benefits of a favorable
judgment are insufficient to repay the costs[60] can be illegal
under the antitrust laws if the effect is to suppress
competition.

Some commentators,[61] however, feel that Grip-Pak has
been undermined by the Supreme Court's subsequent decision
in Bill Johnson's Restaurants v. NLRB (1983). The Court's
opinion in Sure-Tan, Inc. v. NLRB (1984) is also cited to
support this view. The position taken in this report is that
Grip-Pak is basically consistent with these subsequent labor
law opinions, though neither case is fully probative of the
relevant issues. The demonstration of that position awaits an
economic interpretation of the case law. That is taken up
next.

III. An Economic Interpretation of the Case Law

The Walker Process and California Motor Transport cases
illustrate the two general types of sham litigation discussed
in the preceding chapter. Walker Process involves the
seeking of an otherwise legitimate court judgment through
the use of fraud; California Motor Transport exemplifies
the use of litigation to attain a collateral goal unassociated
with success on the merits in court. These two cases are

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[60] In the context of Chapter Two, "benefits ...
insufficient to repay the costs" means $B < L$, which is the
economic condition for strategic litigation.

[61] See Hurwitz (1985), and Handler and De Sevo (1984).

discussed below, followed by consideration of the cost-benefit analysis derived from Grip-Pak. Finally, the Grip-Pak analysis is illustrated by its application to two recent labor law cases decided by the Supreme Court.

The analysis of the Walker Process case is straightforward. Food Machinery sought to prevent or delay the entry of competitors by the procurement and enforcement of a fraudulently obtained patent. In its infringement suit against Walker Process, it sought a judgment that its patent was infringed and intended to win that judgment in court. The anticompetitive effect was a direct result of the fraudulently obtained patent decision, not a collateral reason for the action. This clearly violates the antitrust laws and would be included under the fraudulently anticompetitive portion of the sham definition here.

California Motor Transport illustrates the use of sham litigation to achieve an anticompetitive collateral goal, entry deterrence. The large truckers' threat to initiate legal proceedings against small truckers attempting to enter and their establishment of a trust fund to support the costs of those proceedings constitute an attempt to construct a credible threat to potential entrants. The actions of the large truckers were found to violate the Sherman Act.

California Motor Transport has one other important element. It was the first opinion to recognize, consistent with economic analysis, that litigation whose primary motivation was a collateral outcome could lead to an antitrust violation. This opened the door for consideration of whether the alleged predator undertook litigation in order honestly to win a favorable judgment or rather to achieve an anticompetitive collateral goal.

Nevertheless, it was not until Grip-Pak, ten years after the Court's decision in California Motor Transport, that issues concerning predatory strategy were explicitly addressed. In its opinion, the Seventh Circuit examined the alleged predator's economic decision to litigate. It recognized that not all litigation that can be won on the merits is necessarily brought; the plaintiff must expect to benefit sufficiently from a favorable outcome to offset the cost of bringing suit. If this is not the case, the suit would not be brought in the absence of a collateral goal. If this collateral goal is anticompetitive, then antitrust liability may

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attach to the litigation whether it is colorable or not. Because the collateral market benefits of suing are necessary to justify the predator's expense on litigation, one can think of sham litigation as litigation that would not be undertaken if the parties were not competitors.[62]

Despite the positions taken by several legal scholars, an application of the cost-benefit analysis implicit in Grip-Pak to the Supreme Court's recent decisions in labor law illustrates that the Court has, at least, not contradicted the Seventh Circuit's method. Indeed, the Court's decisions in the cases do not appear to be probative of the central issues in the Grip-Pak opinion. To see this, the Court's decisions in Bill Johnson's Restaurants and in Sure-Tan are analyzed below.

In Bill Johnson's, the Court ruled that- an on-going nonfrivolous state lawsuit by an employer (Bill Johnson's) seeking damages against an employee who attempted to organize a union cannot be enjoined as an unfair labor practice, even though the intent of the suit may be solely to prevent an employee from exercising a protected right. Some commentators see the employer's action as analogous to a firm's attempt to use litigation to achieve an anticompetitive result and/or to prevent a competitor from exercising its right of access to the government. Nevertheless, the court refused to enjoin the suit, at least in part because it was not shown to be frivolous. Hence, the commentators read

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[62] In the context of Chapter Two, Grip-Pak was not clear on whether sham suits are characterized by $(B < L)$ alone, or by $(X > L, B < L)$. If the first is correct, then cases where $(B + X > L)$ and $(X < L, B < L)$ could be considered as sham. The second requires that the collateral gain alone justify the litigation. In a recent clarification of the Grip Pak standard, Judge Easterbrook provided an example indicating that sham suits can include cases for which $B > 0$, $B < L$, and $B + X > L$. The collateral gain alone need not be larger than the cost of litigation. See Premier Elec. Const. Co. v. N.E.C.A., Inc.

this to require "frivolousness" or "baselessness" in order to show the analogous antitrust offense of sham.[63]

In Sure-Tan, the Court held that an employer's truthful and accurate informing of the Immigration and Naturalization Service (INS) that some of its employees were illegal aliens was an unfair labor practice when the sole reason for doing so was that the employees were union members. The Court also distinguished this case from Bill Johnson's by noting that the employer in Bill Johnson's could have suffered damage to his reputation. The employer in Sure-Tan, however, "had not suffered a comparable, legally protected injury...and had no judicially cognizable interest in procuring enforcement of the immigration laws by the INS." In this way, some commentators see the "frivolousness" of the Sure-Tan employer's act as crucial to its illegality and apply this, by analogy, to sham litigation.

Additional light can be shed on these decisions by analyzing them with the equations of Chapter Two. The employer's suit in Bill Johnson's may have been justified by the expectation of recovering damages, $B > L$; by contrast the employers in Sure-Tan had suffered no injury and had nothing to gain by their actions, $B = 0 < L$, except the suppression of the union, $X > 0$. Therefore, the economics of these Supreme Court decisions is consistent with a wide range of sham standards and does not contradict Grip-Pak.[64]

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[63] While this is similar to the "access-barring" language in some sham litigation case law, it is also possible to read this decision as an extension of the Supreme Court's general aversion to enjoining state court suits while still in progress. See Clipper Express (1982) in which the Ninth Circuit discusses Vendo (1977).

[64] This analysis is consistent with the Court's discussion of Bill Johnson's in Sure-Tan, but may not agree with the earlier decision taken alone. The Court assumed the intent of the employer was improper in Bill Johnson's and went on to hold that the suit could not be enjoined because it was not frivolous. In contrast, the Sure-Tan discussion seems to hold out the possibility of a mixed motive as the distinguishing characteristic of Bill Johnson's.

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The broader definition of sham in the _Grip-Pak_ decision raises questions concerning optimal enforcement policy. The effect of a broader definition of sham is not only to discourage sham activity but also to discourage the filing of legitimate suits. The increased chance of antitrust countersuits (and possible treble damage awards) can be expected to make some otherwise marginally beneficial legitimate suits uneconomic.[65] This means that further deterrence of sham litigators may come only at the expense of chilling legitimate suits.[66]

One other possible type of anticompetitive litigation has not been addressed by the courts. That is the case in which the plaintiff seeks to win a judgment on the merits in part because of benefits realized through the anticompetitive effects of such a judgment. For example, a firm might litigate to force the adoption of a specific pollution control technology by its industry, even though the direct internal benefits to the firm of adopting that technology are minimal. If, however, its competitors' costs would be raised more than the plaintiff's own costs by the technology, so that the plaintiff's profits would increase, this anticompetitive effect of success in litigation could make its litigation expenditures pay off.[67]

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[65] Let C represent the expected net cost (or loss) associated with a possible countersuit. Under _Grip-Pak_, a legitimate suit, $B > L$, with an expected collateral gain, $X > 0$, might risk a countersuit by the defendant. The potential plaintiff's calculus would require $(B+X) - (L+C) > 0$ in order to bring suit. Thus, marginal suits for which the legitimate net benefits plus the collateral gain are less than the cost associated with a countersuit, $0 < (B-L) + X < C$, would be deterred.

[66] An economic model that leads to this result is developed in Klein (1986).

[67] This is similar to the case of equation 3 in Chapter Two: $B < L$ and $X < L$, but $(B+X) > L$. However, the plaintiff in the present case must expect to win the suit in order to obtain the anticompetitive gain X.

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This case may not be covered under Grip-Pak, which addresses the bringing of colorable claims to achieve an anticompetitive collateral goal. It does not address suits that must be won on the merits in order to gain that anticompetitive end. In fact, one interpretation of Bill Johnson's is that suits which are brought for the purpose of winning on the merits, regardless of the sort of benefits to be gained, are presumptively legal. The recent Premier Electrical decision addresses this issue, but stops somewhat short of this interpretation. Judge Easterbrook noted that:

> If the [competitive] injury is caused by persuading the government, then the antitrust laws do not apply to the squelching (Parker v. Brown) or the persuasion (Noerr-Pennington). If the injury flows directly from the "petitioning" -- if the injury occurs no matter how the government responds to the request for aid -- then we have an antitrust case. When private parties help themselves to a reduction in competition, the antitrust laws apply.

This discussion appears to imply that if the petitioner is successful in persuading the government, then antitrust liability cannot attach to the petitioning or to the lawful action subsequently allowed by the government, unless the petitioning alone imposed significant enough costs on rivals to make the litigation viable. In terms of our notation in Chapter 2, the portion of X gained via petitioning (regardless of the outcome) must exceed L - B. In this case the anticompetitive costs imposed on rivals via petitioning will be sufficient to cause the competitor to petition.

With this in mind, the various suggestions for defining sham litigation in the recent legal literature are contrasted with the economic definition in the following section.

IV. Standards for Sham Litigation

Several legal commentators have recently suggested standards to apply in determining whether litigation is sham.

These range from a strict baselessness standard[68] through an abuse of process standard[69] to a three or four part "screening" approach.[70] All seem to agree that a plausible anticompetitive effect must be directly related to the litigation.[71] None propose rules as precisely grounded on market characteristics as the analysis in Chapter Two suggests.

The baselessness standard would require, in addition to the presence of an anticompetitive effect, that the plaintiff in the alleged sham action knowingly institute one or more "baseless", "meritless", or "frivolous" lawsuits. This standard easily contains the category of sham litigation involving fraud, but its sweep beyond that point is unclear.[72] One might imagine that it refers to lawsuits which the plaintiff has no expectation of winning, but from which it expects to derive net benefits because of anticompetitive effects (caused by delay, for instance). From an economic perspective, this is an unduly restrictive standard that would allow much anticompetitive litigation.

The abuse of process standard would impose the common law tort standard of the same name to sham litigation. The tort of abuse of process consists of using litigation fraudulently or without regard to outcome to gain a

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[68] Handler and De Sevo (1984) advocate this position based, in part, on their analysis of <u>Bill Johnson's Restaurants</u>.

[69] This is discussed by Balmer (1980).

[70] Hurwitz proposes successive "tests" which attempt to accommodate recent court decisions. Bien (1981) advocates a similar position.

[71] Easterbrook (1986) was one of the early commentators to emphasize the importance of an antitrust violation in analyzing sham cases. He tends to support a <u>Grip-Pak</u> test, however, which he likens to the abuse of process standard.

[72] Some commentators intend a fraud standard. See Handler and De Sevo (1984).

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collateral end. Under this standard, sham litigation is defined as litigation that would not be pursued for the expected benefits of a favorable judgment, but is pursued because of a collateral (and anticompetitive) goal independent of the outcome of the litigation itself (that is, B < L, X > L).[73]

Nevertheless, two types of potentially undesirable behavior could escape this standard. One technicality arises because the common law tort of abuse of process requires that an act independent of the litigation be used to achieve the improper end. Thus, a strict interpretation of this standard would eliminate from the purview of the antitrust laws those cases of predatory litigation in which the predator limited its acts to the court system.[74] This flaw could be easily corrected. Secondly, the standard would not discourage cases where the anticompetitive benefits that would accrue to the plaintiff as a collateral goal of the litigation are necessary but not sufficient to justify the case (that is, where B < L, B + X > L, but X < L).

Other commentators advocate what amounts to a series of "screens" through which a case would have to pass to qualify as sham. The first test requires that an antitrust violation could have occurred. For example, conditions necessary for market power must be satisfied. The second test requires that the action not be "petitioning". This test is intended to eliminate those cases in which, for example, a regulated firm or group of firms issues a tariff for which it claims Noerr protection.[75] The third test requires that the

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[73] This approach is advocated by Balmer (1980) and, to some extent, by Easterbrook (1986). Hurwitz (1985) proposes an exception to the baselessness standard that would encompass litigating without regard to outcome by defining it as "not petitioning."

[74] See the discussion in Handler and De Sevo (1984), p. 53.

[75] This was the situation alleged in Litton Systems v. AT&T Co.. AT&T filed a tariff which Litton claimed was anticompetitive. AT&T claimed Noerr protection, even though

litigation not have a legitimate intent defense.[76] This screen requires that sham litigation be brought without regard to the merits, involve unethical conduct (fraud), be part of a larger anticompetitive scheme, or satisfy either the Grip-Pak or "baselessness" standard (depending on which standard one believes is correct).[77]

The net effect of this screening process is very similar to a corrected abuse of process standard, except that an additional test is applied to those cases which might not be caught by the abuse of process standard. Nevertheless, it is possible that there are few cases that would fall outside the abuse of process standard and would be caught in a Grip-Pak or a baselessness screen. If so, the successive screening approach may differ very little from the abuse of process approach in practice.

This discussion suggests that court decisions, to the extent the commentators have based these standards on them, may have reached conclusions very similar to those suggested by economic analysis. That is one subject of the empirical study reported in the following chapter.

V. Conclusion

In summary, the economic and legal approaches to sham litigation agree on the broad outlines of defining an antitrust violation. Indeed, both approaches dismiss suits with the following characteristics from antitrust liability:[78]

1) The suit lacks an anticompetitive effect.

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no government body, including the FCC, ever approved the tariff.

[76] Hurwitz (1985), from whom much of this is borrowed, also suggests a political activity screen.

[77] Hurwitz (1985) prefers baselessness, although he allows the Grip-Pak standard to apply if the courts adopt it explicitly. Bien (1981) has similar standards, but stops after the first three.

[78] In addition, suits sanctioned by state restrictions on competition are protected by state action immunity.

2) The expected gains from successful litigation on the
    merits exceed the costs of litigation, so that any
    collateral anticompetitive benefit is irrelevant to the
    decision to bring the suit (B > L).

Similarly, both generally agree that suits brought to achieve
an anticompetitive collateral goal (B < L, X > 0) carry
antitrust liability, if they embody at least one of the
following characteristics:

1) They involve fraud.
2) They involve claims that are "baseless," "frivolous,"
    or otherwise not colorable (B = 0, X > L).

In this context, the major disagreements arise over cases in
which the plaintiffs have some chance of winning, but any of
the following conditions hold:

1) Both collateral benefits from bringing the suit
    (regardless of outcome), X, and direct benefits from
    winning, B, are required to justify bringing suit (B
    + X > L, B < L, X < L).
2) The collateral gains alone could prompt the suit,
    while the benefits on the merits are positive but less
    than litigation costs (X > L, 0 < B < L).

In these two cases where disagreement arises, there is
potential for anticompetitive effects from sham litigation.
However a case-by-case analysis of sham litigation could chill
some legitimate litigation. While there has been some
disagreement in the case law, the traditional conservative
legal approach to sham litigation has been to exempt
presumptively these two cases from antitrust challenge. This
approach insures as much as possible that all persons can
"have their day in court" without fear of reprisal.
Unfortunately, the approach also tends to maximize the
chances that anticompetitive suits will be allowed. A full
benefit-cost analysis of sham litigation would require that we
consider any external benefits from "free speech" that result
from allowing virtually all litigation.

Regardless of how one weighs the costs and benefits of
"free speech", the review of the case law and of sham
standards suggests that the courts may have adopted
attitudes toward sham litigation that are reconcilable with
economic analysis in many cases. Although rarely advocating
the use of economic methods, the courts' decisions may have
produced outcomes very similar to those that would have

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been realized by explicitly applying economic analysis. Indeed, _Grip-Pak_ comes very close to synthesizing the legal and economic approaches into one. Thus, the stage is set to examine the economic characteristics of sham litigation cases.

CHAPTER FOUR

ECONOMIC CHARACTERISTICS OF SHAM CASES

I. Introduction

This chapter investigates whether some of the economic characteristics that are conducive to predation are important to the courts' decisions on Sherman Act countersuits alleging sham litigation as an antitrust violation. After such countersuits were located, information collected from the published court decisions concerning both the alleged sham action and the countersuit was analyzed statistically.[79] The

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[79] Apart from Stigler's (1966) study of antitrust enforcement, serious statistical analysis of the courts began around 1970. This has been a fertile field for study to which Posner (1970), Long, Schramm and Tollison (1973), Hay and Kelley (1974), and Siegfried (1975) have all contributed. A study of price predation cases by Koller (1970) attempted an analysis similar to that performed here, but found too few cases had reached final judgment to allow statistical tests. Koller therefore confined his analysis to case studies.

Statistical analysis of other court related subjects developed during the 1970s. In 1971, Landes investigated the economic determinants of trying criminal cases. Landes and Posner (1976) examined the creation of precedent. Recent work has addressed the trial and settlement of torts. See Priest and Klein (1984) and the exchange between Wittman (1985) and Priest (1985); also see Jarrell (1985).

Posner is indirectly responsible for a good deal of this literature. Hrezo and Hrezo (1984), for instance, examine the courts' use of Posnerian "wealth maximization" criteria in the form of references to cost-benefit analysis. This is similar to the present study of sham litigation, because the economic theory is based on cost-benefit analysis. Hrezo and Hrezo, however, examine statements in the court decisions which mention these topics, rather than the resulting decisions or the economic characteristics of the cases. In contrast, the view taken here is that while the courts may

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mechanics of the data collection are discussed in section II, and descriptive statistics for the cases are presented in section III. The statistical analysis is taken up in section IV. Section V provides a short summary.

Section IV discusses a statistical test for the hypothesis that the presence of economic characteristics associated with predation is unrelated to the outcome of a motion to dismiss a countersuit. This hypothesis is rejected using two of six alternative sets of predation criteria. Although a large proportion of the countersuits with characteristics conducive to predation survive motions to dismiss, a relatively large proportion of countersuits without these characteristics also survive. This suggests that the courts may allow many countersuits to proceed to trial even though the alleged sham actions, in fact, have no anticompetitive implications. This could be a policy problem.

II. The Data Collection Process

Countersuits alleging sham litigation were identified by performing a LEXIS search for citations of California Motor Transport in all federal court opinions. California Motor Transport is the most recent Supreme Court decision to deal specifically with sham litigation and, therefore, is a likely reference for subsequent court decisions involving alleged sham acts. Its 1972 date provides a convenient time period for the analysis. The search produced a list of 402 citations in decisions issued prior to January 1, 1986.[80] It is important to note that few, if any, of the cases seemed to

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make "wealth maximizing" decisions for the "wrong" reasons, that should not cloud our assessment of the courts' effectiveness.

For an interesting examination of Posner's writings from the bench, see Samuels and Mercuro (1984) and Posner's (1984) reply.

[80] Similar searches for citations to Noerr (1961) and Walker (1965) produced 484 cites and 352 cites, respectively, even though these decisions are much older than California Motor Transport (1972).

be of the fraudulent anticompetitive type, as we have defined it here. That is, virtually all of the cases would fall into the predatory class of our sham definition, if they are valid sham cases under this definition.[81]

The next step was to examine the court decisions in order to identify those cases which alleged sham violations of the Sherman Act in adjudicatory settings. Only those cases with decisions reported in the Supreme Court, F. 2d. or F. Supp. series, or in CCH Trade Cases were examined.[82] Determining which cases involved Sherman Act countersuits alleging sham acts was straightforward; determining which cases alleged sham acts in adjudicative proceedings was a more complex process.

Outside the court system itself, regulatory bodies of various kinds conduct quasi-adjudicative as well as quasi-legislative proceedings. The alleged sham acts before agencies acting quasi-legislatively were distinguished from those before agencies acting quasi-adjudicatively using the following standard: An adjudicatory proceeding involves the determination of a single case, whereas a legislative act involves the determination of general principles or rules. This method of separation was suggested by the case law.[83]

Examination of the published records yielded 117 countersuits meeting these requirements, once duplications and multiple decisions involving the same suit were

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[81] In legal terms, there appear to be few, if any, pure Walker Process type cases in the sample.

[82] Decisions withheld by the court from publication were unavailable for analysis. Of the 402 cites, only 30 involved cases with no decision ever published in any one of these sources. When a citation was located in an unpublished decision, the sources were searched for other decisions on the same matter that were published. When this failed to locate any information on a case, it was dropped from the sample.

[83] See Wheeling-Pittsburgh Steel Corp. v. Allied Tube and Conduit Corp.

reconciled.[84] Every published decision involving each of these 117 cases was examined and economic information about the alleged sham suit, the countersuit, and the court outcome was collected. This information was then coded as a set of dichotomous (i.e., zero-one or dummy) variables. It is important to note that the economic characteristics that were coded in this fashion are those alleged in the complaint; they should not be taken as proven or, necessarily, economically relevant outside of the adjudicative context. The characteristics presented below are those relevant to the courts' decisions on motions to dismiss. Any further implications for actual markets or competitive relationships in general cannot be construed from these data.

III.   The Characteristics of the Sample

Table 4-1 shows the percentage of the alleged sham acts possessing various characteristics. The characteristics are divided into six groups. The first characteristic is the outcome of the motion to dismiss the Sherman Act allegation of sham in the countersuit. In this sample, 37.6 percent of the cases were dismissed; conversely, 62.4 percent of the cases proceeded to the presentation of evidence in support of the allegations of sham behavior, or to a complete trial.[85]

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[84] This number conflicts with the statistic on sham acts involving litigation reported by Handler and De Sevo (1984), who used citations of Noerr (1961) as of mid-1984 in compiling their list of cases. Furthermore, they classified their cases into legislative, regulatory, and litigative groups based only on the forum in which the alleged sham acts occurred. The present study, in contrast, aims at examining all adjudicative proceedings regardless of forum, and the criteria for selecting cases reflect this goal.

[85] Motions to dismiss are usually the first point for a decision in the trial process and are based solely on the allegations, perhaps supported by affidavits, and the defendant's response. The allegations must state facts that are sufficient to constitute a violation of the law and that can reasonably be expected to be proved or disproved at trial

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TABLE 4-1

Economic Characteristics of Sham Cases

Characteristic (Number of Cases)*	Percent of Cases**
Countersuit dismissed (117 Cases)	37.6
Product Group (116 Cases)	
Electric Utility	6.9
Health Services	5.2
Telecommunications	6.9
Banking	2.6
Construction	6.0
Manufacturing	26.1
Services	11.2
Other	39.6
Geographic Area (116 Cases)	
City	12.9
Part of a state	21.5
State	13.8
Region	1.7
U.S.	45.7
International	6.0
Relationship of Target to Predator (117 Cases)	
Competitor/Competitor	32.5
Entrant/Competitor	20.5
Competitor/Conspirators	21.3
Entrant/Conspirators	10.3
Entrant/Entrant	1.7
Competitor/Entrant	2.5
Supplier/Customer	7.7
Customer/Supplier	23.1
Target sells complement	5.1
Predator sells complement	18.0
Unrelated	7.7

TABLE 4-1 Continued

Characteristic (Number of Cases)*	Percent of Cases**
Sham Forum	
(116 Cases)	
Federal Courts	43.1
State or Local Courts	34.5
Other State Government	17.2
Other Local Government	11.2
F.C.C.	9.5
I.C.C.	5.2
Other Federal Government	13.8
Sham Issues	
(116 Cases)	
Patents	6.9
Trademarks	6.9
Copyrights	4.3
Trade Secrets	8.6
Environmental Regulation	1.7
Price Regulation	12.9
Entry Restrictions	31.0
Employment Contracts	5.2
Other Contracts	8.6
Interconnection***	10.3
Antitrust	7.7
Other	24.1
Alleged Effect of Sham Acts	
(115 Cases)	
Prevented entry/growth	25.2
Delayed entry/growth	16.5
Target exited	7.0
Target lost sales	12.2
Raised business costs	12.2
Imposed litigation costs	63.5
Target enjoined	14.7

TABLE 4-1 Continued

NOTES   * The number of cases is determined by the number of observations without missing values in the relevant dimension.

**   The percentages in each category may not sum to 100 because of rounding and because a case could be assigned more than one category.

*** Includes wheeling and other vertical issues in regulated industries. Wheeling is the term used in the electric utility industry to indicate the sale of electricity from seller to buyer using the transmission lines of a third party.

The second group of characteristics concerns the alleged markets. The most common product group was manufacturing, 26.1 percent, followed by professional services (excluding health) at 11.2 percent. The traditionally regulated industries, electric utilities and telephones, comprised almost 14 percent of the sample. Nevertheless, the "other" category, which includes transportation, real estate, and retailing, as well as the ambiguous cases, accounts for nearly 40 percent of the countersuits. Most of the alleged geographic markets were national. The "part of a state" category, comprising areas larger than a city but smaller than a state, is a significant second, followed by the state and city categories. Clearly, the incidence of countersuits alleging sham acts is well dispersed across product groups and geographic markets.

The next group of characteristics reveals the market relationship of the alleged targets of sham acts to the alleged predators. Over 50 percent of the cases involve a competitor of, or an entrant competing against, the alleged predator. Nearly a third of the cases allege predatory conspiracies.[86] The theoretical curiosities of entrant-on-entrant predation and predatory entry were rarely alleged, totalling less than 5 percent of the sample. Nearly a third of the sample, however, involved firms with vertical relationships. In fact, almost a quarter of the countersuits

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in order for the suit to survive a motion to dismiss. Having survived this phase, the suit is still vulnerable to motions for summary judgment, which generally follow the presentation of at least part of the evidence.

[86] Conspiracies may or may not include competing firms. When a case involved a conspiracy of competitors it was assigned both a "competitor" and a "conspirator" characteristic. Thus, a single case may possess one of the first pair of characteristics as well as one of the second pair in this group.

alleged predation by a supplier against a customer.[87]   A similar proportion of cases involved complementary products.[88]   Firms that had no competitive or market relationship were involved in a relatively large proportion of the sample -- almost 8 percent.[89]

The most popular forum for the alleged shams in the sample was the federal court system, followed closely by state and local court systems. Over 75 percent of the cases involved courts at some point, not a surprising result given the legal approach to defining sham litigation. The case law notwithstanding, over 20 percent of the countersuits alleged sham acts outside of the court system.[90]

The distribution of countersuits across the issues involved in the alleged sham acts is relatively unconcentrated, with the notable exception that over 30

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[87] Often, one of the firms was a potential entrant or was attempting entry which could foreclose a market to the predator (i.e., municipalities building their own electricity generating plants). One case, Associated Radio v. Page Airways, involved a customer's attempt to acquire a highly profitable specialized supplier through litigation aimed at forcing the supplier to liquidate.

[88] These often arose in interconnection disputes involving regulated telephone companies.

[89] This suggests that sham countersuits may occur, probably involving rents of some kind.

[90] The cases were coded so that the court systems were independent -- that is, if a case was ever in the federal courts it was coded only as a federal court forum. A court case entirely outside the federal system was coded as state or local. Cases could possess more than one of the remaining forum characteristics in addition to any court characteristics.

percent of the cases involved licenses, certificates, authorizations, or other types of entry restrictions.[91]

Nevertheless, it is also instructive to note that many of the remaining issues concern disputes over property rights-- trademarks, copyrights, patents, trade secrets, etc. This suggests that rent-seeking may be a powerful incentive to undertake litigation, apart from any anticompetitive effects.

The final group of characteristics comprises the alleged effects of the alleged sham acts. Over 40 percent of the countersuits alleged the prevention or delay of entry or expansion by rivals, while only 7 percent alleged that the target was forced to exit. This suggests that classical predation, in which the predator forces its smaller competitors to exit, may be fairly rare and that predatory litigation appears to be more often used to deter entry. The alleged predators allegedly raised the targets' cost of doing business in about 12 percent of the cases[92] and imposed significant litigation costs on the targets in over 63 percent of the cases.[93] An injunction against the target was granted in over 14 percent of the cases. These figures suggest that sham acts may involve substantial costs, not only in

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[91] Cases were frequently assigned multiple characteristics in the issues group. Thus, the various categories are not mutually exclusive. This means that summing the proportions across groups is misleading and that the percentages reported do not sum to 100.

[92] That is, the sort of costs contemplated in Salop and Scheffman's (1983) theory of raising rivals' costs, as opposed to fixed costs or costs of litigation.

[93] This is the scenario posited by Klein (1986). In some cases, the predator may be unsuccessful at imposing significant costs due to the weakness of its legal argument or standing. This is common in regulatory hearings in which competitors are allowed to protest, but the target is not obligated to offer a defense unless the regulatory body agrees with the protestors. Over 36 percent of the alleged shams appear to have imposed insignificant additional litigation costs on the target in similar ways.

"unnecessary" litigation, but in market misallocations and price distortions as well.

IV. The Statistical Analysis

In this section we attempt to determine whether the courts' decisions on motions to dismiss in Sherman Act countersuits have been consistent with the predictions of economic theory. In order to survive a motion to dismiss, a countersuit must only allege the bare minimum of facts necessary to define a violation of the law. We wish to construct an economic standard, comparable to this legal standard, that embodies the bare minimum of characteristics likely to indicate a possible anticompetitive result. The analysis of Chapter Two provides the following alternatives. The classic predation model suggests that predatory behavior is more plausible if the alleged predator is a dominant firm and the target is a competitor that is forced to exit. The entry deterrence model suggests that the predator must be a dominant firm or group of firms, and the target must be an entrant or potential entrant whose entry is prevented. What we will call a competitive rent-seeking model suggests only that the predator and target compete or potentially compete, and that the litigation hampers the target's ability to compete in a manner beneficial to the predator.[94]

The characteristics suggested by these economic models are embodied in the dummy variables representing predatory criteria defined in Table 4-2. ACRIT, BCRIT, and CCRIT represent variations on the criteria of the classic predation model. DCRIT, representing the criteria of the competitive rent-seeking model, defines a broader set of criteria within which all the cases identified by the other criteria are contained. Thus, we would expect predatory cases to be covered by the DCRIT criteria along with many nonpredatory cases. ECRIT and FCRIT represent the entry deterrence criteria. All the variables embody three main

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[94] A general rent-seeking model would require only that the predator earn sufficient rents from its actions to offset the costs, regardless of the existence of a market relationship between the firms.

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TABLE 4-2

Definition of Predatory Criteria

Classic Predation Model

1. ACRIT = 1 if:
   The predator is a dominant firm or a conspiracy.
   The target is an entrant or a competitor.
   Entry/growth was prevented or delayed, or exit occurred.

2. BCRIT = 1 if:
   The predator is a dominant firm.
   The target is unrestricted.
   Entry/growth was prevented or delayed, or exit occurred.

3. CCRIT = 1 if:
   The predator is a conspiracy.
   The target is an entrant or a competitor.
   Entry/growth was prevented or delayed, or exit occurred.

Competitive Rent-seeking Model

4. DCRIT = 1 if:
   The predator is a competitor or a conspiracy.
   The target is an entrant or a competitor.
   Entry/growth was prevented or delayed, or exit occurred.

Entry Deterrence Model

5. ECRIT = 1 if:
   The predator is a dominant firm or a conspiracy.
   The target is an entrant.
   Entry/growth was prevented or delayed, or exit occurred.

6. FCRIT = 1 if:
   The predator is a competitor or a conspiracy.
   The target is an entrant.
   Entry/growth was prevented or delayed, or exit occurred.

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characteristics: the market position of the alleged predator, the market position of the target, and the effect of the alleged sham action.[95]

We now wish to test for the existence of a statistical relationship between the presence of these predatory characteristics and the success of the countersuits in passing a motion to dismiss. This is done by constructing contingency tables as shown in Table 4-3. The columns of these tables contain the number of countersuits with and without predatory characteristics, and the rows contain the number dismissed and not dismissed. Each cell in the table shows the number of countersuits falling in the intersection of the corresponding predatory and court outcome characteristics. The cell in the first row and first column, for example, shows the number of countersuits lacking predatory characteristics that were dismissed.

If the courts considered the economic criteria discussed here, then we would expect to find that countersuits alleging predatory characteristics would be dismissed less often than countersuits that fail to allege predatory characteristics. In the extreme, if the courts used a particular set of criteria exclusively, we would find that all oberservations fall into the upper left and lower right-hand quadrants of the contingency tables. Alternatively, if the courts do not consider these criteria at all, an equal proportion of the predatory and nonpredatory cases would be found in the top two quadrants. We will examine this second hypothesis

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[95] Since all the economic models require the sham act to have an economic effect, this criterion appears in all the variable definitions. Thus, the different models are distinguished by the market positions of the predator and target that they posit. Naturally, there is an element of subjectivity in the classification of firms. In particular, firms were classified as "dominant" if the complaint alleged that the firm was much larger than the competitor, the firm was a monopolist in the alleged market, or the firm had a large market share (in excess of 40 percent). The firm was classified as part of a conspiracy if there was any allegation that the firm behaved as part of a group or was supported by a group.

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TABLE 4-3

Contingency Tables

CLASSIC PREDATION MODEL

1. Criteria: ACRIT

	Nonpredatory	Predatory	N = 117
Dismissed	30	14	
Not Dismissed	40	33	

Chi-square^{+} value: 2.05

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2. Criteria: BCRIT

	Nonpredatory	Predatory	N = 80***
Dismissed	26	3	
Not Dismissed	35	16	

Chi-square value: 4.51*

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3. Criteria: CCRIT

	Nonpredatory	Predatory	N = 88***
Dismissed	28	6	
Not Dismissed	40	14	

Chi-square value: 0.81

COMPETITIVE RENT-SEEKING MODEL

4. Criteria: DCRIT

	Nonpredatory	Predatory	N = 117
Dismissed	33	11	
Not Dismissed	36	37	

Chi-square value: 7.48**

TABLE 4-3 -- Continued

ENTRY DETERRENCE MODEL

5. Criteria: ECRIT

	Nonpredatory	Predatory	N = 117
Dismissed	37	7	
Not Dismissed	56	17	

Chi-square value: 0.91

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6. Criteria: FCRIT

	Nonpredatory	Predatory	- N = 117
Dismissed	37	7	
Not Dismissed	53	20	

Chi-square value: 2.04

NOTES   +   Because there is only 1 degree of freedom in these contingency tables, a Yates correction for continuity may give a better approximation of the chi-square statistic (see Walpole (1968)). The test based on the Yates statistic is reported for results that are significant under the traditional test. Insignificant results remain insignificant with the Yates statistic.

*   Significant at the 0.05 level (or at the .10 level for the Yates-adjusted chi-square test).

**   Significant at the 0.01 level (or at the .025 level for the Yates-adjusted chi-square test).

***   The total number of cases N in each contingency table may vary because of missing values in the underlying characteristics of the criteria.

statistically by presenting a Chi-square test of the null hypothesis that the dismissal decision is independent of the predatory criteria, that is, that the proportion of countersuits dismissed is equal for cases with and without the predation characteristics.[96] [97]

It is important to note that the data used in this study relate only to litigated countersuits. This sample may be substantially different from the set of all countersuits that would exist if the courts did not dismiss any such suits. For instance, the countersuits observed may disproportionately be those for which an outcome is difficult to predict in advance, even based on the economic criteria considered here, because strong countersuits may be more likely to settle prior to trial, and weak potential countersuits may be less likely ever to be filed. This will tend to reduce the chances that a statistical test based on our sample would result in rejection of the null hypothesis. The finding of a statistically significant association in the face of this possible bias must be interpreted as a strong result.[98]

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[96] The test statistic is based on the difference between the frequency of cases in each cell and the frequency which would be predicted assuming there were no relationship between the predatory characteristics and the dismissal record of the countersuits. The test is suggested by Kmenta (1974) and explained in detail in Freund (1971), pp. 334-337.

[97] An alternative statistical methodology using regression analysis to explain the probability that a countersuit will be dismissed based on the characteristics alleged in the suit is included as Appendix II. The results of that analysis are consistent with those found using the contingency tables.

[98] Bebchuk (1984), Nalebuff (1986), Klein and Priest (1984), Fudenberg and Maskin (1986), and Milgrom and Roberts (1982) suggest that the set of litigated cases is much weaker than a set including both litigated and settled disputes. Some of this research implies no relationship between the economic characteristics of cases and the

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The value of the test statistic associated with each contingency table is shown immediately below the table. The null hypothesis of no relationship is rejected at the 10 percent level or better only for BCRIT and DCRIT,[99] which are significant at the 5 and 1 percent levels respectively. This is consistent with the courts considering the economic characteristics suggested by the predation models in deciding motions to dismiss countersuits alleging sham actions. While the courts are sensitive to some elements of the classic predation model (BCRIT), they appear to be more sensitive to the more general characteristics suggested by the competitive rent-seeking model (DCRIT).[100]

At first glance, this may seem to be an odd result. After all, competitive rent-seeking that lacks any anticompetitive effect is not a violation of the Sherman Act. Nevertheless, it is difficult to imagine a litigation violating the Sherman Act in a situation not covered by the competitive rent-seeking criteria. In this way, the competitive rent-seeking criteria may form a close economic parallel to the minimal "basis in law and fact" required of allegations passing motions to dismiss by the courts. Furthermore, these criteria may capture cases of litigation used to enforce (tacit) collusive pricing and attempts to discipline competitors that the criteria of the other models could overlook.

Nevertheless, a closer examination of the contingency tables reveals that the economic characteristics are very imperfect predictors of the countersuits that survive motions to dismiss. Under every set of criteria, cases which had the

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probability that they go to trial.

[99] Note, however, that ACRIT and FCRIT are significant at about the 12 percent level. The size of the sample differs across the tables due to the frequency of missing values in the underlying variables.

[100] In addition, at least one cell of the contingency table for BCRIT contains less than five observations. This makes the statistical test unreliable and the result using this criterion somewhat suspect.

examined predatory characteristics were more likely to go to trial than cases without such characteristics, but cases lacking these predatory characteristics were nevertheless more likely to reach trial than not.[101] This suggests that while these economic characteristics do matter to the courts, they may not matter very much.

This result is disturbing from a policy perspective, as it is the balancing of the costs of false negatives (dismissed predatory cases) and false positives (nonpredatory cases that are not dismissed) that is important in maximizing welfare with regard to predation cases.[102] False positives encourage sham countersuits while discouraging some legitimate underlying suits with the threat of countersuits. This suggests a role for public policy which is taken up in Chapter Five.

What characteristics do predatory cases possess? Table 4-4 shows descriptive statistics for the set of cases satisfying the DCRIT criteria. A comparison of Table 4-4 and Table 4-1 is especially instructive. This reveals that cases satisfying the DCRIT criteria are more likely than the other criteria to involve 1) firms with complementary as well as horizontal relationships, and 2) firms subject to direct regulation of prices, entry, or interconnection (i.e., regulation of vertical relationships).

The significant proportion of regulated vertical and complementary relationships is something of a surprise and suggests an area for future research. Certainly, some of these cases involve attempts at entry through vertical integration or from adjacent geographic or product markets (interconnection and wheeling of electric power). Otherwise, since most firms are not regulated in this sense, these results suggest that claims of sham acts are more likely to involve firms in regulated markets for which the costs of

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[101] The nonpredatory cases involved firms with lesser competitive relationships and/or in which entry or growth was not alleged to be affected.

[102] See Joskow and Klevorick (1979). Although they deal with price predation cases, the analysis is appropriate for nonprice predation cases as well.

Table 4-4

Economic Characteristics of Countersuits

Competitive Rent-Seeking Model (DCRIT = 1)

Characteristic (Number of Cases)*	Percent of Cases**
Countersuit Dismissed (48 Cases)	22.9
Product Group (48 Cases)	
Electric Utility	8.3
Health Service	12.5
Telecommunications	14.6
Banking	4.2
Construction	6.2
Manufacturing	12.5
Services	12.5
Other	33.3
Geographic Area (48 Cases)	
City	18.7
Part of a State	20.8
State	20.8
Region	4.2
U.S.	35.4
International	2.1
Relationship of Target to Predator (48 Cases)	
Competitor/Competitor	25.0
Entrant/Competitor	37.5
Competitor/Conspiracy	20.8
Entrant/Conspiracy	20.8
Entrant/Entrant	0.0
Competitor/Entrant	0.0
Supplier/Customer	8.3
Customer/Supplier	18.7
Target sells complement	8.3
Predator sells complement	31.2
Unrelated	0.0

Table continued on next page.

Table 4-4 -- Continued.

Characteristic (Number of Cases)*	Percent of Cases**
Sham Forum	
(47 Cases)	
Federal Courts	25.5
State or Local Courts	42.5
Other State Government	31.9
Other Local Government	17.0
F.C.C.	17.0
I.C.C.	10.6
Other Federal Government	10.6
Sham Issue	
(48 Cases)	
Patents	2.1
Trademarks	0.0
Copyrights	0.0
Trade Secrets	6.2
Environmental Regulation	0.0
Price Regulation	16.7
Entry Restrictions	52.1
Employment Contracts	2.1
Other Contracts	4.2
Interconnection***	20.8
Antitrust	4.2
Other	22.9
Alleged Effect of Sham Acts	
(48 Cases)	
Prevented entry/growth	56.2
Delayed entry/growth	39.5
Target exited	14.6
Target lost sales	10.4
Raised business costs	16.7
Imposed litigation costs	75.0
Target enjoined	10.4

Table 4-4 -- Continued.

NOTES   *   The number of cases is determined by the number of observations without missing values in the relevant dimension.

**   The percentages in each category may not sum to 100 because of rounding and because a case could be assigned more than one category.

***   Includes wheeling and other vertical issues in regulated industries. Wheeling is the term used in the electric utility industry to indicate the sale of electricity from seller to buyer using the transmission lines of a third party.

adjudicatory regulatory proceedings may be lower, at least on the margin, than the costs of litigation in the courts.

There appear to be no strong time trends in either the number of countersuits going to trial or the proportion defined as predatory by the various criteria considered here. This is illustrated in Table 4-5 and is confirmed in the regression analysis in Appendix II. Despite the claims of various legal commentators,[103] there is little support from the number of litigated cases for the view that the number of countersuits is increasing dramatically. In about 1977 there may have been a once and for all rise in the annual number of litigated countersuits from less than 4 to 10-12.[104] Since then, however, the annual number of countersuits has fluctuated within the latter range with only two exceptions and with no significant trend.

V. Conclusion

Starting with 402 citations to California Motor Transport (1972) in federal court decisions, 117 claims of sham litigation violations of the Sherman Act were located. All published decisions involving these 117 countersuits were read and data on over 50 economic characteristics were assembled for each countersuit. These data revealed a wide dispersion of alleged market definitions and forums. Most of the parties to the litigation were competitively related, although many vertical and complementary relationships were observed. The most common issues in the alleged sham proceedings were price and entry regulation, while the imposition of litigation costs was the most frequently claimed effect.

The predation, entry deterrence, and competitive rent-seeking models of Chapter Two suggested six sets of criteria for defining anticompetitive litigation. Two of these, one set of "classical predation" criteria and the set of competitive

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[103] See Hurwitz (1985) and Handler and DeSevo (1984).

[104] No definitive explanation is offered for this increase. Possibly it reflects the reaction to the California Motor Transport case (1972) and the Otter Tail Power decision (1973).

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Table 4-5

Countersuits Not Dismissed and
Countersuits With Predatory Characteristics, 1976 - 1985*

Year	Number	Percent Not Dismissed	Percent with Predatory Characteristics[1]			
			ACRIT=1	BCRIT=1[2]	DCRIT=1	FCRIT=1
1976	4	50.0	0.0	25.0	0.0	0.0
1977	10	50.0	0.0	37.5	30.0	30.0
1978	9	77.7	55.5	20.0	55.5	11.1
1979	10	70.0	30.0	12.5	30.0	30.0
1980	12	33.3	58.3	80.0	58.3	33.3
1981	12	75.0	25.0	9.0	41.7	16.7
1982	12	83.3	50.0	33.3	50.0	41.7
1983	11	63.6	9.0	10.0	18.2	9.0
1984	16	68.7	43.7	35.7	43.7	12.5
1985	11	36.4	54.5	33.3	45.4	36.4

NOTES   *   Only 9 countersuits occurred during the sample period prior to 1976.

[1]   These percentages do not distinguish between cases that were or were not dismissed.

[2]   These percentages are generally based on fewer than the total number of cases for the year because of missing data in the criteria for BCRIT.

rent-seeking criteria, were found to have a significant statistical relationship to the court outcomes on motions to dismiss the countersuits. Countersuits satisfying these criteria were significantly more likely to pass a motion to dismiss and to continue to trial than were other countersuits. This is a relatively strong result given the possible bias toward insignificance. It suggests that to a significant extent court outcomes have been consistent with the economic characteristics of the countersuits and with the economic approach to defining sham litigation.

Nevertheless, a relatively large proportion of the sample lacked the predatory criteria, yet passed motions to dismiss. Indeed, countersuits lacking the competitive rent-seeking criteria displayed approximately a 50-50 chance of proceeding to trial. This suggests the conclusion that economic characteristics matter to the courts, although they may not matter much.

The data on litigated cases do not offer support to the hypothesis that there has been a dramatic rise in the frequency of countersuits in recent years. An increase over the number during the years prior to 1977 is apparent, but no significant trend is evident for the subsequent period.

CHAPTER FIVE

POLICY IMPLICATIONS

I. Introduction

If the economic criteria conducive to nonprice predation that are used in this study are good predictors of predatory behavior, then it would be socially beneficial to reduce the number of litigated countersuits involving underlying alleged sham suits that do not satisfy these economic criteria for nonprice predation. This could be accomplished by making some form of the predatory criteria explicit in the case law definition of sham litigation.[105]

Section II reviews briefly the empirical work and the policy inferences that can be drawn from it. Section III discusses the policy options, and Section IV addresses the definition of sham litigation that these options could employ. A brief conclusion follows in Section V.

II. Empirical Inferences

The empirical work revealed several facts about sham litigation that suggest the limits of the problem. The first is that the number of litigated countersuits is smaller, and the recent increase in this number is less, than some in the legal community have claimed. The second is that a high proportion of countersuits survive motions to dismiss even though they lack the predatory economic characteristics examined here. Indeed, the contingency tables suggest that the use of a very simple economic screen could have nearly doubled the number of dismissals in the sample, other things equal. This second fact suggests one of the following possible implications:

    1) The case law is inconsistent with economic reasoning

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[105] The economic welfare effects from a change in sham litigation standards also depend on the amount of legitimate litigation that might be chilled by a different standard.

on the proper outcome for countersuits lacking the predation characteristics.

2) The predation criteria employed in the empirical analysis are not sufficient to delineate most predatory cases.

If the first of these possibilities is true, it suggests both an excessive number of sham countersuits under the Sherman Act and a chilling of legitimate suits because of the resulting likelihood of confronting a Sherman Act countersuit. This would imply benefits from changing the standards in the case law.[106] The second implication would lead one to conclude that a better understanding of the economic criteria of predation is needed.

III. The Policy Options

In the former case, the courts themselves might incorporate increased use of the economic criteria in their decision-making. Beyond this, one policy option is for public agencies to pursue cases of alleged sham litigation as violations of the Sherman Act. This, however, may not be effective in altering the case law so as to reduce the number of countersuits that survive a motion to dismiss even though they do not reveal characteristics conducive to predation in the underlying suit. It is difficult to establish precedents for dismissing cases that fail to meet the proper sham definition by bringing sound cases to trial. Another option is for the public agencies to attack sham countersuits. The establishment of case law finding such improper uses of the

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[106] Clarification of the case law is a classic form of public good. Clarifying the case law benefits society as a whole, while the private benefit to any particular litigant is likely to be very small. Thus, clarifying suits are likely to be under-supplied by private litigants. This gives public antitrust agencies a social welfare enhancing role in bringing beneficial suits that would otherwise never be filed; that is, suits in which the public benefits are high and the private benefits are low.

Sherman Act illegal could directly alter the incentives for bringing these cases.

IV. Defining Sham Litigation

The empirical results suggest that requiring countersuits alleging sham litigation to assert the presence of some simple economic characteristics associated with nonprice predation might be beneficial.[107] These characteristics could be as simple as:

1) The parties to the alleged sham act actually or potentially compete.

2) The alleged sham acts are likely to raise the market price or reduce the market quantity of the relevant product.

These characteristics are no more difficult to prove than many other claims in antitrust litigation. In fact, they are necessary conditions for the "dangerous probability of success" which must be shown in monopolization cases alleging predation. The use of these characteristics could have nearly doubled the number of countersuits dismissed in our sample.

Two other elements of the definition of sham acts are suggested by the theoretical discussion. These are fraud and/or the pursuit of a collateral goal. Fraud contains the "baseless" and "frivolous" cases to the extent these indicate that some act was initiated with the expectation that the

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[107] Some commentators may claim that this will not affect the ability of countersuits to pass motions to dismiss, because those which failed this test in the past could pass it by merely asserting additional facts without evidence. If forced to prove these facts, however, many cases may fail to win a favorable judgment or to impose large costs on the defense. Eventually, the number of such cases brought would decline due to the reduced chances for success. Similarly, the threat of initiating a suit which is unlikely to be supported by the facts lacks credibility for the purpose of negotiating a favorable settlement.

false assertions would be sufficient to support the outcome sought from the court. The pursuit of a collateral goal parallels the tort of abuse of process, apart from the latter's requirement of an act outside of the abused process in support of the improper goal.

The economic characteristics, fraud, and pursuit of a collateral goal seem to contain all those tests for sham litigation suggested by legal commentators and the courts which are compatible with the economics of sham litigation. Thus, the implications of the theoretical review and the empirical analysis are not inconsistent with the use of multiple "screens" in defining sham, as suggested by several legal commentators.[108]

V. Conclusion

Future developments in the case law on sham litigation should encourage the use of economic evidence and theory by the courts at an early stage in the litigation of Sherman Act countersuits. This has been suggested by several legal scholars and is reinforced by the research in this report. A significant number of countersuits that did not involve predatory acts might have been dismissed at an earlier stage, or never have been brought at all, if some simple economic reasoning had been applied to them. The analysis in this report indicates that the courts may be too lenient in allowing cases to pass motions to dismiss, and this may encourage abuse of the court system through strategic behavior.

These possibilities notwithstanding, the magnitude of sham litigation as a policy problem is not clear. Fewer countersuits are litigated than had been suggested by the simple litigation statistics provided in previous studies: about a dozen suits appear to be litigated each year. Consequently, the costs to society of sham litigation may not be as large as some previous commentators have implied. However, it is important to recognize that in this study, as in the other research in the area, the number of litigated cases does not

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[108] See, for example, Easterbrook (1986), Hurwitz (1985), and Bien (1981).

give us insight into the cases that are settled prior to litigation or the cases that are not challenged because of the costs of litigation.

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APPENDIX I

LIST OF CASES

Case Name	Year[1]	Product	Target/Predator	Forum	Issue	Effective[2]
Advisor v. O'Connor	1981	advertising	customer/ supplier	State Court	contract	no
Assoc. of Data Processing Orgs. v. Citibank	1980	data processing	entrant/ conspirators	Federal Court	n.a.	no
Associated Radio v. Page Airways	1981	airplane consoles	supplier/ customer	Federal & State Court	n.a.	no
Aydin v. Loral	1983	microwave equipment	unrelated	State Court	employment contracts	no
Baxter Travenol v. LeMay	1982	unknown	competitor/ competitor	Federal Court	trade secrets	n.a.
Betts Travel v. Air Transport Assoc.	1974	travel services	customer/ supplier	State Court	n.a.	yes
Bolt Assoc. v. Rix Industries	1973	acoustic wave generators	entrant/ competitor	Federal Court	n.a.	no
Borough of Landsdale v. Philadelphia Electric Power	1982	electricity	customer/ supplier	State Govt.	wheeling	no

A-2

Case Name	Year[1]	Product	Target/Predator	Forum	Issue	Effective
Brazil v. Arkansas Board of Dental Examiners	1985	dentures	competitor/ conspirators	State Court	entry regulation	yes
Budget v. Hertz	1982	airport car rental	entrant/ conspirators	n.a.	entry regulation	yes
Bulkferts v. Salatin	1983	fertilizer	competitor/ competitor	Federal & State Court	n.a.	no
Bustop Shelters v. Commerce and Safety Corp.	1981	bus stop shelters in NY	competitor/ competitor	Local Govt.	monopoly franchise	yes
California Motor Transport v. Trucking Unlimited	1972	trucking	entrant/ conspirators	various	entry regulation	yes
Central Bank v. Clayton Bank	1977	banking	entrant/ conspirators	State Court	entry regulation	yes
Central States Forwarding v. B&P Motor Express	1977	freight forwarding	competitor/ conspirators	ICC	entry and price regulation	no
Central Telecom. v. TCI	1985	cable TV	entrant/ competitor	Federal Court	monopoly franchise	yes

A-3

Table continued on next page.

Case Name	Year[1]	Product	Target/Predator	Forum	Issue	Effective
Chest Hill v. Guttman	1981	rental property	customer/ supplier	Federal & State Court	contract	yes
Chromium Industries v. Mirror Plating & Polishing	1978	coatings	competitor/ competitor	Federal Court	patents & trademarks	no
Citicorp. v. Interbank	1979	traveler's checks	entrant/ competitor	Federal Court	antitrust	yes
City of Cleveland v. Cleveland Electric	1984	electricity	customer/ supplier	State Court	wheeling	yes
City of Gainesville v. Florida Power	1980	electricity	supplier/ customer	Federal Court	price regulation	no
City of Lafayette v. Louisiana Power	1978	electricity	supplier/ customer	State & Local Govt.	entry regulation	yes
City of Newark v. Delmarva Power	1980	electricity	supplier/ customer	Federal Ct. & Govt.	price reg. antitrust	no
Clairol v. Boston Discount	1979	hair coloring kits	customer/ supplier	Federal Court	antitrust	no
Classic Film Museum v. Warner Bros.	1981	film distribution	customer/ supplier	Federal Court	copyright	no

A-4

Case Name	Year[1]	Product	Target/Predator	Forum	Issue	Effective
Clipper Express v. Rocky Mtn. Motor Tariff Bur.	1984	freight forwarding & trucking	customer/ supplier and competitors	ICC	price regulation	yes
Coastal States v. Hunt	1983	crude oil	unrelated	Federal & State Court	contracts	no
Coca-Cola v. Overland	1982	soft drinks	unrelated	Federal Court	trademarks	no
Colorado Petroleum Marketers v. Southland	1979	gasoline	competitor/ conspirators	State Court	antitrust	no
Columbia Pictures v. Redd Horne	1983	video tapes	customer/ supplier	Federal Court	copyrights	no
Coors v. A&S	1983	beer	customer/ supplier	Federal Court	contracts	no
Consortium v. Knoxville Int. Energy Exp.	1983	souvenirs	customer/ supplier	Federal Court	trademark	no
Cyborg Systems v. M S. A.	1978	computer software	competitor/ competitor	Federal Court	trade secrets	no

A-5

Table continued on next page.

Case Name	Year[1]	Product	Target/Predator	Forum	Issue	Effective
Dominicus Americana Bohio v. Gulf & Western	1979	caribbean resorts	entrant/competitor	n.a.	n.a.	yes
Energy Conservation v. Heliodyne	1983	solar energy (?)	competitor/competitor	State Court	unknown	no
First American Title v. South Dakota Title Assoc.	1984	title searches	customer/supplier	Federal & State Court	price & entry regulation	no
First Nat. Bank v. Marquette Nat. Bank	1980	bank credit cards	entrant/competitor	Federal & State Court	price regulation	yes
Foret v. Point Landing	1976	barge fleet areas	entrant/entrant	Federal Govt.	grants of authority	no
Franchise Realty v. Culinary Works	1977	restaurants	customer/supplier	Local Govt.	n.a.	yes
Garst v. Mountain View Gen. Hospital	1985	services	supplier/customer entrant/competitor	State & Local Govt.	privileges	yes
Glictronix v. A.T.&T.	1984	telephone equipment	competitor/conspiracy	F.C.C.	inter-connection	yes

Case Name	Year[1]	Product	Target/Predator	Forum	Issue	Effective
Gould v. Control Laser	1978	lasers	competitor/ entrant	Federal Court	patents	no
Grip-Pak v. Illinois Tool Works	1982	plastic six-pack holders	entrant/ competitor	State Court	trade secrets	yes
Hahn v. Codding	1981	shop. center development	competitor/ competitor	State & Federal Ct.	n.a.	yes
Handgards v. Ethicon	1984	plastic gloves	entrant/ competitor	Federal Court	patents	yes
Hospital Building v. Rex Hospital	1982	health services	competitor/ conspirators	State Govt. and Court	certificate of need	yes
Howard v. State Dept. of Highways of Colorado	1973	camp grounds	unrelated	State Govt.	billboard license	no
Humana v. Baptist Medical	1985	health services	supplier/ customer entrant/ competitor	State Govt.	certificate of need	yes
Hydo-Tech v. Sundstrand	1982	centrifugical pumps	entrant/ competitor	State Court	trade secrets	yes

Table continued on next page.

A-7

Case Name	Year[1]	Product	Target/Predator	Forum	Issue	Effective
Impro v. Herrick	1978	animal drugs	unrelated	Federal Govt.	license	yes
Interstate Properties v. Pyramid	1984	real estate	unrelated	State Govt.	environmental regulation	no
Jarvis v. A.T.&T.	1978	telephone equipment	competitor/competitor	F.C.C.	entry regulation	yes
Johns Manville v. Guardian Indus.	1981	fiberglass insulation	competitor/competitor	Federal Court	trade secrets	no
King v. Champlin	1976	petroleum products	customer/supplier	Federal Court	antitrust	no
Landmarks v. Bermant	1981	shopping centers	entrant/conspirators	State Court	n.a.	yes
Litton Systems v. A.T.&T.	1984	telephone equipment	competitor/competitor	F.C.C.	inter-connection	yes
MCI v. A.T.&T.	1984	long distance telecom-munications	competitor/competitor	Federal & State Court, F.C.C.	inter-connection	yes
Manego v. Orleans Board of Trade	1985	discoteque/skating rink	entrant/entrant	Local Govt.	licenses	no

Case Name	Year[1]	Product	Target/Predator	Forum	Issue	Effective
Mark Aero v. TWA	1978	air transport.	entrant/ conspirators	Local Govt.	licenses	yes
Marks Music v. Colorado Magnetics	1974	recorded music	unrelated	Federal Court	copyright	no
Mid-Texas Communications v. A.T.&T.	1980	local telephone service	entrant/ competitor	F.C.C.	inter-connection	yes
Miracle Mile Assoc. v. City of Rochester	1980	real estate development	competitor/ competitor	State Govt.	environ-mental regulation	no
Mtn. Grove Cemetary v. Norwalk Vault	1977	burial vaults	customer/ supplier	State Court	antitrust	no
NCR v. Arnette	1983	computer software	entrant/ competitor	Federal Court	trade secrets	
Newman v. Reinforced Earth Co.	1984	retaining walls	entrant/ competitor	Federal Court	patents	
Oahu Gas Serv. v. Gasco	1979	natural gas distribution	entrant/ competitor	Federal Govt.	purchase rights	
Occidental Petroleum v. Buttes Gas & Oil	1972	oil properties	competitor/ competitor	n.a.	contracts	

A-9

Case Name	Year[1]	Product	Target/Predator	Forum	Issue	Effective
Omni Resources v. Conoco	1984	mineral rights	unrelated	State Court	claim-jumping	no
Orth-o-vision v. Home Box Office	1979	satellite TV distribution	customer/supplier	Federal Court	contracts	yes
Outboard Marine v. Pezetel	1984	electric golf carts	competitor competitor	Federal Court	n.a.	no
Pennwalt v. Zenith Labs.	1979	prescription drugs	competitor/competitor	Federal Court	trade-marks	no
Picante v. Jimenez Food Products	1982	picante sauce	entrant/competitor	Federal Court	trade-marks	no
Platt-Saco-Lowell v. Spindelfabrik	1977	textile machinery	competitor/competitor	Federal Court	patents	no
Plumbers and Steamfitters v. Morris	1981	plumbing construction	supplier customer	Federal Court	n.a.	no
Princeton Center for Infancy v. American Baby	1984	literature on child care	competitor/competitor	Federal Court	trade-marks	unk.[3]
Racetrack Petroleum v. Prince Georges County	1985	gasoline	conspirators	competitor/Govt.	local zoning	no

Table continued on next page.

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Case Name	Year[1]	Product	Target/Predator	Forum	Issue	Effective
Rahal v. Cresmont Cadillac	1981	automobile leasing	customer/ supplier	State Court	contracts	no
Razorback Ready Mix v. L&S Concrete	1985	concrete	competitor/ conspirators	State Court	n.a.	no
REA Express v. Calif. Motor Transport	1975	trucking	competitor/ conspirators	State Govt.	entry regulation	yes
Realco Services v. Holt	1979	container leasing	competitor conspirators	Federal Court	entry regulation	no
Reamco v. Allegheny Airlines	1980	express shipping	competitor/ conspirators	Federal Court	entry regulation	yes
Rohm & Haas v. Dawson Chemical	1983	chemicals	competitor/ competitor	Federal Court	patents	no
Rural Electric v. Cheyenne Light	1985	electricity	competitor/ competitor	State & Local Govt.	contracts & franchises	no
Rush-Hamilton Industries v. Home Ventilating Institute	1976	ventilating fans	competitor/ conspirators	State & Local Govt.	product approval	no
S.M. Arnold, Inc. v. Union Carbide	1980	auto wash and cloths	competitor/ conspirators	Federal Court	n.a.	no

Case Name	Year[1]	Product	Target/Predator	Forum	Issue	Effective
Sage International v. Cadillac Gage	1981	armored cars	entrant/ competitor	State Court	trade-secrets	yes
Saint Joseph's Hospital v. Hospital Authority of America	1985	health services	entrant/ competitor	State Govt. & Court	certificate of need	yes
Schwegan Bros. v. Almaden Vineyards	1980	liquor wholesaling	customer/ supplier	State Govt.	license	yes
Sealy v. Easy Living	1984	mattress and spring sets	customer/ supplier	Federal Court	trademarks	no
Searer v. West Michigan Telecasters	1974	local television	competitor/ conspirators	State Court	various	no
Sharon Steel v. Chase Manhattan Bank	1981	business loans	customer/ supplier	State Court	n.a.	no
Sound, Inc. v. A.T.&T.	1980	telephone equipment	competitor/ competitor	F.C.C. & State Govt.	inter-connection	yes
Southern Pacific Communications v. A.T.&T.	1985	telephone equipment	entrant/ competitor	F.C.C.	inter-connection	no

Case Name	Year[1]	Product	Target/Predator	Forum	Issue	Effective
Spanish Int'l Communications v. Leibowitz	1985	local television	unrelated	F.C.C.	entry regulation	no
Stromberg v. Costello	1978	well drilling equipment	supplier/customer	State Court	n.a.	no
Suburban Restoration v. ACMAT Corp.	1980	construction	competitor/competitor	State Court	contracts	no
Sun Energy v. Aristek	1982	mobile homes	entrant/competitor	State Court	contracts	yes
Taylor Drug Stores v. Assoc. Dry Goods	1977	drug stores	competitor/conspirators	State Court	blue laws	no
Technicon v. Green Bay Packing	1977	computer programming	customer/supplier	Federal Court	trade secrets	no
Town of Massena v. Niagara Mohawk Power	1980	electricity	customer/supplier	Federal Govt. & State Court	price & entry regulation	yes
TransKentucky Transportation R.R. v. L&N R.R.	1983	rail transport.	customer/suppliers & competitors	I.C.C., State Govt. and Court	entry regulation	yes

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Case Name	Year[1]	Product	Target/Predator	Forum	Issue	Effective
U.S. v. A.T. & T.	1982	telephone equipment & services	sellers of complementary products	F.C.C.	inter-connection	yes
U.S. v. Braniff Airways	1978	air transportation	competitor/conspirators	State Govt.	operating rights	yes
U.S. v. Morgan Drive Away	1976	trucking	competitor/conspirators	I.C.C. & State Govt.	entry regulation	yes
U.S. v. Otter Tail Power	1974	electricity	customer/supplier entrant/competitor	Federal Court	wheeling & franchises	yes
U.S. Dental Institute v. American Assoc. of Orthodonists	1977	dental services	entrant/conspirators	State Govt.	licenses & approvals	yes
Vendo v. Lektro-Vend	1982	vending machines	entrant/competitor	State Court	trade secrets	no
WCCB v. Tele Rep	1984	television advertising	competitor/competitor	State & Federal Ct.	employment contracts	no
WIXT v. Meredith	1980	local television	competitor/conspirators	F.C.C. & Local Govt.	n.a.	yes

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Case Name	Year[1]	Product	Target/Predator	Forum	Issue	Effective
Wahl v. Rexnord, Inc.	1979	vibrating bins	competitor/competitor	Federal Court	patents	no
Webb v. Utah Tour Brokers	1977	sightseeing tours	supplier/customer	I.C.C.	licenses	yes
Wheeling-Pittsburgh Steel v. Allied Tube & Conduit	1983	electrical conduit	entrant/competitor	State & Local Govt.	product approval	yes
Wilmorite v. Eagan Real Estate	1978	real estate development	competitor/competitor	State Court	n.a.	yes
Winterland Concessions v. Strela	1984	printed T-shirts	competitor/competitor	Federal Court	trade-marks	no
Yellow Forwarding v. Atlantic Container	1982	freight forwarding	customer/supplier competitor/conspirators	Federal Govt.	price regulation	no
Zenith Radio v. Matsushita	1985	television sets	competitor/conspirators	Federal Govt.	n.a.	no
Zimmel Associates v. Warner Bros.	1977	motion pictures	competitor/competitor	Federal & State Court	copy-right	no

NOTES. 1 Year of last recorded court action.
2 The case appeared to have at least one of the effects captured in the variables V60-V66.
3 Unknown effect.

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APPENDIX II

LOGIT REGRESSIONS

This appendix presents the results of logit regressions using the dependent variable V6, which takes the value of 1 when a countersuit alleging a sham act is not dismissed. The regressions attempt to explain the outcome of a motion to dismiss a countersuit by the presence or absence of certain characteristics corresponding to the characteristics reported in Chapter Four. Table A-I defines all of the variables used in the regression equations.

Economic theory suggests the appropriate signs of the regression coefficients only for the predation characteristics. We expect these coefficients to be positive if the courts have adopted an economic approach to sham litigation. The other coefficients, however, have no required theoretical sign or significance. For this reason, the regressions were treated primarily as an exercise in description, rather than as a test of theory. This approach was implemented by running a series of regressions involving various sets of independent variables. Only those characteristics whose coefficients were consistent in sign and significance throughout the series were interpreted as demonstrating any explanatory power.

Table A-II shows the groups of independent variables included in the regressions L1 through L5. The groups correspond in an obvious way to the blocks of variables defined in Table A-I. The procedure reflected in Table A-II was to begin by including all the independent variables individually in the regression equation, then to delete blocks of variables in stages until only the predation-related variables remained. Regressions L1 through L3 demonstrate this process. Regressions L4 and L5 show the process repeated, except that the predatory criterion, DCRIT, is substituted for the blocks of relationship and outcome variables that were used in its construction.

Table A-III gives the results of regressions L1 through L3. Due to the large number of independent variables, only those coefficients with a t-value greater than 1.0 are reported. The most striking entries in the table are those

TABLE A-I

Variable Definitions*

Name	Definition
Time Trend	
V5	Last 2 digits of year of last court record
Countersuit Outcome	
V6	Not Dismissed
Market Definition: Product	
V11	Electric Utility
V12	Health Services
V13	Telecommunications
V14	Banking
V15	Construction
V16	Manufacturing
V17	Services
V18	Other
Market Definition: Geographic	
V19	City
V20	Part of a state
V21	State
V22	Region
V23	U.S.
V24	International

Name	Definition

Relationship of Target to Predator

V25	Competitor/Competitor
V26	Entrant/Competitor
V27	Entrant/Entrant
V28	Supplier/Customer
V29	Customer/Supplier
V30	Competitor/Conspirator
V31	Entrant/Conspirators
V32	Competitor/Entrant
V33	Target sells complementary product
V34	Predator sells complementary product
V35	Unrelated

Forum of Alleged Sham Activity

V41	Federal Courts
V42	State or Local Courts
V43	Other State Government
V44	Other Local Government
V45	F.C.C.
V46	I.C.C.
V47	Other Federal Government

Name	Definition

Issues in Alleged Sham Activity

V48	Patents
V49	Trademarks
V50	Copyrights
V51	Trade secrets
V52	Environmental Regulation
V53	Price Regulation -
V54	Entry Restrictions
V55	Employment Contracts
V56	Other Contracts
V57	Interconnection
V58	Antitrust
V59	Other

Outcome of Alleged Sham Activity

V60	Prevented entry or expansion
V61	Delayed entry or expansion
V62	Caused target to exit
V63	Caused target to lose sales
V64	Raised target's cost of doing business
V65	Imposed costs of litigation or defence
V66	Enjoined target from some activity

Predatory Criterion

V68	DCRIT (defined in Chapter 4)

* All variables are dummy variables unless otherwise noted in definition.

TABLE A-II

Independent Variable Groups
Regressions L1 - L5

Group	L1	L2	L3	L4	L5
Time Trend	X	X	X	X	X
Market Definition	X			X	
Relationship	X	X	X	-	
Forums	X	X		X	
Issues	X	X		X	X
Outcomes	X	X	X		
Criterion				X	X

TABLE A-III

Logit Regressions: L1 - L3

Dependent Variable: Countersuits Not Dismissed (V6)

Variable[1]	L1		L2		L3	
	Coefficient		Coefficient		Coefficient	
V21	7.78	(1.26)				
V25	7.28	(1.37)*			-	
V29	-13.00	(-1.17)	1.67	(-1.65)*	-0.87	(-1.44)*
V30	10.63	(1.25)				
V31	12.86	(1.35)*	2.82	(1.75)**		
V34	- 7.36	(-1.57)*	-3.18	(-2.18)**	-0.85	(-1.19)
V41			1.26	(1.15)		
V42			2.04	(1.72)**		
V43			1.68	(1.04)		
V44	14.59	(1.47)*	1.86	(1.44)*		
V47	7.79	(1.85)*	1.58	(1.45)*		
V48	-11.82	(-1.01)	-3.37	(-2.07)**		
V49	6.23	(1.09)				
V50			-2.58	(-1.28)		
V53			3.62	(-1.99)*		
V54	-12.12	(-1.75)**	-3.57	(-2.40)**		
V55			-1.91	(-1.16)		
V56	7.29	(1.50)*				
V58	-11.81	(-1.37)*	-3.68	(-2.50)***		
V59	-10.31	(-1.17)	-2.89	(-2.01)**		
V61					1.77	(1.92)
V62			-3.52	(-1.68)*		
V63			-1.35	(-1.08)		
V64	12.74	(1.48)*	3.55	(2.06)**	2.73	(2.05)**
V65	6.41	(1.12)			0.80	(1.54)
V66			-1.27	(-1.13)		

NOTES.

<u>Likelihood Ratio Test</u> (Chi-Squared Test)

L1: 106.16*** with 52 degrees of freedom
L2: 71.46*** with 38 degrees of freedom
L3: 30.89** with 35 degrees of freedom

*   indicates significant at 0.10 level
**   indicates significant at 0.05 level
***   indicates significant at 0.01 level

[1]   t-statistics are reported in parentheses. Only variables whose coefficients had t-statistics greater than 1.0 are reported. See Table A-II for variables included in each regression.

reflecting the poor performance of the competitive relationship variables. Only V25, competitor/competitor, and V31, entrant/conspirators, attain significant coefficients. Even though these coefficients are of the theoretically correct sign, they are not as consistently significant as the coefficients of the vertical relationship variables V29 and V34. Moreover, none of the relationship variables has a significant coefficient in all three regressions.

Most of the forum variables, V41-V47, and the issues variables, V48-V59, also perform poorly. It is worth noting, however, that the issues variables V54, entry restrictions, and V58, antitrust issues, have the most significant coefficients in this group and that the coefficients are negative in sign. Thus, these variables are associated with a reduced chance of surviving a motion to dismiss.

The final group of variables is concerned with the outcomes of the alleged sham activity. Each of the variables V61-V65 is consistent with an anticompetitive outcome, but their coefficients are not consistently significant and two of them display a theoretically curious negative sign. The one consistently significant coefficient, however, is that of V64, the "raising rivals' cost" variable. It also displays the theoretically correct positive sign, although it varies greatly in magnitude.

The behavior of the regression coefficients across these three regressions - the instability in the magnitudes and significance levels of individual coefficients despite the high statistical significance of each regression equation as a whole - indicates strong multicollinearity among some subsets of the explanatory variables. This can be expected in regressions involving a large number of binary variables; at least one variable is fairly likely to approximate a linear combination of some subset of the remaining variables. Little can be done to solve these problems at this stage, except to attempt to construct more theoretically desirable variables. The predatory criteria constructed in Chapter Four are useful in this way. Here we use only the criterion embodied in DCRIT, which is both a theoretically superior variable and the best statistical performer in the contingency table test.

Table A-IV shows the results of regressions L4 and L5, which utilize DCRIT in place of the relationship and outcome variable blocks. Hence, L4 corresponds to L1, while L5

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TABLE A-IV

Logit Regressions: L4 - L5

Dependent Variable: Countersuits Not Dismissed (V6)

	L4		L5	
Variable[1]	Coefficient		Coefficient	
DCRIT	1.52	(1.65)*	1.34	(2.41)**
V48	-1.82	(-1.13)		
V51			1.16	(1.10)
V53	-2.40	(-1.56)*		
V54	-2.33	(-2.00)**	-1.17	(-1.88)**
V57			1.89	(1.58)*
V58	-3.04	(-2.17)**	-1.90	(-2.14)**
V59	-1.76	(-1.61)*		

Likelihood Ratio Test (Chi-squared Test)

L4: 56.36** with 35 degrees of freedom
L5: 25.91** with 14 degrees of freedom

* significant at the 0.10 level.
** significant at the 0.05 level.

[1] t statistics are reported in parentheses. Only those
variables whose coefficients had t statistics greater than 1.0
are reported. Both regressions contain all the listed
variables. See Table A-II for variables included in each regression.

contains only the trend variable, DCRIT, and the issues block. The significance of the regression equations drops to the 0.05 level although L4 is nearly significant at the 0.01 level. The coefficients are similar to those of the previous regressions, except that the coefficient an DCRIT is consistently significant and positive. Otherwise, only the issues' coefficients are ever significant and only those on V54 and V58 are consistently so.

Table A-V shows additional regression results. L6 breaks DCRIT up into its components for use as the independent variables. Only the coefficient on the outcome variable V61, delayed entry or growth, is significant. Furthermore, regression equation L6 is not significant at the 0.10 level, while equations L7 and L8 are. L8 is almost significant at the 0.01 level. L7 utilizes DCRIT with some of the relationship variables as the independent variables. Only DCRIT is significant. L8 adds V54 and V58 to the independent variables used in L7, with similar results. The coefficient on DCRIT is significant and positive, while the issues variables' coefficients are significant and negative. This confirms the importance of all the predatory characteristics taken together, rather than individually.

At this point, some tentative conclusions can be drawn from the regression analysis. The effect of the predation characteristics as a group is consistently significant and positive on the probability of a countersuit passing a motion to dismiss. This is true even though few of the predation characteristics taken individually have any statistically significant effect.

Moreover, although the coefficient on DCRIT appears to be small in magnitude, falling between 1.0 and 1.5, this indicates that the presence of predation characteristics may raise the probability that a countersuit is not dismissed by as much as 33 percentage points. The probability estimates are calculated from the logit coefficients as shown in Table A-VI for L7 and L8. This is consistent with the thrust of Chapter Four: predation characteristics make a difference to court outcomes, but it is not clearly enough difference to obviate the opportunity for policy changes in this area.

Other than this, the results of the statistical analysis are ambiguous. The outcome of the alleged sham activity seems to be important to the courts, especially if it is of the

TABLE A-V

Logit Regressions: L6 - L8

Dependent Variable: Countersuits Not Dismissed (V6)

Variable[1]	L6		L7		L8	
	Coefficient		Coefficient		Coefficient	
DCRIT			1.02	(2.36)**	1.41	(2.71)***
V5	-0.01	(-0.23)				
V25	0.61	(1.06)			-	
V26	0.26	(0.38)				
V28			-0.59	(-0.79)	-0.28	(-0.38)
V29			-0.63	(-1.32)	-0.60	(-1.22)
V30	0.04	(0.06)				
V31	0.04	(0.04)				
V35			-0.59	(-0.81)	-0.52	(-0.68)
V54					-1.01	(-1.95)**
V58					-1.28	(-1.63)**
V60	0.61	(1.09)				
V61	1.92	(2.37)**				
V62	0.81	(0.93)				
Constant	1.03	(0.20)	0.37	(1.02)	0.61	(1.85)**

Likelihood Ratio Test (Chi-squared Test)

L6: 12.25 with 8 degrees of freedom
L7: 10.03** with 4 degrees of freedom
L8: 16.32** with 6 degrees of freedom

*   significant at the 0.10 level
** significant at the 0.05 level
*** significant at the 0.01 level

[1] All included variables are reported. t statistics are in parentheses.

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TABLE A-VI

Effect of Key Characteristics on Probability
That Countersuit Not Dismissed[1]

Regressions L7 and L8

Variable	L7	L8
DCRIT	0.24	0.33
V28	-0.14	-0.07
V29	-0.15	-0.14
V35	-0.14	-0.12
V54		-0.24
V58		-0.30

[1] These effects are estimates of dP/dx, where P is the probability that a countersuit is not dismissed, and x is the independent variable listed from the regression. Due to the nature of the logit regression, these are calculated from the regression coefficients as:

$$dP/dx = P(1-P)B$$

where P is the proportion of countersuits passing motions to dismiss in the sample and B is the logit regression coefficient. For this sample:

$$dP/dx = (0.624)(0.376)B = 0.235B.$$

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raising rivals' cost variety. But, the effect is not necessarily large in magnitude, nor is it consistently significant.

The negative sign of the coefficients on the antitrust and entry restriction issue variables (V58 and V54) suggests that if there is a preponderance of sham-sham activity, it lies here. This interpretation, however, is not clearly correct. One must remember that the regressions estimate effects on court outcomes, not on true outcomes. Thus, the courts may have dismissed relatively more countersuits involving allegations of sham activity concerning entry restrictions on grounds of free speech or states' rights to grant monopolies (the "state-action" doctrine), rather than on the economic merits of the countersuits. Thus, the outcomes of these suits may reflect an unobserved legal value-judgement that balances the benefits of free speech against the costs of anticompetitive effects. The present data cannot shed any light on this question.

The obvious next step required of research in this area is to obtain better data. An accompanying advance in theory that would allow a finer definition and measurement of variables would also prove useful. Short of these advances, we are still left with the conclusion that economic characteristics do make some difference to the courts.