
DETERMINING THE OPTIMAL ANTITRUST STANDARD: HOW TO THINK ABOUT PER SE VERSUS RULE OF REASON

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I. INTRODUCTION

Andrew I. Gavil presents a thoughtful and illuminating portrait of the evolution of the rule of reason in United States antitrust law since *Standard Oil*.¹ While the rule of reason, as initially embodied in *Standard Oil Co. v. United States*² and *Board of Trade of Chicago v. United States* (“*Chicago Board of Trade*”),³ may have once been an invitation to make any and all arguments about the competitive nature of a given restraint, Gavil rightly points out that this is no longer the case. As currently employed, the rule-of-reason analysis is typically quite structured.⁴ The plaintiff must first show that the defendant’s action had an anticompetitive effect.⁵ If she can do this, then the defendant has the burden to prove that its action has a procompetitive benefit.⁶ If, and only if, the court finds that both sides have met their initial burden, will the court proceed to balance the two effects.⁷

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1. Andrew I. Gavil, *Moving Beyond Caricature and Characterization: The Modern Rule of Reason in Practice*, 85 S. CAL. L. REV. 733 (2012). See also Barak Orbach & D. Daniel Sokol, *Antitrust Energy*, 85 S. CAL. L. REV. 429 (2012) (discussing *Standard Oil* and its impact then and now).

2. *Standard Oil Co. v. United States*, 221 U.S. 1 (1911).

3. *Bd. of Trade of Chi. v. United States*, 246 U.S. 231 (1918).

4. See Gavil, *supra* note 1, at 760–61 (discussing “efforts to structure the antitrust inquiry with a greater emphasis on competitive effects”).

5. *Id.* at 763 (quoting *In re Mass. Bd. of Registration in Optometry*, 110 F.T.C. 549, 604 (1988)).

6. *Id.*

7. *Id.*

Of course, the evidence of anti- and procompetitive effects for any particular conduct is always far from perfect. Whenever evidence is imperfect, we know from decision theory (Bayes' rule) that one's prior beliefs about the plausibility of anti- or procompetitive effects will be important (and will be more important the less perfect the evidence).⁸ Thus, one can think of the per se rule in antitrust as just an extreme form of the rule of reason, in which the court's prior beliefs dictate the decision. For example, a court's prior belief that price-fixing is anticompetitive may be so strong that the evidence required to overcome that prior belief (establishing a procompetitive effect on balance) would have to be enormously powerful. One way to express the justification for the per se rule is that the probability that such evidence will exist is so small that it is not worth examining it. In that light, one can also view the structured rule of reason approach as one that should (although, in practice may not) reflect a similar paradigm in less extreme cases: we require stronger evidence of anticompetitive effects for conduct that we think are less likely to be anticompetitive and are more receptive to procompetitive effects arguments in such cases.

Even this decision-theoretic approach, however, does not really give courts much guidance about how to think about choosing between a per se rule and the rule of reason or choosing between a more or less strict rule of reason. The purpose of this Essay is to reflect briefly on some of the important considerations that optimally should be involved in making this choice.

II. PER SE VERSUS RULE OF REASON: THE RELEVANT FACTORS

If one assumes the goal of the antitrust laws (or any laws, for that matter) is to minimize social costs (however defined), then one should design the rules or standards for conduct to optimally manage the trade-off between providing incentives for cost-minimizing conduct with reducing the cost of administering and enforcing the laws.⁹ One can then view the choice between whether to view some conduct as per se illegal or to judge it under the rule of reason as the product of this tradeoff. A simple way to view this tradeoff is to say that the rule of reason, because it allows for

8. See James C. Cooper et al., *A Comparative Study of United States and European Union Approaches to Vertical Policy*, 13 *GEO. MASON L. REV.* 289, 303–05 (2005) (applying a Bayesian framework to vertical restraints).

9. See RICHARD A. EPSTEIN, *SIMPLE RULES FOR A COMPLEX WORLD* 34 (1995) (“The basic trade-off between administrative costs and improved incentives for private behavior is always with us.”).

more evidence, will tend to improve incentives by generating more accurate results. The advantage of the per se rule is that it is cheaper to administer since it does not require the production and evaluation of nearly as much evidence as does the rule of reason.¹⁰

This basic view, however, is really too simplistic because it relies on a few assumptions that are not generally valid. First, it assumes that more evidence necessarily leads to a more accurate outcome. Ideally, this would be the case. However, given a lack of judicial expertise in antitrust economics,¹¹ it could easily be the case that courts might systematically give certain types of evidence more weight than they deserve. If so, there may be cases in which a per se rule (or more limited rule of reason) could actually improve accuracy.

Second, it assumes that greater accuracy necessarily improves incentives for social cost-minimizing conduct. This may not be the case for several reasons. Greater judicial accuracy can only improve incentives if the firms can predict the change in outcome due to the more accurate process at the time they are deciding on their course of action. Similarly, if cases settle prior to trial, greater accuracy at trial will only improve incentives if it also leads to more accurate settlement outcomes. This may not be the case if parties are asymmetrically informed. Lastly, greater accuracy at trial can affect decisions to sue or settle in ways that may or may not lead to better incentives ex ante.¹²

Third, the administrative cost analysis is typically done under the assumption that all cases proceed to trial. In fact, of course, the vast majority of antitrust cases (like all cases) settle.¹³ Thus, one needs to adjust the costs on that basis. In addition, the changed administrative costs can sometimes change the likely settlement outcomes, which can affect incentives. Moreover, greater administrative costs, and any change in the likely trial outcome that results, can affect ex ante behavior in a way that

10. See Phillip C. Kissam, *Antitrust Boycott Doctrine*, 69 IOWA L. REV. 1165, 1206 (1984) (discussing, in the context of the boycott doctrine, that the difference between per se rules and the rule of reason “is simply one of the relative degree of inquiry”).

11. See D. Daniel Sokol, *Limiting Anticompetitive Government Interventions that Benefit Special Interests*, 17 GEO. MASON L. REV. 119, 147 (2009) (“Developing judicial expertise in economic law in general, and antitrust law specifically, is important to ensure appropriate enforcement” of antitrust law).

12. See Scott A. Baker & Anup Malani, *Does Accuracy Improve the Information Value of Trials?* 1 (Nat’l Bureau of Econ. Research, Working Paper No. 17036, 2011) (questioning “the value of court accuracy even if there is no cost to making courts more accurate”).

13. Christopher R. Leslie, *Judgment-Sharing Agreements*, 58 DUKE L.J. 747, 795 (2009) (“[A]ntitrust law favors settlement [and] the vast majority of price-fixing cases settle.”). See *id.* at 768 (“In general, antitrust law favors settlement.”).

might lead to fewer or more cases.

What this means is that whether any particular conduct should be judged under the per se rule or under some form of the rule of reason cannot simply be a question of the degree of uncertainty about the competitive effects of the conduct. One has to think carefully about how parties will respond at several different times to the standard under which their conduct will be judged. Working backwards, one first needs to think about how the standard affects settlement decisions. Then, given settlement decisions, one has to think about how the incentive to investigate or sue over this type of conduct will change. Lastly, one has to think about how, given the change in the incentives to sue and settle, firms will change their primary conduct (whether or not they engage in, or how they engage in, the activity under consideration).

III. BRIEF ELABORATION AND AN APPLICATION TO RESALE PRICE MAINTAINENCE

Because this is a short Essay, I cannot hope to give a fully general or comprehensive account of how to apply the relevant factors to determine what conduct should be deemed per se illegal, what conduct should be judged under the rule of reason, and how the rule of reason should be structured for any given type of conduct. Instead, to illustrate the type of analysis that should go into designing the legal approach to a particular type of conduct, I will briefly (and fairly loosely) discuss how to think about these issues in the context of the optimal standard for judging resale price maintenance (“RPM”). When relevant, I will also compare and contrast this approach with the rationales the Court gave for moving RPM from the per se category to the rule of reason category in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*¹⁴

As the Court reiterated in *Leegin*, evaluating restraints of trade under the rule of reason is the default, and per se treatment is only appropriate when the restraint in question is almost always anticompetitive.¹⁵ It is worth noting at the outset that this “algorithm” for determining how to judge a restraint is somewhat endogenous in that how often one should expect to see an anticompetitive manifestation of a restraint will depend on how that restraint is likely to be judged. The more lenient the standard, the

14. *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 900 (2007).

15. *Id.* at 885–86 (discussing that while “[t]he rule of reason is the accepted standard for testing whether a practice restrains trade in violation of § 1,” “[s]ome types ‘are deemed unlawful per se’”) (quoting *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997)).

more one should expect to see anticompetitive instances of the restraint because the restraint will be less likely to be found to violate the antitrust laws. On the other hand, if a restraint is per se illegal, one should only expect to see the most procompetitive instances of the restraint, in which the defendant can hope to convince the court either to classify it as something else or overrule the existing law. When considering whether to change the treatment of RPM, for example, from the per se rule to the rule of reason, it is not important what fraction of existing uses of RPM are pro- or anticompetitive. Rather, what matters is how many more pro- and anticompetitive instances of RPM will arise under some version of rule-of-reason treatment rather than per se treatment.¹⁶

In addition, shifting to a rule-of-reason approach seems to value accuracy for its own sake rather than for the purposes of generating desirable incentives. For example, suppose (just for the sake of argument, not to suggest this is necessarily true for RPM) that changing to some version of the rule of reason will lead to one hundred more procompetitive uses of RPM and only ten more anticompetitive uses of RPM. This might increase accuracy but still worsen incentives. To see how this could happen, imagine that the procompetitive benefit of these one hundred cases is only \$1 per case (maybe because in all of these cases exclusive territories would work almost as well as RPM in achieving the procompetitive benefits). On the other hand, the anticompetitive harms in the ten cases might be \$100 each (maybe because these are cases in which RPM is critical to enforcing a dealer cartel). Thus, the incentive effect of this change in treatment would be to reduce welfare by \$900 despite the fact that decisions are now more accurate in some sense.

In deciding that RPM should no longer be per se illegal, the Court in *Leegin* did not actually attempt to estimate either what fraction of existing RPM cases are pro- or anticompetitive or how this fraction would change under rule-of-reason treatment. Rather, it examined the economic literature on RPM and determined that there are many explanations for why one might see RPM, and these include both pro- and anticompetitive explanations.¹⁷ Of course, the theoretical economics literature on RPM examines the incentives to use RPM under various conditions.¹⁸ One

16. Louis Kaplow makes this point more generally with respect to determining the optimal burden of proof in *Burden of Proof*, 121 YALE L.J. 738, 855–56 (2012), concluding that the “tradeoff of deterrence and chilling determines how the optimal evidence threshold should be set.”

17. *Leegin*, 551 U.S. at 889–92.

18. See Ralph A. Winter, *Presidential Address: Antitrust Restrictions on Single-Firm Strategies*, 42 CANADIAN J. ECON. 1207, 1217–18 (2009) (discussing the conditions under which RPM can be pro- or anticompetitive).

condition that is almost universally assumed across the entire literature, however, is the absence of antitrust law. Thus, while this literature is surely relevant for any determination of how to optimally judge RPM, the finding that the literature contains many pro- as well as anticompetitive reasons for RPM is far from sufficient to warrant moving to the rule of reason (or staying with the per se rule, for that matter).

In fact, not only does this not tell us the fraction of anticompetitive uses of RPM currently, let alone how it will develop with a change in the rule, it does not even tell us what this fraction would be in a world without antitrust. Furthermore, since the literature assumes away any potential antitrust liability, it never considers whether there are alternative mechanisms for achieving the pro-competitive benefits of RPM that firms might use given that they face potential antitrust liability for using RPM, and how welfare might change if firms were to switch to those alternative mechanisms. On the other hand, it also does not consider whether other forms of antitrust enforcement might be sufficient to deter the anticompetitive uses of RPM (criminal penalties for cartels, for example, might deter even RPM-facilitated cartels) or whether there are alternative mechanisms for achieving the anticompetitive ends of RPM that might be profitable given current antitrust laws.

To properly analyze the likely competitive effects of changing the rule governing RPM from the per se rule to the rule of reason, one needs to consider all of these issues. Furthermore, one needs to consider the structure of the rule of reason to be applied. To see this, imagine that there are a great many instances in which firms would, in the absence of antitrust laws, optimally use RPM in order to, say, provide incentives for dealer services. Maybe there are also a much smaller number of instances in which firms might optimally use RPM to enforce a cartel that would be greatly profitable. In such a world, one might imagine that we would see neither use of RPM under per se treatment. Under a typical rule-of-reason approach, however, one might only see the anticompetitive RPM: If a firm could use some other means of providing incentives for dealer services that was nearly as good as RPM (even if it was not quite as efficient), then it might decide it is not worth the small risk of losing in court (because the rule of reason is unlikely to be perfect) or the settlement that might reflect this small risk. On the other hand, a few firms that thought they had a reasonable chance of getting away with the hugely profitable, but anticompetitive, RPM under the rule of reason might give it a try (even if the rule of reason was reasonably accurate and deterred most of the potentially anticompetitive RPM).

So, it could be that even though RPM is almost always done for efficient purposes, a typical rule-of-reason approach is worse than per se illegality. In this scenario, however, a very prodefendant rule-of-reason approach bordering on per se legality might be still superior. If firms engaging in RPM were never sued, then the efficiency gains from the much greater number of procompetitive uses might (or might not) exceed the costs from the few cartels that were facilitated.

The point here is not to suggest that the rule of reason is categorically a poor rule, for RPM or any other restraint of trade. Rather, it is to point out some of the more subtle issues that are relevant in deciding which rule is optimal. Furthermore, these issues are also relevant in deciding how the rule of reason should be structured (and in what way) in any given instance. The general point is that in deciding what evidence to examine and how carefully to examine it, one needs to think about how this will affect the underlying behavior at issue. And, in thinking about how the underlying behavior will be affected, one has to think about how the incentives to sue and settle will be affected.

The incentives to sue and to settle obviously depend on the likely outcome at trial. They also depend on the particular model of settlement and the information of each party at the time of settlement.¹⁹ Given that discovery costs are often extremely large in antitrust cases, there is a strong incentive to settle prior to extensive discovery. This means that the plaintiff may not know how strong its anticompetitive effects arguments are likely to be and will know even less about the strength of the defendant's procompetitive arguments. In some models of settlement bargaining, this would suggest that settlement amounts might not vary much between mildly culpable defendants and very culpable defendants.²⁰ If so, this could indicate that the value of a more detailed rule-of-reason investigation might be limited to the extent its goal was to distinguish mildly anticompetitive from very anticompetitive RPM (or other conduct). On the other hand, a structured approach that made discovery cheaper by limiting the number of relevant issues could improve incentives by leading to more settlement after discovery, and thus, settlement outcomes that tracked actual culpability more closely (though, it might also paradoxically increase administrative costs if it leads to more discovery).

19. See, e.g., Ezra Friedman & Abraham L. Wickelgren, *No Free Lunch: How Settlement Can Reduce the Legal System's Ability to Induce Efficient Behavior*, 61 SMU L. REV. 1355, 1361–62 (2008) (explaining the effect of asymmetric information on settlement decisions).

20. *Id.* at 1369 (discussing the comparative effect of settlement on culpable versus blameless defendants).

Settlement outcomes can only affect behavior if there is an initial suit. So, one also has to think about how the rule affects the incentive to file suit in the first place. Given that potential plaintiffs often are even more poorly informed at the time of deciding whether to file than they are in pre-discovery settlement negotiations, one can easily imagine that there are many meritorious suits that are not filed and many nonmeritorious ones that are. Changes to the rule or standard that require a great deal of information to assess are not likely to affect the filing decision too much. On the other hand, rules that affect the ease of learning more about the quality of one's case after filing will. It is beyond the scope of this short Essay to fully assess these issues, but they are critically important. It is also important to assess the differing incentives of private and government plaintiffs to file suit. It should not be hard to think of situations in which these incentives might differ in such a way as to justify a different standard depending on whether the case is a private or public one.

IV. CONCLUSION

Gavil's depiction of a move to a more structured approach to the rule of reason is surely a welcome development. Nonetheless, the current approach to deciding just how to apply the rule of reason or the per se rule seems ad hoc relative to the goals the antitrust standard should be trying to achieve. This short Essay has outlined these goals and the most important factors that should be considered in choosing how to judge a particular type of conduct. Because of the complexity of the task and the brevity of this Essay, there is much more to be done to flesh out how all the factors should affect the optimal choice of rule. The goal of this Essay is simply to get courts and commentators thinking about the right issues when making or evaluating these decisions.