Per Se Legality: A New Standard in Antitrust Adjudication Under the Rule of Reason

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The recent suit by the Justice Department against the Microsoft Corporation reinvigorates the discussion surrounding the most effective and efficient way to adjudicate antitrust cases. The traditional method for evaluating certain antitrust cases, the rule of reason, has been criticized as being expensive, and difficult to administer. One consequence to these shortcomings is that an antitrust defendant will almost always avoid liability under the rule of reason. This Note suggests that the traditional rule of reason approach should no longer be employed in antitrust cases. Rather, cases involving Section 1 of the Sherman Antitrust Act should be adjudicated under a new process. Under this amended process, courts would no longer undergo extensive investigation of the economic impact of an agreement falling under the rule of reason. Instead, any agreement formerly adjudicated under the rule of reason would be declared per se legal and be dismissed. The author rationalizes this drastic change by arguing that the free market has a comparative advantage over the courts in evaluating rule of reason cases.

I. INTRODUCTION

Section 1 of the Sherman Antitrust Act was passed by Congress in response to the increased dominance of the monopolizing trust.[1] According to its language, Section 1 of the Sherman Act works to prohibit "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade."[2] However, the courts have refused to apply a literal interpretation to Section 1. Doing so would make nearly every business arrangement illegal, because it is difficult to have a business arrangement without it also working to restrain trade.[3]

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[1] *See* Eleanor M. Fox, *The Politics of Law and Economics in Judicial Decision Making: Antitrust as a Window*, 61 N.Y.U. L. REV. 554, 563 (1986); Jennifer E. Gladieux, Comment, *Towards a Single Standard for Antitrust: The Federal Trade Commission's Evolving Rule of Reason*, 5 GEO. MASON L. REV. 471, 475 (1997). For a more detailed discussion of the history of the passing of the Sherman Act, see *infra* notes 17–25 and accompanying text.

[2] Sherman Act, 15 U.S.C. § 1 (1994).

[3] For example, consider a situation in which two lawyers forming a partnership agree not to compete with each other outside of the partnership. This agreement would impose some restraint upon competition. Under the express language of Section 1, such an agreement would be illegal, even though the agreement imposes minimal restraints upon competition, and serves a legitimate purpose. *See* Phillip Areeda, *The Rule of Reason—A Catechism on Competition*, 55 ANTITRUST 571, 572 (1986).

As a result, at the outset of an antitrust case, courts have typically classified Section 1 cases as falling into one of two categories.[4] On one hand are the agreements deemed to have a clear, negative effect upon competition, without any sort of procompetitive justification. Such agreements are said to fall under the per se rule.[5] Agreements not found to fall under the per se rule have been traditionally adjudicated under what is called the rule of reason.[6]

An antitrust case will be given markedly different treatment depending upon whether or not it falls under the per se rule or the rule of reason. Under the per se rule, the agreement is illegal without any investigation into the actual effect of the agreement upon the market.[7] Under the rule of reason, courts typically undertake a full investigation of the agreement's actual impact upon the economy as well as any procompetitive effects which might justify such an agreement.[8] The rule of reason was intended to provide an opportunity for novel business practices to come under close and careful scrutiny so that their true economic effect might be evaluated.[9] While the concept behind the rule of reason is admirable, the rule of reason is severely flawed in its practical application. It is an expensive process which imposes substantial costs upon the litigants.[10] Additionally, it asks either jury members or judges to understand and evaluate complex economic theory and data, despite the fact that very few judges or jury members are trained in

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[4] Although the categorization of an antitrust case as falling under the rule of reason or the per se rule is an initial matter that must be decided before the case is (theoretically) decided on the merits, it is rarely a simple process. Typically there will be extensive and heated litigation over whether a particular agreement falls under the per se rule or the rule of reason. *See infra* notes 103–105 and accompanying text.

[5] *See* notes 91–101 *infra* and accompanying text.

[6] *See id.*

[7] One of the most striking characteristics of the per se rule is its breadth. Agreements found to fall under the per se rule are automatically illegal, even where their actual effect may be beneficial to competition. *See, e.g.*, Willard K. Tom & Joshua A. Newberg, *Antitrust and Intellectual Property: From Separate Spheres to Unified Field*, 66 ANTITRUST 167, 187 (1997) ("[T]he substantive per se rule takes a formalistic approach that focuses on the intrinsic nature of certain restraints, eschewing any inquiry into the effects of such restraints on competition."). The rationale for the arbitrary nature of the per se rule is that the gains from striking down anticompetitive behavior outweigh the potential costs of striking down behavior that actually aids competition. In addition, certain administrative costs will be reduced by imposition of a per se rule. *See* United States v. Container Corp. of Am., 393 U.S. 333, 341 (1969) (Marshall, J., dissenting); *see also* Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 9–10 (1984) ("The costs of these unfortunate condemnations are less than the costs—both litigation and error costs—of making decisions case by case about competitive benefit.").

[8] *See* Chicago Board of Trade v. United States, 246 U.S. 231, 238 (1918). The rule of reason standard as articulated in Chicago has been universally adopted by other courts in applying the rule of reason. *See infra* note 68–71 and accompanying text.

[9] *See infra* text accompanying notes 221–223.

[10] *See infra* notes 126–29 and accompanying text.

economics.[11] One consequence of these flaws is that in a rule of reason case, the antitrust defendant will almost always win.[12] Commentators have suggested many ways to simplify or alter the rule of reason in order to create a more efficient and just result.[13] However, alterations to the rule do little where the rule itself is inherently flawed.

This Note suggests that the rule of reason should no longer be employed in antitrust cases. Rather, Section 1 cases should be adjudicated under a new process. As before, those agreements falling under the per se rule would be declared automatically illegal. However, for agreements falling under the rule of reason, courts would no longer undergo extensive investigation of a particular agreement's economic impact. Instead, any agreement that formerly would have been adjudicated under the rule of reason would not be evaluated by the courts at all, but would be declared *Per Se Legal* and be dismissed. Admittedly this would represent a drastic change in the field of antitrust adjudication—elimination of the rule of reason would mean the elimination of a judicial device that has been used by the courts for over eighty years.[14] Its removal is premised upon the theory that the free market has a comparative advantage over the courts in evaluating rule of reason cases.

This Note discusses the rule of reason, and how its removal might create fairer and more efficient antitrust adjudication. Part II will discuss the evolution of the rule of reason, from its inception in 1911 to its current application. Part III will discuss the practical problems posed by the rule of reason, and how these problems are an inherent part of the rule of reason. Part IV will discuss why the use of a per se legality standard might be the best way to adjudicate antitrust cases formerly adjudicated under the rule of reason—focusing primarily upon the economic theory of comparative advantage. Part IV will also apply this suggested per se legality standard to the most important antitrust case in recent memory—the pending suit brought by the Justice Department against the Microsoft Corporation.[15]

II. THE DEVELOPMENT OF THE RULE OF REASON

A. *Background: The Goals of the Sherman Act*

Perhaps the best way to begin a discussion of the rule of reason is to discuss

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[11] *See infra* notes 132–41 and accompanying text.

[12] *See infra* Part II.C.5.

[13] *See infra* Part III.B.

[14] The Supreme Court first formally adopted a reasonableness test under Section 1 in 1911. *See infra* Part II.C.2.

[15] *See* Plaintiff's Complaint, United States v. Microsoft Corp., (No. 98-1232), *available at* <http://www.usdoj.gov/atr/cases/f1700/1763.htm> (visited Apr. 20, 2000).

the goals of the Sherman Act itself. As one commentator writes, "[a]ntitrust policy cannot be made rational until we are able to give a firm answer to one question: What is the point of the law—what are its goals? Everything else follows from the answer we give."[16]

The Sherman Act was passed in 1890 in response to the development and growth of the monopolizing trust.[17] However, it remains unclear what should be the policy objective of the Sherman Act. The language of the Sherman Act is broad, written in almost constitutional terms.[18] The primary lobbying group behind the Sherman Act consisted of small business people, including farmers.[19]

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[16] ROBERT H. BORK, THE ANTITRUST PARADOX 50 (Free Press 1993) (1978).

[17] *See* Fox, *supra* note 1, at 563; Gladieux, *supra* note 1, at 475. As companies and markets grew in size, companies within certain markets began to vigorously compete with one another to the point of trying to eliminate their business competitors. There was a rise in public sentiment against these new business practices, and as a result, there were attempts by state courts to revoke the charters of certain businesses which were found to be employing unfair business behavior. *See* DANIEL J. GIFFORD & LEO J. RASKIND, FEDERAL ANTITRUST CASES AND MATERIALS, 3–6 (1998). For an example of where a state was successful in revoking the charter of a business employing unfair business practices under state law, see generally People v. North River Sugar Refining Co., 3 N.Y. Supp. 401 (1889), *aff'd*, 24 N.E. 834 (1890) (finding a transfer of management powers to a board of directors to be not allowed under the company's charter).

However, attempts to curb unfair business practices under state law were thwarted by the increased popularity of a business structure known as the "trust," which allowed a business to move its charter from one state to another without actually moving its physical assets. Therefore, a corporation could easily transfer its place of existence from one state to another in order to avoid the jurisdiction of certain state courts. As a result, there was a rise in popular sentiment for Congress to use Federal Law in order to control the business practices of these "trusts." Due to the rise in popular sentiment, Congress enacted the Sherman Act in 1890. *See* GIFFORD & RASKIND, *supra*, at 3–6.

[18] In describing the language of the Act, Chief Justice Stone has commented in dictum:

> The prohibitions of the Sherman Act were not stated in terms of precision or of crystal clarity and the Act itself did not define them. In consequence of the vagueness of its language, perhaps not uncalculated, the courts have been left to give content to the statute, and in performance of that function it is appropriate that courts should interpret its word in the light of its legislative history and of the particular evils at which the legislation was aimed.

Apex Hosiery Co. v. Leader, 310 U.S. 469, 489 (1940).

[19] *See* Fox, *supra* note 1, at 563–64. In the years following the Civil War, from 1865 to 1890, there was a degree of commercial tension and rivalry between the agrarian sector of the American economy and an emerging industrial sector. As a means of defending themselves in this rivalry, American farmers developed into a powerful and influential political force, which came to be known as the Granger Movement. GIFFORD & RASKIND, *supra* note 17, at 1–2. As firms in the industrial sector began to more vigorously compete with one another, they began to employ certain business practices which were thought to be harmful to the agrarian sector. For

However, the legislative history of the Act could be read to support any number of policy objectives, from the protection of smaller businesses to the maximization of efficiency and consumer welfare.[20]

Today most commentators,[21] as well as the courts,[22] agree the overriding goal of the Sherman Act should be economic efficiency.[23] This is largely because

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example, in his attempt to expand his Standard Oil Empire, John D. Rockefeller was able to obtain preferential railroad freight rates to ship his oil. One consequence of these preferential rates was that the railroads had to compensate by charging higher rates to other customers, including those trying to ship agrarian products. *Id.* at 4 (citing Elizabeth Granitz & Benjamin Klein, *Monopolization by Raising Rivals' Costs: The Standard Oil Case*, 39 J.L. & ECON. 1 (1996)). Such pricing practices were perceived as harmful to farming interests, and as a result the agrarian political voice cried out against these new business methods. *Id.*

[20] *See* Gladieux, *supra* note 1, at 475 ("[A]n examination of legislative history reveals testimonial support from the drafters for almost any policy goal, from the promotion of 'small dealers and worthy men' to the overriding emphasis on the maximization of efficiency and consumer welfare.") (citations omitted). Many commentators have attempted to establish the overriding policy goals of the Sherman Act from its legislative history. See, *e.g.*, Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & ECON. 7 (1966); Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65 (1982).

[21] There are two variations on the view that the Sherman Act should be interpreted to promote the goal of economic efficiency. Some commentators, such as Robert Bork, have concluded that Congress actually intended to promote economic efficiency as the primary goal of the Sherman Act. *See generally* BORK, *supra* note 16; Bork, *supra* note 20. Other commentators, such as Judges Easterbrook and Posner, feel that economic efficiency should be the goals promoted by the Sherman Act regardless of what Congress intended. *See generally*, Richard A. Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282 (1975); Frank H. Easterbrook, *Workable Antitrust Policy*, 84 MICH. L. REV. 1696 (1986). *Cf.* John J. Flynn and James F. Ponsoldt, *Legal Reasoning and the Jurisprudence of Vertical Restraints: The Limitations of Neoclassical Economic Analysis in the Resolution of Antitrust Disputes*, 62 N.Y.U. L. REV. 1125, 1136 (1987). Flynn and Ponsoldt are critical of both variations. They argue that Bork is misreading the legislative history of the Sherman Act. *Id.* at 1137–41. They also argue that Easterbrook and Posner do not show proper deference to the views of Congress. *Id.* at 1114–45; *see also* Lande, *supra* note 20 (arguing that a strict adherence to economic efficiency as the dominant policy goal of the Sherman Act is becoming a less popular view).

[22] *See, e.g.*, National Soc. of Prof. Engineers v. United States, 435 U.S. 679, 695 ("The Sherman Act reflects a legislative judgment that ultimately competition will produce not only lower prices, but also better goods and services."); *see also* Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 767 n.14 (1984) (stating that the law protects competition, not individual competitors); Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 488 (1977) (same).

[23] The emphasis upon efficiency as the overriding policy in antitrust law has been termed the "Chicago School." Gladieux, *supra* note 1 at n.22 (citing Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925 (1979)).

economic efficiency serves as a value-free goal which prevents judges from imposing their own personal views of what exactly represents a fair business practice.[24] For instance, if courts were able to use the Sherman Act to protect small businesses, then the courts would enjoy complete discretion to condemn any business practice deemed to be unfair, despite the fact that the practice will help consumers by improving product quality, increasing product quantity, and reducing price.[25]

However, even where economic efficiency is accepted as the goal of antitrust law, uncertainty still remains. First, there has been disagreement over what is actually meant by the term "economic efficiency." While most case law seems to suggest that the antitrust laws should be read to maximize pure consumer welfare,[26] it has been suggested that the antitrust laws be read to maximize "aggregate economic welfare," which is consumer welfare in addition to stockholder profits.[27] There are also differences of opinion as to what economic model actually represents the marketplace.[28] Are most firms rationally trying to

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[24] *See* Michael P. Kenny & William H. Jordan, The United States v. Microsoft: *Into the Antitrust Regulatory Vacuum Missteps the Department of Justice*, 47 EMORY L.J. 1351, 1364 (1998) ("The salubrious focus on consumer welfare not only has universal applicability, but it also constrains courts from indulging in the fundamentally misguided belief that government agents, rather than market forces, can best determine the allocation of resources."). *But see* Fox, *supra* note 1, at 576–7 (asserting that the use of economics as a blueprint for antitrust law still provides courts with ample opportunity to make their own judgments).

[25] *See* Kenny & Jordan, *supra* note 24, at 1364–65 (citing 1 PHILIP E. AREEDA, ANTITRUST LAW ¶ 11 (1986)).

> [M]uch of the legislative debates over the antitrust laws reveal that individual members of Congress were concerned about protecting small competitors from larger, lower cost, or more aggressive rivals. For one who believes that small business is a valuable part of American business culture, such a concern is appealing. But once it is accepted, what defines its limits? Should we then use the antitrust laws to condemn any innovation, merger, or distribution practice that reduces the defendant's costs with the result that smaller firms are placed at a disadvantage? . . .
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> But almost certainly Congress intended no such thing. It never wanted a rule that would condemn all innovations or cost-reducing (or product enhancing) policies that injured rivals.

Id.

[26] *See, e.g.*, United States v. Long Island Jewish Med. Ctr., 983 F. Supp. 121, 149 (E.D.N.Y. 1997)); Steven C. Salop & R. Craig Romaine, *Preserving Monopoly: Economic Analysis, Legal Standards, and Microsoft*, 7 GEO. MASON L. REV., 617, 647, n.84 (citing FTC v. Staples, Inc., 970 F. Supp. 1066 (D.D.C. 1997).

[27] *See* BORK, *supra* note 16, at 107–15; *see also* Salop & Romaine, *supra* note 26, at 646, n.83 (discussing whether or not Bork's aggregate welfare standard should also include the shareholder profits of the excluded firm).

[28] *See generally*, GIFFORD & RASKIND, *supra* note 17, at 10–11.

maximize profits?[29] Or do firms operate with other goals in mind?[30] Different assumptions about how firms operate will naturally affect how one feels that antitrust law should be applied. As one commentator notes: "It is characteristic of antitrust law that differing perceptions of anti-competitive conduct in different cases comes about from varying premises of the underlying model that is applied to the problem."[31] Even where one consensus economic model of the economy is accepted, there remains disagreement as to what types of behavior are best for the economy.[32] Suggested approaches have ranged from substantial government regulatory control to absolutely no regulatory control at all.[33] Thus, even where the goals of antitrust are clear, the methods of obtaining those goals are not.

This discussion of the goals of the Sherman Act helps show how difficult adjudication of antitrust laws can be. In most areas of law, the goals to be served are fairly clear—fairness, equality, protection of rights.[34] People generally have an idea of what kind of solution to a problem is fair or promotes equality. However, antitrust law is generally understood to promote efficiency.[35] It is

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[29] *See, e.g.*, RICHARD A. POSNER, ECONOMIC ANALYSIS OF THE LAW 4 (4th ed. 1992) ("The concept of man as a rational maximizer of his self-interest implies that people respond to incentives—that if a person's surroundings change in such a way that he could increase his satisfactions by altering his behavior, he will do so. From this proposition derive the . . . fundamental principles of economics.").

[30] *See, e.g.*, Kenneth Arrow, *Risk Perception in Psychology and Economics*, 20 ECONOMIC INQUIRY 1 (1993) ("[A]n important class of intemporal markets shows systematic deviations from individual rational behavior . . . ."); Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 YALE L.J. 209 (1986) (arguing that many firms employ strategic behavior to raise competitors' costs).

[31] GIFFORD & RASKIND, *supra* note 17, at 11.

[32] *See* Fox, *supra* note 1, at 573 ("There are several conceptions of the best way, or at least of promising ways, to promote allocative efficiency.").

[33] *See id.*

[34] *See id.* at 555. Fox characterizes different areas of law as falling upon different areas of a spectrum. ("Antitrust law stands at one end of a spectrum; it is among the legal disciplines that are most nearly efficiency-based. Constitutional law stands at the other end of the spectrum; it is the genre of law that is most clearly rights-, freedom-, and process-based.") *Id.*

[35] Disagreements even arise as to what is meant by the term efficiency. *See, e.g.*, Richard S. Markovits, *The Limits to Simplifying Antitrust: A Reply to Professor Easterbrook*, 63 TEX. L. REV. 41, 45–48 (1984) (noting the distinction between organizational allocative efficiency and competitive impact efficiency). Markovits argues that some activities may increase competitive impact efficiency, while at the same time decreasing organizational allocative efficiency. *See id.* at 45–46. An example of this would be a tying arrangement, where a consumer is forced to buy a desirable product (the tying product) only if she also buys a less desirable product (the tied product). Markovits argues that such an arrangement may actually reduce organizational allocative efficiency by taking away more wealth from consumers than what is given to producers. *See id.* at 48. At the same time, Markovits asserts that the arrangement might not decrease competitive impact efficiency because consumers will still be presented with the same offers by alternative suppliers. *See id.*

unclear even what type of economic model represents that goal, or what steps should be taken to reach it.

B. *Early Application of Section 1 of the Sherman Act*

From the basic language of Section 1, it would seem that any restraint of trade brought out by a contract, combination, or conspiracy would be an illegal one, no matter how minimal the restraint upon trade.[36] This seems to be the initial approach of the United States Supreme Court. In the 1897 case, *United States v. Trans-Missouri Freight Association*,[37] eighteen railroads, who controlled rail traffic west of the Mississippi River, had created an association which set the same freight rates for all of the railroads.[38] The United States Government thought that this association was a violation of the Sherman Act and therefore brought suit under the Act.[39] In its defense, Trans-Missouri argued that Section 1 of the Sherman Act prohibited only those agreements that would have been found unreasonable under the common law.[40] Since the Trans-Missouri price agreement kept prices at a reasonable level, the agreement was legal under the Sherman Act.[41]

A majority of the Justices disagreed with this argument, noting that the language of the Act clearly forbids all agreements in restraint of trade, regardless of whether the restraint was reasonable or not.[42] In an opinion written by Justice Pecham, the majority could find no good reason to depart from such clearly

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[36] *See* 7 PHILIP E. AREEDA, ANTITRUST LAW ¶ 1501 (1986) ("In 1897 application of Sherman Act § 1 seemed deceptively simple. Once a 'contract combination or conspiracy' affecting interstate commerce appeared, the statute made 'every' restraint a crime.").

[37] 166 U.S. 290 (1897).

[38] *See id.* at 292–98.

[39] *See id.* at 309.

[40] *See id.* at 27–28. The common law originally refused to enforce contracts that were a restraint on trade, finding such contracts to be against public policy. However, by the eighteenth century, common law courts began to enforce contracts in restraint of trade, so long as the restraint was ancillary to a lawful business purpose and limited in time and space. *See* 7 AREEDA, *supra* note 36, ¶ 1501 (citing Mitchel v. Reynolds, 1 P. Wms. 181 (K.B. 1711)). As time progressed, a contract in restraint of trade was enforceable so long as it was reasonable, where reasonableness was presumed. By 1890, the common law rule against contracts in restraint of trade was largely nonexistent. *See id.*

[41] *See Trans-Missouri*, 166 U.S. at 327–28.

[42] *See id.* at 312 ("The language of the act includes *every* contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States or with foreign nations."); *see also* MILTON HANDLER, ANTITRUST IN PERSPECTIVE 5 ("To Peckham [author of the majority opinion], the only question in Sherman Act litigation was whether the challenged arrangement constituted a restraint of trade; if so, it fell within the statutory condemnation.").

written language noting: "That impolicy [sic] is not so clear, nor are the reasons for the exception so potent as to permit us to interpolate an exception into the language of the act, and to thus materially alter its meaning and effect."[43] Because the Trans-Missouri railroads activity involved an agreement, and because the agreement resulted in a restraint upon trade, the Supreme Court found the agreement to be illegal, without any investigation into the reasonableness of the agreement.[44]

Four dissenting Justices disagreed with this approach, arguing that the Sherman Act should be read in light of the common law tradition that only contracts creating unreasonable trade restraints were to be found illegal.[45] Because the prices agreed upon by Trans-Missouri were reasonable prices, the dissent asserted that the restraint upon trade was a reasonable one, and thus legal under the Sherman Act.[46]

According to a majority of the *Trans-Missouri* Justices, an investigation into the reasonableness of the restraints caused by particular agreements was not necessary in Section 1 Sherman Act cases. Rather, the majority preferred to make a literal interpretation of statutory language which very clearly seemed to forbid all agreements in restraint of trade. However, it was not long before the courts began to realize that some sort of reasonableness standard was necessary in applying Section 1.

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[43] *Trans-Missouri*, 166 U.S. at 340.

[44] *See id.* at 342 ("[T]he [antitrust] suit of the Government can be maintained without proof of the allegation that the agreement was entered into for the purpose of restraining trade or commerce or for maintaining rates above what was reasonable.").

[45] *See id.* at 346 (White, J. dissenting):

> Is it correct to say that at common law the words "restraint of trade" had a generic signification which embraced all contracts which restrained the freedom of trade, whether reasonable or unreasonable, and, therefore, that all such contracts are within the meaning of the words "every contract in restraint of trade"? I think a brief consideration of the history and development of the law on the subject will not only establish the inaccuracy of this proposition, but also demonstrate that the words "restraint of trade" embrace only contracts which unreasonably restrain trade, and, therefore, that reasonable contracts, although they, in some measure, "restrain trade," are not within the meaning of the words.

Id.; *see also* HANDLER, *supra* note 42, at 5 ("[A]ccording to White's theory, the rule of reason had been built into the very words and structure of the legislation."). It is important to note that, even under a modern application of the Sherman Act employing the rule of reason, the tacit price agreement by the railroad association would still represent a per se violation of Section 1. *See, e.g.*, United States v. Trenton Potteries Co., 273 U.S. 392 (1927) (holding that the per se rule against price-fixing applies to agreements by horizontal competitors to fix prices).

[46] *See Trans-Missouri*, 166 U.S. at 370 (White, J., dissenting) ("It seems to me very clear that that the contract in question is in accord with the [Sherman Act] and should not be avoided.").

C. *Development of the Rule of Reason*

1. *Movement Towards Applying Section 1 Only to "Unreasonable Restraints"*

Not long after *Trans-Missouri* was decided, it began to become clear that a literal interpretation of Section 1 would not work. Nearly every business agreement, no matter how minor or inconsequential, restrains trade in some way.[47] Under a literal interpretation of Section 1, such agreements would be illegal. Surely the Sherman Act was not designed to prohibit such agreements, which posed a minimal threat to commerce and actually promoted legitimate and useful business objectives.

The Supreme Court hinted as much, in the 1898 case, *United States v. Joint-Traffic Association*.[48] In *Joint Traffic Association*, thirty-one competing railroads had formed an association in order to cooperate with each other in developing reasonable rates and fares.[49] Once again a majority of the Justices found the association illegal under Section 1 of the Sherman Act without looking into the reasonableness of the arrangement.[50] However, the majority also suggested in dictum that some restraints might not fall under the control of Section 1. The Court noted that the Sherman Act might not apply to common and useful business practices which restrained trade: "An agreement entered into for the purpose of promoting the legitimate business of an individual or corporation, with no purpose to thereby affect or restrain interstate commerce, is not, as we think, covered by the act, although the agreement may indirectly and remotely affect that commerce."[51] The Court affirmed its willingness to find some restraints as exempted from the Sherman Act in the 1898 case, *Hopkins v. United States*.[52] In its opinion, the majority noted that Section 1 could not be construed to apply to every business arrangement, or else "there would scarcely be an agreement among businessmen that could not be said to have, indirectly or remotely, some bearing upon interstate commerce and, possibly to restrain it."[53] The Court found

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[47] *See supra* note 3.

[48] 171 U.S. 505 (1898).

[49] *See id.* at 505–09.

[50] *See id.* at 505 (stating that the same result should be reached in this case as in *Trans-Missouri*); *see also* GIFFORD & RASKIND, *supra* note 17, at 39 (concluding that in *Joint Traffic Association*, "the Supreme Court construed the [Sherman] Act literally to prohibit concerted 'restraint[s] of trade,' regardless of their reasonableness.").

[51] *Joint Traffic Association*, 171 U.S. at 568; *see also* 7 AREEDA, *supra* note 36, ¶ 1501 (commenting that the *Joint Traffic Association* opinion indicates that "the Court began to doubt that Congress meant to reach every minor restraint").

[52] 171 U.S. 578 (1898).

[53] *Id.* at 600; *see also Joint Traffic Association*, 171 U.S. at 568 (repeating the same

the agreement in question to be legal in *Hopkins*, based upon the fact that the agreement's affect upon commerce was indirect.[54]

Despite some indications that the Supreme Court was willing to apply some sort of reasonableness standard to Section 1 cases, through 1898 the Court had yet to fully embrace such a standard. In *Joint Traffic Association*, the Court had reaffirmed its holding in *Trans-Missouri*, while the reasoning in *Hopkins* was "far from clear."[55] It would be over a decade before the United States Supreme Court accepted completely a reasonableness standard for some Section 1 cases.

2. *Establishment of the Rule of Reason*

The use of a reasonableness standard for adjudicating certain business conduct under the Sherman Act was first articulated[56] by the Supreme Court in two cases: *Standard Oil Co. v. United States*[57] and *United States v. American Tobacco Co.*[58] In *Standard Oil*, the Court once again noted that the language of Section 1 was very broad, expansive enough to "embrace every conceivable contract or combination."[59] The Court rejected such a broad interpretation, instead holding that the proper method of adjudication of Sherman Act cases was the use of a "standard of reason" of a type used in the common law.[60] In *American Tobacco*, the Court articulated similar reasoning, noting: "The Anti-trust Act must have a reasonable construction as there can scarcely be any agreement or contract among business men that does not directly or indirectly affect and possibly restrain commerce."[61]

With its *Standard Oil* and *American Tobacco* opinions, the Supreme Court fully embraced the idea that some sort of reasonableness standard was the proper

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language).

[54] *See id.* at 569 ("An agreement... which does not directly restrain such commerce, is not... covered by the act, although the agreement may indirectly and remotely affect that commerce.").

[55] 7 AREEDA, *supra* note 36, ¶ 1501.

[56] Lower courts, however, had adopted a reasonableness standard before the Supreme Court did. In *United States v. Addyston Pipe and Steel*, the Sixth Circuit employed a common law standard of reasonableness into its opinion, arguing that an agreement could be found reasonable if it was ancillary to an agreement with a legitimate business purpose. 85 F. 271, 282 (6th Cir. 1898), aff'd, 175 U.S. 211 (1899).

[57] 221 U.S. 1 (1911).

[58] 221 U.S. 106 (1911).

[59] *Standard Oil*, 221 U.S. at 60.

[60] *Id.* at 60 ("[T]he standard of reasonableness which had been applied at the common law and in this country in dealing with subjects of the character embraced by the statute, was intended to be the measure used for the purpose of determining whether in a given case a particular act had or had not brought about the wrong against which the statute provided.").

[61] *American Tobacco*, 221 U.S. at 107.

standard in adjudicating some Section 1 cases. However, questions about the application of the rule of reason still remained. Specifically, there was the question of how this reasonableness standard was to be applied.[62] *Standard Oil* suggested that the common law standard should be used to establish reasonableness.[63] Was this the proper standard? Or should the standard of reasonableness be developed through other means? It was not long before the Supreme Court developed what has become the generally accepted construction of the rule of reason.

3. *Application of the Rule of Reason*

In *Standard Oil* and *American Tobacco*, the Supreme Court cemented the idea that at least some agreements would not be found automatically in violation of the Sherman Act, but would now be evaluated under some sort of reasonableness standard. The next question became how this reasonableness standard was going to be applied.

After refusing to adopt common law standards of whether or not a particular agreement was reasonable,[64] courts utilizing the rule of reason have focused their evaluations upon a particular agreement's competitive impact.[65] This focus upon competitive impact is illustrated in the 1918 case, *Chicago Board of Trade v.*

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[62] *See* HANDLER, *supra* note 42, at 9 (noting that Justice White, in trying to get the rule of reason into antitrust jurisprudence, was "more concerned with having it [the rule of reason] recognized than in defining its content").

[63] *See supra* note 60 and accompanying text.

[64] Although the Sherman Act was drafted using restraint of trade language used by the common law, the common law standard of reasonableness has not been found to be the standard employed by courts. *See* 7 AREEDA, *supra* note 36, ¶ 1501 ("Decisions under the Sherman Act have left the common law rulings far behind."). Areeda asserts that the common law served only as a starting point from which judges could assert their own standards of reasonableness:

> In my view, the use of unelaborated common law words and references simply invested the federal courts with a new jurisdiction that inevitably required them to receive, apply, and develop the common law in the same way that a new jurisdiction customarily does—that is, to use certain customary techniques of judicial reasoning, to consider the reasoning and results of common law courts, and to develop, refine, and innovate in the dynamic common law tradition . . . the antitrust courts routinely find unlawful restraints of trade where the common law would not have imagined.

Id.

[65] *See, e.g.*, Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 767 n.14 (1984) (stating that the law protects competition, not individual competitors); Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 488 (1977) (same).

United States[66]—a case that contains the "formulation most often quoted to express the inquiry mandated by Sherman Act § 1."[67] The Supreme Court was asked to determine the legality of the Board of Trade's "Call Rule," which required grain traders dealing after the close of public trading to buy and sell only at the price at which the market had closed.[68] In its opinion, the Supreme Court focused upon the economic effects of the agreement, noting that "the true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promoted competition or whether it is such as may suppress or even destroy competition."[69] The Court went on to explain more fully how to evaluate a particular agreement's effect upon competition, holding that one must make three evaluations: (a) the level of competitive harm resulting from the defendant's activities; (b) the existence of a legitimate and useful purpose behind the activities of the participant; and (c) if there was a legitimate purpose behind the activity, the existence of another, less restrictive means to advance the legitimate and useful purpose behind the participant's activities.[70] These three evaluations are made by "virtually all courts" when applying the rule of reason.[71]

In evaluating competitive harm, courts typically make two separate examinations. First, courts examine whether competition is harmed by a particular agreement.[72] Second, courts examine the extent of this harm.[73] In evaluating the existence of competitive harm, a deviation in prices and output from the competitive level is generally a strong indication of anticompetitive affect.[74] In a rule of reason case, this economic effect is nearly impossible to prove, because it is often impossible to establish what the competitive level

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[66] 246 U.S. 231 (1918).

[67] 7 AREEDA, *supra* note 36, ¶ 1502.

[68] *Chicago Board of Trade*, 246 U.S. at 232–33.

[69] *Id.* at 238.

[70] The *Chicago Board of Trade*'s articulation of this rule is a follows:

> [T]he court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint . . . and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts.

Id.

[71] *See* 7 AREEDA, *supra* note 36, ¶ 1502.

[72] *See* 7 AREEDA, *supra* note 36, ¶ 1503 ("[W]e must go on to determine not only whether that harm is not only possible but likely and significant."); Areeda, *supra* note 3, at 573–74.

[73] *See supra* note 72..

[74] *See* NCAA v. Board of Regents of The Univ. of Oklahoma, 468 U.S. 85, 113 (1984) (noting that the NCAA's plan works to raise prices and restrict output, which operates as a "hallmark [ ] of anticompetitve behavior"); *see also* Areeda, *supra* note 3, at 576 (noting that the most recent antitrust cases require an "actual or potential impairment of price and output").

should be in the first place,[75] let alone that output and prices are differing from that competitive level.[76] Additionally, many business arrangements are evaluated under the antitrust laws before they actually began to produce anticompetitive results.[77]

In evaluating the extent of competitive harm, a determination is usually made of the defendant's share of the relevant market. The higher the firm's share of the market, the greater the extent of harm to competition,[78] because a firm with high

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[75] According to microeconomic theory, in a perfectly competitive market, price equals marginal cost. *See, e.g.*, KARL E. CASE & RAY C. FAIR, PRINCIPLES OF MICROECONOMICS, 211 (4th ed. 1996). Therefore, one approach is to assume that a product's marginal cost is its competitive price level. *See* Michael S. McFalls, *The Role and Assessment of Classical Market Power in Joint Venture Analysis*, 66 ANTITRUST 651, 654 (1998). There are two problems with this approach. First, calculating marginal costs itself is often a difficult process. *See* McFalls *supra*, at 655 (noting the difficulty in calculating a firm's marginal costs at any given time); *see also* Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697, 716–18 (1975) (allowing average costs to be substituted for marginal costs because of the difficulty in calculating marginal costs). Second, it is uncertain whether or not the perfectly competitive market is a realistic model for how the marketplace actually works. If it is not, then firms in a competitive market may charge prices that deviate from marginal costs. *See, e.g.*, Joseph E. Stiglitz, *Imperfect Information in the Product Market*, *in* 1 HANDBOOK OF INDUSTRIAL ORGANIZATION 769, 818 (Richard Schmalensee & Robert D. Willig eds., 1989) (asserting that if one of the assumptions of the perfectly competitive market—perfect information—is eliminated, then firms would be able to charge more than marginal cost, even where competition is robust). The same difficulties exist in calculating competitive output levels. Even if a competitive output level could be calculated under the traditional assumptions of the competitive market, there is no guarantee that these assumptions are correct. *See supra* notes 28–33.

[76] *See* McFalls, *supra* note 75 at 658 ("Even when relevant [output and price] data are available, interpretation may be difficult."). McFalls asserts that it is very difficult to tie a particular price increase to a particular business practice: "Prices may increase for reasons completely unrelated to the practice or transaction under review. Conversely, prices may have decreased during the relevant period, but they might have been even lower in the absence of the conduct at issue." *Id.*

[77] *See, e.g.*, 7 AREEDA, *supra* note 36, ¶ 1503 ("Many alleged restraints are examined before they have had time to work their results.").

[78] *See* Bhan v. NME Hosps., Inc., 929 F.2d 1404, 1413 (9th Cir. 1991) (holding that in order to show competitive harm, an antitrust plaintiff must delineate a relevant market and show that the defendant plays enough of a role in that market to impair competition significantly); United States v. Realty Multi-List, Inc., 629 F.2d 1351 (5th Cir. 1980); Ginzburg, M.D. v. Memorial Healthcare Sys., 993 F. Supp. 998, 1025–26 (S.D. Tex. 1997) (holding that plaintiff could not prevail under the rule of reason because she had not established that defendant had market power); *see also* Areeda, *supra* note 3, at 576 (noting that "the usual way" to determine magnitude of competitive harm is to establish the defendant's market share). Areeda notes that there are two instances where an evaluation of market power need not be made. First, an examination of market power is not necessary where a substantial, adverse economic effect has already been established. For instance, where it is proved that a defendant's actions have caused

market power will be better able to raise prices and extract monopoly profits at the expense of consumers.[79] In some cases, market power might be relatively easy to establish. In other cases, market power might only to be established through protracted litigation and analysis of complex economic data.[80]

In establishing a legitimate business justification for the defendant's activities, courts will focus upon the actual economic effects of the actions, rather than the defendant's good intentions.[81] Further, courts have suggested that, while a particular activity might have a beneficial, noneconomic justification, only a justification creating economic benefits will be considered for Section 1 purposes.[82] In *National Society of Professional Engineers v. United States*,[83] the Society of Engineers defended its price controls by arguing that such restraints were necessary in order to avoid cost-cutting engineering which might endanger consumers' health and safety.[84] The Supreme Court rejected such a defense, stating that one is not to look at the public interest served by an activity, but only

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prices to rise dramatically, then there is no need to establish market power. *See id.* at 577–78. Second, an investigation into market power is not necessary where the defendant has failed to establish any sort of legitimate justification for his or her actions. It has been suggested by the courts that such a "naked restraint" will be condemned without any investigation into market power. *See id.* (discussing Indiana Fed'n of Dentists v. FTC, 745 F.2d 1124 (7th Cir. 1984)).

[79] If a firm has a high share of the market, and if it used its market power to charge higher prices, then it would successfully be able to do so—at least until new entrants into the market are able to undersell the monopolist. *See infra* notes 196–97 and accompanying text. However, a firm with little market power represents no threat to competition, because if it tried to charge monopoly prices, then those comprising the other 90% of the market could easily step in and undersell the firm. *See, e.g.*, Easterbrook, *supra* note 7, at 20 (1984) ("Firms that lack power cannot injure competition no matter how hard they try.").

[80] *See infra* notes 171–82 and accompanying text.

[81] Courts have often disregarded the defendants' intentions. *See, e.g.*, United States v. Container Corp. of America, 393 U.S. 333, 335 (1969) (holding that an agreement to exchange price information to be unreasonable regardless of the defendant's intent); Standard Oil Co. v. United States, 221 U.S. 1, 75 (1911) (creating a presumption that antitrust defendant had the intent to monopolize the oil industry, even without evidence of that specific intent); *see also* 7 AREEDA, *supra* note 36, ¶ 1504 ("[T]he defendants' state of mind is less important for antitrust policy than the objective consequences of their behavior.").

[82] *See, e.g.*, Law v. NCAA, 134 F.3d 1010, 1021 (10th Cir. 1998) ("Justifications offered under the rule of reason may be considered only to the extent that they tend to show that, on balance, 'the challenged restraint enhances competition.'") (quoting NCAA v. Board of Regents for Univ. of Oklahoma, 468 U.S. 85, 104 (1984)); United States v. Realty Multi-List, 629 F.2d 1351, 1370 (5th Cir. 1980) (noting that the rule of reason looks only at the competitive significance of the restraint involved); United States v. Delta Dental of Rhode Island, 943 F. Supp. 172, 186 (D. R.I., 1996) (holding that an examination under the rule of reason entails, among other things, an investigation of the legitimate economic justifications for the business practice).

[83] 435 U.S. 679 (1978).

[84] *See id.* at 693–94.

whether or not it increases competition.[85] However, in many cases a noneconomic justification for a particular activity can be phrased so that it becomes an economic justification.[86] Even where a defendant is able to establish a legitimate, economic justification for his or her activities, the activities may still be declared illegal if the plaintiff can establish that the same economic effect could be obtained through less restrictive means.[87]

Typically, in a rule of reason case the burden of proof will shift several times between the plaintiff and the defendant.[88] First, the plaintiff must allege that competition in some market has been restrained, and then present some evidence to support that allegation in order to avoid summary judgment.[89] If the evidence establishes a restraint, then the burden shifts to the defendant to establish that there is a legitimate business justification for the behavior.[90] Any established

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[85] *See id.* at 695–96.

[86] The courts are reluctant to pay credence to noneconomic justifications for particular activities. *See supra* notes 81–84, and accompanying text. However, many apparently noneconomic justifications can be characterized as economic given proper phrasing. For instance, Professor Areeda discusses an example where three television networks agree to devote two nonoverlapping hours weekly to cultural programming. Initially, the elevation of cultural awareness might seem like a noneconomic, nonlegitimate goal. However, the arrangement might be characterized as a means of satisfying consumers who prefer cultural programming. At the same time, those who prefer noncultural programming are still satisfied, because at any given time they can view non-cultural programming on the other two networks. *See* 7 AREEDA, *supra* note 36, ¶ 1504 ("[M]any claims of redeeming virtue expressed by laymen in public interest terms can be reformulated in terms of promoting competition."); *see also* Albert A. Foer, *The Political-Economic Nature of Antitrust*, 27 ST. LOUIS U. L.J. 331, 338 ("The information necessary to defeat a reasonableness defense usually is very difficult to obtain, it is expensive to obtain, and generally there is enough of a basis on which to show some business rationale that the plaintiff has a very hard and lengthy fight.").

[87] Professor Areeda asserts that determining whether or not a less restrictive means exists is actually a "two-part inquiry." *See* 7 AREEDA, *supra* note 36, ¶ 1505. First, the court must determine whether the restraint actually serves the stated objective. Even where a defendant has established a legitimate justification, the particular restraint might not do much to advance that justification. For instance, where a realty listing company imposes a $1,000 fee upon new members in order to cover capital and operating expenses, the fee is not related to a legitimate justification where the company's capital and operating expenses are virtually nothing. *See* Areeda, *supra* note 3, at 580 (discussing United States v. Realty Multi-List, 629 F.2d 1351, 1370 (5th Cir. 1980)). The second inquiry is whether or not the same objective could be reached through less restrictive means. *See id.* at 581.

[88] *See, e.g.*, K.M.B. Warehouse Distrib., Inc. and KMB/CT Inc., 61 F.3d 123, 127 (2d Cir. 1995) (detailing the three-step process of the rule of reason); Addamax Corp. v. Open Software Found., 888 F. Supp. 274, 283 (D. Mass. 1995) (same).

[89] *See supra* note 88; *see also* 7 AREEDA, *supra* note 36, ¶ 1502 ("To avoid adverse summary judgment, he [plaintiff] must show that there are disputed material facts on that question of [competitive harm].").

[90] *See supra* note 89; *see also supra* note 86 and accompanying text.

justification, however, can be challenged if the plaintiff can establish that there is a less restrictive means to accomplish that objective.[91]

4. *The Rule of Reason in Conjunction with the Per Se Rule*

Under its *Standard Oil* and *American Tobacco* decisions, the Supreme Court had fully embraced the idea that some agreements were to be evaluated under Section 1 by a reasonableness standard. However, this reasonableness standard still had to be reconciled with previous court decisions, such as *Trans-Missouri*, which held all agreements in restraint of trade to be illegal.[92] As a result, antitrust adjudication has developed the per se/rule of reason dichotomy.

Under Section 1, the courts have placed business practices into two categories. In one category were placed the agreements thought to be so plainly anticompetitive as to be per se illegal.[93] Generally, in evaluating Section 1 cases, the courts have identified certain types of agreements which fall into the per se categorization.[94] Some examples of the types of agreements thought to be per se illegal are any horizontal agreements among competitors to fix prices[95] and territorial allocations, where competitors agree to divide the markets among themselves.[96] Sometimes a court will find a particular agreement previously

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[91] *See supra* note 90.

[92] *See* GIFFORD & RASKIND, *supra* note 17, at 40 (discussing the Supreme Court's attempt to reconcile the rule of reason "with earlier decisions which had applied the § 1 prohibition literally").

[93] The Fifth Circuit explained that:

> The probability that anticompetitive consequences will result from a practice and the severity of those consequences must be balanced against its pro-competitive consequences. Cases that do not fit the generalization may arise, but a *per se* rule reflects the judgment that such cases are not sufficiently common or important to justify the time and expense necessary to identify them.

United States v. Realty Multi-List, Inc., 629 F.2d 1351, 1365 (5th Cir. 1980); *see also* Northwest Wholesale Stationers Inc. v. Pacific Stationary & Printing Co., 472 U.S. 284, 298 (1985) ("A plaintiff seeking application of the *per se* rule must present a threshold case that the challenged activity falls into a category likely to have predominantly anticompetitive effects").

[94] For a discussion of the categories of agreements held by the courts to fall under the per se rule, see Gladieux, *supra* note 1, at 480–87; *see also* GIFFORD & RASKIND, *supra* note 17, at 37–270.

[95] *See, e.g.*, United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 223 (1940) ("[A] combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal *per se*.").

[96] *See, e.g.*, Palmer v. BRG of Georgia, Inc., 498 U.S. 46, 49–50 (1990) (per curium) (declaring unlawful on its face an agreement between bar review courses and sales companies to only sell in certain areas).

thought to be per se illegal to fall under the rule of reason.[97] Some types of agreements, such as tying arrangements and group boycotts, may be adjudicated under *either* the per se rule or the rule of reason, depending upon an initial examination of the agreement.[98] Even where an agreement is found to fall into the per se categorization, if the antitrust plaintiff is able to establish a procompetitive justification for his actions, then the agreement will be adjudicated under the rule of reason.[99] Such an approach is known as the "quick-look" rule of reason.[100]

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[97] An example of this is vertical, nonprice agreements, where a supplier agrees with a retailer somewhere down the distribution chain to restrain something other than price. Such agreements were once found to be per se illegal. *See* United States v. Arnold Schwinn & Co., 388 U.S. 365, 379 (1967) (holding that "where a manufacturer sells products to his distributor subject to territorial restrictions upon resale, a *per se* violation of the Sherman Act results."). Subsequently, the Court reversed itself, holding that such agreements were to fall under the rule of reason. *See* Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 58–59 (1977) (holding that the per se rule does not apply to vertical, nonprice restraints).

[98] A tying arrangement exists where the seller conditions the sale of one product (the tying product) upon the purchase of another product (the tied product). Tying arrangements were originally thought to be anticompetitive, based upon the theory that the seller was using market power in the tying product to force consumers to buy the tied product. This was known as leverage theory. *See, e.g.*, Times-Picayune Publ'g Co. v. United States, 345 U.S. 594, 611 (1953) ("[T]he essence of illegality in tying agreements is the wielding of monopolistic leverage; a seller exploits his dominant position in one market to expand his empire into the next."). However, leverage theory came under serious scrutiny, as commentators questioned whether or not a consumer could be forced into buying two tied products at a price that was higher than the amount that the consumer valued the two products. *See generally* Ward S. Bowman, Jr., *Tying Arrangements and the Leverage Problem*, 67 YALE L.J. 19 (1957). As a result, courts have found tying arrangements to be per se illegal only where certain preliminary factors have been established. These factors are: (a) market power in the tying product; (b) the existence of two separate products; (c) actual coercion of consumers; (d) a substantial effect upon interstate commerce. *See generally* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2 (1984).

Group boycotts, where a firm restricts output, or decreases the supply of available goods on the marketplace, is another type of activity once thought to be per se illegal. *See, e.g.*, Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 210–14 (1957) (holding an agreement between electronics manufacturers not to supply a particular store as illegal under Section 1). However, subsequent decisions have suggested that a court may look for market power before condemning a particular boycott. *See* FTC v. Superior Court Trial Lawyers Ass'n, 493 U.S. 411, 438 (1990) (Brennen, J., dissenting and concurring) (noting that "there could be no antitrust violation absent a showing that the boycotted possessed some degree of market power....").

[99] *See, e.g.*, BMI v. Columbia Broad. Sys., 441 U.S. 1, 23–25 (1979) (finding a price fixing agreement to fall under the rule of reason because the agreement actually helped promote competition). Courts are also reluctant to apply the per se rule where the agreement, although falling into the per se categorization, is necessary for there even to be a product in the first place. *See, e.g.*, NCAA v. Board of Regents of the Univ. of Oklahoma, 468 U.S. 85, 117–20 (1984) (applying rule of reason to a price-fixing arrangement because the arrangement was necessary

Once an agreement is found to fall under the per se rule, it is declared to be automatically illegal, usually without additional investigation into its economic impact.[101] Any agreement not found to fit into any of the per se categories is evaluated under the rule of reason. Under the rule of reason, the economic impact of these agreements would be determined using the factors and criteria articulated in *Chicago Board of Trade*.[102] As noted above, this investigation requires detailed investigation into an agreement's economic impact, its procompetitive justifications, and the existence of less restrictive alternatives.[103]

The per se rule is perceived as a short-cut, where an antitrust plaintiff will be able to establish an antitrust violation without the legal and factual inquiries that are required in rule of reason adjudication.[104] As a result, there will often be heated, preliminary litigation just in establishing whether a case should be adjudicated under the per se rule or the rule of reason.[105] While the antitrust

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to have intercollegiate athletics in the first place). Courts are also reluctant to apply the per se rule where the arrangement involves professional association rules. *See, e.g.*, FTC v. Indiana Fed'n of Dentists, 476 U.S. 447 (1986) ("[W]e have been slow to condemn rules adopted by professional associations as unreasonable per se . . . .").

[100] *See, e.g.*, Jay N. Fastow, *Does the Per Se Rule in Antitrust Law Remain Viable? The U.S. Supreme Court Has Oscillated in Its Own Application of the Doctrine, Creating Some Uncertainty*, NAT'L L.J., July 27, 1998, at B4 (noting that the "quick-look" rule of reason examines a defendant's procompetitive justifications to determine whether a full rule of reason analysis is necessary).

[101] *See* Northern Pacific Ry. Co. v. United States, 356 U.S. 1, 5 (1958):

> [T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use. This principle of per se unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable—an inquiry so often wholly fruitless when undertaken.

Id.; *see also* GIFFORD & RASKIND, *supra* note 17, at 40 (noting that in a price-fixing agreement, "the plaintiff need only prove an agreement among competitors about price").

[102] *See supra* notes 66–91 and accompanying text.

[103] *See id.*

[104] In addition to making for an easier trial, conventional wisdom suggests that the antitrust plaintiff's only chance of winning might lie under a per se rule. *See infra* part II.C.5.

[105] Gifford and Raskind make this point:

plaintiff tries to show that the agreement falls into one of the per se categorizations, the antitrust defendant is trying to show that it does not.[106] Even where it is clear that the arrangement in question belongs to the per se categorization, considerable litigation will often occur at the preliminary stage as the defendant attempts to establish some procompetitive justification that would warrant analysis under the rule of reason.[107] The extensive nature of this preliminary litigation is well warranted. As will be discussed below, a court's preliminary classification of a particular agreement will often determine the outcome of the case.

5. *The Result Today—Per Se Legality*

As first articulated in *Chicago Board of Trade*, the rule of reason analysis should require a careful examination of both the positive and negative competitive effects posed by a specific agreement. In reality, however, under rule of reason analysis, the agreement under scrutiny is almost never declared

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> Because the *per se* approach is designed to be a short-cut method for reaching similar overall results which would be reached under the rule of reason, tension between the two rules arises in those cases in which a plaintiff would be able to prove its case under the *per se* rule but would not be able to prove a case under the rule of reason.

GIFFORD & RASKIND, *supra* note 17, at 40.

[106] There are some close cases as to whether or not a particular agreement deserves to fall into a per se category. *See, e.g.*, Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752 (1984) (discussing the identity of a certain arrangement under Section 1 of the Sherman Act). A major issue of the case was whether the arrangement was a vertical price arrangement, and therefore per se illegal, or a vertical *non*-price agreement, which would fall under the rule of reason. *See id.* at 760–65.

One determination which might make or break an antitrust case is whether a particular arrangement is horizontal or vertical. A particular arrangement may be per se illegal if judged to be horizontal, but may fall under the rule of reason if found to be vertical in nature. *See* Val D. Ricks, *Seeing the Diagonal Clearly: Telling Vertical from Horizontal in Antitrust Law*, 28 U. TOL. L. REV. 151, 151–55 (1996). Recently, some courts have become confused as to whether a particular arrangement is horizontal or vertical. *See generally* Discon, Inc. v. Nynex Corp., 93 F.3d 1055 (2d Cir. 1996), *judgment vacated*, 525 U.S. 1019 (1998). In *Discon*, the Second Circuit characterized a particular arrangement as a "two-firm group boycott," which is a horizontal arrangement, rather than as an exclusive dealings contract, which is "essentially vertical in nature." *Id.* at 1060–61. Commentators have suggested that the Second Circuit's characterization has the potential of "condemning potentially reasonable exclusive dealerships as per se illegal group boycotts without adequate (or any) consideration of possible procompetitive justifications." Deborah A. Widiss, Note, *Uneasy Labeling*, 107 YALE L.J. 1529, 1534 (1998). The Supreme Court ultimately reversed the Second Circuit, holding that the arrangement could not be properly characterized as a "group-boycott." Nynex Corp. v. Discon, Inc., 119 S. Ct. 493, 497 (1998).

[107] *See supra* notes 97–98 and accompanying text.

illegal.[108] The reason for this overwhelming disparity is not necessarily because the antitrust plaintiff is always right on the merits. The rule of reason is set up in such a way so that even meritorious claims have little chance of winning. There are several reasons why an antitrust plaintiff will have a particularly hard time winning a Section 1 rule of reason case.

First, in a rule of reason situation, the plaintiff bears the initial burden of establishing competitive harm.[109] Generally this means establishing that the price and supply of goods on the market is different from the levels that would be offered in a competitive market.[110] As noted above, due to lag effects[111] and

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[108] *See, e.g.*, Frank H. Easterbrook, *Allocating Antitrust Decisionmaking Tasks*, 76 GEO. L.J. 305, 305 (1987) (declaring that adjudication under the rule of reason "as a practical matter meant that they were declared lawful per se"); Foer, *supra* note 84, at 337–38 ("With only slight exaggeration, there is really only one thing one needs to know about the rule of reason: when the rule is applied, the defendant virtually always wins."); Thomas A. Piraino, Jr., *Reconciling the Per Se and Rule of Reason Approaches to Antitrust Analysis*, 64 S. CAL. L. REV. 685, 685 (1991); Richard A. Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision*, 45 U. CHI. L. REV. 1, 14 (1977) ("[T]he content of the Rule of Reason is largely unknown; in practice, it is little more than a euphemism for nonliability."); Widiss, *supra* note 106, at 1529 ("In theory, rule-of-reason analysis requires a careful examination of the competitive impact of a specific agreement; in practice, however, the challenged agreement is rarely struck down."). The courts have also acknowledged the practical result of rule of reason cases. *See, e.g.*, Discon, Inc. v. Nynex Corp., 93 F.3d 1055 (2d Cir. 1996) *decision vacated* Nynex Corp. v. Discon, Inc., 119 S. Ct. 493, 497 (1998) ("[T]he initial categorization is often outcome determinative.").

Admittedly, the idea that defendants will rarely be found liable under the rule of reason is merely representative of conventional antitrust wisdom and not the product of empirical data. A reasonable question to ask is why anyone would even bring a rule of reason antitrust suit, if one was certain to lose? An answer to that question may be found in a recent empirical study detailing the success rate of claims brought under the Americans with Disabilities Act. *See generally* Ruth Colker, *The Americans with Disabilities Act: A Windfall for Defendants*, 34 HARV. C.R.-C.L. L. REV. 99 (1999). Colker's study concludes that 84% of ADA claims brought on appeal resulted in a victory for the defendant. *See id.* at 107. Colker then asks the question: Why do plaintiffs bring appeals at all if they know that there is a strong probability that they will lose? *See id.* at 109. Several of her answers translate well into an antitrust context: (a) lawyers may not be aware of the statistics involved in the specific type of case; and (b) lawyers may feel that the case they are litigating is different from previous cases. *See id.* at 110. Another explanation may lie in the fact that an antitrust suit will impose substantial litigation costs upon an antitrust plaintiff, regardless of outcome. Competitors might view antitrust suits as an opportunity to inflict enormous economic damage upon a rival, regardless of the outcome of the actual suit. *See generally* Edward A. Snyder & Thomas E. Kauper, *Misuse of the Antitrust Laws: The Competitor Plaintiff*, 90 MICH. L. REV. 551 (1991) (concluding that very few antitrust suits brought by competitors are meritorious).

[109] *See supra* notes 70–78, 89 and accompanying text.

[110] *See supra* notes 74–76 and accompanying text.

[111] *See supra* note 77 and accompanying text.

difficulties in establishing competitive levels in the first place,[112] this situation is nearly impossible to establish, even where the claim itself might be meritorious.[113] Furthermore, even where the plaintiff is able to establish deviations of supply from the competitive level, the plaintiff will still lose if the defendant can produce some legitimate business rationale for its behavior.[114] In many cases, a defendant will be able to establish some justification for its actions.[115] Even when a plaintiff is capable of establishing competitive harm in the absence of a competitive justification, it will in all but a few cases be at a tremendous expense.[116] Due to the length and complexity of an antitrust suit, the legal fees required in a rule of reason suit would be immense.[117] Rule of reason adjudication requires complex analysis of economic data and extensive discovery such an analysis and discovery will be extremely costly, completely independent of attorney's fees.[118] Therefore, the information required to win a rule of reason

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[112] *See supra* notes 75–76 and accompanying text.

[113] There are numerous cases where an antitrust claim is dismissed, purely because one side was unable to present any evidence of adverse economic effect. *See, e.g.*, Cascade Cabinet Co. v. Western Cabinet & Millwork, Inc., 710 F.2d 1366, 1373 (9th Cir. 1983) (affirming summary judgment on a rule of reason claim because Cascade had failed to present any evidence of injury to competition); Zoslaw v. MCA Distrib. Corp., 693 F.2d 870, 887 (9th Cir. 1982) ("[W]hile appellants point to injury to their particular business, they do not make the necessary showing of a substantially adverse effect on competition in the record market in general."); Knutson v. Daily Review, Inc., 548 F.2d 795, 812 (9th Cir. 1976) (holding that the plaintiffs had failed to produce independent data indicating competitive harm). *But see* J.F. Feeser, Inc. v. Serv-A-Portion, Inc., 909 F.2d 1524, 1539 (3rd Cir. 1990) (holding that the plaintiff had presented adequate evidence of economic harm); *see also* GIFFORD & RASKIND, *supra* note 17, at 40 ("As the cases indicate, an unreasonable restraint is one in which the supply of goods on the market is limited to levels below those which would be offered in a competitive market. In many situations it is difficult or impossible for a plaintiff to prove this market effect."); Piraino, *supra* note 108, at 702 (noting that under the rule of reason, "[p]laintiffs will find it increasingly difficult to prove the requisite anticompetitive effect necessary to prevail at trial").

[114] *See supra* notes 81–87, 90 and accompanying text.

[115] Establishing a procompetitive justification might be easier than one realizes. *See supra* note 86 and accompanying text.

[116] *See* Foer, *supra* note 86, at 338.

[117] In 1986, it is estimated that antitrust cases consumed $250 million a year in legal fees alone. *See* Steven C. Salop & Lawrence J. White, *Economic Analysis of Private Antitrust Litigation*, 74 GEO. L.J. 1001, 1016 (1986). The Justice Department has disclosed that its suit against Microsoft has cost $13.3 million. *See Justice Department Spent $13.3 Million on its Microsoft Case*, WALL ST. J., Oct. 7, 1999, at B6, *available in* 1999 WL-WSJ 24916878 [hereinafter Justice Department].

[118] *See* Mark Crane, *The Future Direction of Antitrust*, 56 ANTITRUST 3, 16–17 ("The rule of reason requires documents from third parties, expert testimony, and statistical data as well. The result is not only a longer trial but substantially increased discovery and pretrial expense."). In 1980, it was estimated that antitrust suits cost a total of $2 billion. *See* Robert R. Reich, *The*

antitrust suit will be both difficult and expensive to obtain.

Second, the expense of an antitrust trial is likely to adversely affect the antitrust plaintiff in other ways unrelated to the merits of the case. The extensive costs might impose a substantial burden upon a private antitrust plaintiff, who might have limited resources to bring this lawsuit.[119] Given such a heavy financial burden, a well-funded antitrust defendant will be more likely to win the case simply by exhausting the plaintiff through endless discovery and other tactics.[120]

Third, a court's decision to adjudicate a case under the rule of reason might diminish an antirust plaintiff's incentive to even bring the lawsuit.[121] When a lawyer is advising a client whether or not to bring an antitrust case, he is concerned about two things: the costs of carrying the case and the potential award if the case is won.[122] If costs are in excess of the potential award, then the plaintiff's lawyer can be expected to not bring suit.[123] A determination that a particular case will be brought under the rule of reason will have two effects.

Antitrust Industry, 68 GEO. L.J. 1053, 1068 (1980).

[119] Presumably, the burden upon the federal government as an antitrust plaintiff would not be so high, since the government has access to far more financial resources than a typical private plaintiff. *See* Kenny & Jordan, *supra* note 24, at 1371 ("The [Antitrust] division has extraordinary one-way investigatory tools at its disposal prior to the filing of any lawsuit . . . ."). However, one result of the tremendous costs associated with an antitrust suit is that the government will have to expend its entire budget on one suit, with nothing left to bring other suits. Still, despite these resources, the government plaintiff still must bear its burden of establishing economic harm—not an easy thing to do. *See, e.g.*, *supra* note 77 and accompanying text.

[120] *See, e.g.*, R.J. Gerber, *Victory vs. Truth: The Adversary System and Its Ethics*, 19 ARIZ. ST. L.J. 3, 13 (1987) ("Many average litigants today are overdiscovered, overinterrogated, overdeposed, and underqualified financially for all this attention. Discovery marathons readily induce the parties to 'buy out' of litigation because discovery may well cost more than the value of the claim.").

[121] *See* Crane, *supra* note 118, at 15 (noting that it is hard to justify bringing a rule of reason suit); Piraino, *supra* note 108, at 702–03 ("[Plaintiffs] will not want to risk the significant costs of a rule of reason antitrust case on an uncertain outcome."); Ricks, *supra* note 106, at 155 ("Rule of reason cases are not often brought; they are too expensive to prosecute, especially given the significant chance that the defendant might prevail.") (citations omitted).

[122] The decision to bring a case can be expressed by balancing the expected value of filing a claim (EVF) against the litigation costs of filing a claim (FC). *See* ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS 339–40 (2d ed. 1997). Essentially, the EVF is determined by multiplying one's probability of winning the case against the expected award. *See id.* at 339. (This is a simplification. A more accurate model would also take into account the expected benefits of bargaining to settle the case.) The FC represents legal fees, filing fees and opportunity costs of filing and litigating the lawsuit. *See id.* Where FC exceeds EVF, one should not continue with the lawsuit. Where EVF exceeds FC or is equal to FC, then one should file the lawsuit. *See id.* at 340.

[123] *See id.* at 340.

First, it will substantially decrease the plaintiff's chances of winning the suit, given the high burden of proof placed upon plaintiffs under the rule of reason.[124] Second, it will substantially enhance the costs of bringing suit.[125] Therefore, an antitrust case will raise the costs of bringing suit while reducing the potential award—indicating that a rational plaintiff will not want to bring suit under the rule of reason, even where he or she may have a meritorious claim.

Thus the expense and heavy burden of proof involved in a rule of reason lawsuit make it difficult for an antitrust plaintiff to win a suit under the rule of reason. However, this bias against defendants represents only one of the rule of reason's several flaws.

III. THE FLAWED RULE OF REASON

A. *Problems with the Rule of Reason*

In theory, the rule of reason indicates that the approach was originally intended to be an opportunity for courts to make a careful and close analysis of questionable business practices. It was intended to provide courts with the necessary flexibility to deal with constantly developing and changing business practices.[126] In practice however, the rule has several notable flaws.

First, as noted above, an agreement producing an anticompetitive result will still be found legal under the rule of reason: not because the agreement is legal on the merits, but because of the heavy burden of proof and financial burden which is placed upon the antitrust plaintiff.[127] Second, the rule of reason is a tremendously costly judicial device. Litigation and other trial expenses are likely to be enormous.[128] In addition, rule of reason adjudication may impose other costs—the lost opportunity costs of business people forced to participate in the rule of reason trial.[129] As one commentator notes: "Instead of spending their time

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[124] *See supra* notes 109–13 and accompanying text.

[125] *See supra* notes 116–18 and accompanying text.

[126] One commentator describes the rationale for the rule of reason as follows:

> The courts want to render correct judgments. Since economic consequences are hard to predict, the courts should consider all consequences of the allegedly illegal action before condemning it. The result is a full scale rule of reason trial, complete with proof of market, proof of market power, proof of economic effect and proof (by the defendant) of the procompetitive aspects of its conduct. But, says the conventional wisdom, nothing less will enable the courts to render a just decision.

Crane, *supra* note 118, at 14.

[127] *See supra* Part II.C.5.

[128] *See supra* notes 116–18.

[129] *See* Piraino, *supra* note 108, at 702.

devising practical and creative solutions to competition problems, managers are required to prepare for and attend depositions, assist in answering interrogatories, and review voluminous pleadings."[130] Given the value of top-level employees to their employers, these lost opportunity costs may be substantial.[131]

Finally, and perhaps most importantly, the rule of reason imposes upon judges and juries complex economic issues and volumes of economic data which they are incapable of comprehending so as to produce a rational result.[132] While typical cases require juries to decide basic factual issues such as "who did what, when and why,"[133] rule of reason cases require jurors to decide issues that go well beyond the typical juror's experience, such as market power and competitive impact.[134] In a rule of reason trial, nearly every piece of evidence is relevant, therefore such a trial will typically require juries and judges to sift through enormous amounts of material.[135] As one commentator notes: "If you do not share this concern [about the ability of jurors to understand antitrust cases] I recommend that you take a few moments to watch the videotape of the jury deliberations at the rule of reason trial that formed part of our National Institute

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130 *Id.*

131 *See* Curtis H. Barnette, *The Importance of Alternative Dispute Resolution: Reducing Litigation Costs as a Corporate Objective*, 53 ANTITRUST 277, 277 (1984) ("'Commercial litigation takes business executives and their staffs away from the creative tasks of development and production and often inflicts more wear and tear on them than the most difficult business problems.'") (quoting Chief Justice Burger).

132 Concerns about the ability of courts to handle complex litigation has troubled commentators "throughout the history of the American judicial system." *See Development in the Law—The Civil Jury: The Jury's Capacity to Decide Complex Civil Cases*, 110 HARV. L. REV. 1489, 1489 (1997) (citations omitted) [hereinafter *The Civil Jury*]. These concerns became especially acute when antitrust litigation was involved. *See id.* at 1490 ("Early debate about jury performance in complex cases arose predominantly around antitrust litigation."); Eric Kades, *The Laws of Complexity and the Complexity of Laws: The Implications of Computational Complexity Theory for the Law*, 49 RUTGERS L. REV. 403, 413 (1996) ("[M]odern interest [in complex litigation] was triggered in large part by the difficulties the federal courts were facing with the increasingly larger antitrust suits that arose after World War II.").

133 *See* Crane, *supra* note 118, at 15.

134 *See, id.* at 15 (noting that juries are "ill-equipped" to understand the economic information presented in an antitrust trial); Easterbrook, *supra* note 7, at 11 (noting that "it is fantastic" to suppose that judges and juries could make the detailed factual inquiries necessary in a rule of reason case). Professor Areeda seems to disagree with this view asserting that many antitrust cases can be dismissed at the summary judgment stage without getting into the complexity of a particular case. *See* 7 AREEDA, *supra* note 36, ¶ 1508.

135 *See* Kades, *supra* note 132 at 415 ("Parties can submit evidence on a wide range of issues, and the judge and jury are left to sort out the factual mess."). A typical rule of reason case will involve voluminous amounts of paperwork. The average antitrust case involves 70 docket entries, and includes a docket file eight inches thick. *See* Salop & White, *supra* note 117, at 1009.

last fall."[136] The Court has recognized its own inability to deal with the complexity of antitrust cases, noting that "courts are of limited utility in examining difficult economic problems."[137] The result of this inability to deal with economic data and economic theory, is a series of decisions that are neither correct nor consistent.[138]

It might be argued that today's judges and clerks are far more familiar with economic theory and are therefore capable of making the factual inquiries necessary in a rule of reason case.[139] However, the field of antitrust law is such that *no one*, not even the most skilled economist, will be able to come up with a consistent, rational result. The field of economics is inherently uncertain. No one is able to agree as to what economic model most closely represents reality, and economists are in constant disagreement over economic policy.[140] As one commentator writes:

> [I]t is fantastic to suppose that judges and juries could make such an evaluation. The welfare implications of most forms of business conduct are beyond our ken. If we assembled twelve economists and gave them all the available data about a business practice, plus an unlimited computer budget, we would not get agreement about whether the practice promoted consumers' welfare or economic efficiency more broadly defined. They would discover some gaps in the data.... Someone would invoke the principle of second best, claiming that monopoly could be a beneficial offset to distortions elsewhere. At least one of the economists would construct a new model showing how the practice *could* reduce efficiency if certain things (unknowable from the data) were present.[141]

One consequence of the irrational, inconsistent nature of antitrust law is that it fails to provide with any certainty, a set of certain guidelines for businesses to follow in complying with antitrust law.[142] In order to avoid the huge litigation and

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[136] Crane, *supra* note 118, at 15.

[137] United States v. Topco Assocs., 405 U.S. 596, 609 (1972) (citations omitted); *see also* Standard Oil Co. v. United States, 337 U.S. 293, 307-14 (1999).

[138] *See, e.g.*, Easterbrook, *supra* note 7, at 3 ("Small wonder that the history of antitrust is filled with decisions that now seem blunders.").

[139] *See* Markovits, *supra* note 35, at 51 (noting the "increasing economic sophistication of the practicing antitrust bar, the Supreme Court clerks, and the Justices themselves"); Oliver E. Williamson, *Antitrust Enforcement: Where It's Been, Where It's Going*, 27 ST. LOUIS U. L.J. 289, 298–99 (1983) (arguing that in the 1970s, the Supreme Court began to use more sophisticated economic analysis in their antitrust decisions).

[140] *See supra* notes 26–33 and accompanying text.

[141] Easterbrook, *supra* note 7, at 11.

[142] *See Crane*, supra note 118, at 16 ("[I]t is difficult—or perhaps impossible—for the lawyer to reach an informed opinion as to the chances of success prior to filing suit.").

other costs associated with antitrust suits,[143] companies are going to want to comply with antitrust law as much as possible while avoiding litigation. However, a rule of reason case will produce inherently uncertain results. Because judges and juries are ill-equipped to deal with the complex economic analysis necessary in order to produce rational decisions under the rule of reason analysis, companies (and the lawyers advising them) will often have a difficult time telling their clients what types of behavior will result in litigation.[144]

Thus the rule of reason is flawed. It imposes substantial costs upon the litigants, and it is so complex that it is nearly impossible to produce consistent, rational results. However, other areas of the law are also expensive and complex. Securities litigation, patent law, and medical malpractice are all examples of litigation that is at least as expensive and complex to administer as antitrust law.[145] However, antitrust law is distinguished from other areas of litigation by the fact that the costs imposed by an erroneous antitrust decision will be far more substantial than errors in other areas of the law.

For instance, consider litigation involving an alleged violation of rule 10(b)(5)'s prohibition against an insider trading on inside information.[146] If a court were to erroneously condemn a certain stock deal because it violated 10(b)(5), the error will only have limited effect.[147] Those accused of violating the securities laws will be forbidden from performing a particular activity. Additionally, other insiders similarly situated will be forbidden from performing the same activities. Therefore, the costs of an erroneous decision will usually be imposed upon a limited group of securities traders.[148] In addition, while these

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[143] Although a firm will very likely avoid legal liability under rule of reason analysis, they will still have to incur substantial legal costs in defending a rule of reason action. *See* Easterbrook, *supra* note 108, at 305 (noting that the attorney's fees paid in defending a rule of reason case were "a hefty tax on the lawful conduct").

[144] *See* Crane, *supra* note 118, at 16 ("Even more pernicious is the tendency for aggressive businessmen to conclude that the rule of reason legitimizes any business conduct that they can rationalize. Unless there is a case directly on point, it is virtually impossible to tell a determined client that his proposed course of action will not pass muster under the rule of reason when it seems perfectly reasonable to him.").

[145] *See generally The Civil Jury*, *supra* note 132, at 1489.

[146] *See* Securities Exchange Act of 1934, 15 U.S.C. § 78(j)(b) (1994) ("It shall be unlawful . . . to use or employ, in connection with the purchase or sale of any security registered . . . any manipulative or deceptive device or contrivance."). The courts have held the situation where an insider trades on inside, material information to be a violation of this statute. *See, e.g.*, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968).

[147] Assume perhaps, that the court had held the inside information to be material, when in fact, it was not material in nature. The erroneous condemnation of an efficient practice is called a *false positive*. *See* Frank H. Easterbrook, *Comparative Advantage and Antitrust Law*, 75 CAL. L. REV. 983, 985 (1987).

[148] To be sure, there is a strong public interest in the outcome of securities litigation. The

traders will have lost the benefits of a potential stock deal, in reality what is lost is a potential *transfer* of wealth—the condemned securities deal would not have produced any efficiencies leading to a creation of wealth.[149] The costs of an erroneous antitrust decision, however, will be far more substantial. If a beneficial economic activity is struck down as illegal under the Sherman Act, the firm responsible will be forbidden from performing that activity, as will all other firms.[150] Rather than just affecting a few individuals, an erroneous antitrust decision might impact an entire industry.[151] Unlike in securities litigation, the condemned activity would not just effectuate a transfer of wealth, but would create efficiencies for consumers which would actually create wealth.[152] If many other firms would have employed this efficient activity but for the erroneous condemnation, then the foregone wealth creation could be substantial.[153]

In summary, there are problems with the rule of reason—it is expensive and uncertain. One consequence of these problems is that the antitrust defendant will always win. Commentators have noticed these problems and many have proposed

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securities laws were designed to protect the interests of all investors, not just the ones involved in the litigation. *See* John R. Allison, *Arbitration of Private Antitrust Claims in International Trade: A Study in the Subordination of National Interests to the Demands of a World Market*, 18 N.Y.U. J. INT'L L. & POL. 361, 397–98 (noting that some types of litigation, such as securities law and patent law, are not subject to private litigation because of the substantial public interest in their outcome). However, this public interest comes into play only when a particular securities sale is erroneously declared to be *legal* (a false negative). In the case of a false negative in securities litigation, the entire investing public must bear the costs. On the other hand, where a false *positive* is involved, it is only an isolated group of securities investors who are prohibited from performing a certain activity.

[149] Consider what happens in a sale of securities. A share of a corporation passes from one individual to another. The benefits of the sale are enjoyed by the two individual traders, not by the company. Out of the sale, the company receives no funds which might be used to develop new technologies or create new efficient business practices. Therefore, the sale does nothing to create new wealth by reducing a company's costs or increasing production. It is simply a transfer of wealth between two private individuals.

[150] *See* Easterbrook, *supra* note 7, at 2. ("If the court errs by condemning a beneficial practice, the benefits may be lost for good. Any other firm that uses the condemned practice faces sanctions in the name of stare decisis, no matter the benefits.").

[151] In articulating the potential damages posed by antitrust violations, the Second Circuit has noted: "Antitrust violations can affect hundreds of thousands--perhaps millions--of people and inflict staggering economic damage." American Safety Equip. v. Hickok Mfg. Co., 391 F.2d 821, 826 (2d Cir. 1968). Surely the costs of forbidding a beneficial activity must be as comparably high as the costs of allowing violations.

[152] If the condemned activity is actually efficient, then it will work to possibly reduce costs, increase output, or perhaps create new product market. These effects work to create wealth for the company.

[153] *See supra* note 152.

solutions.[154] Typically these proposed solutions involve a simplification of the rule of reason analysis—an "intermediate rule of reason."[155]

B. *The Intermediate Rule of Reason*

The underlying premise of the rule of reason—careful examination of the economic impact of novel business practices—is admirable. Therefore, commentators are eager to keep the rule of reason as a part of antitrust jurisprudence, while suggesting minor modifications to make its application less costly and more fair.[156] However, no matter how the rule of reason is restructured in order to reduce costs and simplify the analysis, problems still remain, for even the most basic inquiries under the rule of reason are expensive and difficult to accurately obtain.[157]

Perhaps the most well-known construction of an intermediate rule of reason has been proposed by Judge Frank H. Easterbrook.[158] Easterbrook begins his analysis by observing the inability of judges and juries to adequately deal with complex antitrust issues under the rule of reason.[159] He goes on to note that this inability imposes substantial costs—the possibility that an erroneous

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[154] *See generally* 56 ANTITRUST 193–234 (1987) (a collection of several commentators' suggestions for making the rule of reason more manageable); M. Laurence Popofsky & David B. Goodwin, *The "Hard-Boiled" Rule of Reason Revisited*, 56 ANTITRUST 195 (1987) (suggesting that courts are using a series of presumptions and shortcuts to simplify rule of reason analysis); F.M. Scherer, *Making the Rule of Reason Analysis More Manageable*, 56 ANTITRUST 229 (1987) (making a number of suggestions, such as economic training for judges and employing economists as clerks); The Honorable William W. Schwarzer, *Summary Judgment and Case Management*, 56 ANTITRUST 213 (1987) (suggesting the use of summary judgment in order to make cases more manageable).

[155] *See* Gladieux, *supra* note 1, at 489 (noting how various commentators have suggested alternative approaches to the rule of reason involving the use of presumptions and key factors of analysis. Gladieux suggests that these alternative approaches create an "intermediate rule of reason" somewhere in the between the "sharply defined dichotomy of per se and rule of reason.").

[156] *See, e.g.*, 7 AREEDA, *supra* note 36, at 1500–11 (1986); Easterbrook, *supra* note 7; Piraino, *supra* note 108 (proposing a "continuum" where the burden placed upon an antitrust plaintiff shifts depending upon the type of agreement in question); Lawrence A. Sullivan, *The Viability of the Current Law on Horizontal Restraints*, 75 CAL. L. REV. 835 (1987). These four approaches have been collected and summarized in Gladieux, *supra* note 1, at 489–93.

[157] *See infra* note 183 and accompanying text.

[158] *See* Easterbrook, *supra* note 7. Easterbrook's suggestions have stimulated numerous criticisms and responses. *See, e.g.*, Markovits, *supra* note 33 (concluding that simplifying the rule of reason will lead to inaccuracies); Oliver E. Williamson, *Delimiting Antitrust*, 76 GEO. L.J. 271 (1987–88) (concluding that Easterbrook's filters are not an accurate measure of a particular agreement's economic impact).

[159] *See* Easterbrook, *supra* note 7, at 4–6.

condemnation will forbid the use of an efficient business activity for all time.[160] As a solution, Easterbrook observes how economists deal with complex theoretical issues—they use a series of presumptions and shortcuts in order to simplify the analysis.[161] Easterbrook proposes that the courts should adopt a similar approach under the rule of reason, where a series of presumptions could be used to simplify and structure the rule of reason analysis.[162] Easterbrook refers to this use of presumptions as "[a] filter approach to antitrust scrutiny."[163]

Easterbrook proposes using a series of "filters" which will weed out from the judicial system cases involving practices which are not likely to cause substantial economic harm. If a case is unable to pass through a certain filter, then it is dismissed.[164] Some of Easterbrook's proposed filters include (1) market power;[165] (2) whether the defendant is enriching him or herself at the expense of consumers;[166] (3) the widespread adoption of the same business practices by competitors;[167] (4) the effect of this business practice upon output and survival;[168] and (5) the identity of the plaintiff.[169] Easterbrook argues that the

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[160] *See id.*

[161] *See id.* at 11 (noting that economists resort to "clues and shortcuts" in order to solve complicated economic issues).

[162] *See id.* at 14 ("Courts should use the economists' way out. They should adopt some simple presumptions that structure antitrust inquiry. Strong presumptions would guide businesses in planning their affairs by making it possible for counsel to state that some things do not create risks of liability.").

[163] *Id.*

[164] *See id.* at 17 (describing the filter system as a method of weeding out of the legal system those practices which are "probably-beneficial").

[165] Market power is the power to control prices or exclude competition. *See* United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 389 (1956). If an antitrust defendant has no market power, then the likelihood that a defendant's actions are causing economic harm is minimal. If the defendant engages in some anticompetitive activity that harms consumers, then competitors will be able sell at a lower price, thus causing substantial harm to the defendant. *See id.* at 19.

[166] *See* Easterbrook, *supra* note 7, at 24 ("Unless there is a link between the antitrust injury and the defendant's profit, there is no need for judges to impose a sanction."). In other words, if the defendant is not profiting by his or her business practices then the subsequent business losses will force the defendant to quit the activity. *Id.*

[167] Easterbrook argues that unless nearly all the firms in a given industry are employing the same business practice, then the antitrust action should be dismissed. *See id.* at 30–33. Easterbrook premises this assertion upon the idea that nearly all arrangements which get past the first two filters will be vertical arrangements, where a firm that is higher in the chain of production (e.g. a manufacturer) imposes a restraint upon a firm farther down the chain of production (e.g. a retailer). *See id.* at 29. Easterbrook argues that such a vertical restraint will not work unless all other firms are practicing the same restraint. If not, then another firm not employing the restraint will be able to take business away from the defendant. *See id.*

[168] Easterbrook asserts that if a firm's output and market share have not decreased since

adoption of these filters will insure that only those cases likely to have an actual, adverse economic effect will be adjudicated under the rule of reason.

Use of presumptions of the sort recommended by Easterbrook will certainly reduce costs and improve certainty in antitrust adjudication—to an extent.[170] However, the nature of Easterbrook's suggested rule of reason is such that establishing even preliminary matters will be an extremely burdensome task. For instance, consider Easterbrook's first filter, market power.[171] Under Easterbrook's system, if an antitrust plaintiff can not prove that the defendant had market power, then the case will be dismissed.[172] In his discussion of the market power filter, Easterbrook notes that in many cases, it will be fairly easy to establish market power, suggesting that a court could establish market power nearly instantaneously by establishing either (a) an ability to raise prices or (b) a price difference between the defendant's goods and the products of rivals.[173] However, even these "simple" cases will likely require extensive evaluation of economic data and a substantial possibility of an erroneous decision.[174] Of more concern are those cases where these economic effects are difficult or impossible

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employing the business practice in question, then the practice is not anticompetitive and the antitrust action should be dismissed. *See id.* at 31. Easterbrook premises this filter upon the law of demand—if a firm is raising the price of a product, and the product remains at the same quality, then it will sell less of that product. *Id.*

169 Easterbrook notes that bringing an antitrust claim against a rival might be an effective way to impose substantial costs upon that rival. *See id.* at 33–34 ("Antitrust is attractive as a method of raising rivals' costs because of the asymmetrical structure of incentives."). Therefore he asserts that antitrust suits should continue to be dismissed depending upon the identity of the antitrust plaintiff (consumer or rival) and the nature of the antitrust claim. *See id.* at 36. For instance, a suit brought against a firm by a competitor alleging predatory pricing can be dismissed without too much threat of competitive harm, because it is more likely that the defendant is employing efficient business practices than that the plaintiff is unwilling or unable to duplicate. *See id.* at 36–37.

170 It is worth noting that Easterbrook's proposed filter system will not work to reverse the fact that a rule of reason case will nearly always result in a victory for the defendant. As Easterbrook himself concedes, "[i]t is hard to compile a list of ten cases in the history of antitrust that would proceed past [the third] filter [without getting dismissed]." *Id.* at 31.

171 An examination of market power has been deemed an important element of the intermediate rule of reason by other commentators. *See, e.g.*, Piraino, *supra* note 108 (encouraging courts to employ market power analysis to decide cases under his "continuum approach").

172 *See supra* note 165.

173 *See* Easterbrook, *supra* note 7, at 22–23.

174 As noted above, lag effects may result in an economic effect, which might not become apparent until a substantial time period after the firm obtains market power. *See supra* notes 75–77 and accompanying text. In addition, it is dangerous to attribute a rise in prices to market power, because a firm may be able to raise prices above its rivals for completely legitimate reasons. *See, e.g.*, George A. Hay, *Market Power in Antitrust*, 60 ANTITRUST 807, 814–15 (1991–92).

to establish. In that case, most commentators agree that a court would have to first define the relevant product market and then establish the defendant's share of that market.[175] Defining the relevant market is rarely easy, for one must consider not only the product being sold by the defendant, but also any possible substitutes for that product.[176] Defining a relevant product market is a difficult task, often representing the sole issue in lengthy and protracted litigation.[177] Defining the

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[175] *See, e.g.*, McFalls, *supra* note 75, at 661 ("Foremost among these measures [of market power] is market share, the percentage of sales or capacity that a firm controls in a relevant market.").

However, there are other suggested methods of determining market power, each of which are as difficult to administer as the market share analysis. One method is the Lerner Index, which tries to measure market power by how much a firm's price differs from its marginal cost. The Lerner Index is calculated by subtracting a firm's marginal cost from its price, and then dividing that figure by the firm's price. The closer this figure is to approaching one, the higher a firm's market power. *See id.* at 659. However, the Lerner Index is difficult o administer because it is very difficult to calculate a firm's marginal cost at any given time. The Lerner Index also fails to take into account external factors which might cause a shift in price, such as a change in consumer demand or a change in the price of materials. *See id.* Additionally, a firm may be able to price above marginal cost in certain situations, not because it has market power, but because it is able to produce a superior product. *See* Hay, *supra* note 174, at 814–15.

Another suggested method is the Herfindahl-Hirschman Index (HHI) which determines market power by measuring a firm's market share in relation to the shares. The HHI squares the market shares held by each firm in order to establish an indication of how concentrated the market is. *See* McFalls, *supra* note 75, at 663. The HHI is used largely to reflect how concentrated the market is in order to reflect the possibility of oligopolistic pricing coordination. *See id.* The problem with the HHI is that in order to calculate the HHI, you must first calculate market share, something that is often very difficult to do. *See infra* notes 177–78 and accompanying text.

Some commentators suggest that market power should be determined by first, evaluating how inelastic a particular firm's demand curve is, and then evaluating whether this demand curve is just a transitory result or something more permanent. *See* Warren S. Grimes, *When Do Franchisors Have Market Power? Antitrust Remedies for Franchisor Opportunism*, 65 ANTITRUST 105, 113 (1996).

[176] *See, e.g.*, United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 395 (1956).

[177] *See generally E.I. du Pont de Nemours & Co.*, 351 U.S. at 377. The basis of the controversy in *du Pont* was whether the relevant market should be expanded to include products that would make a substitute for du Pont's cellophane packaging. It is worth noting that many commentators feel that the *du Pont* court used erroneous economic reasoning in reaching its decision. The *du Pont* court reasoned that du Pont could not raise its prices without losing business to other types of flexible packaging. However, the Court failed to consider that perhaps du Pont was *already* pricing at monopoly levels, and was only prevented from raising prices even further. This error in reasoning is referred to as The Cellophane Fallacy. *See* Donald F. Turner, *Antitrust Policy and the Cellophane Case*, 70 HARV. L. REV. 281, 308–10 (1956); Gene C. Schaerr, Note, *The Cellophane Fallacy and the Justice Department's Guidelines for Horizontal Mergers*, 94 YALE L.J. 670, 676–77 (1985).

The difficulty in defining the relevant market is indicated by the complexity of the 1992 federal Merger Guidelines. *See* Grimes, *supra* note 175, at 114 & n.34 (citing U.S. DEP'T OF

relevant market has become increasingly more difficult, with the globalization of the economy, making it more difficult to ascertain when reasonable substitutes exist and when they do not.[178] Once the market is defined, collecting and interpreting a firm's data in order to establish the firm's share of that market is an equally difficult process.[179] Additional factors make the process even more demanding. In a market that is particularly volatile or dynamic, market share might not be an accurate representation of a firm's market power.[180] If a firm has a high market share, it still must be determined whether or not the firm is capable of maintaining that market share—an additional complication which must be dealt with.[181] Additionally, there is considerable debate as to how much of a market share is actually required to constitute market power.[182] Easterbrook tries to use filters in order to eliminate costs and improve certainty in rule of reason adjudication. However, even his most basic initial filter, market power, is very difficult and expensive to apply.

The problems with Easterbrook's market power filter are illustrative of a broader problem that is inherent to the rule of reason analysis. In order to be truly a rule of reason, a method of analysis must make some determinations on a case-by-case basis.[183] As the above discussion of the market power filter suggests, even the most basic, initial factual inquiries will be enormously expensive and will produce uncertain results. An intermediate rule of reason may be useful in reducing litigation costs and simplifying the process. However, no matter how

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JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES (1992), *reprinted in* Merger Guidelines—1992, 4 Trade Reg. Rep. (CCH) ¶ 13,104, at 20, 569 (May 5, 1992)).

[178] *See, e.g.*, Andrew L. Shapiro, *Does Microsoft Play by the Rules?*, WEB MAGAZINE, Feb. 1998, at 29 (noting how the global nature of the technology market makes markets difficult to define).

[179] *See* McFalls, *supra* note 75, at 662 (noting that market share calculations can be "complex and expensive undertakings").

[180] *See* Hay, *supra* note 174, at 821 (noting that market shares are based upon historical data, which may not provide an accurate representation of volatile markets).

[181] *See, e.g.*, United States v. Syufy Enters., 903 F.2d 659 (9th Cir. 1990) (holding no market power where there was ease of entry into the movie theatre market).

[182] Judge Learned Hand's discussion of market share: "The percentage we have already mentioned—over ninety . . . is enough to constitute a monopoly; it is doubtful whether sixty or sixty-four percent would be enough; and certainly thirty-three percent is not." United States v. Aluminum Co. of Am., 148 F.2d 416, 424 (2d Cir. 1945). Courts have had a difficult time determining exactly what share of the market is necessary to constitute market power. *See, e.g.*, Reazin v. Blue Cross & Blue Shield, 899 F.2d 951 (10th Cir. 1990) (commenting on how different courts have reached different results as to what minimum share of the market constitutes market power).

[183] If the test does not involve some sort of case-by-case determination, then it would cease to become a rule of reason, and would look more like a per se determination.

abbreviated and simplified the process is, some factual determinations must still be made, and these determinations will always be difficult and expensive.

IV. RECOMMENDATIONS—ABOLITION OF THE RULE OF REASON

A. *The Proposal*

In tracing the development and application of the rule of reason, it becomes apparent that the rule of reason has become an expensive process where the agreement will almost always be found legal.[184] This result has disturbed many commentators, resulting in many suggestions as to how application of the rule of reason might be altered in order to reduce costs and produce a more just result.[185] However, perhaps mere alteration of the rule of reason is not enough.[186] Perhaps the rule of reason is inherently flawed and should be eliminated.

This Note suggests that the full-blown rule of reason should no longer be applied in Section 1 antitrust cases. In its place should be a new standard of per se legality. Under this new method of adjudication, Section 1 antitrust cases would still be divided into two categories. In one category would still contain the cases so blatantly anticompetitive as to be per se illegal. The second category would include all cases that did not qualify as per se illegal. Ordinarily these cases would then be adjudicated under the rule of reason. Under the new standard, these agreements would be declared per se legal and dismissed.

As noted above, there are often extensive investigations made before a particular activity is found to fall under the rule of reason or the per se rule.[187] Some categories of behavior, such as group boycotts and tying arrangements, require extensive investigation before categorizing the activity as per se illegal.[188] Other cases warrant a "quick look" before it is determined whether or not the full-blown rule of reason is necessary.[189] It must be noted that the per se legality standard suggested by this Note does *not* work to eliminate these initial inquiries, but only the full-blown rule of reason analysis that follows.

This proposed change seems to represent a radical departure from traditional antitrust adjudication, of which the rule of reason has been a major part since

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184 *See supra* Part II.C.5.

185 *See supra* note 154 and accompanying text; *see also supra* Part III.B.

186 This is because no matter how simplified the rule of reason becomes, at least some factual inquiries must still be made, and these inquiries will be inherently expensive. *See supra* text accompanying notes 164–83.

187 *See supra* notes 98–103 and accompanying text; *see also* Gladieux, *supra* note 1, at 480 (asserting that the Supreme Court has "eroded the traditional, sharp distinction between per se and rule of reason cases in favor of factual inquiries").

188 *See supra* note 98 and accompanying text.

189 *See supra* note 99–100 and accompanying text.

1911.[190] However, for all practical purposes, the change is minimal. As noted above, a plaintiff will, almost without exception, avoid liability under the rule of reason.[191] Applying a per se legality standard, will directly do what had been done before indirectly.

While for all practical purposes, imposition of a per se legality standard will result in minimal change, this new rule will eliminate the substantial litigation and information costs which are part of the rule of reason. The new rule will not merely transfer these costs over to the preliminary stage of the litigation, where a case is initially classified as per se illegal or falling under the rule of reason. As noted above, given the extreme difficulty associated with winning a rule of reason case, the litigation at the initial stages of a Section 1 case will be fierce.[192] Both sides will be expending tremendous resources trying to show that a particular case is either per se illegal or not.[193] In most cases, it seems fair to say that, at the initial level of a trial, both sides are expending the maximum level of available resources because this initial determination effectively determines the outcome of the trial.[194] Because both sides are likely to be *already* expending the maximum level of resources at the initial stage of a Section 1 trial, imposition of a per se legality standard will do little to increase costs at this stage.[195]

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[190] *See supra* Part II.C.2 and accompanying text.

[191] *See supra* Part II.C.5 and accompanying text. Where certain types of cases result in a large percentage of verdicts favoring one side or the other, there are two explanations. First, perhaps the merits of a particular type of case are such that one side should always win. Second, perhaps there are certain flaws in the adjudication process which give one side a particular advantage that is completely independent of the merits of the case. *See id.* In a rule of reason case, either explanation supports the per se legality standard. If antitrust defendants are rightfully winning on the merits, then nothing is lost by immediately dismissing the case at the outset. If antitrust defendants are winning for reasons unrelated to the merits, then in all likelihood, it is a problem that cannot be avoided. As noted above, the advantages that an antitrust defendant enjoys are the result of problems that are inherent to the rule of reason. *See supra* notes 170–83.

[192] *See supra* notes 105–07 and accompanying text.

[193] *See id.*

[194] The present antitrust suit brought by the government might represent the best indication of the time and expense that is involved in the initial classification of the agreement. The justice department's principle Section 1 claim against Microsoft is that it has engaged in illegal tying arrangements. *See infra* notes 235–41. As a result, both sides have expended tremendous resources characterizing the tying arrangement as falling under either the per se rule or the rule of reason. For a more detailed discussion of these expenditures, see *infra* note 246 and accompanying text.

[195] Remember also that the examination made at the initial stages of a Section 1 trial requires an examination of *different factors* than the examination made at the rule of reason stage. At the initial stage of a trial, the primary controversy will likely center around classifying the agreement—does it fall into a category which has typically been found to be per se illegal? *See, e.g.*, Discon, Inc. v. Nynex Corp., 93 F.3d 1055 (2d Cir. 1996) *decision vacated*, 119 S. Ct.

This proposed per se legality rule seems absurdly unfair. Some economic arrangements may not qualify as per se illegal, but may still be anticompetitive. Under the proposed change, these anticompetitive activities would be allowed to continue unchecked by the American justice system. However, while these activities might avoid scrutiny in the courtroom, they will not be able to avoid scrutiny in the marketplace. The marketplace may very well provide a superior means of evaluating these activities.

B. *The Comparative Advantage of Markets over Courts*

In many instances, where a firm is abusing monopoly power, the free market will be able to step in and cure the defect. Any firm with monopoly power will likely be charging higher prices than what will be charged in a perfectly competitive market.[196] Other individuals will see what high prices might be had in this market, and therefore enter the market, undersell the market, and take away business.[197] Judge Easterbrook has taken note of the free market's ability to correct situations where a firm is utilizing market power, often suggesting that the free market actually might be superior to the courts in adjudicating antitrust disputes.[198] Easterbrook has often based his argument upon the economic theory of comparative advantage.[199]

Comparative advantage means that one option has a relative advantage over

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493, 497 (1998). Or, in the case of tying arrangements or group boycotts, the controversy will center around whether certain requirements, such as market power, have been satisfied. *See supra* note 98 and accompanying text. At the rule of reason stage of a trial, the controversy will likely center around factors such as adverse economic effect. While these factual examinations might overlap to an extent, e.g., both might require a determination of market power, they remain different controversies at different stages of the trial. By implementing a per se legality standard, the costs associated with the full-blown rule of reason analysis could be eliminated.

[196] In a perfectly competitive market, the price that one firm will be able to charge will always be equal to marginal costs. *See* ROBERT S. PINDYCK & DANIEL L. RUBINFELD, MICROECONOMICS 240 (3d ed. 1995). Where a firm is exerting monopoly power, it will be able to charge a higher price. *See id.* at 322–24.

[197] *See id.* at 259. Where there is a high rate of return, other investors will divert funds from other sources and enter into the more profitable market. The increased number of suppliers will cause the supply curve for the market to shift out, reducing price until it returns to a competitive level. This competitive level is referred to as the long-run competitive equilibrium. *Id.*

[198] *See, e.g.*, Easterbrook, *supra* note 108, at 307 ("If there are profits to be made, rivals enter (or expand their production) and undercut the monopolists."); Easterbrook, *supra* note 147 (same); *see also*, 7 AREEDA, *supra* note 36, at ¶ 112 ("If the facts do not support a fairly unambiguous judgment that intervention will make things better, then the best course of action for the antitrust tribunal is not to intervene at all.").

[199] The theory of comparative advantage was first developed by David Ricardo, a major nineteenth-century British economist. *See* CASE & FAIR, *supra* note 75, at 30, 547.

the next best option, despite the fact that the first option might have an absolute advantage over the second.[200] For instance, consider a lawyer and an automobile mechanic. The lawyer might be better at both practicing law and fixing cars than the mechanic. However, if the lawyer was to fix her own car, she would have to forego time spent practicing law. Therefore her time is spent most productively if she practices law full time and delegates fixing the car to the mechanic.[201] The economic theory of comparative advantage "argues for specialization."[202]

The law might have an absolute advantage over markets in adjudicating antitrust disputes. It might be able to speed up the market forces that work to restore a competitive equilibrium.[203] However, it is unclear whether or not the law does work faster and more efficiently than the free market. If it does not, then perhaps antitrust law might be best delegated to the free market while the courts work out other disputes.[204] Easterbrook suggests three factors to consider in determining whether or not the market has a comparative advantage over courts in adjudicating a particular type of antitrust dispute.

First, Easterbrook asserts that in order to have a comparative advantage over the courts, the free market must be able to adjudicate a case faster than the market will be able to do so. If the free market can step in and undo an antitrust violation before the courts can, then it does not make sense to incur the litigation costs of a trial that does not need to take place.[205]

Second, Easterbrook looks at the costs of courts taking action under the antitrust laws. Easterbrook notes that one substantial cost of antitrust law might be condemnation of behavior which might actually be economically beneficial.[206] As noted above, the costs of these false positives might be substantial[207]—an

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200 *See* PINDYCK & RUBINFELD, *supra* note 196, at 582 (discussing comparative advantage in the context of international trade).

201 For similar examples, see *id.* (using two countries, each one has, a comparative advantage over the other in producing a certain product); Easterbrook, *supra* note 147, at 984–85 (comparing a computer repair person and a law professor).

202 COOTER & ULEN, *supra* note 122, at 28.

203 *See, e.g.*, 7 AREEDA, *supra* note 36, at ¶ 112 (concluding that the free market may need occasional legal intervention).

204 *See* Easterbrook, *supra* note 147, at 985 ("Perhaps antitrust law speeds up the arrival of the long run. Perhaps it does not. Unless we know it does, judges ought to apply their talents in other fields, where they have a comparative advantage over other institutions.").

205 *Id.* ("If rivals will undo a monopoly or evade a questionable practice before judges can decide the case, there is little point in incurring the costs of litigation and suffering the inevitable mistaken judgments.").

206 *Id.* ("If a judge wrongly condemns as monopolistic a business practice that is efficient and beneficial to consumers, that is a false positive. Consumers would be better off if the judge had decided the case the other way.").

207 *See supra* notes 150–53.

efficient business activity might be gone for good.[208] Easterbrook asserts that if the business practice is new or novel, courts are more likely to make mistakes, declaring business practices to be illegal before their true economic impact is ever developed, thus increasing the costs of using the law to decide antitrust cases.[209]

Third, Easterbrook evaluates the costs of judicial inaction—even where an inefficient business practice is allowed to continue. Easterbrook suggests that the market may have a competitive advantage over the law where an erroneous dismissal can be quickly rectified by the market. In that case, the problem is quickly solved and the costs of judicial inaction are minimized. If the market is slow about fixing situations where an inefficient practice is allowed to continue, then it is best for the courts to step in and speed up the process.[210] Thus Easterbrook asserts that markets may have a comparative advantage over judges in adjudicating antitrust disputes when (a) legal processes are slow; (b) the judges and jury are unfamiliar with the economic practices so that there is a high risk of false positives; and (c) the market is quickly able to correct any false negatives.[211]

Describing the theory of comparative advantage, Easterbrook notes that there

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[208] *See* Easterbrook, *supra* note 147, at 986:

> It may be prudent for a court to act on limited knowledge if a mistaken condemnation can be washed away as easily as the contrary error would be. Yet there is a bias in the error-correcting devices of the law. Mistakes of *law* are not subject to competitive pressures. If a judge errs in saying that the NCAA's contract with the TV networks for college football is a violation, there is no competitive way to undermine the contract. Once the court speaks, the contract is gone. If the prohibition was mistaken, we shall suffer the consequences indefinitely.

Easterbrook's statement is a slight exaggeration. When an efficient business activity is mistakenly condemned by the court, there is always the chance that the court will reverse itself, once it realizes its error. For example, consider vertical nonprice restraints. At one time these types of agreements were held to be per se illegal. *See generally* United States v. Arnold Schwinn & Co., 388 U.S. 365 (1967). However, the *Schwinn* decision was widely criticized on historical, logical, and economic grounds. *See, e.g.*, Milton Handler, *Changing Trends in Antitrust Doctrine: An Unprecedented Supreme Court Term—1977*, 77 COLUM. L. REV. 979, 980 (1977). After 10 years, the *Schwinn* decision was overruled by a Supreme Court decision holding nonprice vertical restraints to be adjudicated under the rule of reason. *See generally* Continental v. GTE Sylvania, 433 U.S. 36 (1977). However, even in the case of *Schwinn*, firms were denied the opportunity to employ a potentially efficient business practice for a full 10 years—at a substantial economic cost.

[209] *See* Easterbrook, *supra* note 108, at 308 ("The conditions for useful legal intervention may be met when we know a lot about the practice—for when we know but little, the cost of error goes up, and the risks of false positives may be substantial.").

[210] *See* Easterbrook, *supra* note 147, at 985 ("Unless there is a strong reason to suspect that a monopoly or monopolistic practice can survive the attempts of other firms to undermine it, then the costs of inaction (excusing harmful conduct) are low.").

[211] *See id.* at 986.

are certain types of antitrust cases where the law might have a comparative advantage over markets—specifically naked price-fixing cartels and large mergers in markets with high barriers to entry can be quickly and accurately condemned by the courts.[212] Easterbrook also suggests that courts rarely have a comparative advantage over markets where the business activity is new or novel.[213] However, Easterbrook leaves the issue of comparative advantage and its application to antitrust law largely unresolved, noting that: "having raised the issue [of comparative advantage], I shall leave the implications unexplored for now."[214] In particular, Easterbrook does not theorize as to how the theory of comparative advantage might be applied to rule of reason cases. As noted above, in regards to the rule of reason, Easterbrook has written in support of an intermediate rule of reason.[215] However, when Easterbrook's comparative advantage theory is applied to rule of reason cases, the market might have a comparative advantage to the courts in adjudicating antitrust cases—indicating that these cases should simply be dismissed and left to the market to resolve.

Easterbrook asserts that markets have a comparative advantage to judges when legal processes are slow.[216] There are not many trials which last as long or proceed as slowly as a rule of reason antitrust suit. The average antitrust trial lasts for two years.[217] Given its complexity and need for extensive data gathering and interpretation, a rule of reason case may take much longer to resolve. Additionally, while the actual trial time for an antitrust case may be substantial, one must also consider any time lapse between when the anticompetitve practice is begun, and when suit is actually brought.[218] While a court case may take months or even years to reach the courtroom, market forces will begin almost immediately after competing firms recognize an opportunity to enter into the market. This gives the free market ample time to remedy the problem before courts do. For example, a federal district court in Utah has begun to make headway in an antitrust case brought by a software developer called Caldera

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212 *See* Easterbrook, *supra* note 108, at 309–10.

213 *Id.*

214 Easterbrook, *supra* note 147 at 989.

215 *See supra* notes 158–69 and accompanying text.

216 *See* Easterbrook, *supra* note 147 at 986.

217 *See* Salop & White, *supra* note 117, at 1009.

218 For example, after Microsoft's tremendous success in the software industry started to attract attention, the FTC began to conduct an investigation of Microsoft's activities. The initial investigation began in 1990. *See* Kenny & Jordan, *supra* note 24, at 1374. After three years of investigation, the FTC decided it did not have sufficient evidence to bring a significant suit against Microsoft. *Id.* The Antitrust Division of the Justice Department decided to take up the investigation of Microsoft, and in 1993, filed both a complaint and a proposed consent decree in federal district court. *Id.* Thus it took over three years from the time the alleged anticompetitive conduct was noticed until the time that an actual suit was filed—a significant time lag.

against Microsoft for anticompetitive practices dating back *six* years, involving its DOS operating system.[219] In that six year period, the DOS operating system has become severely outdated—replaced by the Windows operating system.

Easterbrook next notes that markets have a comparative advantage where it is a novel business practice being evaluated which has never come before the courts.[220] Any rule-of-reason case will invariably present a novel or unusual business practice. More traditional categories of economic behavior will be dispensed with by the per se rule.[221] Of the types of behavior categorized under the rule of reason, any economic behavior that the courts are familiar with and have already ruled upon will not likely result in litigation.[222] This leaves only those novel and unusual business practices unfamiliar to the courts to be actually adjudicated under the rule of reason[223]—thus increasing the risk of mistakes and increasing the possibility that markets have a comparative advantage over courts.

Even where the courts are making erroneous dismissals, Easterbrook argues that the law will have a comparative advantage over markets where the market is

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219 *See* Shapiro, *supra* note 178, at 27 (discussing Caldera v. Microsoft Corp., No. 96-CV-645 B (D. Utah 1998)).

220 *See* Easterbrook, *supra* note 147, at 985–86 (discussing how hasty decisions regarding novel business practices may be costly).

221 The per se cases are the cases where judges will place the greatest emphasis on past antitrust precedent. *See generally* United States v. Topco Assoc., Inc., 405 U.S. 596 (1972). In *Topco*, the Supreme Court invoked the per se rule against naked cartels to condemn exclusive marketing territories used by a joint venture of small grocers, in the face of trial court findings that the exclusivity was necessary to the joint venture's success. *See id.* at 608 & n.8 (citing United States v. Topco Assoc., Inc., 319 F. Supp. 1031, 1042 (N.D. Ill. 1970)). The Court did not disagree with these findings. Rather, the Court held that the case was controlled by precedent which could not be altered by economic findings. *See id.* at 608, 610–11. The Court explicitly advocated adhering to hard and fast legal rules rather than "rambl[ing] through the wilds of economic theory in order to maintain a flexible approach." *See id.* at 609–10 n.10; *see also* Thomas C. Arthur, *Farewell to the Sea of Doubt: Jettisoning the Constitutional Sherman Act*, 74 CAL. L. REV. 263, 309 (1986) (stating that, when using the per se rule, "the Supreme Court purports to follow precedent, acting as if antitrust law were a coherent body of congressionally-set legal principles"); Ralph Eiseg Bienstock, *Municipal Antitrust Liability: Beyond Immunity*, 73 CAL. L. REV. 1829, 1838 (1985) ("The purpose of any per se rule is to simplify litigation in cases which present familiar fact patterns."); Ricks, *supra* note 106, at 175 ("The per se rule should only be applied when the court is familiar enough with the arrangement at issue to say with certainty that the arrangement is almost always anticompetitive.").

222 Where there is a case directly on point, business people will be less likely to perform the activity in the first place. *See* Crane, *supra* note 118, at 16 (noting that it will be easier to convince a client not to perform a certain business activity if there is a case directly on point).

223 *See, e.g.*, Broadcast Music Inc. v. Columbia Broadcast System, 441 U.S. 1, 9–10 (1979) (noting that "it is only after considerable experience with certain relationships that the courts classify them as per se violations") (citing United States v. Topco Assoc., Inc., 405 U.S. 596, 607–08 (1972)).

"sluggish" in responding where a procompetitive activity is mistakenly declared to be illegal.[224] In today's economy, however, competitive processes move faster than ever to correct market flaws. With today's globalized economy, more and more potential competitors are poised to step in and undersell firms selling at monopoly prices.[225] Today's markets have proven to be highly competitive, where one firm is rarely dominant for long.[226] This is particularly true in today's growing high-tech industry.[227] For instance, in 1974, IBM was perceived as the "monolithic, irrepressible force in the computer industry,"[228] yet by 1982 it had become clear that IBM was no longer a power in the computer market.[229] These are strong indications that the market is able to move quickly to remedy anticompetitive conduct which is allowed to continue by the courts.

Using Easterbrook's theory of comparative advantage, there is a strong argument that it is the market, and not the court system, which might be the best means of evaluating business activities under the rule of reason. With this conclusion, it becomes far less disturbing to allow certain business practices evaluated under the rule of reason to be declared per se legal and dismissed. Although this new construction of Section 1 would insulate certain business practices from judicial scrutiny, these practices would still be scrutinized by a free market that would be more capable of evaluating the economic activity.

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224 *See supra* note 208 and accompanying text.

225 *See* Crane, *supra* note 118, at 6. (noting that the "internationalization" of the American economy has "limited the ability of domestic companies, even those that were considered near-monopolies a generation ago, to raise price."). Crane cites the steel and automobile industries as two specific examples where domestic firms are unable to abuse domestic monopoly power because of competitive pressures from foreign firms. *Id.*

226 *See* Kenny & Jordan, *supra* note 24, at 1365 (noting that "today's winners can very easily be tomorrow's losers.").

227 *See* Charles T.C. Compton, *Cooperation, Collaboration, and Coalition: A Perspective on the Types and Purposes of Technology Joint Ventures*, 61 ANTITRUST 861, 868–69 (1993) ("High technology companies are typically locked in a vicious circle of global competition: Innovation creates demand; demand creates more competition; competition leads to lower prices and more innovation, at ever-increasing fixed costs; price erosion and performance improvements accelerate demand further."); *see also* PETER HUBER, THE LAW AND DISORDER IN CYBERSPACE 9 (1997) (noting that the computer industry has "set reasonable prices, and delivered more hardware and more services to more people faster than any other industry in history").

228 Kenny & Jordan, *supra* note 24, at 1365–66.

229 *See id.* at 1366 (citing HUBER, *supra* note 227, at 92) ("By 1982 the competitive outlook was clear.... Between 1985 and 1992 IBM shed a hundred thousand employees. IBM's stock, worth $176 a share in 1987, collapsed to $52 by year's end 1992.... In a desperate scramble for survival, IBM began breaking itself up into autonomous units and spinning off some of its more successful divisions.").

C. *Application of the Per Se Legality Standard to the Justice Department's Suit Against Microsoft*

If a per se legality standard is going to be used to resolve Section 1 rule of reason cases, then it is imperative that some devices still remain that will be able to cure abuses of market power. Otherwise, there would be no check on a firm's ability to enter into inefficient business agreements. An application of Easterbrook's comparative advantage theory suggests that the market might be comparatively superior to courts in resolving antitrust issues. However, it remains to be seen how this theory might work in an actual case. A useful case to examine is the current antitrust suit by United States Justice Department against Microsoft.[230]

Currently, Microsoft owns a commanding share of the market for operating systems.[231] Microsoft has achieved this high market share through a variety of aggressive business tactics—many of which have been declared by others to be morally and legally questionable.[232] As a result, Microsoft has often come under the scrutiny of the antitrust laws.[233] Most recently, the United States Justice

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[230] *See* Plaintiff's Complaint, United States v. Microsoft Corp., (No. 98-1232), *available at* <http://www.usdoj.gov/atr/cases/f1700/1763.htm> (visited Apr. 20, 2000).

[231] The Justice Department contends that Microsoft owns 90% of the market for operating systems for new Intel-compatible computers. *See* Plaintiff's Complaint at ¶ 1. Even if the relevant market was expanded to include non-Intel compatible computers, such as computers using the Motorolla microprocessor, Microsoft's market share remains at 80%. *See* Bryce J. Jones, II & James R. Turner, *Can an Operating System Vendor Have a Duty to Aid Its Competitors?* 37 JURIMETRICS J. 355, 370 (1997). Such a high market share does create a presumption of market power. Not only does Microsoft have a high market share, but, the government contends, that it is very capable of maintaining that share through a series of "network effects." *See infra* note 264.

[232] The story of Microsoft's rise to power is well-known. In 1980, IBM, then a giant in the field of personal computers, needed an operating system for its new computer. *See* Kenny & Jordan, *supra* note 24, at 1374. Originally, it went to a firm called Digital Research Incorporated (DRI), which had developed the dominant operating system of the day, called CP/M. *See id.* DRI, however, refused IBM's bid to license CP/M. *See id.* IBM next solicited the fledgling Microsoft corporation. Microsoft bought the rights to a CP/M clone called QDOS, made a few modifications, and licensed the program as MS-DOS. *See id.* Microsoft, however, also retained the rights to license MS-DOS to other computer manufacturers besides IBM. *See id.* Due to the success of the IBM personal computer, there became a tremendous demand for computer software, developed largely by Microsoft, which would be compatible with MS-DOS. *See id.* at 1375. Other computer manufacturers also used the MS-DOS operating system, increasing the demand for Microsoft products. Later on, consumer demand remained high for other Microsoft products, most notably its Windows 95 operating system. *See id.* By 1998, Microsoft's market capitalization passed $200 billion. *See id.* (citing Robert O'Brien, *Stocks Race to Further Records; Microsoft Shares Attain Milestone*, WALL ST. J., Feb. 26, 1998, at C4).

[233] For an overview of the government's antitrust investigations and legal actions taken

Department has brought suit against Microsoft, alleging violations of both Section 1 and Section 2 of the Sherman Act.[234]

The government has suggested two agreements which Microsoft has made which might qualify as Section 1 violations. First, that Microsoft has violated the of Section 1 through its use of illegal tying agreements with personal computer manufacturers, also known as Original Equipment Manufacturers (OEMs).[235] The government alleges that Microsoft is forcing the OEMs to sell Microsoft Windows (the tying product) along with Microsoft's web browser—Internet Explorer (the tied product).[236] As noted above, an illegal tying arrangement may be found to be either per se illegal, or to fall under the rule of reason.[237] A tying arrangement is per se illegal only where certain conditions, such as market power in the tying product, are satisfied.[238] Otherwise, the agreement is adjudicated under the rule of reason.[239] In the present Microsoft case, it is questionable whether Microsoft's tying arrangements satisfy the necessary per se conditions of separate products[240] and coercion.[241] For the sake of argument, assume that

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against Microsoft, see Kenny & Jordan, *supra* note 24, at 1374–82 (discussing the initial investigation and the government's use of the consent decree to regulate Microsoft). For an example of where private competitors have brought suit against Microsoft, see, e.g., Caldera v. Microsoft Corp., 72 F. Supp.2d 1295 (D. Utah 1998).

234 *See* Plaintiff's Complaint, United States v. Microsoft Corp., (No. 98-1232), *available at* <http://www.usdoj.gov/atr/cases/f1700/1763.htm> (visited Apr. 20, 2000).

235 *See* Plaintiff's Complaint at ¶ 48.

236 *See id.* The government alleges that this tying arrangement "prevents customers from choosing among Internet browsers on their merits." *Id.*

237 *See supra* note 98 and accompanying text.

238 *See id.*

239 *See id.*

240 In order to be an illegal tying arrangement, there must be the linking of "two separate product markets." *See* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. at 2, 21 (1983). In *Jefferson Parish*, the majority of the Supreme Court held that whether or not products were separate products depended upon whether or not there was separate demand for the products. *See id.* at 19 ("[T]he answer to whether one or two products are involved turns not on the functional relationship between them, but rather on the character of demand for the two items."). The government alleges that Windows and Internet Explorer are two separate and distinct products. *See* Plaintiff's Complaint at ¶ 48. The government's position is bolstered by the majority opinion in *Jefferson Parish*, because there appears to be separate demands for Windows and Internet Explorer. Microsoft contends that the two computer applications are so integrated as to be one product. *See, e.g.*, Benjamin Klein, *An Economic Analysis of Microsoft's Conduct*, ANTITRUST, Fall 1999, at 38, 40. In support of its position, Microsoft might cite to a strong *Jefferson Parish* concurrence, which argued that one should look at whether or not the products are functionally interrelated, rather than upon the character of demand. *See Jefferson Parish*, 466 U.S. at 39–40 (O'Connor, J., concurring). Microsoft's case is bolstered by the D.C. Circuit's conclusion that Windows and Internet Explorer are in fact one product. *See* United States v. Microsoft Corp., 147 F.3d 935, 952 (1996) ("If the products have no separate

neither of these two requirements have been satisfied, meaning that the agreements will be adjudicated under the rule of reason.

The Justice Department's second alleged Section 1 violation is that Microsoft has engaged in a series of agreements which unreasonably restrain trade in violation of Section 1.[242] Specifically, the justice department cites to agreements between Microsoft and Internet Service Providers (ISPs) and Internet Content Providers (ICPs), where Microsoft exchanges a favorable position on its Windows desktop in exchange for the agreement not to "license, distribute or promote non-Microsoft products."[243] The government also cites to agreements between Microsoft and the OEMs, where Microsoft exchanges permission to license Windows in exchange for the OEMs' promise not to modify the boot-up sequence and desktop screen which come with Windows.[244] All of these agreements are adjudicated under the rule of reason.[245]

Therefore, it is at least arguable that all of the Justice Department's Section 1

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existence, it is incorrect to speak of the purchaser combining them."). *But see*, Case Note, *Revisiting the Separate Products Issue*, 108 YALE L.J. 1441, 1441 (1999) (criticizing the D.C. Circuit's decision as inconsistent with existing tying law).

241 In order to constitute an illegal tying arrangement, consumers must actually be forced into buying a product that they do not want to buy. *See, e.g., Jefferson Parish*, 466 U.S. at 26–29 (holding that consumers were not coerced into using anesthesiology services bundled together with medical care, because consumers lacked price consciousness when they chose their source of medical care). The government alleges that Microsoft's arrangements with the OEMs are coercive in that many consumers who want the Windows operating system do not want the accompanying web browser. *See* Plaintiff's Complaint at ¶ 36 (discussing how corporate customers do not want their employees having internet access). Microsoft contends that while Internet Explorer is packaged along with Windows, no one is forcing consumers to use Internet Explorer. Consumers are free to choose whichever browser they want, using minimal time and effort. *See* Kenneth N. Gilpin, *In Microsoft Case, A Lot of Not Very Much*, N.Y. TIMES, Nov. 1, 1998, at 3–7.

242 *See* Plaintiff's Complaint at ¶ 47.

243 *See id.*

244 *See id.*

245 The agreements with the ISPs and ICPs are best characterized as exclusive dealings contracts, where two parties agree to do business with each other at the exclusion of competitors. Such agreements are adjudicated under the rule of reason and are typically not found to be anticompetitive. *See, e.g.*, Pachard Motor Car Co. v. Webster Motor Car Co., 243 F.2d 418, 420 (D.C. Cir. 1957) ("When an exclusive dealership 'is not part and parcel of a scheme to monopolize and effective competition exists at both the seller and buyer levels, the arrangement has invariably been upheld as a reasonable restraint of trade....'"). The agreements with the OEMs are also exclusionary contracts adjudicated under the rule of reason. *See* Plaintiff's Complaint at ¶ 47.

One thing to consider is that Microsoft has yet to come up with a legitimate economic justification for these exclusionary contracts. It has been suggested that Section 1 agreements, even where usually brought under the rule of reason, might be found per se illegal in the complete absence of an economic justification. *See supra* note 82 and accompanying text.

claims would be adjudicated under the rule of reason. Under antitrust law in its present state, this means a lengthy and costly trial.[246] The government faces an uphill battle on the rule of reason issues. With the government as the plaintiff in this case, the financial burden placed on a plaintiff in a rule of reason case might not be as large a concern.[247] However, in a rule of reason case, the burden still remains upon the government to prove competitive harm. This will be difficult to do. In regards to the tying claim, Microsoft is packaging Internet Explorer along with Windows at no extra cost to the consumer.[248] It is difficult to see how consumers are harmed when they are getting something for free.[249] Even if competitive harm might be established, Microsoft could argue that it has a legitimate business justification in bundling the products together. Microsoft

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[246] In the present case brought by the Justice Department against Microsoft, the trial, begun on October 19, 1998, while once expected to last two months, has dragged on for much longer than expected. *See* Jube Shiver Jr., *Change in Industry Dims Relevance of Microsoft Trial Technology: Allegation of Unfair Use of Dominance Is Undermined by AOL-Netscape Merger*, L.A. TIMES, Dec. 14, 1998 at A1, *available in* 1998 WL 18903649. There will almost certainly be an appeal—the case will likely go all the way to the Supreme Court, adding several years to the process. *See* Michael M. Weinstein, *Previous Antitrust Cases Leave Room for Both Sides to Cite Them Now*, N.Y. TIMES, Oct. 19, 1998, at C-10; Dori Jones Yang, *The Empire Strikes Out: The Legal Prognosis Isn't Real Pretty. And the Marketplace is Even Scarier*, U.S. NEWS & WORLD REPORT, Nov. 15, 1999, at 48 (noting that if there is an appeal, then the trial will continue for at least another year).

As an indication of the litigation costs involved in the Microsoft trial, it is estimated that in the most recent suit against Microsoft, the Justice Department has spent an estimated $13.3 million. *See Justice Department*, *supra* note 117.

[247] *See supra* note 119 and accompanying text.

[248] *See* Heather Green, *Has Netscape Hit the "Innovation Ceiling?"*, BUS. WK., Jan. 19, 1998, at 69 (noting that both Netscape and Microsoft have offered their browsers free of charge).

[249] It is hard to see how consumers are harmed by lower prices. One notable exception is predatory pricing, where one competitor sells a product at below cost in order to drive competitors out of the business. Once competitors are eliminated, the survivor can sell at monopoly prices *See generally* GIFFORD & RASKIND, *supra* note 17, at 429–60. Typically, predatory pricing schemes are self-deterring, because, while a firm is selling at below-cost prices, it is incurring tremendous losses which it has no guarantee of recouping in the future. *See, e.g.*, Matsushita Electric Industrial Co. v. Zenith Radio Corp., 475 U.S. 574, 589 ("[T]he success of such [predatory] schemes is inherently uncertain: the short-run loss is definite, but the long-run gain depends on successfully neutralizing the competition."). Professors Areeda and Turner suggest that a predatory pricing scheme should only be found illegal where a firm is selling its products at below marginal costs (or average costs, where marginal costs are difficult to calculate). *See generally* Areeda & Turner, *supra* note 75. Microsoft is giving away the browser software for free, which would have them pricing below marginal costs regardless of how low the marginal costs were for producing software. *But see* Klein, *supra* note 240 at 46 n.22. (suggesting that because vendors will pay Microsoft to get consumers to adopt Internet Explorer, "the competitive price of browser software is negative").

could argue that computer purchasers often prefer to purchase their computers in conjunction with other additional products—such as software.[250] By bundling an internet browser into its Windows operating system, Microsoft might actually be creating a more desirable product.[251] In regards to the restrictive dealings contract, economic impact might be difficult to establish because of the significant lag effects which delay the actual impact of an anticompetitve activity.[252] Of even more concern is the possibility, however slight, that the Justice Department might erroneously[253] win on the rule of reason issues. The

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[250] *See* Kenny & Jordan, *supra* note 24, at 1396:

> Consumers of personal computers often prefer to purchase computers bundled with peripheral equipment, such as modem, monitor, printer and speakers. They have also expressed a preference for the integration of software products, which initially came in 'separate boxes'—for example, printer drivers, disk defragmentation programs and hard drive controllers—into one operating system. Although consumers could purchase products in both these categories individually, they have expressed a preference to buy these products at the same time.

[251] *See id.*; *see generally* Robert A. Levy, *Microsoft's "Monopolies" Spur Competition*, SEATTLE TIMES, Jan. 7, 1998, at B5 (detailing how computer manufacturers have all bundled various internet browsers with Windows, because they realize that it produces a superior product).

[252] *See supra* note 75 and accompanying text.

[253] The length and complexity of the pending Microsoft case increases the likelihood that the case will result in an irrational verdict. As an indication of the immense volume of information that has been presented at trial, some testimony presented at the trial, such as the direct testimony of AOL Senior Vice President David Colburn, has been presented in written rather than oral form in order to save time. *See* Eun-Kyung Kim, *Executive Tells How AOL, Microsoft Struck Deal*, BUFFALO NEWS, Oct. 28, 1998, at 3A. Additionally, U.S. District Court Judge Penfield Jackson ruled that all 20 hours of a videotaped interview with Bill Gates would be played at trial. *See id.* It is unlikely that any judge or juror would be able to pay attention to anything for 20 hours. As one observer at the Microsoft trial has noted:

> [Justice Department Attorney] Burt's questions are so highly technical that the courtroom is in a state of near stupor. (The room is also very hot, which doesn't help.) Judge Thomas Penfield Jackson is visibly struggling to stay awake. Even [witness] Gosling seems bored to tears. Less than an hour into the afternoon session, Jackson calls for an unprecedented half-hour recess. We're guessing he needs a nap.

Joseph Nocera, *The Empire Strikes Back*, FORTUNE, Jan. 11, 1999, at 105. As the above material indicates, judges and jurors have difficulty digesting the masses of information available in an antitrust trial. Since this is a bench trial, the final outcome of the case will be decided by Jackson. *See, e.g.*, Karen Donovan, *And the Winner Is . . .*, NAT'L L.J., July 5, 1999, at A1. Because it seems highly unlikely that Jackson will be able to digest all of the information available to him at trial, it is less likely that his decision will result in a rational outcome because he is making a decision based upon partial knowledge.

true economic impact of the tying arrangements and restrictive agreements are still uncertain. Perhaps they harm consumers, perhaps they do not. What is certain is that if a court erroneously condemns Microsoft's business practices, then a potentially beneficial business practice would be gone forever.[254]

Under the new per se legality standard proposed by this Note, the Section 1 claims would be dismissed, thus eliminating the substantial costs associated with a rule of reason trial. The problem with a dismissal of the Justice Department's rule of reason claims against Microsoft is that dismissal might allow Microsoft to continue its anticompetitive activities without any sort of check. However, even if charges brought under the rule of reason are dismissed, Microsoft's activities will still be checked by: (a) other antitrust laws; and (b) the free market.

1. *Microsoft May Still Be Prosecuted Under Other Antitrust Laws*

It is important to remember that an antitrust defendant may be prosecuted under judicial mechanisms other than just the rule of reason. Aside from just the Sherman Act, defendants in some instances may be prosecuted under other federal statutes, such as the Clayton Act,[255] which was passed largely out of fear that the rule of reason would render the Sherman Act toothless.[256] In addition, an antitrust plaintiff may also be prosecuted under state antitrust laws.[257] In the context of the Microsoft case, the most important alternatives to the rule of reason under Section 1 of the Sherman Act are: (a) the per se illegality rule under Section 1; and (b) Section 2 of the Sherman Act.

As noted above, a business practice may be declared illegal per se under

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254 *See supra* notes 150–52 and accompanying text.

255 *See* Clayton Act, 15 U.S.C. §§ 12–19 (1994). More specifically, Section 18 of the Act forbids a person from acquiring "directly or indirectly, the whole or any part of the stock or other share capital . . . of another person engaged also in commerce." *See id.* at § 18. A key goal of Section 18 is to prevent firms from engaging in "coordinated interaction that harms consumers"—the same type of competitive evil that is regulated by § 1 of the Sherman Act. DEPARTMENT OF JUSTICE AND FEDERAL TRADE COMMISSION, HORIZONTAL MERGER GUIDELINES, Apr. 2, 1992, § 2.1.

256 *See* JAY DRATLER, JR., LICENSING OF INTELLECTUAL PROPERTY § 5.02(3) (1999) ("[The Clayton Act] was intended to cover specific abuses of economic power that the Sherman Act appeared not to cover, or at least not to cover adequately."); E. THOMAS SULLIVAN & HERBERT HOVENKAMP, ANTITRUST LAW, POLICY AND PROCEDURE 818 (1999) ("The Clayton Act was passed in 1914, largely because Congress feared that the 'Rule of Reason' . . . would eviscerate the Sherman Act.").

257 *See, e.g.*, California v. ARC Am. Corp., 490 U.S. 93, 100–02 (1989) (holding that state antitrust laws are not subject to federal preemption merely because they might be interpreted to impose liability on antitrust defendants beyond that imposed by federal antitrust law); *see also* Richard C. Stanley, *Antitrust Law*, 36 LOY. L. REV. 665, 683 ([An] emerging principle in antitrust is the meaningful use of state antitrust laws.").

Section 1 of the Sherman Act where the defense can present absolutely no procompetitive justifications for its actions.[258] In the present case, Microsoft can present no procompetitive justifications for many of its activities.[259]

Section 2 of the Sherman Act states that one may not "monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states."[260] The elements of a Section 2 monopolization claim are thought to consist of (a) market power, and (b) some sort of monopolistic or anticompetitive conduct.[261] The elements of attempted monopolization are (a) proof of specific intent to monopolize; (b) proof of a dangerous probability that the attempt will succeed, and (c) anticompetitive or exclusionary conduct.[262]

In its complaint, the government has alleged that Microsoft possesses market power in the market for PC operating systems.[263] The government has also alleged that Microsoft's tying arrangements and exclusive dealing contracts constitute monopolization in violation of Section 2 of the Sherman Act.[264] In the alternative, the government has alleged that Microsoft has attempted to obtain market power in the Internet browser market in violation of the attempted monopolization prohibition in Section 2.[265]

Given the findings of fact recently released by Judge Jackson,[266] it does appear that the Microsoft trial will be analyzed as a Section 2 violation.[267] What is more, Judge Jackson's findings of fact seem to demand the conclusion that

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[258] *See supra* note 82.

[259] *See* United States v. Microsoft, Findings of Fact, 65 F. Supp.2d 1, 44–49 (D.C. 1999); *see also . . . And Now for the Endgame*, BUS. WK., July 14, 1999 at 47.

[260] Sherman Act, 15 U.S.C. § 2 (1994).

[261] *See* Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 595 (1985); *see also* GIFFORD & RASKIND, *supra* note 17, at 333; SULLIVAN & HOVENKAMP, *supra* note 256, at 627.

[262] *See* Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 456 (1993); Swift Co. v. United States, 196 U.S. 375, 396 (1905); *see also* GIFFORD & RASKIND, *supra* note 17, at 401; SULLIVAN & HOVENKAMP, *supra* note 256, at 723.

[263] *See* Plaintiff's Complaint at ¶ 49, United States v. Microsoft Corp. (No. 98-1232), *available at* <http://www.usdoj.gov/atr/cases/f1700/1763.htm> (visited Apr. 20, 2000).

[264] *See id.*

[265] *See id.*

[266] *See generally* United States v. Microsoft, Findings of Fact, 65 F. Supp.2d 1 (D.C. 1999).

[267] *See* Klein *supra* note 249, at 38 ("The recent Findings of Fact in *United States v. Microsoft* paint a vivid picture of a monopolist abusing its dominant position."); *see also* Karen Donovan, *Microsoft Faces Stiff Hurdles on Appeal: Judge Jackson Seems to Have Bulletproofed His Key Fact Findings*, NAT'L L.J., Nov. 22, 1999, at A5 ("Judge Jackson's stunning findings make it hard to remember that the Justice Department's original case against Microsoft amounted to a simple tie-in claim.").

Microsoft is in violation of Section 2. First, Judge Jackson concludes that Microsoft does possess market power in the PC operating systems market.[268] Second, Judge Jackson concludes that Microsoft's activities do amount to monopolization.[269] While Judge Jackson's ultimate conclusions of law have yet to be released, all factors seem to indicate that Microsoft can be effectively prosecuted under Section 2, regardless of the outcome under the rule of reason.

2. *Even if Microsoft's Activities Were to Escape Scrutiny Under the Antitrust Laws, the Free Market Will Act as an Effective Regulator of Microsoft*

There remains the slight possibility that Microsoft would avoid prosecution under other devices such as Section 2 of the Sherman Act. If all rule of reason issues were to be dismissed, as suggested by this Note, then Microsoft would be able to completely avoid scrutiny under the courts. If inefficient, then Microsoft's business practices would be left for the market to fix. As noted above, given the intense level of competition in the computer industry, coupled with a rapid rate of technological advancement, this process might occur very quickly.[270] In the case of Microsoft, however, the process might occur more slowly because of two separate factors. First, because intellectual property law gives Microsoft a property right over its Windows code, it is very difficult for competitors to develop duplicate products.[271] Second, because Windows represents the dominant operating system in the computer industry, computer software writers will write the majority of their software for Windows.[272] Because most of the software available is written for Windows, people will naturally purchase Windows as their operating system.[273] Thus, the dominance of Microsoft over the operating systems market is self-perpetuating.[274]

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[268] *See Microsoft*, *supra* note 266, at 10–16 ("Microsoft enjoys so much power in the market for Intel-compatible PC operating systems that if it wished to exercise this power solely in terms of price, it could charge a price for Windows substantially above that which could be charged in a competitive market.").

[269] *See id.* at 102 ("As has been shown, Microsoft also engaged in a concerted series of actions designed to protect the applications barrier to entry, and hence its monopoly power for a variety of middleware threats .... Many of these threats have harmed consumers in ways that are immediate and easily discernible.").

[270] *See supra* notes 221–27 and accompanying text.

[271] *See* Mark A. Lemley & David McGowan, *Could Java Change Everything? The Competitive Propriety of a Proprietary Standard*, 43 ANTITRUST BULL. 715, 716 (1998).

[272] *See* Plaintiff's Complaint at ¶ 57, United States v. Microsoft Corp. (No. 98-1232), *available at* <http://www.usdoj.gov/atr/cases/f1700/1763.htm> (visited Apr. 20, 2000).

[273] *See id.*

[274] *See* United States v. Microsoft, 65 F. Supp. 2d 1, 11 (D.C. 1999) ("What for Microsoft

However, despite such high barriers to entry in the operating systems market—given the rapid pace of technology in the computer industry, one major technological breakthrough could render Microsoft's market dominance worthless. Such a breakthrough might be the Java programming language. Java is a programming code, which is capable of working on many different operating systems and web browsers.[275] If Java became the dominant programming code, then Microsoft's operating system dominance would become less disturbing.[276] Because a program could be run on any available operating system, consumers would choose their browser based upon the merits of the browser, instead of the amount of programs compatible with that browser.[277] However, the whole purpose of Microsoft's actions are to limit the dissemination of Java technology. In its complaint, the Justice Department alleges that many of Microsoft's business tactics are designed to stop the dissemination of Java programming through the

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is a positive feedback loop is for would-be competitors a vicious cycle."); *see also id.* ("Economies of Scale and network effects, which reinforce one another, result in high barriers to entry."); Salop & Romaine, *supra* note 26, at 621 ("As a result of this positive feedback process, a single operating system can achieve a dominant or monopoly position."); Mark A. Lemly & David McGowan, *Could Java Change Everything? The Competitive Propriety of a Proprietary Standard, in* SECOND ANNUAL INTERNET LAW INSTITUTE, at 453 (Patents, Copyrights, Trademarks, & Literary Property Course Handbook Series No. 520, 1998) ("[T]he operating systems market is characterized by strong (albeit virtual) network effects, meaning that users will naturally gravitate towards a single standard platform and tend to stay there.").

[275] *See* Plaintiff's Second Amended Complaint at ¶ 2, Sun Microsystems v. Microsoft Corp., (N.D. Cal. 1998) (No. C-97-20884 RMW) ("[Java is] a standardized application programming environment that affords software developers the opportunity to create and distribute a single version of a programming code which is capable of operating on many different, otherwise incompatible systems platforms and browsers."); *see also* Lemley & McGowan, *supra* note 274, at 717 (same).

[276] *See* Saul P. Mortenson & Eamon O'Kelly, *Antitrust Enforcement in High Technology Industries: Keeping Cyberspace Safe for Innovators or Just Another Speed Trap on the Information Superhighway?, in* 19TH ANNUAL INSTITUTE ON COMPUTER LAW, at 1009, 1033 (PLI Patents, Copyrights, Trademarks, & Literary Property Course Handbook Series No. 547, 1999) (noting how the development of the Java programming language might lead to increased competition in the operating systems market); *see generally* Lemley & McGowan, *supra* note 274. Scott McNeely, the founder of the Sun Microsystems company which developed Java, is particularly optimistic, as he predicts: "I wouldn't be surprised if four years from now Microsoft's market capitalization fell from $300 billion to $1 billion." *See* Andrew Glass, *Microsoft: At Some Point Gates Will Have to Strike Deal*, DAYTON DAILY NEWS, Feb. 16, 1999, at 6A. However, Lemley and McGowan also voice a concern that, while the Microsoft monopoly might be reduced, the rise of Java might result in Sun Microsystems as a new monopoly power. Lemley & McGowan, *supra* note 258, at 751.

[277] *See* Lemley & McGowan, *supra* note 274, at 717–18 ("Java offers the opportunity of platform–independant computing . . . [which would] allow both consumers and programmers to choose operating systems free of the constraints (but while enjoying the benefits) of network effects.").

Internet, thus preserving its dominant position.[278] In particular, it is alleged that Microsoft was trying to eliminate Netscape Navigator, a web browser that was actually working as a "platform" from which Java programs could be produced.[279] However, even if Microsoft is allowed to run an unimpeded attack upon Netscape, it will not likely succeed in preventing the dissemination of Java technology. Netscape's share of the browser market remains strong,[280] meaning that it has ample opportunity to distribute Java. Even if Netscape were unable to distribute Java, there is the possibility that it could be distributed through other browsers. Additionally, Microsoft continues to face competition from other operating systems, including the emerging Unix and Linux operating systems.[281] The presence of paradigm-shifting technology such as Java, indicates that the rapidly-developing and fiercely competitive computer industry is fully capable of handling the Microsoft problem.[282]

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[278] *See* Plaintiff's Complaint at ¶ 1–6, United States v. Microsoft Corp. (No. 98-1232), *available at* <http://www.usdoj.gov/atr/cases/f1700/1763.htm> (visited Apr. 20, 2000).

[279] *See id.* at 3–4 ("Microsoft recognized that Netscape's browser was itself a 'platform' to which many [Java] applications were being written . . . .").

[280] In presenting its side of the case, Microsoft's council has presented evidence that Netscape Navigator was bundled with 22% of all personal computer shipments and that it owned 24% of the market of top Internet Service Providers. *See* Karen Donovan, *Microsoft Turns Tables*, NAT'L L.J., June 14, 1999, at A7. Microsoft has also presented evidence that, during the first week of the Microsoft trial, there were 1.8 million downloads of Netscape Navigator from the Internet. *See id.* (The accuracy of this figure is dubious. If extrapolated over one year, the 1.8 million figure results in one Netscape Navigator download for every 1.6 Internet users in the world.) *See id.* In addition, it is at least arguable that Netscape's merger with the online services provider America Online will increase Netscape's ability to compete. *See, e.g.*, Rajiv Chandrasekaran, *Microsoft Says AOL Deal Undercuts Antitrust Case*, WASH. POST, Apr. 29, 1999, at E1; Associated Press, *AOL Combo Could Rival Giant: Netscape Buy Would Let AOL Send a Challenge to Microsoft*, STAR TRIB. NEWSPAPER OF THE TWIN CITIES, Nov. 24, 1998, at 1D ("The planned marriage of America Online and Netscape would create a single Internet company with remarkable reach across the high-tech world—and influence to challenge giant Microsoft's dominance in key areas."). However, Netscape's merger with AOL could also be characterized as the end result of Microsoft's anticompetitive conduct—as a weakened Netscape is forced to submit to a merger in order to survive.

[281] *See* Mortenson & O'Kelly, *supra* note 276 at 1033. In regards to the Linux system, see Dem Foust, *Can Red Hat Stay Red Hot?*, BUS. WK., July 5, 1999, at 85 (noting the success of Red Hat Software Inc.'s Linux operating system, which has been given away for free in order to grab a solid market share).

[282] But is there a problem in the first place? The market for operating systems might be such that it is actually efficient for there to be only one dominant firm. Those writing software might be deterred from the extra effort that it will take to write several programs for a variety of operating systems. *See* Salop & Romaine, *supra* note 26, at 617 (discussing how expensive and time-consuming it is to rewrite an application for each different operating system). Thus Microsoft's market dominance might encourage innovation in the software industry. *See* Shapiro, *supra* note 178, at 29 (noting that one dominant technology may actually be beneficial

Under the rule of reason in its present state, the Microsoft litigation will result in a long and expensive trial. The government bears a heavy burden in proving the rule of reason issues. If the government does not lose, then there is the risk of a false positive. Under the per se legality standard suggested by this Note, the costs associated with litigating rule of reason issues would be eliminated, as would the risks of a false positive. Additionally, the per se legality standard results in the same outcome as would most likely occur in a rule of reason trial. While the per se legality standard insulates Microsoft from Section 1 liability under the law, Microsoft remains liable under other overlapping areas of antitrust law, such as Section 2. In addition, there is a strong possibility that the ultra-competitive computer market will regulate Microsoft's conduct so as to produce the most efficient result.

V. CONCLUSION

As a jibe against the free-market theories expressed by Chicago-school economists, it is often asked:

> Question: "How many Chicago economists does it take to change a lightbulb?"
>
> Answer: "None. If it needs changing, the market would have changed it already."[283]

This joke expresses a common criticism of the Chicago school. Market responses to economic problems, if they occur at all, will never be quick and painless. However, one thing to consider is that rule of reason antitrust trials, also, will never be quick and painless. They are long, and they are expensive. They are difficult for judges and juries to handle. In addition, there is the risk of erroneously condemning a practice which is actually procompetitive. It is true that the free market might not be an ideal method for handling rule of reason cases, but it is better then the next best alternative.

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for consumers, because they do not have to worry about their products getting replaced by different products).

[283] Markovits, *supra* note 35, at 86.