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Parens Patriae: Will We Treble In Its Wake?

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Notes

Parens Patriae: Will We Treble In Its Wake?

On September 30, 1976, President Ford signed the Hart-Scott-Rodino Antitrust Improvements Act of 1976.[1] Title III of the Act, the parens patriae provision, gives state attorneys general the authority to sue businesses for damages incurred by natural citizens to their states caused by Sherman Act violations.[2] Because of the revolutionary nature of some of the Act's provisions, and the extensive and often internally inconsistent legislative history, the district courts will be faced with serious problems in the interpretation and administration of parens patriae.[3]

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Initially, the courts must determine whether the primary purpose of parens patriae is deterrence of antitrust violations or compensation of the plantiffs.[4] The distinction between compensation and deterrence is vital

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[1]Pub. L. 94-435, 90 Stat. 1383 (codified at 15 U.S.C. §§ 15c-15f, 18a, 1311-14 (1976) [hereinafter cited as the Act].

[2]*See id.* (codified at 15 U.S.C. § 15c(a)(1) (1976)). The major provisions of the Act include: (1) state attorneys general may sue for damages inflicted not on the state, but on its citizen-consumers; (2) damage recoveries may not include duplicative awards; (3) business entities are precluded from being members of the parens patriae class; (4) where the antitrust violation alleged is price-fixing, and such allegation is proved, damages may be determined in the aggregate or by statistical or sampling methods; (5) damages recovered may be deposited with the state as general revenues, or distributed in such manner as the district court authorizes, as long as all injured persons have a reasonable opportunity to secure their appropriate share. *See* 15 U.S.C. §§ 15c-15f (1976).

[3]One major problem is raised by the Supreme Court decision in Illinois Brick v. Illinois, 97 Sup. Ct. 2061 (1977). There the court limited antitrust recovery to direct purchasers. Under this decision, many end-user plaintiffs now are precluded. This severely limits the effectiveness of parens patriae and appears to be in direct conflict with the purposes of the Act. *See* Illinois Brick v. Illinois, 97 Sup. Ct. 2061 (1977) (Brennan, J., dissent). There are numerous proposals designed to negate the *Illinois Brick* decision and return full effectiveness to the Act. The Act itself argues for such a result and the following analysis is based upon the outcome.

[4]Ideally, these two concepts are opposite sides of the same coin of result: defendant harms plaintiff by x amount of dollars; plaintiff recovers from defendant x amount of dollars and is thereby compensated; defendant is made x dollars less than whole and it is thought thereby deterred from similar acts in the future. In private treble damage actions, the theory is the same, but the balance favors the plaintiff by a factor of three: plaintiff receives a windfall in addition to being made whole, and this additional cost to defendant is justified by the strong societal interest in deterring future antitrust violations. This deterrence theory of treble damages appears to be based on the idea that the rational antitrust law violator will conclude that on a cost-benefit basis, it costs more than it is worth to violate antitrust law if there is some degree of certainty that he will be forced to pay treble damages.

because it will mold the courts' attitude in interpretating the provision.[5]

This note will use an economic model to develop three themes: (1) a compensation theory of regular treble damage suits has several economic inefficiencies; (2) parens patriae, analyzed under a deterrence theory, cures most of these inefficiencies; and (3) the value of this increased economic efficiency is to some extent negated by inefficiencies at the middleman level.[6]

COMPENSATION VS. DETERRENCE

Since the passage of the Sherman Act,[6] in the area of private actions the courts seem to have generally adopted the compensation theory. This is reflected by a fairly strict, if not overly precise, interpretation of standing for private plaintiffs.[7]

Part of the interpretative problem with parens patriae is that according to its legislative history, the purpose of the Act is *both* compensation and

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[5][I]f the appropriate purpose . . . is deterrence, the litigation of private suits should then be encouraged in the courts and the awarding of damages becomes paramount. Damages should be awarded to *someone* (so that a deterrent effect is manifested), even if that party is not the one specifically injured by the antitrust violation. However, if compensation is the goal, then those not injured by anticompetitive activity have no business in court (even if their suit attacks a bona fide antitrust violation). . .

K. ELZINGA & W. BREIT, THE ANTITRUST PENALTIES 66 (1976) [hereinafter cited as ELZINGA & BREIT].

[6]For this analysis, economic models formulated by Elzinga and Breit have been used extensively as well as the legislative history of parens patriae, primarily the hearings before the Senate Subcommittee on Antitrust and Monopoly.

The approach will be to examine first whether the intent of parens patriae, as revealed by the legislative history, is primarily deterrence or compensation. Economic models and cost-benefit analysis will then be used to identify the primary effect to predict the likely impact of the Act. As part of this analysis, the problems of damage assessment and duplicative recoveries will be addressed.

Finally, an interpretaiton of the Act will be suggested which will show how parens patriae can be applied with maximum economic efficiency.

[7]Act of July 20, 1890 c.647, 26 Stat. 209 (1890) codified 15 U.S.C. §§ 1-7 (1970).

The various circuits have, for example, applied the tests of (1) whether the injury was direct or incidental; and (2) whether the plaintiff was in the target area of the violation. Each of these theories has at times been used to deny standing without reaching the merits of the plaintiff's claim. For example, in the Sixth Circuit, under the direct injury approach, plaintiff suppliers were found to be too remote and far removed from the direct injury (against supplier's customers) to recover damages. *See* Volasco Products Co. v. Lloyd A. Fry Roofing Co., 308 F.2d 383, 395 (6th Cir. 1962), *cert. denied*, 372 U.S. 907 (1963).

Under the broader target area approach of the Ninth Circuit, remote purchasers were denied standing as plaintiffs by a finding that their injury did not occur within the area of the economy affected by the antitrust violation. *See In re* Multidistrict Vehicle Air Pollution, M.D.L. No. 31, 481 F.2d 122, 129 (9th Cir. 1973).

These and similar cases reflect the Supreme Court's 1972 observation that Congress did not intend the antitrust laws to remedy all injuries conceivably traceable to an antitrust violation. *See* Hawaii v. Standard Oil Co., 405 U.S. 251, 263-65 (1972).

For a survey of the various standing doctrines and a detailed analysis of how these doctrines have been applied, see Berger & Bernstein, *An Analytical Framework for Antitrust Standing*, 86 YALE L.J. 809 (1977).

deterrence.[8] On the one hand, "substantive standards of the antitrust laws are not changed [by parens patriae]",[9] *i.e.*, plaintiff still has the burden of proving that the damages suffered were by reason of defendant's antitrust violation. This language sounds quite similar to present standing rules. On the other hand, a cause of action is vested in the state attorney general to sue in the stead of the ultimate consumer, thereby apparently implying standing as long as a violation, and harm flowing therefrom, is proved. Here one of the major interpretive problems becomes more apparent. Assuming an antitrust violation is proved, treble damages will be extracted from the defendant, but are not strictly required to be distributed to plaintiffs. This suggests that deterrence may be the primary goal of parens patriae. If this is valid, the question then becomes whether and how the provision can be applied to avoid the inefficiencies present under a compensation theory model.

What follows is an economic model analysis of traditional treble damage actions under a compensation theory, and a comparison with the parens patriae provision under a deterrence theory.[10] Emphasis is placed on the inefficiencies inherent under each theory."

Ronald Coase has proposed a set of ideas for maximizing the value of the economy's total output. Coase argues that public policy should attempt to balance the loss in the value of production against the gain in the value of production resulting from a given policy.[12] Elzinga and Breit have developed a theory of the reciprocal nature of the costs of antitrust enforcement based on this Coasian framework.[13] They conclude that the private treble damage

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[8]"The title is intended to provide compensation for the victims of antitrust offenses; to prevent antitrust violations from retaining the fruits of their illegal activities, and to deter antitrust violations." S. REP. NO. 229, 94th Cong. 2d Sess. 39 (1976) [hereinafter cited as S. REP. NO.

[9]*Id.* at 5.

[10]Professor John Flynn has stated: "[I]nsight gained by rigorous economic analysis are an indispensible starting place in analyzing economic behavior or structure, enforcement policy and the development of antitrust doctrine" *The Antitrust Improvements Act of 1975: Hearings on S. 1284 Before the Senate Subcomm. on Antitrust and Monopoly of the Senate Judiciary Committee,* 94th Cong., 1st Sess., (pt. 2), 538 (1975) (statements of Professor John Flynn) [hereinafter cited as *Hearings*].

[11]According to Posner, there is a large incidence of antitrust violations and a limited amount of resources available with which to combat them. *See* Posner, *A Statistical Study of Antitrust Enforcement,* 13 J.L. & ECON. 365, 416-19 (1970) [hereinafter cited as Posner]. It is therefore in the public interest to use these limited resources as efficiently as possible.

[12]Coase, *The Problem of Social Cost,* 3 J.L. & ECON. 1 (1960). An example of Coasian analysis is as follows: given a situation where A inflicts harm on B, the problem is commonly thought to be: how should we restrain A?

> But this is wrong. We are dealing with a problem of a reciprocal nature. To avoid the harm to B would inflict harm on A. The real question that has to be decided is: should A be allowed to harm B or should B be allowed to harm A? The problem is to avoid the more serious harm. . . . What answer should be given is, of course, not clear unless we know the value of what is obtained as well as the value of what is sacrifieced to obtain it.

Id. at 2.

[13]If the liability is imposed on the consumer, a monopolist causes damage to the consumer . . . But if the liability is imposed on the monopolist through some form of an-

award system, whereby the antitrust violator pays compensation to the injured plaintiff, is inefficient in economic terms because of three forces. These forces are: (1) the "perverse incentives" effect; (2) the "misinformation" effect; and (3) the "reparations costs" effect. What follows is an analysis of how a deterrence theory application of parens patriae may minimize these effects.

The "perverse incentives" effect refers to that phenomenon whereby a private party neglects to modify his behavior when the damage inflicted on him by the antitrust violator exceeds the costs to him of avoiding that damage.[14] Theoretically at least, a person who believes that reparations greater than the harm suffered will be forthcoming will have little incentive to seek out competitive substitutes or otherwise mitigate his harm.[15]

Parens patriae is aimed at that type of violation where there is "relatively small economic damage to each of a large number of people."[16] Many if not most consumers who are victims of this type of antitrust violation are unaware of their victim status. In a parens patriae action, therefore, the perverse incentives effect for any individual consumer could be de minimis.

Since the injured party (all consumers within a state) and the initiator of the action (the state attorney general) are not one and the same, the perverse incentives effect is further distorted. The perverse incentives effect predicts that the greater the probability of collecting damages, and the greater the amount of the damages awards allowed by law, the more will this incentive be operative.[17] It is likely that both the probability of collecting damages as well as the amount of the damages will be greater under parens patriae actions, since a less rigorous standard of proof than that required in traditional class actions will be permitted. Statistical estimation of damages and aggregation are also permitted under parens patriae. Further, simplified proof standards may also be expected to increase the number of suits brought. Posner found that since 1945 or so, the number of private antitrust suits has greatly

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> titrust law, the consumer . . . in insisting through the law that the monopolistic behavior end, imposes a cost on the monopolist, the cost of lost monopoly returns. The question of "fault" is largely irrelevant in such a setting. The real issue is: what party to the transaction is most efficient in preventing the misallocation resulting from the monopoly?

ELZINGA & BREIT, *supra* note 5, at 83.

[14]This incentive would exist whenever the expected value of the reparations is greater than the amount of damage. *Id.* at 84.

[15]In some areas of law, "unclean hands," contributory negligence or failure to mitigate may serve as a partial or full defense; however, in antitrust law, particularly if deterrence is the intent, such factors will not bar recovery. In 1968, the Supreme Court held that "the doctrine of in pari delicto . . . is not to be recognized as a defense to an antitrust action." *See* Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. 13, 140 (1968). Although there had been some question here as to the extent of plaintiffs' wrongdoing, the court reasoned that although plaintiff might be no less morally reprehensible than defendant, "the law encourages his suit to further the overriding public policy if favor of competition." *See id.* at 139.

[16]S. REP. NO. 229, *supra* note 8, at 40.

[17]*See* ELZINGA & BREIT, *supra* note 5, at 90.

increased in relation to the number of government suits.[18] He speculates that this increase might be attributable to the *Bigelow* decision[19] which greatly simplified proof of damages required in private antitrust actions. Thus an increase in the number of antitrust suits brought as a result of parens patriae may be expected. It is likely that the simplified proof standards will also result in higher average damage awards.[20]

So, although the probability of collecting damages and the likely amount of the awards are both increased, it appears that there is no single recipient (attorney general) or class of recipients (consumers) with an adequate incentive to tolerate antitrust violations with the hope of increasing collectable damages. Indeed the opposite fear was expressed, that is, that attorneys general might be too eager to bring antitrust actions in the expectation of gaining large amounts of general revenue for the state.[21] It therefore seems that the separation of the damaged consumer from the likely major recipient of the damage award will largely mitigate the perverse incentives effect.

The "misinformation" effect[22] refers to that propensity for a private party to claim that anticompetitive behavior has taken place when in fact it has not.[23] It is frequently pointed out that the rational businessman is a risk minimizer.[24] Therefore, however groundless a claim might appear to be, a rational management must attach some positive probability to the prospect of losing if the claim is litigated, and will frequently choose to settle out of court to avoid the possibility of losing.[25]

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[18]Prior to 1945, there was a fairly constant relationship between the number of government suits and the number of private suits instituted for antitrust violations. *See* Posner, *supra* note 11, at 372-73.

[19]Bigelow v. RKO Radio Pictures, Inc. 327 U.S. 251 (1946). *See* Posner, *supra* note 11, at 374.

[20]As to the amount of damages awarded, it is similarly likely for the same reasons as above, parens patriae actions will result in significantly higher damage awards. There is frequent and positive reference in the hearings to the *Tetracycline* settlement cited as In re Cooridnated Pretrial Proceedings in Antibiotics Actions, 333 F. Supp. 278 (S.D.N.Y. 1971)). which although a class action in form, was treated as a model for what parens patriae actions could be expected to accomplish. *See, e.g.*, S. REP. NO. 229, *supra* note 8, at 48-49. The defendants in that case reached settlements with several classes of consumer plaintiffs in an amount exceeding $100,000,000, of which less than 30% was paid as direct compensation to consumers. The balance of unclaimed funds was then awarded to the state under a type of cy pres doctrine, for use to support a variety of local welfare projects. *See Hearings, supra* note 10, (pt. 3), 120 (statement of Philip Lacovara).

[21]S. REP.NO. 94-803, 942 Cong., 2d Sess. (pt. 2) 173-75, 271 (1976) (minority views).

[22]This effect differs from the perverse incentives effect in that in the latter case there is actual damage, while here, the claim is spurious.

[23]Elzinga and Breit point out that private antitrust suits are particularly prone to this "nuisance suit" effect for several reasons. First, because of the ambiguous nature of what sorts of combinations, territorial arrangements and refusals to sell will eventually be found illegal, it is hard for a potential defendant to make a confident prediction of innocence or guilt. In addition, there is uncertainty in the outcome of a jury trial which is concerned with complex economic issues, as well as potential exposure to huge damage liability. ELZINGA & BREIT, *supra* note 5, at 91-94.

[24]*See generally* R. CYERT & J. MARCH, A BEHAVIORAL THEORY OF THE FIRM (1963).

[25]For some statistics on our of court settlements, see Posner, *supra* note 11, at 375-76.

Parens patriae appears to deal with this effect to some degree. To the extent that the initiator of the action (attorney general) does not stand to personally benefit from the damage award, he does not have the characteristic pecuniary self-interest motivation that seems to be behind many such nuisance suits. The Act also provides that a defendant may be awarded reasonable attorneys fees if it is found that a state attorney general has acted in bad faith or for oppressive reasons, and that a parens patriae action once brought may not be dismissed or compromised without court approval. These two provisions arguably will have a "filtering" effect on attorneys general, so that they will bring actions only in good faith, and with some likelihood of success on the merits, since they will not have an automatic right to settle out of court, as do private plaintiffs.

The legislative history reveals some concern about attorneys general acting not so much in bad faith as for self-serving political ends,[26] this being referred to as the "white horse attorney general" theory.[27] The misinformation effect has traditionally appeared where settlement was likely and where personal financial gain was involved. So although the normal political processes and full exposure to the public through the judicial system appear to add a level of scrutiny, it is too early to tell whether this will be sufficient to control the bringing of improperly motivated suits. To the extent that the number of such suits increases, parens patriae will have contributed to the inefficiencies of the misinformation effect.

The third inefficiency associated with private treble damage actions identified by Elzinga and Breit is "reparations costs." This term refers to the overall costs, in terms of resources used, of determining and allocating damages.[28] This particular effect is not mitigated by parens patriae, and represents a problem in the future administration of the Act.

The Elzinga-Breit theory, favoring deterrence over compensation, argues that the compensation process is itself too costly to justify.[29] Parens patriae is only a partial solution to this criticism because of its hybrid nature. In effect, parens patriae will likely function as a deterrent. Its form, however, in terms of calculating the amount of damage, is one of compensation, i.e., not a civil fine but an award based on some per capita headcount multiplied by a factor of three. Although parens patriae is addressed to all Sherman Act violations,

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[26]*See Hearings, supra* note 10 (pt. 3), at 229 (letter from Professor Richard Posner). *See also id.* at 109 (statement of Charles Wiggins).

[27]*Id.* at 109. For example, the minority views are highly critical of a rather grandiose antitrust action recently brought by the attorney general of Florida against seventeen major oil companies, charging a "worldwide scheme" of anticompetitive activities in the production, transportation, refining and marketing of petroleum products. Florida ex rel. Shevin v. Exxon Corp., 526 F.2d 266 (5th Cir. 1976). *See, e.g.*, S. REP. NO. 231, 94th Cong., 2d Sess. 174-75 (1976).

[28]These costs include for example all legal expenses involved in bringing and defending the suit, court costs (time and money), and efforts spent in damage determinations.

[29]*See* ELZINGA & BREIT, *supra* note 5, at 96.

simplified methods of proof (aggregation and sampling) are permitted only for price fixing allegations. The legislative history deals to a far greater extent with price fixing than any of the other common forms of antitrust violation (monopoly, attempt to monopolize, boycotts, etc.).[30] It seems reasonable to assume that a good percentage of parens patriae actions will therefore involve price fixing.

The legislative history and hearings are disturbingly sparse in their treatment of the problems associated with calculation of damages.[31] The computation problem has always existed in price fixing cases; however, given the broad sweep of parens patriae this problem will likely be magnified. The use of aggregation and statistical methods will probably make easier proof of the number of injured plaintiffs, for example, through use of defendant's sales figures to class members within a state during the relevant period, or from use of national sales figures, with an estimated percentage breakdown of sales to the state in question.

The harder question is proof of the amount of damages per consumer.[32] Generally, a plaintiff may recover if he purchased at a price higher than he would have paid under competitive conditions.[33] The easier situation is where a large number of consumers all purchased at the same fixed price, but this is often not the case. Davidow points out that "the primary aim of many price fixing conspiracies is not vastly higher prices, but simply market stabalization—the limitation of vigorous competition."[34] The conspiracy often takes the form of an agreement to stick to existing prices, or to refrain from offering special discounts, or to limit the size of discounts. In such cases, there is no agreed price increase, and damages must therefore be estimated. It is clear that damage estimation, even prior to parens patriae, was appropriate, once a violation was established.[35] The simplest approach would be to compare prices before and after the conspiracy. However, once the conspiracy ends and litigation begins, defendant's pricing might will be subject to

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[30]*See, e.g.*, S. REP. NO. 229, *supra* note 8, at 39.

[31]"In a price fixing case, for example, frequently the only method of determining the total impact . . . will be to measure total overcharges during the relevant period to members of the damaged class. Once this figure has been computed and assessed. . ." *Id.* at 48.

[33]The determination of amount of damages in massive price fixing cases has been described as "an exercise in pure imagination in which the wildest flight of fancy is entered as a judgment, trebled, and supplemented by generous attorneys fees to compensate the creator of the theory for the breadth of his vision." *See* Davidow, *Proof of Purchases and Damages by Public Buyers of Price-Fixed Goods,* 17 ANTITRUST BULL. 363, 363 (1972).

[33]"The basic economic problem . . . is to attempt to 'turn back the calendar,' remove the effects of conspiratorial or other alleged illegal behavior, reconstruct the situation *that would have prevailed* under the type of competitive conditions *that would have existed,* absent the conspriacy. . . " Lanzillotti, *Problems of Proof of Damages in Antitrust Suits,* 16 ANTITRUST BULL 329, 330 (1971).

[34]Davidow, *Proof of Purchases and Damages by Public Buyers of Price-Fixed Goods,* 17 ANTITRUST BULL. 363, 376 (1972).

[35]Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 125 (1969).

the advice of attorneys who would warn that a precipitous price decline would be strong evidence against them.[36]

Given over a decade of inflation, the changing value of money, and a general trend of product improvement, it is not surprising that prices are rarely lower in later years than in earlier ones, regardless of conspiracies. Price comparisons with other nonprice-fixers at that point in time could also be misleading because even nonconspirators might tend to keep their prices higher than purely competitive because of the artificial stability induced by the conspiracy. In such situations, there is a need for sound theoretical analysis and empirical knowledge of the operations of the relevant market.[37]

The problems of parens patriae relief as a form of compensation are substantial, even with the simplified methods of proof for price fixing allegations. However, the problem is compounded by the fact that where price fixing arrangements have been prosecuted, it is frequently in combination with other ancillary violations, for example, division of markets, resale price maintenance, or patent agreements.[38] It appears that for these reasons, parens patriae actions will not alleviate the reparations costs effects. Thus, although parens patriae will minimize the first two of Elzinga and Breit's inefficiencies, the perverse incentives effect and the misinformation effect, the third inefficiency, reparations costs effect, will still be operative.

THE MIDDLEMAN PROBLEM

This analysis now turns to the problems of the middle levels of the distribution chain under parens patriae actions. Specifically, the question becomes whether the net gain in efficiencies achieved at the end-user level is sustained at the middleman level. The Act provides that any damages awarded will exclude amounts which duplicate damages already awarded for the same injury and permits parens patriae actions on behalf of natural persons only, thereby excluding corporations, partnerships, and the like. The legislative history is sparse with respect to this problem. What discussion there

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[36]Davidow, *Proof of Purchase and Damages by Public Buyers of Price-Fixed Goods*, 17 ANTITRUST BULL. 363, 376 (1972).

[37]Lanzillotti, *Problems of Proof of Damages in Antitrust Suits*, 16 ANTITRUST BULL. 329, 331 (1971). Some of the relevant data needed include: (1) knowledge of the way in which the relevant market and product functioned in the past; (2) knowledge of how the alleged price fixing affected general market forces, as well as prices, costs, sales and profits of the product in question, and using (1) and (2), deriving (3) estimates of what results would have emerged had buyers and sellers been subject to normal competitive forces characteristic of that product, *e.g.*, levels of demand and cost conditions. *See id.*

[38]Posner, *supra* note 11, at 399-400. Professor Posner speculates that the reasons for this may be either that conspiracies to fix prices are difficult to effectuate without such ancillary agreements, or that the adoption of such arrangements increases the probability of detection. *See id.* at 399. Whichever hypothesis is true, given that simplified proof applies only to price fixing, difficulties in the assessment of damages in such situations are vastly compounded, and the cost likewise increased.

is concerns the status of the middleman's cause of action, particularly if he is precluded from joining the parens patriae suit.

> [The Act] raise(s) the possibility . . .of double recovery, this time by purchasers at different levels of the distribution network. . . .
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> Specifically, are the bills intended to permit cumulative recovery by purchasers at different levels. . .?. . .
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> [T]he threat of duplication might trigger unwarranted settlements by putative defendants who simply could not afford to litigate in the face of such exposures. [Some members of our committee] question whether the incremental deterrent effect of, perhaps, sextuple recovery outweighs these risks.[39]

In short, this is the component-to-finished-product, several-levels-of-distribution problem, with possibly several types of antitrust violations, creating damage assessment problems of "nearly insuperable difficulty," as Justice White described them in *Hanover Shoe.*[40] Further, what is to become of:

> Claims of the initial purchasers who, as the parties most directly injured, have the greatest incentive to seek redress and the easiest burden of proof? If their claims are barred by *parens patriae* actions on behalf of indirect purchasers, do we not promote the interest of the alleged wrongdoer by substituting plaintiffs who will encounter the maximum difficulty in sustaining their claims in place of those whose task is least burdensome? On the other hand, if both direct and indirect purchasers are permitted to recover, don't we unfairly penalize the defendant with multiple liability for the same wrong?[41]

The first way to analyze this problem is to look at the Act's impact on pending litigation. "Title IV. . .does not apply to any civil action alleging the same violation previously alleged in any other civil action brought on behalf of a class of consumers against the same defendants."[42] This appears to mean that a regular class action against one defendant cannot be converted into a parens patriae action. Whether a separate parens patriae action could be

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[39]*Hearings, supra* note 10, (pt. 2), at 724 (Report by the Committee on Trade Regulation of the Association of the Bar of the City of New York). Professor Milton Handler posed this variation of the problem:

> [H]ow can it be determined . . . that an antitrust conspiracy among component fabricators has had a measurable impact on a consumer of the finished product three or four levels down the chain of distribution? Since the manufacturer who purchases directly from the fabricator sets his price based on his own independent business judgment, as does each other person further down the chain, whatever price the consumer ultimately pays is not necessarily attributable to the antitrust violation.

Id. at 643-44 (article by Milton Handler).

[40]Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481 (1968).

[41]*Hearings, supra* note 10 (pt. 2), at 644 (article by Milton Handler).

[42]S. REP. NO. 299, *supra* note 8, at 57.

brought against that defendant, and if so, whether the original class plaintiffs could be included in that action, is unclear.

As to middleman (frequently not natural persons within the meaning of the Act), there is some concern expressed as to what effect parens patriae will have on their cause of action.[43] The Senate Report purports to deal with this problem of double liability and preservation of a middleman cause of action by reference to the Act's provison of duplicative recovery.[44] However, the report goes on to state what seems to be a more permissive attitude on the possibility of duplicative recovery (without actually stating whether the intent is one of compensation or deterrence). [Parens patriae] also contains a proviso that

> defendants are not subjected to duplicative liability, particularly in a chain-of-distribution situation where it is claimed that middleman absorbed all or part of the illegal overcharge. The Committee intention is to codify the holding of the Ninth Circuit in *In re Western Liquid Asphalt Cases*.[45] "We therefore see no problem of double recovery. . .if this difficulty should arise. . .the district court will be able to fashion relief accordingly. . .consolidation of cases. . .is one means. . .statutory interpleader. . .by antitrust defendants. . .special masters. . .res judicata. . .collateral estoppel and procedures for compulsory joinder. . . .Where the choice is between a windfall to intermediaries or letting guilty defendants go free, liability is imposed. . . .so, too, between ultimate purchasers and defendants."[46]

Any potential plaintiffs within the chain of distribution between defendant and end-user will have an incentive to enter a parens patriae action (at the risk of being precluded from so doing at a later time), and possibly a greater incentive to institute an action first. This might occur where such a plaintiff feared he would fail to receive his full recovery under the parens patriae distribution formula;[47] he might also fear that the strong end-user bias of parens patriae would prejudice his amount of recovery, and finally, he might fear that a jury might hesitate to award a figure large enough to give him the trebled amount he might expect in an individual suit. Therefore, it appears that the perverse incentives effect in such a situation would be dramatic.

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[43]A cause of action, having become vested, is a right protected by article 1, section 10 and the due process clause in the fourteenth amendment, of the U.S. Constitution. Coombes v. Getz, 285 U.S. 434, 448 (1932).

[44]S. REP. NO. 229, *supra* note 8, at 44. This aparently means that where for example retailers successfully sued and recovered against manufacturer-defendants, this recovery will be by some unspecified formula excluded from a later successful parens patriae damage award from the same defendants.

[45]487 F.2d 191 (9th Cir. 1973).

[46]S. REP. NO. 299, *supra* note 8, at 44.

[47]It is unclear whether damages awarded in joined action would likewise fall under the court distribution formula.

Of no less concern here would be the misinformation effect, for example, even where a legitimate parens patriae claim is being made, a middleman might calculate that he had little to lose by joining his spurious claim to the parens patriae claim, especially since to some extent this would furnish a "free ride" in terms of legal discovery and trial preparation. As to the third effect, reparations costs, clearly the effects of such massive suits could be staggering.[48]

It therefore seems that most of the efficiencies gained by parens patriae actions at the end-user level may well be lost at the middleman level.[49]

THE DETERRENCE EFFECT MODEL

The final issue to be explored is how parens patriae can be applied by the courts to have maximum impact. The first issue to examine is what impact present antitrust laws have on violations, particularly price-fixing, and what difference the parens patriae actions may make.

Why do businessmen, faced with the possibility of treble damage suits, engage in price fixing? Economic theory suggests two related reasons: First, price fixing for the rational profit maximizer may involve a sizeable profit factor and a reliable revenue stabalizer, and second, the overall benefits of price fixing tend to outweigh overall costs. Erickson identifies four factors which the rational profit maximizer will consider in determining whether the price fixing benefits will outweigh the treble damage costs: (1) the likelihood of getting caught; (2) if caught, the percentage of defendant's total conspiratorial profits that are likely to form the basis of the ensuing treble damage recovery (the "coverage" ratio); (3) the length of time between the initial violation and the court order requiring payment of treble damages (time lag); and (4) the size of the damage award likely to be assessed.[50] Erickson then sets forth a startling hypothetical situation illustrating the interplay of these four factors.[51]

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[48]*See, e.g., Hearings, supra* note 10 (pt. 3), at 22 (statement of Frederick Rowe).

[49]One curious sidelight has emerged since parens patriae came into effect. Some state governments are beginning to ask certain contractors to assign to the state their rights to sue for damages caused by antitrust violations. This has been described as a means of circumventing the effects of the recent Supreme Court ruling in Illinois Brick Co. v. Illinois, 97 S. Ct. 2061 (1977), (which limited antitrust recovery to direct purchasers in privacy with the violator).

It is too early to tell how many middlemen will avail themselves of this alternative, or how much in damages they will receive in return for this assignment. However, to the extent that middlemen choose this method and remove themselves as potential plaintiffs, the inefficiencies of parens patriae actions will be diminished.

[50]Erickson, *The Profitability of Violating the Antitrust Laws: Dissolution and Treble Damages in Private Antitrust*, 5 ANTITRUST L. & ECON. REV. 101, 103 (Summer 1972) [hereinafter cited as Erickson].

[51]One major premise of his analysis is that a dollar acquired at one point in time has a different value at some later point in time, *i.e.*, that money generates more money through interest, legally or illegally, and that interest earnings can exceed the principal which generated them where long time lags are involved. *See id.* at 104.

Briefly, the hypothetical concerns a two-year price fixing conspiracy, producing $60,000 of additional illegal profits; the conspiracy is discovered seven years after its inception and defendants are convicted three years later. Three years after that, a private treble damage action is brought, as a result of which treble damages in the amount of $90,000 are awarded (apparently under a formula whereby only provable injury is compensated, thereby missing some of the illegal profits). The damage award is 50% more than the total conspiratorial profits received by the defendants during the conspiracy.[52]

Erickson concludes that under these facts, there is no deterrence whatever; in fact defendants actually made money in this situation. Defendants had the use of plaintiffs' money for this time period, and after deducting taxes and calculating returns on this money, he estimates that the $90,000 assessed by the court had reaped total monetary benefits to the defendants of $121,600 over the twelve years, or $31,600 more than they had to pay out as damages. When the benefits exceed the costs as here, not only is there no deterrence, but indeed there is an incentive to continue the violations. The four Erickson factors therefore which if applied in some combination may result in deterrence are:

(1) high risk of getting caught;
(2) damages cover all of defendant's illgotten gains;
(3) short time lag between violation and restitution;
(4) damages large in relation to size of defendant's total gains from the illegality.[53]

Erickson's factors do not take into account what is to be done with the damages once they are extracted from the defendants. Partly for this reason, the Erickson analysis meshes well into the Elzinga and Breit analysis. These two theories taken together provide a conceptual framework for maximum parens patriae application. This analysis of parens patriae leads to the conclusion that it potentially can function as a deterrence tool when tested against the above model.

A potential antitrust defendant can be expected to try to maximize his expected utility and as stated earlier, antitrust violation will occur where the expected utility from anticompetitive behavior exceeds the expected utility from competing.[54] The probabilities with which he is concerned in making

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[52]Erickson made some assumptions which understated the long-run profitability of antitrust violations: (1) there was a 100% probability of getting caught; (2) all conspiratorial sales are included in the damage computation, *i.e.*, 100% converage ratio; (3) time lag between violation and the damage payment is relatively short (12-13 years); and (4) the court did not underestimate plaintiff's damages. *See id.* at 107.

[53]For a detailed examination of this theory and the calculations used, *see id.* at 104-07. This is a striking conclusion, since none of this type of analysis is found in the legislative history or the hearings on parens patriae; on the contrary, the Act appeared to be a very political bill, addressed to a politically sensitive issue, that of consumer protection. In other words, parens patriae may be the right answer, but probably for the wrong reasons.

[54]ELZINGA & BREIT, *supra* note 5, at 117.

this decision include the present value of future illegal profits, discounted by the probability of detection and risk of penalties, and the most significant variable, his attitude toward risk.[55]

Elzinga and Breit suggest that in general today's average business management is much more risk-aversive than in past decades.[56] This risk aversiveness has implications for antitrust policy, namely, that a risk averse management is more likely to be deterred by high financial penalties than by a high probability of detection and conviction with less severe penalties.[57] Elzinga and Breit perform a risk attitude analysis to identify the degrees of disutility which will be associated with either high detection probabilities or high damage probabilities to persons with varying degrees of risk aversiveness. They conclude that the risk averse person will prefer the large probability of small loss to the small probability of large loss.[58] Therefore, if Elzinga and Breit's hypothesis as to management's risk aversiveness is correct, and parens patriae results in dramatically higher damage awards, it is likely that there will be a significant deterrent effect on potential antitrust violators, regardless of whether or not the risk of detection is increased.

The conclusion here is that limited antitrust resources would be spent most efficiently by extracting large financial penalties from fewer defendants rather than by increasing amount spent for detection and conviction. Extraction of financial penalties from defendants is, however, only one side of the equation: there remains the question of how most efficiently to distribute these penalties, without replacing the deterrent effect as to defendants with some equally undesireable effect as to plaintiffs.[59]

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[55]The more averse he is to risk, the more he will be deterred by any given reduction in the present value of his monopoly profits resulting from increased risk. *Id.*

[56]"The use of complex decision theory and organization theory has led . . . economists . . . to conclude that contemporary management wishes to avoid risk and uncertainty." *Id.* at 127. *See, e.g.*, R. CYERT & J. MARCH, A BEHAVIORAL THEORY OF THE FIRM 119 (1963).

[57]ELZINGA & BREIT, *supra* note 5, at 128-29. In effect, they choose to stress the amount of damages—Erickson's points two and four, instead of the risk of getting caught—Erickson's point one. It will be recalled that Erickson postulates that all four factors need not present, but only some unspecified combination with some unspecified degree of probability.

[58]*Id.* at 120. They use the following example: if a large loss is ten times a smaller loss, and the probability of the occurrence of the smaller loss is ten times as great as that of the large loss, the expected value of these two losses is said to be equal. Assume then that there are two antitrust enforcement proposals, one calling for high damages, with less money going to detection and conviction, and the other calling for reduced penalties, but more funds to enforcement, and hence a higher risk of getting caught. Finally, assume that under the first proposal, the higher penalty is ten times the lower, and under the second, the probability of having to pay the lower penalty is ten times as great as the probability of having to pay the higher one. In economic terms, the expected value of the illegal acts is the same. "However, the risk averse manager's attitude will lead him to practice more collusion under the policy involving the larger probability of paying the smaller financial penalty." *Id.* at 121.

[59]It will be recalled that Elzinga & Breit have illustrated the reciprocal nature of damages. They argue that to fully maximize the value of total output, liability must be shared between the violator and the consumer. "Under the ideal solution, they would desist from all monopolistic behavior, but they would exempt from paying compesation to anyone who purchases from them. . ." *Id.* at 113.

If Elzinga and Breit are right, parens patriae's treatment of consumer compensation is among its strongest points. Both proponents and opponents of parens patriae argued extensively over the fact that most consumer injury is de minimis, and that the bulk of damage awards will go to the state.[60] To the extent that the perverse incentives effect and the misinformation effect are to be avoided, this is the appropriate result. In addition, Elzinga and Breit, as well as several of the witnesses before the committees, argue strongly for a system of heavy civil fines, tailored in some degree to the size of the firm (large enough to achieve deterrence, but not so large as to cause bankruptcy).[60] To the extent that damages under parens patriae are directly related to a firm's actual sales within a state, and defendant's records will likely be the basis for this data, the amount of damages awarded will to some extent be "custom-tailored" to the financial dimensions of the violator.

Parens patriae as written merely authorizes a new form of action which a state may or may not choose to exercise. No federal funding has been provided to implement the Act, and it will be for each state to decide whether and how heavily to fund such actions. Therefore, at this point in time, it cannot be predicted whether or not parens patriae will increase the probability of detection and prosecution. It seems reasonable to conclude, however, that what parens patriae actions are brought will result in significantly higher damage awards than those in traditional private treble damage actions.[62] This will result primarily because of (1) the enlarged number of possible plaintiffs, that is, all state consumers excepting only those who take positive action to opt out; and (2) elimination of the requirement of individually-proved damages, and substitution of the use of aggregation andstatistical damage estimation techniques.

CONCLUSION

Parens patriae, although a compensatory scheme in form, will actually function more in the nature of a scheme of individualized civil fines. Assuming the validity of the economic models illustrated above, such a system will

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The reason for eliminating compensation is to eliminate the perverse incentives and misinformation effects which will exist regardless of the extent of the deterrence, as long as compensation is paid to the plaintiffs. Of course, the greater the damages, and hence the greater the deterrence, the stronger will be the force of these two effects. So, Elzinga and Breit conclude, even if *total* deterrence could be achieved under a system of private suits, it "still would not be *efficient* deterrence because of the resources misalloacted to nuisance and *in terrorem* suits. Indeed, the closer the approach to total deterrence, the greater would be the extent of this misallocation." *Id.* at 114 (emphasis added).

[60]*Hearings, supra* note 10 (pt. 3), at 138 (statement of Professor Milton Handler).

[61]*See, e.g.*, ELZINGA & BREIT, *supra* note 5, at 113; S. REP. NO. 94-803, 94th Cong., 2d Sess. (pt. 2) 194-95 (1976) (minority views).

[62]This was one of the strongest points made throughout the legislative history, by both proponents and opponents of the Act. *See, e.g., id.* at 3 (statement of Frederick Rowe against parens patriae); *id.* at 100-01 (statement of Charles Wiggins recommending heavy fines instead of damage awards).

probably have a greater deterrent effect than the traditional private treble damage suit. This effect evidently will operate regardless of whether or not a great number of such suits are brought; the mere fact of the existence of the parens patriae remedy, and the business community's awareness of it, will apparently be enough to trigger the deterrent effect.

There still remains the duplicative recovery problem at the middleman level; however, to the extent that this model is correct, it would be most efficient, economically speaking, to permit them to litigate as parens patriae parties. Since this is not allowed under the Act as written, there appears no way to eliminate the perverse incentives effect or the misinformation effect as to this group of potential plaintiffs.

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