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# THE DETERRENT EFFECT OF PRIVATE TREBLE DAMAGE SUITS: FACT OR FANTASY

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Section 7 of the Sherman Act, as amended by section 4 of the Clayton Act, gives a private right of action for treble damages to persons "injured in . . . business or property by reason of anything forbidden in the antitrust laws. . . ."<sup>1</sup>

This section was meant to provide compensation for those affected by violations, to discourage violations,<sup>2</sup> and "to supply an ancillary force of private investigators to supplement the Department of Justice in law enforcement."<sup>3</sup> Or as expressed by one Court, "The treble-damage action was intended not merely to redress injury to an individual through the prohibited practices, but to aid in achieving the broad social object of the statute."<sup>4</sup> Thus the successful private treble-damage suit, which has been described as a "curious combination of public regulatory and private compensatory law,"<sup>5</sup> will result in the awarding of damages which may be properly viewed to include both "punitive" and "compensatory" elements.

The recent *Report of the Task Force on Productivity and Competition* (widely referred to as the *Stigler Report*, after the Task Forces' Chairman, Dr. George Stigler of the University of Chicago) has emphasized the necessity for "punitive" antitrust sanctions noting that it is essential that the sanctions for violations be effective in compelling compliance.<sup>6</sup> But, the report concludes, ". . . the deterrent sanction in antitrust is weak."<sup>7</sup> Although the violator may be imprisoned and fined, it is recognized that prison terms are almost

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1. Clayton Act §4, 15 U.S.C.A. §15 (1964), formerly ch. 323, §4, 38 Stat. 731 (1914). Section 4 provides:

Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust law may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and the cost of suit, including a reasonable attorney's fee.

2. *Maltz v. Sax*, 134 F.2d 2, 4 (7th Cir. 1943), cert. denied, 319 U.S. 772 (1942); *Fanchon & Marco v. Paramount Pictures*, 100 F. Supp. 84, 88 (S.D. Cal. 1951), aff'd, 215 F.2d 167 (9th Cir. 1954), cert. denied, 348 U.S. 912 (1955); *Weinberg v. Sinclair Refining Co.*, 48 F. Supp. 203, 205 (E.D.N.Y. 1942).

3. *Weinberg v. Sinclair Refining Co.*, 48 F. Supp. 203, 205 (E.D.N.Y. 1942).

4. *Karseal Corp. v. Richfield Oil Corp.*, 221 F.2d 358, 365 (9th Cir. 1955).

5. *Antitrust Enforcement By Private Parties: Analysis of Developments in the Treble Damage Suit*. 61 Yale L.J., 1010, 1011 (1952).

6. Stigler et al., *Report of the Task Force on Productivity and Competition*, 2 Antitrust L. & Econ. Rev. 13, 32-33 (1969).

7. *Id.* at 33.

never used and that the maximum existing criminal fine (\$50,000) is clearly inadequate.<sup>8</sup>

The possibility of private treble-damage suits providing an additional deterrent effect was also recognized in the Stigler Report. While noting serious limitations to the use of private suits as a deterrent,<sup>9</sup> the report also states that “. . . the excess over actual damages and costs represents a pure windfall to the private plaintiff.”<sup>10</sup> This statement would clearly suggest that damages awarded the successful plaintiff in a private treble-damage suit are *excessive*. Nevertheless, given the inadequacy of existing criminal penalties this “windfall,” as defined by the Stigler Report, becomes perhaps the only significant “punitive” antitrust sanction. The existence and magnitude of this “windfall” thus becomes extremely important in determining the effectiveness of existing “punitive” antitrust sanctions and the dimensions of the existing incentive for private enforcement.

If we define the injury resulting from the violation as “actual damages and costs” we may now divide the damages awarded the plaintiff in a successful private treble-damage suit into two components—“compensatory damages” and “punitive damages.” “Compensatory damages” are defined as those which reimburse the plaintiff for the injury sustained. The term “punitive damages” (now synonymous with the “windfall” of the Stigler Report) is used to identify those damages awarded in excess of the injury actually sustained.

The total damage award (compensatory and punitive damages) less attorney’s fees and related expenses provide the incentive for private enforcement. The deterrent effect of the private treble-damage suit is reflected in the level of punitive damages awarded. Thus it must follow that, other things equal, the greater the level of punitive damages the greater incentive for private enforcement and the stronger the deterrent sanction in antitrust.

The treble-damage provision states that the person injured “. . . shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney’s fee.”<sup>11</sup> This would apparently imply a one-third and two-thirds division of trebled damages between

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8. *Id.* at 33.

. . . judges are reluctant to authorize damage awards that seriously hurt a company; damages are difficult to prove in price fixing cases; and most important, the injury caused by a price-fixing conspiracy is often so widely diffused (for example, among millions of consumers) that no one has an incentive to bring suit. The government itself can sue for damages only when it was the victim of the unlawful conspiracy.

9. *Id.* at 33.

10. *Id.* at 34.

11. Clayton Act §4, 15 U.S.C. §15 (1964).

compensatory and punitive damages. In fact punitive damages tend to vary greatly from the two-thirds figure inferred by the treble damage provision.

The simple numerical example developed below will help to clarify the division of trebled damages between compensatory and punitive damages and place in perspective the incentive and deterrent effects of private treble-damage suits.

#### THE MEASUREMENT OF COMPENSATORY DAMAGES

Assume that reliable estimates of damages resulting from price-fixing indicate that the State Highway Department (or other state or local government agency) was overcharged \$100,000 in 1960. As is generally the case, assume a substantial period of time has elapsed between the date at which damages were sustained and the date at which damages are awarded. Thus damages are awarded at the end of 1970.

In current case law the courts have rejected arguments that the time interval between the date of injury and the date damages are awarded is a factor to be included in damage computations. This rejection is evident in court rulings that interest is not recoverable in statutory actions for double and treble damages,<sup>12</sup> and that the amount of damages should not be adjusted to reflect the greater purchasing power of the dollar in the years injury was sustained.<sup>13</sup>

This means that, assuming the jury accepted the \$100,000 damage estimate, no adjustment will be made for interest or changes in the purchasing power of money. Plaintiff will therefore receive treble damages of \$300,000, plus the cost of suit and a reasonable attorney's fee. Discussion of the latter two elements will be deferred for the moment.

The correct measure of compensatory damages must include not only the overcharges paid, but also compensation for the loss of use of this purchasing power in the years between the injury and the awarding of damages. Thus, in our example, the \$100,000 damage figure seriously underestimates the injury sustained by plaintiff.

#### THE RATIONALE FOR THE MEASUREMENT OF COMPENSATORY DAMAGES

The rationale for the above conclusion is provided by either of two approaches. First, we may consider plaintiff to have an extensive list of alternative uses of additional funds, but with a fixed budget. Second, we may consider plaintiff with a fixed number of indispensable projects, but a somewhat more flexible budget.

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12. 22 Am. Jur. 2d, *Damages*, §267 (1965).

13. *Locklin v. Switzer Bros., Inc.*, Trade Cas. ¶86,524 (N.D. Ill. 1969).

Applying the first approach in the example developed above, we may logically assume that the state or local government involved has a number of alternative uses for the funds that were paid in the overcharge. For example, the overcharge could have been allocated among the several uses listed, in order of priority, below:

- 1st Educational Program X
- 2nd Highway Project #1
- 3rd Flood Control Project
- 4th Highway Project #2
- .
- .
- .
- .
- .
- nth Time Deposits
- n + 1 Cash Balances.

It may be argued that absent the price-fixing violation the overcharges paid would have been applied to one or more of the above listed uses. It is, of course, possible to estimate the return from only the last two of the listed alternatives. If plaintiff would have placed the money paid as an overcharge in time deposits and thus earned 6 percent on these funds, then plaintiff must receive the amount of the overcharge plus the interest that would have accrued in order to be fully compensated for the injury. For our example this amounts to \$181,402 (\$100,000 + \$81,402 interest).<sup>14</sup> The fact that the investment in time deposits was a low priority use of these funds suggests that even this figure (\$181,402) underestimates compensatory damages.

Stated negatively, the \$100,000 figure provides an acceptable estimate of compensatory damages *only* if it is assumed that the funds saved, absent the overcharge, would have been held as surplus cash balances, thus providing no benefit (not even a feeling of security) to the plaintiff. Such an assumption is heroic to say the very least.

Support for the inclusion of interest in damage computations may also be provided by the second approach, *i.e.*, considering plaintiff to have a fixed number of indispensable projects, but a somewhat more flexible budget.

Applying this approach to our example we may argue that as a result of the price-fixing conspiracy plaintiff has been required to obtain additional funds to finance the indispensable projects. Here we are assuming that the purchases that resulted in the overcharge were in connection with one of the indispensable projects, *i.e.*, a project

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14. \$81,402 is six percent interest compounded quarterly on \$100,000 for ten years, 1961 through 1970.

that could not be delayed. Thus plaintiff has been required, for example, to issue municipal bonds in excess of the amount that would have been issued absent the overcharge. This approach clearly suggests that the correct measure of plaintiff compensatory damages in our example would be the overcharge plus \$81,402 in additional interest expense (assuming a 6 percent interest on municipal bonds for 10 years).

Regardless of whether the interest figure is viewed as in the first approach as income lost or as in the second approach as added expense, the interest figure clearly does represent damages to the plaintiff which resulted from the violation.

### COMPENSATORY VS. PUNITIVE DAMAGES

Application of the above argument for the inclusion of interest in damage computations has a significant effect on the division of the total recovery between compensatory and punitive damages.

In our example as summarized below, the inclusion of interest in the measure of compensatory damages reduces punitive damages to less than 40 percent of the total recovery.

Single Damages	Treble Damages	Total Recovery	Compensatory Damages	Plaintiff's Punitive Damages	Defendant's Punitive Damages
100,000	300,000	300,000	\$181,402 (60.5%)	118,598 (39.5%)	118,598 (39.5%)

The introduction of a reasonable attorney's fee and the tax treatment of treble damages further complicate the division of total recovery between compensatory and punitive damages. In our example we shall assume that \$30,000 in attorney's fees are awarded by the court and that attorney and client have agreed on a contingency fee equal to one-third of the total recovery. Thus plaintiff will pay \$110,000 of the \$330,000 total recovery in attorney's fees. Plaintiff's net total recovery is now \$220,000, and compensatory and punitive damages for plaintiff are 82.5 percent and 17.5 percent, respectively, of the net total recovery. The effect is again summarized below.

Court Awarded Attorney's Fee	Total Recovery	Attorney's Fees	Net Total Recovery	Compensatory Damages	Plaintiff's Punitive Damages	Defendant's Punitive Damages
30,000	330,000	110,000	220,000	181,402 (82.5%)	38,598 (17.5%)	83,598 (31.5%)

The tax-exempt plaintiff is of course unaffected by the introduction of taxes, but defendant's punitive damages are affected. Amended IRC §162 disallows any deduction for two-thirds of any judgment or settlement paid in a private antitrust action when the defendant has been previously convicted or has pleaded guilty or *nolo contendere* in a related criminal action. It thus appears that \$200,000 of the total payment is not deductible as ordinary business expense, but \$130,000 is deductible.<sup>15</sup> Defendant's payment adjusted for taxes becomes \$265,000 (= \$200,000 + \$65,000), and defendant's punitive damages (= \$265,000 - \$181,402) are thus reduced to \$83,598 or 31.5 percent of defendant's payment adjusted for taxes.

Caution is required in the interpretation of the dollar amounts and percentages estimated for both plaintiff's and defendant's "punitive damages." First it should be noted that the computation of defendant's "punitive damages" has ignored defendant's litigation expense including fees for legal counsel, expert witnesses and related expenses. These additional expenses clearly increase defendant's punitive damages. More important, the computations of plaintiff's and defendant's punitive damages have assumed that the jury will award the actual amount of the overcharge paid. If the jury, in response to a combination of conflicting expert testimony and knowledge of the trebling provision,<sup>16</sup> awards damages equal to one-half the actual overcharge, punitive damages may disappear. This is demonstrated in the following table:

Single Damages	Treble Damages	Court Awarded Attorney's Fees	Total Recovery	Net Total Recovery	Compensatory Damages	Plaintiff's Punitive Damages	Defendant's Punitive Damages
50,000	150,000	30,000	180,000	120,000	181,402	-61,402	-41,402

Under these circumstances the plaintiff does not receive and defendant is not required to pay punitive damages. The recognition of these other factors which may affect plaintiff's and defendant's punitive damages does not, however, alter the impact of the Court's decision to exclude the time element from damage computation. It is clear that this decision reduces punitive damages well below the two-thirds figure implied by the treble damage provision.

#### AN ALTERNATIVE METHOD OF COMPUTATION

The obvious alternative to the present method of damage computation would be to include the time element as a factor in damage

15. All tax computations assume a 50 percent tax rate.

16. Parker, *Treble Damage Action—A Financial Deterrent to Antitrust Violations?*, 16 Antitrust Bull. 483-505 (1971).

computations. Such an alternative, using the example of the previous section, is developed below. The court-awarded attorney's fee, the contingency fee arrangement, and the tax treatment of damages remain the same as in the earlier example.

When the "time element" is included in the damage computation, single damages become the overcharge plus the interest that could have been earned (or saved) in the time interval between the injury and the awarding of damages. Therefore, as summarized below, single damages (assuming 6 percent interest compounded quarterly) becomes \$181,402. Plaintiff's punitive damages are increased to 52.6 percent of the net total recovery while defendant's punitive damages are increased to 61.3% of defendant payment adjusted for taxes (\$468,505).

Single Damages	Treble Damages	Court Awarded Attorney's Fee	Total Recovery	Net Total Recovery	Compensatory Damages	Plaintiff's Punitive Damages	Defendant's Punitive Damages
181,402	544,206	30,000	574,206	382,804	181,402 (47.4%)	201,402 (52.6%)	287,103 (61.3%)

These computations are based on the assumption that the jury awards the actual overcharge plus interest. If the jury in fact awards damages equal to one-half the overcharge punitive damages for plaintiff and defendant are affected as follows:

90,701	272,103	30,000	302,103	201,402	181,402 (90.1%)	20,000 (9.9%)	60,351 (25.0%)
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Plaintiff's punitive damages remain at almost 10 percent of the net total recovery while defendant's punitive damages remain at 25 percent of defendant's payment adjusted for taxes.

### CONCLUSIONS

There appears to be no objective standard by which to judge the adequacy of punitive damages awarded under the treble damage provision. When this problem is viewed from the perspective of providing an incentive for private enforcement and an effective deterrent to antitrust violations the primary issue does become clear. Prospective recovery must be sufficient both to encourage those with valid claims to initiate private action and to discourage the potential violator. At the same time prospective recovery must not be so large as to encourage unwarranted private suits. Achieving such a balance is clearly a difficult if not impossible task.

Recognizing this problem the numerical examples that have been developed above suggest the following conclusions: First, the division of the treble damage award between compensatory and punitive damages may vary greatly from the one-third and two-thirds division implied by the treble damage provision. Second, the decision of the courts to exclude the time element from damage computations has significantly reduced the possibility that the plaintiff will receive or that the defendant will be required to pay punitive damages. Third, the examples suggest that the incentive provided to the plaintiff and the deterrent effect on the defendant are substantially less than that implied by the treble damage provision. Finally, the deterrent sanction in the private treble damage suit is minimal and not an effective substitute or supplement to adequate criminal penalties.