LOOKING BACKWARD, THINKING FORWARD SHOULD DISTRIBUTIVE CONCERNS COUNT IN COMPETITION LAW?

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Abstract

Over the last years, Peruvian competition Agency has showed a tendency towards sanctioning abuses of dominant position on distributive grounds, regardless of efficiency concerns. This has caused both ideological and practical debates. Hereby, I will put aside the former to focus on the latter. This research shows that there are some conducts that should be prosecuted by antitrust law, which are essentially exploitative; i.e., price discrimination via “metering”. This practice might cause wealth-transfers, along with efficiencies and inefficiencies. Hence, I will use cases decided in the United States on this conduct to answer whether antitrust law can be considered, at least sometimes, well-equipped to address distributive concerns. I hope this will shed some light on the ongoing debate regarding the usage of distributive concerns in antitrust law.

I. INTRODUCTION

Competition law is a set of rules originated and developed in North-America to control the undesirable social effects of economic power. But the passage of the Peruvian competition statute was not the result of public choice. In fact, competition law was introduced to Peruvian legal system in 1991, as a consequence of international pressure to adopt the Washington Consensus. Hence, its roots are weak and few people understand its goal.

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The enforcement of Peruvian competition law began with a liberal approach focused on efficiency concerns. The reason was not only ideological, but also practical; arguably, antitrust law was ill-equipped to address cases that raise distributive concerns. However, in the last years, Peruvian Competition Agency (INDECOPI) has showed a tendency towards using antitrust to re-distribute wealth within the market. In *Cab Cable vs. Electrocentro*¹, the Tribunal decided that a refusal to deal was subject to competition law scrutinize, even when the parties did not compete between themselves actually or potentially. Furthermore, in *CUT & Javier Diez Canseco v. Private Pension Fund Companies*², the Tribunal ruled *in dicta* that even excessive pricing may be subject to antitrust law scrutinize, because the abuse of dominant position may consist on exclusionary and exploitative conducts³.

The exclusionary-exploitative categorization was developed in Europe to distinguish unilateral practices that challenge competitors’ positions in the market from conducts aimed at taking more money from consumers’ pockets. The classification appears somewhat fuzzy at the boundaries, because exploitative effects usually come along with exclusionary ones. This has led Europeans to disregard such distinction⁴.

However, I have found that cases involving price discrimination via “metering” in tying schemas are essentially exploitative. These cases raise distributive concerns, since they might potentially cause wealth transfers, inefficiencies and efficiencies. Interestingly, antitrust law appears to be well-equipped to scrutinize these conducts. I intend this analysis to shed some light on Peruvian ongoing debate regarding distributive concerns in competition law⁵.

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¹ Decision Nº 0869-2002/TDC-INDECOPI.
² Decision Nº 0225-2004/TDC-INDECOPI.
³ In *CUT*, the Tribunal of INDECOPI mentioned as examples of exclusionary conducts: predatory pricing and refusals to deal. Likewise it referred to excessive pricing, price discrimination, and tying, as examples of exploitative conducts. The Tribunal also recognized that price discrimination may have exclusionary effects and refusals to deal may have exploitative effects.
⁵ In this paper I will assume that wealth transfers do occur in trade, as well as that they reduce consumer welfare. In other words, I will assume all of the following:
• Wealth is transferred on average from the poorer to the richer people of society; since by definition one dollar have different values for them, it will be assumed that a transfer of wealth from the former to the latter decreases consumer welfare.
• Rent-seeking activities do not enhance welfare; hence I won’t consider them as an argument for discarding wealth transfers concerns.
• Wealth transfer is not a critical incentive to invest in R&D.
II. THE ADOPTION OF COMPETITION LAW IN PERU

Between 1968 and 1975 Peru was ruled by a socialist military dictatorship, led by General Juan Velasco Alvarado. Most of the agriculture properties were confiscated through an agrarian reform program, the consequences of which are still lingering. Likewise, most of the enterprises were nationalized and a price control system was established.

Back into a democracy, the economic policy did not change much. Fernando Belaúnde Terry’s government (1980-1985) – although democratic – persisted using an interventionist government policy. In 1985, Alan García was elected President. The economic policy of his government – highly centrally planned – led the country to the most severe economic crisis of its history, reaching a hyperinflation of 7,000 percent.

Ironically, García’s Administration passed the first regulation on competition law - the Supreme Decree 467-85-EF enacted in 1985. However, this statute was not aimed at fostering competition. It was actually meant to stifle it, by granting the Government the power to regulate every private enterprise that holds a dominant position; regardless whether an abuse had occurred or not.

In 1990, Fujimori was elected President. He intended to reinsert Peru in the international financial community, from which we got isolated when the former President decided not to pay the external debt. For that purpose, the international financial organizations required Peru to liberalize the economy following the Washington Consensus. Accordingly, Fujimori promoted a severe economic liberalization process that included the passage of a competition statute - Legislative Decree 701. Due to the liberal ideology of the people that led the National Competition Agency (INDECOPI) at this stage, competition policy was efficiency-oriented. Distributive concerns were just discarded as not well-achievable via antitrust law.

III. NEW AGE CONCERNS IN PERUVIAN COMPETITION POLICY

Over the past five years, INDECOPI has been promoting several policy changes that reflect a tendency towards using antitrust to re-distribute wealth within the market; even regardless of efficiency concerns. The following case law will illustrate my point:

6 He governed the country from 1990 to 2000.

7 This trend can be seen both in new decisions and in the advocacy for the passage of a new competition statute. This proposal has not been passed yet, and it seems that the current government is not going to support it. The point I am trying to make here can be illustrated by reference to case law. Hence, I won’t refer here to such statutory proposal.
In Cab Cable vs. Electrocentro\(^8\), the latter was accused of refusing to share its electricity distribution poles with Cab Cable – a cable company. The Tribunal decided that this refusal was subject to competition law scrutinize, even when the parties did not compete between themselves actually or potentially\(^9\). But, if such rule were adopted, how would the Agency qualify a refusal as justifiable or unjustifiable? Obviously no hint could be extracted from rational choice analysis, because by definition no rational choice led the firm to the refusal. The consequence would be twofold: an unlimited power over trade and takings without fair compensation.

In CUT & Javier Diez Canseco v. Private Pension Fund Companies\(^10\), four companies rendering private pension funds services were accused of abusing their joint dominant position for fixing commissions. Here, the Tribunal ruled in dicta that excessive pricing may be subject to antitrust law scrutinize, because an abuse of a dominant position may take place either through exclusionary or exploitative practices. It argued that such a finding was supported by Peruvian Constitution and Legislative Decree 701; among other things, because European Legislation, which was used as a reference for drafting Legislative Decree 701, also condemns unfair prices\(^11\).

In my opinion, the Agency is ill-equipped to set a “non-excessive” price over time. These tasks can only be well-achieved by a market regulator. Moreover, administrative price setting has been forbidden by article 4 of Legislative Decree 757; unless the market is regulated. Finally, a quick look at the European history will undermine the Tribunal’s support on European Law\(^12\).

\(^8\) Decision Nº 0869-2002/TDC-INDECOPI.

\(^9\) The evidence showed that there were technical reasons for such refusal – some poles were small-wood poles that didn’t resist two lines, but the Tribunal considered that it was not a justifiable motive (?).

\(^10\) Decision Nº 0225-2004/TDC-INDECOPI.

\(^11\) Article 82 of the EC Treaty (ex Article 86).- Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between Member States. Such abuse may, in particular, consist in: (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions.”

\(^12\) The idea of sanctioning “abusive pricing” appeared in Europe as a way to face inflation left by the wars. After the Great Depression of 1929, Keynes’ ideas of intervening strongly the economy to improve welfare gained force - one of such ideas being setting prices at “affordable” levels. Nevertheless, when the international community noticed the big mistakes of Keynesianism, the prosecution of abusive prices lost ideological support. The European Legislation does contain a provision that sanctions unfair or abusive prices, but the idea of sanctioning them already has failed – due to the absence of ideological support and the inability of the European Court of Justice to set a clear rule to apply it. See, General Motors Continental N.V. v.
Let alone the legal arguments used by the Tribunal in these cases, it is apparent that its members think that antitrust law can be used to redistribute wealth within the market, regardless of efficiency concerns. This might be something politically appealing. But antitrust law is ill-equipped to reach such objective.

IV. THE UPCOMING CHALLENGE

The idea of competition as a way of social regulation—as economic, political, and moral force—grew stronger roots in the United States (and other developed countries) in part because it didn’t have to compete with aristocratic, militarist or labor-socialist theories.

In Peru we have been fighting against all of those theories for decades. On the other hand, as we have seen above, the Agency in charged of enforcing competition law has shifted considerably the orientation of its policy over the past 15 years. In this scenario, we cannot expect the lay person to understand the role of this institution.

It is apparent that antitrust law should not be used for redistributing wealth within the market, regardless of efficiency concerns. But it is not clear whether some room should be reserved for distributive concerns at all or not: this is the upcoming challenge.

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14 “American Competition policy reflects a set of singular social and historic events. (…) its insertion into a different legal context may not be easy. Therefore, its enforcement may result significantly more difficult for transition economies. This reflects what some have called the transfer problem. It minimizes the cultural, institutional, and economic obstacles that lead to the implementation of competition policy” (Rodriguez A. and M. Williams, Do we need harmonized Competition Policy in an Integrated World Economy? p.5 n. 23).
V. LESSONS FROM NORTH-AMERICA

V.1 The goals of antitrust law

Based on the legislative history of the Sherman Act, it has been argued that competition policy should be aimed at decentralizing economic power through the protection of small and independent businesses\(^\text{15}\). Accordingly, an economic order characterized by dispersed economic power shall be preserved as valuable in itself\(^\text{16}\). This so-called populist goal has been criticized for the following reasons:

- The notion of fragmentation is too vague to be used as guidance for enforcing antitrust law\(^\text{17}\).
- The best competition policy from the perspective of small businesses is not having any policy at all, because cartelization helps them competing by offering cheaper prices – they lack, by definition, economies of scale\(^\text{18}\).
- A competition policy aimed at monitoring prices from big players to avoid price-cutting that affect small business would be administratively impracticable\(^\text{19}\).
- The most effective way to protect small firms is using other legislations such as those that grant tax benefits and subsidies\(^\text{20}\).

Let alone the legislative history of the Sherman Act, there is no accepted reason why the so-called populist goal should be followed in the United States. In fact, the goal that drives competition policy in the United States is consumer welfare. The pending question in this country is merely whether wealth-distribution concerns do have any space in antitrust law, along with efficiency.

\(^{15}\) See, United States v. Aluminium Co. of America, 148 F.2d 416, 427 (2d Cir. 1945), and Brown Shoe Co. v. United States, 370 U.S. 294, 344, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962).

\(^{16}\) Interestingly, this goal is not necessarily consistent with the interest of small and independent entrepreneurs, who may benefit from selling their assets in an M&A. (S. Ross, Principles of Antitrust Law, New York: The Foundation Press, 1993. n.12, pp. 6)


V.2 What’s price discrimination via metering?

The Chicago School has long argued that a monopolist vertically integrated into a complementary competitive market, cannot increase its profits by trying to leverage market power through bundling or tying. The reason is that, at the end of the supply chain, consumers assign value to the final product (complementary ones included). Hence, an attempt to increase monopoly rents through leverage without any compensation would tend to reduce the final product consumption. As a consequence, they argue that there is one single profit-maximizing price for a final product; which means that all the monopoly rents may be extracted from the monopolized market. This is called the one-monopoly rent theory.

However, an alternative explanation has come to challenge the idea that a monopolist cannot maximize its profits through tying – i.e., price discrimination via metering. This works with a monopolist that requires its customers to buy a complementary product through a requirement tying arrangement. If the firm sets the complementary product price at a level above marginal cost, it may end up charging a higher price to high-value customers and a lower one to low-value ones - without offering any compensation\(^{21}\). As will be explained in section 4.4, this conduct might cause efficiencies, inefficiencies, and wealth-transfers.

V.3 Is antitrust law well-equipped to identify price discrimination via metering?

In order to approach antitrust cases, it is always necessary to identify the economic rationales that led a firm engage in that practice. The economic rationales typically advanced for tying arrangements are preservation of quality and reputation, cost savings, risk allocation, and leveraging of market power\(^{22}\). Professors Nalebuff, Ayres and Sullivan (hereinafter Nalebuff et.al) argued that in many cases involving the sale or lease of a patented product conditioned on the purchase of complementary products, the best explanation is price discrimination via metering. They found that in \textit{Intl Salt Co. v. United States}, \textit{Leitch Mfg Co. v. Barber Co.}, \textit{IBM Corp. v. United States Dev. Corp.}, \textit{Carbice Corp. of Am. V. A. Patents Dev.}, \textit{Henry v. A.B. Dick Co}.

\(^{21}\) There is another type of metering called direct metering. It takes place when an entrepreneur charges a per-use or metered fee for one single product – i.e., Summit developed a patent-protected laser machine for correcting vision. Since its value to a doctor was proportional to the number of eyes corrected using the machine, the company charged a per-use fee. (B. Nalebuff, I. Ayres, and L. Sullivan as Amici Curiae in support of Respondent in Illinois Tool Works, Inc. and Trident, Inc., Petitioners v. Independent Ink, Inc., Respondent. p. 23)

the Supreme Court accepted leverage as the best economic rationale\(^{23}\). However, they believe that metering was the best explanation, because it didn’t make sense to try to leverage market power into commodity markets like salt, tar, punch cards, dry ice, or mimeograph fluid\(^{24}\).

This section will be analyzing three Supreme Court decisions on patented products requirements tying arrangements to determine under what circumstances metering is the controlling explanation. In *Illinois Tool Works, Inc. and Trident, Inc., v. Independent Ink, Inc.*, petitioners manufacture and market printing systems that include a patented print-head and ink container and unpatented ink, which they sell to original equipment manufacturers that agree to purchase ink exclusively from petitioners, as well as that neither they nor their customers will refill the patented containers with ink of any type. The following economic rationales are worth to be discussed here:

**Preservation of Quality and Reputation.** - Petitioners alleged that respondent’s ink was of lower quality and caused damage to their printer heads – without proving it. But this claim can be easily discarded, because chemical analysis showed that the inks were not distinguishable\(^{25}\).

**Leveraging of Market Power.** - Respondent alleged that Illinois Tools monopolized, attempted to monopolize, and conspired to monopolize the market for ink used in the latter’s print head system, in violation of Section 2 of the Sherman Act\(^{26}\). However, if the ink required by such print head system was a common-indistinguishable one, it wouldn’t make sense to condemn petitioners for monopolizing the ink market or raising rivals’ cost to enter the print head system market.

**Risk Allocation.** - Petitioners also argued that this tying was efficient because it improved risk allocation; arguably, the buyer pays a small amount upfront and a price with each use, making the sale more like a lease where the costs of the patented product may be spread over time\(^{27}\). Nalebuff *et al.* ascertained that “if risk allocation were a motivation, then the customer would be asking for a metering, and it would be an option, not a requirement imposed upon the customers”\(^{28}\). An

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\(^{28}\) Ibid; p. 10.
imposed requirement tying may end up being valuable for those customers that lack enough cash flow to buy the device and/or do not know how much they are going to use it. However, the other customers may be worst off because the lock-in would impede them to get cheaper ink. Hence, a firm may loose business opportunities if trying to impose a requirements tying for all of its customers – unless it has market power, but in that event the metering rationale would be a better explanation.

**Metering.**- Nalebuff *et al.* affirmed that this is the most powerful explanation for the requirements tie in *Illinois Tool*. They may be right. Once the other rationales are discarded, metering appears to be the best explanation; provided market power exists, because otherwise high-value customers would readily shift their consumption to substitutes.

In *International Salt*, the defendant leased its patented salt injecting machines for canned food only to lessees who also agreed to purchase the defendant’s salt. But the lessees were required to purchase the salt from the defendant only if the defendant was willing to match the prevailing market price. If a lessee was able to buy salt cheaper elsewhere, he was free to do so. The following economic rationales are worth to be discussed here:

**Metering.**- As Professor Hovenkamp has explained, “Since tying arrangements work as price discrimination devices only if the lessor can charge a monopoly price for the tied product, it is unlikely that the International Salt case involved price discrimination”29. Accordingly, metering does not make much sense here.

**Preservation of Quality and Reputation.**- Hovenkamp asserted that the best rationale explanation for using a tying here is the one advanced by defendant; “that only high quality salt, suitable for its machines, was used by the lessees”30.

**Leveraging of Market Power.**- If Hovenkamp is right, however, the hypothesis of leveraging may also stand. The firm may have been trying to monopolize the salt for its patented devices or raising rivals’ cost to artificially extend the duration of its patent.

In *IBM*, the defendant tied paper computer cards to its leases of patented computing machines. There was ample evidence that precision cards could be produced by competitors even at a lesser cost. The following economic rationales are worth to be discussed here:

30 Ibid.
**Preservation of Quality and Reputation.** The company argued that the function of the machines required precision cards. Hence, restricting lessee’s use to cards manufactured by the company was necessary to prevent injury to the reputation of the machines. This goal could be well achieved by leasing the machines under the condition that lessee uses cards that conform to the company’s. If they impose a requirement tying arrangement, consumers will be worst off because the lock-in would impede them to get cheaper cards. Hence, a firm may lose business opportunities if trying to impose a requirements tying to accomplish this purpose – unless it has market power, but in that event the metering rationale would be a better explanation.

**Leveraging of Market Power.** If the cards required by the computing machines were kind of a commodity, it wouldn’t make sense to condemn petitioners for monopolizing the punch cards market or raising rivals’ cost to enter the computer machines market through tying.

**Metering.** Once the other explanations are discarded, metering appears to be the best rationale in this case.

The preceding analysis shows that metering is a practice feasible to be distinguished in cases involving products with market power (there is no apparent reason for constraining this conclusion to patented products) that are sold or leased tied with commodities. However, where the tied products are not commodities, the chance of a leverage explanation becomes feasible and the distinction between metering and leveraging less clear.

**V.4 The effects of metering on consumer welfare**

Nalebuff et.al ascertained that metering may hamper competitors in the tied product market. However, this hypothesis doesn’t appear to make sense where the tied products are commodities. Where the tied product is not a commodity, the leverage explanation may appear more plausible; because a tying may theoretically serve the firm the purpose of monopolizing the tied product market or raise rivals’ costs to enter the tying product market. The most important effects of metering are those on consumers. Hence, this kind of conduct has essentially exploitative effects.

Price discrimination via metering appears to have different effects on consumer welfare, according to the value that consumers assign to the tying product. They

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31 Ibid.
may be divided in three groups: (i) consumers with a reserve price higher than the profit-maximizing price, who will end up paying more for the monopolized product than in the one-price-to-all schema (the first type of consumers); (ii) consumers with a reserve price higher than the profit-maximizing price, who will end up paying less for the monopolized product than in the one-price-to-all schema (the second type of consumers); and, (iii) consumers with a reserve price lower than the profit-maximizing price under a one-price-to-all scenario, who will be able to consume the monopolized product under a metering schema (the third type of consumers). The potential effects on these consumers are the following:

**Efficiencies.** - Nalebuff *et al* stated that price discrimination via metering may result in a gain to consumers under the following circumstances: the practice must lead to a large increase in output, the increased output must result in significant economies of scale, and high-value consumers shall obtain very little surplus under the one-price-to-all contract. However, they end up arguing that price discrimination via metering does not advance any efficiency; because even if the arrangement is efficient itself, it could always be accomplished through direct metering (see footnote number 22).

**Inefficiencies.** - It has been stated that as the monopolist uses metering to capture more surplus from the first type of consumers, the second and third types may be excluded from the market; as a result, total output and efficiency will fall. Likewise, firms may spend lots of resources to impose price discrimination and consumers to avoid it. Finally, price discrimination may cause the first type of consumers to substitute their consumption.

**Transfers of Wealth.** - Nalebuff *et al* affirmed that consumer surplus typically falls upon the exercise of price discrimination via metering. They affirmed that the largest source of increased profits is the transfer from consumers to producers; arguably, consumers with the highest reserve price (the first type of consumers) will end up paying the biggest price increase, and those with the smallest surplus (the third type of consumers) will keep little of it.

Therefore, theoretically price discrimination via metering may cause efficiencies, inefficiencies and wealth-transfers, which should be balanced under a rule of reason analysis. Since price discrimination via metering requires market power in the tying product, a rebuttable presumption of market power ought to be adopted.

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34 Ibid.; pp. 3-4.
35 In exclusionary cases, the rule of reason analysis focuses on the impact of the conduct on the structure of supply (barriers to entry, foreclosure, etc.), as a proxy to determine the impact on consumer welfare. In these cases, it is relatively easy to get information because there are other firms involved. However, in exploitative conducts, it might be costly to get data on the impact on consumers. Hence, it makes sense to apply a test that reduces administrative costs.
VI. LESSONS FOR PERUVIAN COMPETITION POLICY

- Antitrust law should not be used to try to redistribute wealth without considering efficiency concerns.

- Price discrimination via metering is targeted directly at final consumers; hence, it can be characterized as an exploitative conduct.

- Antitrust law is well-equipped to identify when price discrimination via metering is the best rationale for a requirement tying arrangement.

- This exploitative conduct may cause efficiencies, inefficiencies and wealth-transfers, which should be balanced under a rule of reason analysis.

- Since price discrimination via metering requires market power in the tying product, a refutable presumption of market power ought to be adopted. It might help reducing administrative costs.

REFERENCES


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