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VERTICAL-HORIZONTAL DICHOTOMY

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ABSTRACT

This article compares the European Union and the United States with respect to competition law and enforcement practices as it pertains to agreements among competitors in a market (horizontal) and agreements among firms in a supply chain (vertical). Regarding horizontal agreements, the primary difference in the law is the ability of the competition authority to bring a criminal case in the U.S. and a more subtle difference is the presence of concerted practices in the EU. Enforcement differs in the far more active role of private litigation in the U.S. The differences are greater when one turns to vertical agreements. Though the EU provides safe harbors for vertical agreements, something which is absent in the U.S., it is abundantly clear that the U.S.is more lenient in the law and in enforcement. Also provided is a discussion of some recent departures between the U.S. and EU.

INTRODUCTION

Vertical agreements between competitors are not exempted by the vertical block exemption. There is an exception, though, for agreements "where competing undertakings enter into a non-reciprocal vertical agreement and:

(a) the supplier is a manufacturer and a distributor of goods, while the buyer is a distributor and not a competing undertaking at the manufacturing level;". In other words, non-reciprocal agreements in dual distribution scenarios fall under the VBER. This type of agreement is exempted by the VBER under the same requirements as the other exempted agreements: the supplier must not have a market share exceeding

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30 % of the market where it sells the products and the distributor must not have a market share exceeding 30 % on the market where it buys the products. Another requirement is that the agreement does not contain any hardcore restrictions.

In cases other than the non-reciprocal agreements described above the vertical[3] aspects of the agreement are assessed under the vertical guidelines, while the horizontal aspects are dealt with in the horizontal guidelines. The Commission has further stated in the vertical guidelines that "[i]n case of dual distribution it is considered that in general any potential impact on the competitive relationship between the manufacturer and retailer at the retail level is of lesser importance than the potential impact of the vertical supply agreement on competition in general at the manufacturing[4] or retail level." The necessary prerequisite "non-reciprocal agreement" is interpreted in Section 4.1 and the effects of dual distribution is presented in Section 4.2. In Section 4.3 dual distribution in Commission decisions is discussed and finally, in Section 4.4 the Danish Hugo Boss decisions which concerned information exchange in dual distribution scenarios are presented.

THE MEANING OF "NON-RECIPROCAL AGREEMENTS" IN ARTICLE 2(4)

The first question that arises when reading Article 2(4) VBER concerns what a non-reciprocal agreement is, as there are no definitions in the VBER, in the guidelines or in any dual distribution related caselaw. According to the Cambridge Dictionary, a reciprocal agreement is an agreement "involving two people or organizations who agree to help each other by behaving in the same way or by giving each other similar advantages". The term reciprocity is not foreign to EU Competition law. In regard to information exchange the Court of First Instance expressed in *Cimenteries* that reciprocity is essential for there to be a concerted practice. Conversely a truly unilateral provision of information by one party to a second, completely passive, party is not considered a concerted practice. The party receiving the information is not considered

[3]Article 2(4) VBER.

[4]Note that the term *agreement* in the VBER includes concerted practices, see Article 1(1)(a) VBER; Article 2(4) VBER.

passive though, if it requests or accepts the information.[5] By requesting the meeting and not making any reservations or objections when given the information, the receiving party in *Cimenteries* was deemed to have expressed acceptance, according to the Court.

The conclusion based on this definition is that there is no reciprocity in situations with truly unilateral provision of information to a completely passive party. However, those situations are not considered to qualify as concerted practices, and if there is not even a concerted practice, how could there be an agreement? At the same time reciprocity is achieved if the party receiving information accepts it, and the party is considered to have accepted it if it does not object to the information and remains on the relevant market. Article 2(4) VBER does not only apply to information exchange, though, and this definition is more difficult to apply to a vertical restraint like a maximum resale price. If the agreement must be non-reciprocal and it turns reciprocal as soon as the distributor accepts the maximum resale price, then no agreements would ever fall under Article 2(4).

The term non-reciprocal agreement is used in other guidelines from the Commission. In relation to technology transfer agreements the Commission says: "[a] non-reciprocal agreement is an agreement where only one of the parties is licensing its technology rights to the other party or where, in the case of cross licensing, the licensed technologies rights are not competing technologies and the rights licensed cannot be used for the production of competing products". This indicate that Article 2(4) applies to agreements where the obligations of the agreement are one-sided.

As mentioned in the introduction the current VBER is the second version of the vertical block exemption and just like the second one, the first version of the VBER had related guidelines written by the Commission. In these older guidelines there is a definition of non-reciprocal agreement: "non-reciprocal means, for instance, that while one manufacturer becomes the distributor of the products[6] of another manufacturer, the latter does not become the distributor of the products of the first manufacturer". This definition is not present in the new version of the guidelines, which means that the Commission for some reason removed it in the last renewal process. Because of this it should not be held

[5]Cimenteries para. 1848–1850.

[6]Guidelines on Vertical Restraints (2000/C 291/01).

as the current definition[7] of the term. It does however suggest that the non-reciprocity means that two manufacturers cannot [8]come to an agreement to distribute each other's products and enjoy the exemptions from Article 101 TFEU that the VBER offers. If this is the case, then why is the same thing expressed in 2(4)(a)? As mentioned above, that part of the article says that a requirement to fall under the article is that "the supplier is a manufacturer and a distributor of goods, while the buyer is a distributor and not a competing undertaking at the manufacturing level". In summary, it is not easy to understand what the Commission means with the term "non-reciprocal agreement". This raises legal certainty concerns that will be discussed in Section 5.2.

The effects of dual distribution

When the supplier is also a retailer its incentives are changed. In these cases, the supplier suddenly may benefit from eliminating competition on the retailer level as it can benefit from it in a way that is similar to a horizontal situation. According to Gilo, the anticompetitive effect might still not be the same as in a purely horizontal restraint, but it might be stronger than with purely vertical restraints. Depending[9] on whether the supplier's profit comes from the wholesale price per unit or from fixed fees the anticompetitive effect differs, as the anticompetitive effect of dual distribution gets stronger the more the profit depends on the wholesale price. This is because in the cases where the profit is based on fixed fees, the incentive to increase the supplier's own sales at the cost of the sales at the retailers is lower. The retailers' willingness to pay these fees depends on their own profit, the higher the profit, the higher their willingness to pay a higher fee.

Some vertical restraints, for example minimum resale price maintenance[10], can normally only be explained by the need to improve efficiency in distribution, as it would not be beneficial for a supplier to eliminate price competition among its retailers. In dual distribution scenarios this is not the case, however. Instead, the relationship of the

[7]Guidelines on Vertical Restraints (2000/C 291/01 para. 27.

[8]Definition of *reciprocal* from the Cambridge Business English Dictionary

[9]Gilo p. 152.

[10]Gilo p. 153–154

supplier and distributors has effects that are similar to the effects of a price fixing cartel. It can even be the case that the supplier wants to eliminate intra-brand competition to increase the profits of its own retail outlet. Exclusive territories in dual distribution scenarios can have similar anticompetitive goals and Gilo argues that this fact "bears on the rationale for treating such a vertical restraint differently than a horizontal one".

Lianos brings up more pro- and anti-competitive effects of dual distribution practices. The pro-competitive effects are for example that it provides the supplier with an opportunity to monitor the performance of the retailers, the result of which the supplier can take into account when deciding on using vertical restraints to increase competition on the retail market. Through dual distribution practices the supplier can also prevent free-riding, protect its reputation and increase[11] opportunities to serve different types of customers. The same vertical effects can be reached by purely vertical practices, though, meaning that the vertical effects of dual distribution should be examined the same way as those purely vertical practices, according to Lianos. The anti-competitive effects, such as horizontal collusion, stem especially from the horizontal dimension of dual distribution. Another effect of dual distribution is that the supplier might want to increase its market share at the retail level, at the cost of the other retailers. This harms the intra-brand competition and combined with vertical restraints on retailers selling different brands it might even harm the inter-brand competition. Overall Lianos is of the opinion that while the anti-competitive effects of dual distribution "may be stronger than those of purely[12] vertical restraints […], they are in any case less harmful for consumers than purely horizontal restraints".

DUAL DISTRIBUTION IN COMMISSION DECISIONS

Dual distribution scenarios are not common in Commission decisions. However, the 2019 *Guess* decision had a dual distribution aspect to it, even though it did not concern information exchange. Guess Europe had used its selective distribution system to impose restrictive provisions on its third-party retailers, most notably online search advertisement restrictions, online sales restrictions, restrictions on cross selling among members of the

[11]Gilo p. 154–156

[12]Gilo p. 156.

selective distribution system, restrictions on cross border sales to end customers and resale price maintenance.Guess Europe was active as a manufacturer and distributor of Guess branded products in Europe and because of this was contracting party in the distribution agreements with the independent retailers. However, following a global strategy implemented since at least 2008, Guess Europe had become more vertically integrated and had started to sell its own products, both in its brick-and-mortar shops and online.[13] Globally, Guess wanted to grow online by directing traffic to its own site and to obtain that objective Guess Europe tried to control the competitive pressure from independent distributors selling Guess products online. In other words, it tried to restrict the intra-brand competition on the retail level. The Commission did not discuss Article 2(4) of the VBER in its decision, nor the dual distribution aspect in general. Instead, it simply stated that since the agreements in question were vertical, they should be considered less harmful to competition than horizontal agreements. A lost opportunity to bring some clarity to an article in great need of clarification.

Amazon marketplace – similarities with dual distribution.

In November of 2020 the Commission communicated that it had informed Amazon of its preliminary view that Amazon's conduct on its marketplace in regard to the independent sellers on the marketplace breached EU Competition law. The Commission also communicated that it had opened a second antitrust investigation into the possible preferential treatment of Amazon's own retail offers and those of marketplace sellers that use the Amazon's logistics and delivery services.[182] Amazon's dual role as both a platform provider and a retailer on the same platform makes it possible for the company to attain non-public, sensitive information on things like "[…] the number of ordered and shipped units of products, the sellers' revenues on the marketplace, the number of visits to sellers' offers, data relating to shipping, to sellers' past performance, and other consumer claims on products[14], including the activated guarantees."[183] Because of this the Commission started an investigation into Amazon's conduct to decide if it infringes on Article 102 TFEU.

[13]Guess para. 23 and 34.

[14]Press release of 10 November 2020.

Amazon takes advantage of the fact that its competitors also are its customers and while this practice differs from the traditional [15]dual distribution arrangement, Bloodstein argues that dual distribution can be a helpful lens to view Amazon's practices through.Amazon is a dominant actor and can exercise power over both big and small users of its services in a way that would not be possible without its dominant position. Amazon can choose to launch products, knowing that there is a high demand for those products, as it has data from its users. It can then sell those products for a lower price than the users ever could and draw attention on the platform to its own products instead of the users'. Thereby Amazon stifles competition and innovation on the platform to its own benefit, all while the users feel pressure to remain on the platform because of Amazon's market power and the number of potential customers on the platform.

This case is interesting because of its similarities with dual distribution scenarios. Even though Amazon is not present on, for example, both the manufacturer and retailer level it is still present at two different levels of trade. This results in Amazon having dual relationships with users of its platform: both the vertical *provider of service-customer* relationship and the horizontal *competitor-competitor* relationship. Information also plays a central role inthis case, albeit not a reciprocal exchange of that information. Instead, Amazon uses its dual role to unilaterally extract sensitive business information from the users. In the vertical guidelines, when explaining the assessment of the risk of eliminating competition under the efficiency defence, the Commission emphasised that Article 101(3) and Article 102 TFEU must be read together. This case is another example of how the line between horizontal and vertical relations not always is as obvious as it might seem.

HUGO BOSS – INFORMATION EXCHANGE IN DUAL DISTRIBUTION SCENARIOS

On June 24, 2020, the Danish National Competition Authority[16] (the NCA) published two decisions regarding information exchange in a dual distribution scenario. The decisions concerned conduct by Hugo Boss Nordic ApS (Hugo Boss) and Ginsborg and Hugo Boss and Kaufmann, respectively. Hugo Boss was active on the clothing market both as a

[15]Press release of 10 November 2020.

[16]Bloodstein p. 214.

supplier, supplying Ginsborg and Kaufmann with HUGO BOSS branded clothing, and as a retailer. Information was sent from the wholesale section of Hugo Boss to Ginsborg and Kaufmann, respectively. The NCA considered the information exchange activities to be on the retailer market anyways. On this market the parties were actual competitors and therefore the NCA concluded that the relationship was horizontal. The information was strategic, individualized and concerned future relations, including prices, rebates and quantities related to future clearance sales.The exchange led to, among other things, lower rebates resulting on higher retail prices for the consumers and a more coordinated, uniform and in some instances a smaller assortment on clearance sale at Hugo Boss, Ginsborg and Kaufmann. The NCA came to the conclusion that the conduct was not covered by any block exemption and that the companies had not proved any efficiencies, and therefore the conduct violated Article 101 TFEU and the Danish Competition law. The reasoning of the NCA in relation to whether the information exchange is part of the vertical or horizontal relationship and why the VBER was not applied in the decisions are examined below.

A vertical or horizontal relationship

The Danish Competition Authority considered the information[17] exchange to be part of horizontal concerted practices in both decisions. It had three main reasons for this view. Firstly, the NCA referred to the *Tate & Lyle* case, in which the CJEU stated that even though a party can claim that a concerted practice is of vertical nature it cannot avoid taking the information into account. Secondly, the NCA referred to its own statements in earlier decisions in which it had stated that there is a risk for restriction of competition when vertically integrated companies engage in vertical information exchange. This was because[18] of the risk for information being exchanged horizontally as well. Lastly, in a case concerning an agreement on partitioning of consumers the Danish Maritime and Trade Court had stated that since the parties were actual competitors at the time of the conclusion of the agreement, it was to be considered a horizontal agreement. It was not to

[17]Hugo Boss and Ginsborg, Summary para. 11; Hugo Boss and Kaufmann, Summary para. 10.

[18]In Danish: *udsalg*. See Hugo Boss and Ginsborg, Summary para. 6; Hugo Boss and Kaufmann, Summary para. 5.

be considered a vertical agreement, part of a distribution agreement, or an expression of an agency relationship. The NCA concluded that since Hugo Boss was vertically integrated and active on both the manufacturer/supplier and the retailer markets and Ginsborg and Kaufmann were active on the retailer market, all three companies selling HUGO BOSS branded products, they were active on the same relevant product and geographical market. They were therefore actual competitors and the concerted practices of horizontal nature.

In both cases Hugo Boss argued that since there was no communication between the retail section and the wholesale section of Hugo Boss and because the information exchange was between the wholesale section of Hugo Boss and Ginsborg and Kaufmann respectively, the practices should be considered part of their vertical relationship. The NCA acknowledged that it was possible that information connected to the vertical relationship also was exchanged between the parties. However, it also stated that vertical information exchange was not brought into question in this case and the information that was under scrutiny did not concern the parties' relationship as supplier and retailer. The NCA also stated that even though the wholesale section and the retail section of Hugo Boss allegedly were completely independent and exchanged no information between each other, wholesale still had detailed information on retail that it shared with Ginsburg and Kaufmann. In addition to this, wholesale and retail of Hugo Boss were partof the same economic entity. The objections were because of this deemed to be without merit.

The Danish Competition Authority points out that the VBER only applies to vertical agreements and that the vertical guidelines says that the horizontal effects of vertical agreements should be treated the same as other horizontal agreements. The concerted practices in these cases did not concern vertical aspects such as distribution of the products, but future prices, rebates and quantities regarding the retail market where the companies were actual competitors. In addition to this, the NCA considered the information exchange in the two cases to be examples of by object restrictions that, as a general rule, cannot be exempted from the prohibition in Article 101 TFEU.

CONCLUSION

The legal certainty issues regarding information exchange in dual distribution scenarios arise primarily from a lack of predictability. This unpredictability is caused by Article 2(4) as it contains necessary conditions with unclear meaning and by the guidelines as they offer no explanations as well. Another issue that decreases the predictability is that EU Competition law is stuck in a way of reasoning centring around the vertical-horizontal dichotomy without fully recognizing the cases that are not as easily divided into one of the two.

The legal certainty issues can be resolved in a number of ways. It can be done by adding a definition of the phrase "non-reciprocal agreement" in the new VBER, or by removing the phrase completely if it lacks importance. The Commission could also add guidelines on how to separate the vertical and the horizontal aspects of information exchange in dual distribution scenarios, or it could add a completely new section in the vertical guidelines that explains how to make an overall assessment of several different kinds of conduct that blur the line between vertical and horizontal relationships in EU Competition law.

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