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Hub-and-spoke arrangements – Note by Korea

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More documents related to this discussion can be found at
http://www.oecd.org/daf/competition/hub-and-spoke-arrangements.htm

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1. Introduction

1. Suppliers and buyers gather and use information on competitors' pricing policies in the process of negotiating details of terms and conditions. Negotiating and interacting freely based on such information is generally considered pro-competitive. However, competitive concerns arise when interactions between suppliers and buyers are used as a means of facilitating competition-sensitive information exchanges among competitors.

2. When a third party acts as an intermediary or conduit to facilitate information exchanges that restrain competition among competitors, this may constitute a hub-and-spoke cartel. In that case, the third party is generally a common buyer or supplier that enables competitors to exchange competition-sensitive information. Hub-and-spoke arrangements are often formed between a common supplier (or manufacturer) and its retailers (or distributors) or between a common retailer and its suppliers.

3. Hub-and-spoke arrangements involve elements of various theories that have been discussed in regard to collusion. For this reason, there are diverse views on hub-and-spoke cartel: it is regarded as (1) a unique type of vertical agreement that has the effects of a horizontal cartel, or (2) a more sophisticated version of a typical horizontal cartel, or (3) a mere act of information exchange categorized as horizontal collusion, etc.

4. In Korea, it is not easy to find a typical form of hub-and-spoke cartel cases where vertical information exchanges cause the effects of horizontal agreements[1]. Against this backdrop, the following goes over jurisprudence about information exchanges, and the regulations on resale price maintenance (hereinafter referred to as "RPM") in the context of hub-and-spoke in Korea.

2. Information exchanges that facilitate collusion

5. Information exchanges take one of two forms: (1) a horizontal information exchange made between competitors; and (2) a vertical information exchange between firms operating at different levels of the production or distribution chain. Hub-and-spoke cartel is a concept formulated with regard to acts that have the same effects as horizontal agreements without any horizontal communications or information exchanges.

6. Vertical information exchanges can in some cases facilitate vertical agreements or horizontal agreements, which create various legal issues such as cartels, unfair trade practices, and RPM practices under the Monopoly Regulation and Fair Trade Act (hereinafter referred to as "MRFTA"). Although the KFTC has applied Article 19 (Prohibition of Unfair Collusive Acts) of the MRFTA to cases that have elements of both vertical and horizontal agreements,

[1] The KFTC has enforced against horizontal cartel cases where one of competitors took the hub-like role to the rest and facilitated collusion through sequential communications with each of the competitors. Although these cases are distinguished from a typical form of cartels where all participants simultaneously decide to join the cartel, they cannot be categorized as hub-and-spoke arrangements since they are horizontal agreements without vertical information exchanges.

purely vertical agreements without horizontal elements have never been recognized as cartels under Article 19 of the MRFTA.[2]

7. The position of the Supreme Court of Korea on horizontal information exchanges between competitors is manifested in its decision on the case regarding 16 life insurance companies which colluded to determine the premium rate[3]. In this case, the Supreme Court concluded that there was no unlawful agreement[4], noting that, "Information exchange can be a probable basis for recognizing the reciprocity of the communication of intent between firms, as it can be a means to ease or facilitate collusion by eliminating uncertainties regarding the decision-making on price, etc. Even so, the existence of information exchange by itself does not lead to the conclusion that there was an agreement to engage in acts that unfairly restrict competition."

8. As described above, the KFTC and the courts as well are taking a strict and conservative approach in recognizing collusion through information exchanges. That being said, the proposed amendment to the MRFTA, which was submitted to the National Assembly in 2018, adds an agreement to exchange information between firms to the list of potentially illegal agreements. If the bill passes the National Assembly, collusion through agreement to exchange information will be enforceable by the KFTC as a cartel offence.

9. Meanwhile, in another cartel case involving both vertical and horizontal relations among firms, the court concluded that if the upstream firm had a sufficient economic incentive to collude, and played an active role for the agreement, the vertically related firm should be held liable for violating Article 19 of the MRFTA which prohibits improper collusive acts[5].

3. RPM and hub-and-spoke

10. The MRFTA[6] defines RPM as "an act whereby a business entity sets a price for a counterpart entity or an entity in the next stage of transaction and forces them to sell goods or to provide services at the fixed price, or to make a transaction 'under an agreement or binding terms and conditions thereon' for such purpose in the transaction of such goods or services." At the same time, the MRFTA[7] stipulates minimum RPM is illegal in principle.

[2] In the case of unfair collusive acts by GlaxoSmithKline (GSK) and Dong-A Pharmaceutical, the court stated that, "Because both the plaintiffs and Dong-A are developing, manufacturing and selling various drugs in the domestic market, it is justified that Dong-A is potentially in competition with the plaintiffs even if Dong-A is not actually developing or selling the same drugs manufactured by the plaintiffs." This shows that the court basically requires the existence of a horizontal agreement for recognizing unfair collusive acts.

[3] Supreme Court Decision 2013Du16951. Decided July 24, 2014

[4] Similar decisions were made on some cases including Supreme Court Decision on Price-fixing by Soju manufacturers (2011Du16046. Decided February 13, 2014) and Supreme Court Decision on Price-fixing of Instant noodles (2014Du939. Decided January 14, 2016).

[5] Bid-rigging at auctions for constructing Onnara system for four District Offices in Busan, Seoul High Court Decision 2014Nu1521. Decided January 30, 2015

[6] Article 2(6) of the MRFTA

[7] Article 29(1) of the MRFTA

11. Nevertheless, in minimum RPM cases of Callaway Golf Korea[8] and TaylorMade Korea[9], the Supreme Court concluded that the minimum RPM practice, which has similar appearance as the vertical price-fixing arrangement, should also be assessed based on the comparison between its pro-competitive and anti-competitive effects, and it may not be seen as illegal when the former outweighs the latter.

12. In Korea, the practice of RPM, as defined in the MRFTA, is regarded as unlawful if it is unilaterally forced or conducted under binding terms and conditions. On the other hand, RPM is regulated as a type of vertical collusion in many other jurisdictions[10].

13. It has been widely recognized that the practice of RPM can be used as a means of facilitating horizontal agreements between suppliers or between retailers. When suppliers set a minimum resale price with their retailers at the level arranged between the suppliers, it would be easy to monitor possible deviations from the cartel agreement. Retailers, on the other hand, may request or induce manufacturers to set a minimum resale price instead of directly colluding with other retailers. In this regard, active enforcement against RPM practices can serve as a complementary instrument for regulating hub-and-spoke arrangements in Korea since such a form of collusive acts in vertical transactions between suppliers and retailers has never been enforced or recognized as a cartel offence. However, the severity of penalty for RPM (surcharge of up to 2% of the relevant turnover) is much lower than that of cartels (up to 10% of the relevant turnover) in Korea.

14. If RPM practices are regulated as a unilateral conduct, as it is the case in Korea, it is impossible to sanction downstream distributors which may have actively engaged in and taken advantage of the RPM practices. That's why some argue that RPM must be enforced as a vertical agreement (cartel) as it is in the United States and the European Union. On the other hand, there is also a view that it is better to continue regulating RPM as a type of unilateral conducts, taking into consideration that, the burden of proof may increase as the competition authority has to prove the existence of agreements between firms in cartel enforcement, and that also the MRFTA has separate provisions to distinguish RPM from collusive acts.

[8] Supreme Court Decision 2010Du9976. Decided March 10, 2011

[9] Supreme Court Decision 2010Du13753. Decided July 14, 2011

[10] RPM is regulated as agreements that restrain competition under Section 1 of the Sherman Act in the United States and Article 101 of the Treaty on the Functioning of the European Union respectively.