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DLC COUNTDOWN

"VERTICAL" IN THE SPOTLIGHT: AGENCY ("DUAL ROLE" AGENTS)

WHAT?

Over the past few years, a trend has been noticeable toward a commercial strategy combining agency and distribution models. In particular, depending on the products or customers involved, a business partner is sometimes requested by the same supplier to act as both its independent distributor and its commercial agent. Such business partners are often referred to as "**dual role**" **agents**.

Let us make things concrete. A **supplier of cooking appliances** relies on independent distributors for the distribution of the majority of its appliances. For a new, innovative type of cooker hood, the supplier wishes to keep a tight control over the launch and, in particular, over the price level, the distribution channels and the customer relationships. The distributors who are interested to participate in the launch are therefore invited to do so in the capacity of a genuine agent and not as an independent distributor.

The key question in this context is whether, and under what conditions, the business partner can qualify as a **genuine agent** (from a competition law perspective) for the new cooker hood notwithstanding his mixed role. As set out in the DLC Countdown no.4, the genuine agency test is only met if the agent does not bear any or only insignificant risks associated with the transactions it concludes or negotiates on behalf of the principal.

The difficulty with the application of the test in this scenario is to distinguish between investments and costs relating to the agency set-up and those relating to the independent distributorship. This applies in particular to market-specific investments, i.e. investments in sales promotion or investments specifically linked to the transactions, such as equipment, premises or training of personnel.

NOW?

No relevant guidance is provided under the current VBER and Vertical Guidelines with respect to "dual role" agents.

Following the adoption of the VBER and the Vertical Guidelines, there seems to have been a growing concern on the part of DG Competition of the European Commission that the agency may trigger **spill-over effects** into the business partner's role as an independent distributor. If the business partner qualifies as a genuine agent, the supplier is entitled to set the price for the product (in our example: the new cooker hood) and to restrict the customers to whom sales are made. The perceived competition law risk is that, as a result, the agent is incentivized to set higher prices for the other cooking appliances it sells as an independent distributor. In other words, the implementation of the pricing policy the agent must comply with in relation to the sales under the agency agreement would cause the application of higher prices for the other products.

In 2021, the European Commission drafted a Working Paper on "*Distributors that also act as agents for certain products for the same supplier*" ("**Working Paper**"). The Working Paper reflects the above-mentioned concerns and provides a framework for the assessment of "dual role" agents.

THE FUTURE AS OF 1 JUNE 2022?

The Working Paper is very much reflected in the current proposals of the Vertical Guidelines.

According to these proposals, an independent distributor of a supplier may also act as an agent for other products or services of the same supplier, provided that each of the following conditions is met:

- It must be possible to **effectively delineate** the commercial and financial risks related to the agency. This is for instance the case when the agency concerns products or services presenting additional functionalities or new features.
- The independent distributor must be **genuinely free** to enter into the agency agreement. For instance, a supplier may not threaten to terminate or worsen the terms and conditions of the distribution agreement if the distributor does not agree to an agency set-up.

- All relevant **commercial and financial risks** (including market-specific investments) connected to the products and services covered by the agency agreement must be borne by the principal-supplier.

With respect to the **market-specific investments**, the current proposals of the Vertical Guidelines provide that the principal is required to reimburse all investments made in the framework of the agent's activity. Only those investments that concern exclusively the sale of differentiated products (even within the same product market) as an independent distributor must not be reimbursed.

However, the example provided in the draft Vertical Guidelines applies these principles very **rigidly**. Even for differentiated products belonging to the same product market, the rule seems to be that the market-specific investments related to the entire product market must be covered in full by the supplier. If such condition is not fulfilled, the rule seems to exclude the possibility of qualifying as a genuine agent.

This means concretely for our example that a principal must pay for the shop lay-out or promotional investments not only related to the new innovative cooker hoods, but also for any other cooker hood models that are sold as an independent distributor. The principal is not required to cover any investment relating to other cooking appliances, such as dishwashers and ovens.

In practice?

The test to qualify as a genuine agent (in a "dual role" scenario) becomes very **burdensome and costly**. In order to organize the launch of a particular new product by means of genuine agency, the supplier shall in principle cover all the market-specific investments related to the entire product market to which the new product belongs.

Assessment?

It is difficult to understand why the concerns outlined above (spill-over effects on pricing as an independent distributor) are translated into an extreme position in terms of the market-specific investments to be carried by the supplier. If the agency scenario is used to put **pricing pressure** in the context of the independent distributorship, the proper way to tackle this is by means of the RPM route. The chosen "allocation of costs" route is in practice simply a showstopper for "dual role" scenarios. The reason is twofold: the costs are too high and, when getting it wrong, the consequences are too serious (the set-up comes into conflict with the black list of the block exemption).

It is doubtful that the chosen approach matches with the test put forward in the case law of the European Court of Justice. In order to comply with such case law, a “**but for**” **test** would seem to be sufficient: consider a scenario in which the agency would not exist and consider the costs that would disappear. These costs are the ones which must be covered by the supplier.

The fact that this criticism has merit is proven if one contemplates a scenario where the supplier does not appoint its own distributor, but that of a competitor as its (genuine) agent. In that scenario, the supplier would have to cover only the market-specific investments related to the agency, and not the investments made by the distributor with regard to the products of the competitor that belong to the same product market. This is simply not logical and, furthermore, inconsistent with the theory of harm that is invoked to justify the extreme cost allocation requirement in order to qualify as a genuine agent.

THE FINAL REVISED VBER IS PLANNED TO ENTER INTO FORCE ON 1 JUNE 2022.

WANT TO KNOW MORE? STAY TUNED…

Counting down towards 1 June 2022, we aim to provide you with regular updates and the necessary legal know-how in order to fully prepare your business for the future. Please also check out the Distribution Law Center platform (www.distributionlawcenter.com) and our LinkedIn page for much more information on the laws governing vertical agreements, covering both competition and commercial law. 27 specialized teams from all over the EEA are working hard to turn the platform into your favourite source of guidance and information.