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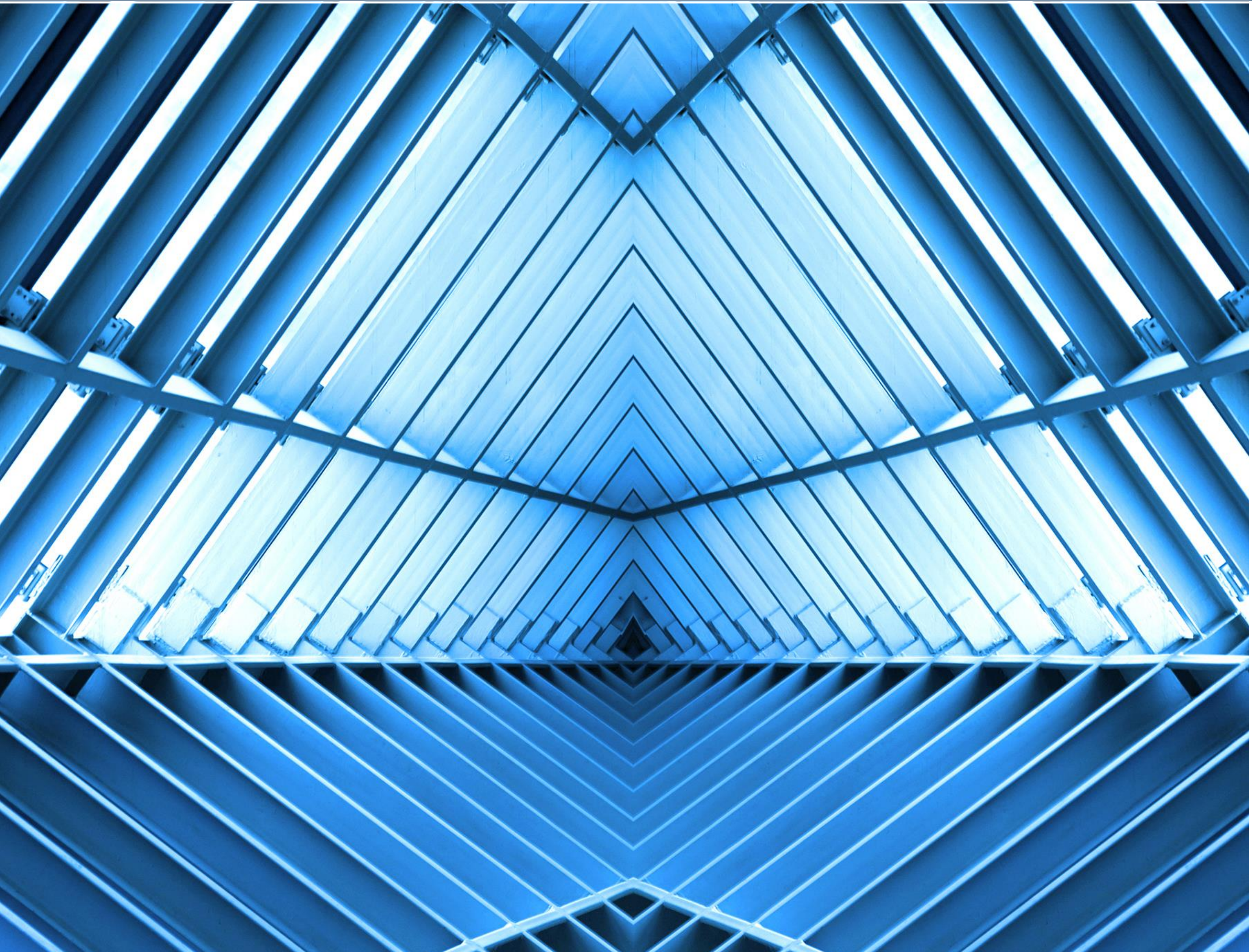

ANTITRUST CLIENT BRIEFING

EC Working Paper on dual roles in distribution

10 February 2021

At a Glance

The European Commission ("EC") has published a Working Paper on dealing with distributors that also act as agents for certain products for the same supplier. The Working Paper is an attempt by the EC to clarify the current rules regarding agency agreements in the context of the ongoing review of the competition rules on vertical restraints.

Key Points:

- Under EU competition law, the distributor of certain goods of a supplier may also be an agent of that same supplier for the distribution of other goods.
- The difference between agent and distributor is not without consequence. In agency relationships the supplier is the seller vis-à-vis customers and may fix the prices of its products sold by its agent as well as restrict where and to whom its products are sold.
- Determining when a distributor also acts as an agent for the same supplier is a complex exercise. A strict delineation of responsibilities is necessary.
- The Working Paper seeks to clarify which costs should be covered or reimbursed by the principal and puts forward methods for financing such costs. The Working Paper also gives an example illustrating how the principles it describes can be applied practically.

Background

The EC is currently reviewing its competition rules on vertical restraints. The rules give parties to vertical agreements (entered into between businesses operating at different levels of the production or distribution chain) increased certainty about the compatibility of their agreements with Article 101(1) TFEU by creating a safe harbour. The EC is assessing whether the rules are still fit for purpose, especially in view of the emergence and development of e-commerce.

In October 2020, the EC published an Inception Impact Assessment of policy options for its review of the EU Vertical Block Exemption Regulation ("VBER") and accompanying Vertical Guidelines for consultation (see Latham & Watkins' Antitrust Client Briefing here). In December 2020, the EC published a more detailed Impact Assessment for public consultation. Dual distribution was among the areas highlighted for further analysis.

Respondents have indicated that the guidance in the Vertical Guidelines is not sufficiently clear as to whether a company active on a downstream market may act as both a genuine agent and an independent distributor for different products of the same supplier ("dual role" agents). In addition, DG Competition has noted increased use of models combining agency and distribution in consumer goods markets, under which a single undertaking combines the functions of agent and independent distributor for the same principal/supplier. The Working Paper is meant to give additional guidance, although it is by no means the final position of the EC and may evolve based on evidence provided by stakeholders during the consultation.

The Working Paper

A genuine agency agreement is not caught by Article 101(1) TFEU

The Working Paper reaffirms the well-established position that an agency relationship will only fall outside the scope of Article 101(1) TFEU on anticompetitive agreements if the agent does not bear any (or bears only insignificant) risks associated with the contracts negotiated on behalf of the principal and operates as an auxiliary organ. The question of risk must be assessed on a case-by-case basis, taking account of the economic reality of the situation.

The EC interprets the agency principles restrictively, and only exceptionally finds a genuine agency agreement.

Principles governing dual roles

The Working Paper makes clear that the existence of a genuine agency agreement is not incompatible as such with the agent also acting as an independent distributor. But strict conditions must be met, since there is a risk that the pricing policy of the principal for the products sold under the agency agreement will influence the incentives of the agent/distributor to independently price the products it sells as an independent distributor.

Agent must be genuinely free

The distributor must be genuinely free to enter into the agency agreement. For instance, if the agency agreement is imposed by the principal through a threat to terminate or worsen the terms of the parallel distribution relationship, the agency relationship will not be genuine and will therefore be subject to Article 101(1) TFEU.

The agency and distribution activities must be clearly defined

As mentioned above, all relevant risks linked to the sale of goods covered by the agency agreement to third parties must be borne by the principal. The use of a system combining agency and independent distribution for the same supplier raises difficulties in distinguishing between investments and costs that relate to the agency function and those only relating to the independent distribution activity. If products are differentiated, presenting objectively distinct characteristics, it may be easier to delineate both activities. Delineation will be more difficult for homogeneous products.

Clearly delineating the scope of the agency and distribution agreements can therefore be a complex exercise in which lines are blurred in practice. However, delineating the contours of the agency relationship is key to ensure that the agent does not incur any of the risks associated with the contracts negotiated on behalf of the principal.

For example, the agent should not:

- Receive a transfer of title of the goods.
- Contribute to the costs relating to the supply/purchase of the contract goods or services, including the costs of transporting the goods.
- Maintain at its own cost or risk stocks of the contract goods.
- Undertake responsibility towards third parties for damage caused by the products sold.
- Take responsibility for customers’ non-performance of the contract.
- Feel obliged, directly or indirectly, to invest in sales promotion.
- Make market-specific investments in equipment, premises, or training of personnel; investments related to the provision of agency services in general are not to be borne by the principal unless they are common to the provision of services and specifically required for the activity for which the agent has been appointed by the principal (e.g., a website or general advertising for a shop).

Reimbursing the costs incurred for the agency mission

The relevant costs incurred by the agent must be borne by the principal. The Working Paper clarifies that an agent can be reimbursed in more than one way. What matters is that the agent is fully reimbursed in practice. Reimbursement can be achieved by: reimbursing the precise costs incurred, covering the costs by way of a fixed lump sum, or paying the agent a share (i.e., a fixed percentage) of the revenue from the products sold under the agency agreement.

These multiple options may require a reimbursement system that allows the agent to easily declare and request the reimbursement of any costs that exceed the lump sum or fixed percentage. They may also require the principal to monitor and review changes to the relevant costs and adapt the reimbursement method.

If a supplier enters into an agency agreement with independent distributors that are already active on the relevant market, many of the relevant costs will likely have already been incurred, thus raising questions about whether and to what extent the principal should cover such costs. The Working Paper advocates for a partial reimbursement of such costs (taking into account depreciation, etc.).

In addition to the challenges of strictly delineating the scope of the agency agreement versus the distribution agreement, the correct cost calculation/allocation will be a tricky exercise for the parties. While the Working Paper is a welcome step to provide clarity, suppliers wishing to enter into dual distribution systems will continue to face practical difficulties.

Next Steps: Timeline

2021: Draft of the revised rules (VBER and Vertical Guidelines) for stakeholders to comment

Q4 of 2021: Finalisation of the Impact Assessment and submission to the EC Regulatory Scrutiny Board

31 May 2022: New rules to enter into force

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