Distribution Law Center
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Distribution Law Center Countdown III - Agency (Legal test)

What?

The particular nature of agency agreements triggers the application of a specific competition law regime. This regime is based on a split between (i) the role assumed by the agent acting as an intermediary of the principal (i.e. where he is trying to secure transactions for the principal) and (ii) the position of the agent as a provider of agency services to principals (i.e. where he seeks appointments as an agent).

With regard to the second aspect, the agent acts as an undertaking that is separate from the principal. It makes agency services available to the market. In this context, the rules of EU competition law apply in their entirety, as they would in any other situation where companies offer services.

The position is different with regard to the first aspect. This is where the specific competition law regime comes into play. Indeed, the agent acts as an extension of the principal. The agent reaches out to secure business for the principal. Under specific conditions, this role of the agent does not trigger the application of the EU competition rules as the agent is deemed an integral part of the principal (similarly to the employees of the principal).

If the specific conditions are met, the practical consequences are considerable. The principal will be able to dictate the price at which the agent must conclude business transactions on his behalf. This means that there is no risk of prohibited vertical price fixing or RPM. The principal can also dictate in the most absolute terms where the agent may be active and with which customers he may deal. This means that there is no risk of prohibited territorial or customer restrictions.

Now?

The current Vertical Guidelines accompanying the current VBER provide that the determining factor in defining an agency agreement for competition law purposes is the financial or commercial risk borne by the agent in relation

to the activities for which he has been appointed by the principal (the “agency test”). In accordance with the case law of the European Court of Justice, the agency test is only met if the agent does not bear any or only insignificant risks associated with the transactions he concludes or negotiates on behalf of the principal.

Imagine that an agent is required to bear the cost of transporting the goods of the principal to the customers, or that he must maintain stocks of such goods at his own cost. In these cases, the agent assumes risks endangering his status as a “genuine” agent for EU competition law purposes. The nature and the level of such financial or commercial risks result in the agent acting as an independent market participant, rather than as a market player whose market behaviour is attributable to the principal.

The Vertical Guidelines refer to three categories of risks that are material and include a non-exhaustive list of practical examples for each category:

- Contract-specific risks: these risks relate directly to the agreements that the agent concludes or negotiates on behalf of the principal. Practical examples are the financing of stocks, the cost of transporting goods, the responsibility towards third parties for damage caused by the products sold and the responsibility for non-performance by customers.
- Market-specific investments: these are investments specifically required for the type of activity for which the agent has been appointed by the principal and are usually sunk. “Sunk” means that the investments cannot be used for other activities (or at a significant loss) if the agent were to abandon his activities for the principal. Practical examples include investments in sales promotion or investments specifically linked to the transactions, such as equipment, premises or training of personnel.
- Risks related to other activities undertaken on the same product market that an agent is required to undertake by the principal on his own risk, unless they are fully reimbursed by the principal. The practical relevance of this risk category will depend on the specifics of the situation and the market at hand.

If the agency test in relation to the aforesaid categories of risks is *not* met, the agent will be subject to the same EU competition law regime as an independent distributor. In the opposite scenario (meaning that no or insignificant risks are borne), the agent will not be subject to that regime and will be deemed an integral part of the principal.

The future as of 1 June 2022?

The current Commission proposals maintain the agency test, which is based on the absence or insignificant level of the risks assumed by the agent. It is fair to assume that this position will remain unchanged in the future amended proposals (to be expected beginning of 2022) and in the definitive texts. Hence, the crux of the agency test remains the risk criterion. The current proposals of the Vertical Guidelines add, however, that this exception must be interpreted narrowly.

The same three types of risks are identified in the current proposals, but a new test is added to measure the significance of the risks undertaken by the agent. Reference is made to the revenues generated by the agent from providing the agency services (e.g. the commission paid by the principal to the agent) rather than the revenues generated by the sale of the goods or services covered by the agency agreement or the overall business profile of the agent (for whom the agency activities performed for the principal may represent only a fraction of his overall activities).

The current proposals of the Vertical Guidelines clarify that a principal may use various methods to eliminate the risks for the agent by reimbursing the relevant costs. To that end, a principal may reimburse the precise costs incurred, provide a fixed lump sum or pay the agent a fixed percentage of the revenues realized from the goods or services sold under the agency agreement. Any such a reimbursement method is only effective if it ensures that the agent bears no or only insignificant risks.

According to the Commission, it may therefore be required to provide a simple method for the agent to declare and request the reimbursement of any costs exceeding the agreed lump sum or fixed percentage. It may also be necessary for the principal to systematically monitor any changes to the relevant costs in order to adapt the lump sum or fixed percentage accordingly.

Where the relevant costs are reimbursed by way of a percentage of the price of the products sold under the agency agreement, the principal must also take into account the fact that the agent may incur relevant market-specific investments (the second type of risks) even where he makes limited or no sales for a certain period of time. Such costs must be reimbursed by the principal irrespective of the level of the activities conducted for the principal.

In practice?

- The agency test based on the level of risk (no or insignificant) assumed by the agent remains fully applicable under the current Commission proposals.
- The current Commission proposals call for a narrow interpretation of the agency test.
- The current Commission proposals measure the significance of the risks incurred by an agent against the revenues generated by the agent from the agency services performed for the principal (typically the commission received).
- A very detailed overview with respect to the possibility to reimburse the agent's costs is provided in the current Commission proposals. The reimbursement mechanism itself is not of decisive importance. The key issue is whether the mechanism is devised in such a manner that it eliminates all risks or brings them back to a *de minimis* level.

Assessment?

There are at least three striking features in the current Commission proposals and it will be interesting to see whether they will be retained in the amended proposals:

- The call for a narrow interpretation of the agency test seems to reflect a degree of suspicion on the side of the Commission with regard to the use of "genuine" agency (i.e. agency that escapes the rules of EU competition law). This call is unnecessary and, in fact, may trigger legal uncertainty. The agency test (which is based on case law of the Court and requires the assumption of no or insignificant risks) is already very strict in - and by - itself.
- It is a policy choice to measure the level of the risk assumed against the revenues generated by means of the particular agency services concerned. An equally valid (and presumably economically more relevant) parameter can be to measure the risk against the overall business profile of the agent.
- The current Commission proposals cast some doubt as to whether costs incurred on other relevant markets may be relevant to the agency test. The case law of the Court is clear in this respect and such extension is not justified. The references to the *Mercedes* case law in the current proposals seem inappropriate in this context.

Want to know more? Stay tuned...

Counting down towards 1 June 2022 we aim to provide you with regular updates and the necessary legal knowhow in order to fully prepare your business for the future. Please also check out the Distribution Law Center platform 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.

A translation of this Countdown newsletter is available in the following languages: Czech, Croatian, Danish, Portuguese, Romanian, Slovak, Spanish and Swedish.

Read the available DLC Countdown newsletters on the changes to be expected here.