Commercial agents can be valuable to any business. By working for a number of clients, or because of his contacts, a commercial agent can extend the marketing reach of the business and bring in customers which it otherwise could not obtain. However, commercial agents enjoy substantial legal protection which is not unlike that given to employees. Both parties need to be aware of the position.

In 1993, the Commercial Agents (Council Directive) Regulations 1993 were introduced pursuant to EU directive to bring the UK into line with other member states, notably France and Germany.

As so often happens with UK legislation imported from the EU, the regulations are not as clear as they should be. Whatever may be said about the shortcomings of English Law it is often better drafted than European law. Unfortunately the English tradition of clarity has not been carried into these regulations. In particular, the Regulations themselves do not deal with how compensation payments are to be calculated.

What is important is to realise the impact of these Regulation on agency contracts and the damages that may be payable on termination. It is hoped this guide will provide a good starting point for both agents and principals.

What is a commercial agent?

The regulations say that a commercial agent is a self employed intermediary who has continuing authority to negotiate the sale or purchase of goods on behalf of another person (the "principal"), or to negotiate and conclude the sale or purchase of goods on behalf of and in the name of that principal.

However, a person who has power to enter into commitments on behalf of a company in his capacity as an officer of a company is not a commercial agent. Neither is a partner acting as a partner in his firm.

Duties of and to a commercial agent

A principal owes duties to a commercial agent:-

  - To provide him with the necessary documentation regarding the goods concerned
  - To obtain for the agent the information which the agent needs to perform the agency contract
  - To notify the agent if he anticipates that the volume of commercial transactions will be lower than the agent could normally have expected.

An agent owes duties to the principal:-
To make proper efforts to negotiate and conclude transactions.
To communicate to the principal all the necessary information available to him.
To comply with the principal's reasonable instructions.

The parties cannot contract out of these duties.

Remuneration of commercial agents

Rules make provisions which include the following:-

If there is no agreement as to remuneration (which as a matter of good practice there should be) the agent is entitled to remuneration customarily allowed to agents for the type of goods involved in the area where the agent carries on his activities. If there is no such customary practice, the agent is entitled to reasonable remuneration. Where remuneration is wholly or partly commission based, there are general rules dealing with entitlement to commission payments, commission on transactions concluded after the end of the agency contract, apportionment of commission between old and new agents, and when commission becomes due. The principal must provide statements of commission quarterly and the agent must be provided with all available information which he needs to check the amount of commission due to him. He is entitled to extracts from accounting records and this rule probably allows a right to inspect the actual books so far as relevant.

Duration and termination of the agency contract

Each of the agent and the principal is entitled to receive from the other on request a signed statement setting out the terms of the agency.

Where an agency contract is for a fixed term but continues after the end of that term, it is converted into a contract for an indefinite period.

Where there is a contract for an indefinite period, either party may terminate it by notice. The periods of notice are:-

1 month for the first year
2 months during the second year
3 months during the third and later years.

Shorter periods may not be agreed, but longer ones can be. However, if longer periods are agreed, the notice to be given by the principal may not be shorter than the notice to be given by the agent.

Unless otherwise agreed, notice must be given to coincide with the end of a calendar month.

These rules do not prevent immediate termination for breach or exceptional circumstances where the general law permits.

Compensation for agent on termination of the agency

It is very important to realise that on termination of an agency, the agent may well be entitled to claim damages (which can be substantial) from the principal. This may be payable whether or not the contract is terminated in breach of contract by the principal.

The rules provide that on termination the agent is entitled either to be indemnified OR to compensation for damage.

An agent is only entitled to an indemnity if that method of compensation is specified in the agency agreement. If the agreement is silent on that point, or there is no written agreement, the agent will be entitled to compensation.

Indemnity

The Regulations set out the basis upon which an agent will be entitled to receive an indemnity. Two tests apply; firstly, the agent must have brought the principal new customers or have significantly increased the volume of business with existing customers and the principal is continuing to derive substantial benefits from this business. Secondly, the payment of an indemnity must be equitable, having regard to all of the circumstances and in particular, the commission the agent has lost on transactions with those customers.
If the above tests are satisfied, then the Regulations set an upper limit on the amount of the payment. That is said to be one year's average commission calculated with reference to the commission received in the preceding five years (or if less than five years the actual period).

Compensation

Where the agent is entitled to compensation the rule is that the agent is entitled to compensation for the damage he suffers as a result of the termination of his relations with his principal. The rules are rather vague about how compensation is to be calculated.

Until 2007, there had been considerable debate about the exact method to be adopted in calculating the agent’s loss. However, in July of that year, this was decided by the House of Lords (as they then were) in a case called Lonsdale v Howard & Hallam Limited ([Lonsdale v Howard & Hallam Limited [2007] UKHL 32]

The Law Lords decided that the damage suffered by the agent on termination of the agency relationship was the loss of the value of the agency relationship. They said that the value of the agency lies in the future income stream that it would have generated and it is this which must be valued. Valuing the agency relationship requires the parties to assess what a hypothetical purchaser might reasonably have been willing to pay for the agency as at the date of termination. Essentially, they said that compensation is based on the value of the goodwill in the agent’s business.

In order to assess the value of the business and what a hypothetical purchaser might pay, it will usually be necessary for an agent to obtain expert evidence. This is effectively an accounting exercise and the principles that apply are much the same as one would adopt when valuing a business for sale on the open market. Although it should be noted that in Lonsdale, the Lords set out a number of factors that should be taken into account.

Surprisingly, the agent is entitled to compensation if the contract ends because of his death.

Agents should take note that an agent loses his right to claim if he fails to notify the principal within a year of the end of the contract that he intends to make a claim. This does not mean a court action needs to be brought, just that the principal is notified. This is best done in writing.

Where compensation does not apply

The rights to compensation and/or indemnity is lost where:-

The principal terminates the agreement where he could have justified immediate termination because of the agent's default.

The agent terminates, EXCEPT where termination is justified because of the principal's default or where the agent terminated because owing to age, infirmity or illness he cannot reasonably be expected to carry on.

The agent assigns the agreement to another person with the agreement of the principal.

Turing this round, this means that an agent can claim damages if he himself terminates his contract because he wants to retire or because he is too ill to carry on. It also means that where a principal terminates due to an agent’s breach, damages may be payable unless that breach is so serious that it would justify the principal terminating immediately.

It should also be noted that the parties cannot contract out of the rules for compensation and indemnity to the detriment of the agent.

Compensation or Indemnity?

It can be difficult to work out which is the method to adopt when negotiating a new agency contract. On the one hand, an indemnity requires satisfaction of the two tests and sets an upper limit. On the other hand, compensation is based on goodwill and has no upper limit.

In practice, each contract should be looked at in context. For example, in a growing business with large volumes of sales being concluded by an agent, an indemnity might limit the damages whereas compensation might be very costly.

Restraint of trade clauses
A restraint of trade clause is an agreement restricting the business activities of a commercial agent after the agency contract comes to an end.

A restraint of trade clause is valid only if and to the extent that:

- It is in writing; and
- It relates to the geographical area or to the group of customers or to the type of goods entrusted to the agent under the contract.

There is a maximum restriction period of two years.

Any such clause must also satisfy the usual common law tests of validity and must not be in unreasonable restraint of trade.

What should I do now?

As you will have seen, the Regulations will significantly affect the relationship between agent and principal. This guide is only intended to be an outline of the legal position and should not be used as a substitute for talking proper legal advice.

If you are thinking about entering into a contract (whether as agent or principal) that might be affected by the Regulations, you should take legal advice first. Equally, if you are already in such a contract and the issue of termination is on the horizon, take advice quickly.

All too often we are instructed to advise in matters where parties were unaware of the Regulations or their extent and this has resulted in costly litigation.

At Sharp Young & Pearce we have a specialist lawyer who can advise on all of these issues and guide you through the maze of the legislation and its pitfalls. If you want an initial discussion about your problem please contact:

Richard Bates on 0115 8525835 (direct) or 0115 9590055 or email him on rbates@syplaw.com

Further information

Visit the government website legislation.co.uk for the full text of the Regulations.

The Regulations have been amended twice since made. Be aware that the Regulations as they appear on that site are as originally enacted. Changes made after enactment are not incorporated into the text.