



## Commercial Agents - Update

July 2007

Since the Commercial Agents (Council Directive) Regulations 1993 came into force on 1 January 1994, there has been significant doubt as to the correct basis on which commercial agents should be compensated upon the termination of their agencies. In the first case on this issue to reach the appeal Courts in England, the House of Lords handed down its long-awaited judgment in *Lonsdale v Hallam* on 4 July 2007. This has provided definitive guidance which will now form the foundation of all assessments of compensation where an agency relationship is governed by the Regulations.

### Background

The Regulations include a mandatory right for agents to claim a lump sum payment of either an "indemnity" or "compensation" on termination of their agency. This is separate from any contractual right which the agent may have to a payment on termination, such as a right to claim damages for breach of contract, and is payable even if the agent has no other claim in respect of the termination.

An agent can claim an indemnity if this is specifically provided for in the agency agreement and if he has brought the principal new business or significantly increased business with existing customers. The indemnity is based on average annual commission over the preceding five years of the contract (or the life of the contract, if less than five years), capped at one year's commission. It is generally considered that the indemnity alternative is more favourable to principals, mainly because the amount payable is capped at a one year's commission.

Alternatively, if the agency agreement provides for compensation or if the parties have failed to specify which option should apply, the agent is entitled to a payment to reflect the damage he suffers as a result of the termination of his relations with his principal, with no cap on the payment due. It is how that damage should be calculated

which has caused the English and Scottish Courts so much difficulty since 1994. Some have sought to find guidance from the French system which underlies the compensation principle, others have sought to award a sum which seemed just and equitable in all the circumstances. It would seem both are wrong.

### Lonsdale v Hallam

The House of Lords upheld the decisions of the Court of Appeal and the Oxford County Court at first instance. The compensation to which an agent is entitled under the Regulations must be based on the value of the agency at the time of termination.

In placing a value on the agency, the House of Lords gave the following guidance:

- It must be assumed that the agency would have been acquired and continued by a hypothetical purchaser, even if in practice the agency was non-assignable or there is no market for such agencies. The value of the agency is the amount that the hypothetical purchaser would be willing to pay to make that acquisition.
- How much the hypothetical purchaser would be willing to pay would be affected by the circumstances that existed in the real world as at the date of termination. For example, if the market for the products was declining, a hypothetical purchaser would wish to pay less. If the market has disappeared altogether, the agency would have no value because no hypothetical purchaser would buy it.
- The value should be fixed by reference to net anticipated earnings because the hypothetical purchaser would incur expenses in continuing the agency in the same manner as the original agent.
- As a present value is being placed on a future income, those future earnings should be subject to a discount by an appropriate rate of interest.

The valuation of an agency within these guidelines will require expert assistance. However, the House of Lords expressed a view that comparable small businesses are bought and sold every day so it should not be difficult to determine

a "going rate". Nonetheless, given the numerous methods which might legitimately be used to value small businesses, we suspect that disputes on valuation will be a regular feature in higher value cases.

### Practical relevance

This decision confirms the possibility of large compensation claims where valuable agency agreements are terminated. Such exposure raises the question of whether principals might wish to charge their agents a premium upon entering into an agency agreement in order to off-set their potential future liabilities upon termination. Such premiums are commonplace on the continent.

Principals who wish to avoid uncertainty and the potential for open-ended claims by their agents altogether would be well-advised to ensure that their agency agreements contain a specific provision opting for the indemnity alternative as this is capped.

Agents remain in a strong position where their business is well-established and supported by a healthy principal. However, a lesson can be learnt from *Lonsdale*. After 13 years acting as an agent for Hallam, the House of Lords ruled that the judge at first instance could have legitimately dismissed Mr Lonsdale's claim without awarding him any compensation for the termination of his agency. Hallam had ceased trading so Mr Lonsdale's agency had no future prospects and, therefore, no value to a hypothetical purchaser.

For further information or advice on commercial agency matters, please contact Philip Davey or Andrew Burnette.

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