



technicalguide

Contents

1.	Introduction.....	1
2.	The Previous Position.....	1
3.	Commercial Agent.....	2
4.	Rights and Duties	3
5.	Remuneration.....	4
6.	Conclusion and Termination of the Agency Contract.....	6
7.	Restraint of Trade.....	9
8.	The Future.....	9
9.	Fox Williams LLP.....	10

1. Introduction

In an attempt to create a single economic market within the European Community efforts were and continue to be made to harmonise the laws of the member states. Usually this is through the European Council or Commission issuing directives which are addressed to member states. The directives require the introduction of relevant implementing legislation by the member states.

One of the earliest harmonisation measures was a directive issued by the Council in 1986 to co-ordinate the laws of the member states relating to self-employed commercial agents. This directive has been implemented in Great Britain by means of secondary legislation under the European Communities Act 1972. The Department of Trade and Industry has prepared regulations known as The Commercial Agents (Council Directive) Regulations 1993. As a result of a drafting error by the DTI, the regulations were amended by the Commercial Agents (Council Directive) (Amendment) Regulations 1993. However, together they are commonly known as the Commercial Agents Regulations. They came into force on 1 January 1994.

The regulations represent substantial changes to the English law of agency. The terms of the regulations are implied into all commercial agency agreements, both written and oral, formal and informal.

2. The Previous Position

Prior to 1 January 1994 there was little English statute law governing the rights and obligations of principals and agents. Their rights and duties depended on the express or implied terms of the agency contract between them. Common law rules existed in the absence of, or overrode, express stipulation by the parties. For example, there was an implied duty on both parties to act in good faith. If the contract did not expressly provide for remuneration, a term for reasonable remuneration would be implied. In the absence of agreement between the parties there was no provision for the consequences of termination of the contract. Each case was decided on its facts taking into consideration the intention of the parties and all other surrounding circumstances.

The regulations on the other hand, specify the rights and duties of both principal and agent, the remuneration payable to an agent as well as the continuing obligations after the termination of the contract. Some of these provisions are mandatory. This means

that it is not possible to avoid them by contrary express or implied provisions in the contract.

3. Commercial Agent

The regulations do not cover all agency agreements. They apply only to commercial agents. A commercial agent is defined as:

“a self-employed intermediary who has continuing authority to negotiate the sale and 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...”

For this purpose a “self-employed intermediary” will include companies and firms as well as individuals.

The regulations go on to exclude certain categories of persons from the definition of commercial agent. These include:

- a person who, in his capacity as an officer (meaning a director, chief executive, secretary or manager), is empowered to enter into commitments binding on a company or association. For this purpose “an officer” is thought to mean a director, chief executive, secretary or manager;
- a partner who is lawfully authorised to enter into commitments binding on his partners;
- a person who acts as insolvency practitioner (as defined in section 388, Insolvency Act 1986) or the equivalent in other countries;
- a person whose activities are unpaid;
- a person who is operating on commodity exchanges or in the commodity market.

The regulations also do not apply to persons whose activities as commercial agents are to be considered secondary. Various detailed indications are set out in the schedule to the regulations to assist in determining whether particular arrangements come within the regulations. Accordingly the activities of a person as a commercial

agent will be considered secondary, and an arrangement to which he is a party will be considered as not coming within the regulations, where:

- the principal is not the manufacturer, importer or distributor of the goods;
- the goods are not specifically identified with the principal in the market in question;
- the agent does not devote substantially the whole of his time to representative activities;
- the goods are available in the market in question other than by means of the agent;
- the arrangement is described other than as one of commercial agency;
- promotional material is supplied direct to potential customers;
- agencies are granted without reference to existing agents in a particular area or in relation to a particular group;
- customers normally select the goods for themselves and merely place their orders through the agent.

In addition, unless the contrary is established, mail order catalogue agents for consumer goods and consumer credit agents are presumed to come outside of the regulations.

4. Rights and Duties

Under the regulations a commercial agent owes certain duties to a principal. In essence these are a general duty to look after the principal's interests and act dutifully and in good faith. In addition an agent is required to make proper efforts to negotiate, and conclude, the transactions he is instructed to take care of. An agent is also required to communicate to his principal all necessary information available to him and to comply with his principal's reasonable instructions.

A principal has a corresponding obligation under the regulations to act dutifully and in good faith towards his commercial agent. In addition a principal is required to provide his agent with the necessary documentation relating to the goods and obtain for him information for the performance of the agency contract. A principal is also required to

notify his agent within a reasonable period once it is anticipated that the volume of business will be significantly lower than the agent could normally have expected.

As a separate duty a principal is required to inform his agent within a reasonable period of his acceptance, refusal or non-execution of business that his agent has arranged. In essence this will require a principal to keep his agent informed of any omissions on his part in completing a transaction.

All of these provisions concerning the rights and duties of a principal and commercial agent are mandatory. It is not possible for them to be contracted out.

5. Remuneration

The regulations contain express provisions as to the remuneration of a commercial agent, where the contract is silent on the subject. The commercial agent has a right to such remuneration as it is customary for commercial agents to receive for negotiating the sale or purchase of the goods in question, in the place where he carries on his activities. Where there is no such customary practice, reasonable remuneration is payable, taking into account all the aspects of the transaction. There is no customary practice with regard to the remuneration of agents in the United Kingdom. However, a term for reasonable remuneration is implied by the common law.

For the purpose of the regulations, commercial transactions on which commission is payable to a commercial agent fall into two categories:

- those concluded during the period of the agency contract;
- those concluded after the agency contract has been terminated.

The latter category is a new concept in English law.

Where a commercial transaction is concluded during the period of the agency contract, a principal is obliged by the regulations to pay commission to his commercial agent on that transaction if:

- the conclusion of the transaction resulted from the act of the agent;
- the transaction is a repeat order from a customer previously acquired by the agent, even if the order was not placed through him;

- the agent has an exclusive right to act as a commercial agent on behalf of the principal in a specific geographical area or in relation to a specific group of customers and where the transaction has been entered into with a customer belonging to that area or group.

As a result an agent is entitled to commission on passive sales, and an exclusive agent is entitled to commission on generic and passive sales, unless the parties contract out.

Where a commercial transaction is concluded after the agency contract has been terminated, commission is payable by a principal to his commercial agent provided that:

- the transaction is mainly attributable to the agent's efforts during the period covered by the contract and the transaction was entered into within a reasonable time after the termination of the contract;
- the order of the third party reached the principal or the agent before the termination of the contract and either the conclusion of the transaction resulted from the act of the agent or the transaction was a repeat order from a previously acquired customer of the agent.

In the former situation, no definite cut off point is specified in respect of transactions entered into after the contract has been terminated. In order to avoid the possibility of dispute to determine what is reasonable, consideration will need to be given to making express provision in the agency contract in respect of payment of commission after termination of the contract.

A new agent will not be entitled to commission where it is payable to his predecessor unless it is possible to show that it is equitable for the commission to be shared between them.

Having established the circumstances in which an entitlement to commission arises, the next step is to determine when commission becomes due and payment should be made. The regulations state that the commission becomes due as soon as one of the following circumstances occurs:

- when the principal has executed the transaction, or, according to his agreement with the third party, should have executed the transaction; or

- when the third party has executed the transaction; or
- at the latest when the third party has executed his part of the transaction or when the third party should have done so if the principal had executed his part of the transaction when he should have.

On the face of them, these provisions considerably increase the burden on a principal in paying his commercial agent. He is no longer able to delay payment merely because he has not himself been paid by a third party.

When the commission has become due, a principal has to pay his commercial agent not later than on the last day of the month following the quarter in which it became due. By the same time, the principal has to produce a statement to his agent showing how the commission has been calculated. If demanded by the agent he is also required to give to his agent all the information available to him as principal, including extracts from his own books of account, which is necessary to enable his agent to check the statement. However, if it would be contrary to public policy to disclose such information, the principal is not required to do so.

Any term contained in the agreement between a principal and commercial agent will be void if it is an attempt to exclude the protection afforded to a commercial agent with regard to when commission becomes due, when it must be and the obligation to furnish statements and information. Nevertheless, in an attempt to impose clarity, it may be appropriate to specify in the agency contract what statements and information will be made available to the agent.

A commercial agent will lose his right to commission if, through no fault of his principal, no contract between the third party and the principal is executed. An agent will have to refund any commission which he has received if his right to it is extinguished. The regulations do not specify the period within which such a refund should be made. It is prudent, therefore, to provide for this expressly in the contract with the agent.

The parties are not able to contract out of this provision except insofar as it is to the benefit of the commercial agent.

6. Conclusion and Termination of the Agency Contract

One of the most controversial aspects of the regulations is that they regulate the conclusion and termination of agency contracts.

Regardless of any agreement to the contrary, either party is entitled, on request, to receive from the other a signed written document setting out the terms of the agency contract, including any terms subsequently agreed. Any purported waiver of this right is void.

Where an agency contract is entered into for an indefinite period, it will be possible for it to be terminated by either party giving notice to the other, provided that the period of notice is one month for the first year of the contract, two months when the second year of the contract has commenced and three months when the third year has commenced and for subsequent years of the contract. The parties may be able to agree on a longer period of notice. However, that period may not be shorter for a principal than his agent. Unless otherwise agreed by the parties, the end of a notice period must coincide with the end of a calendar month.

Where an agency contract is entered into for a fixed period, but continues to be performed by both parties following the expiry of the fixed period, it will be deemed to be converted into a contract for an indefinite period. The fixed period will have to be taken into account when calculating the period of notice.

An agency contract may be terminated immediately under the general law, because of the failure of one party to carry out all or part of his contractual obligations or where exceptional circumstances arise.

A key feature of the regulations is the entitlement of the agent to an indemnity **or** compensation for the damage suffered as a result of the termination of the agency contract. Arguably this applies to the expiry of a fixed term contract as well as to one for an indefinite period.

The agent will only be entitled to an indemnity if there is a provision to that effect in the agency contract. If there is not, the right to compensation applies.

The agent's entitlement to an indemnity will arise if and to the extent that:

- he has brought the principal new customers or has significantly increased the volume of business with existing customers. In addition the principal must continue to derive substantial benefits from the business with such customers (although the regulations do not make it clear whether these are new or existing customers); and

- payment of an indemnity is equitable having regard to all the circumstances and, in particular, the commission lost by the commercial agent on the business transacted with such customers.

The regulations cap the amount of the indemnity so that it cannot exceed a figure equivalent to one year calculated from the agent's average annual remuneration over the preceding five years or a shorter period if the agency contract has been in existence for less than five years.

The language of the regulations in respect of the indemnity is such that it is uncertain as to whether the principal can look to see whether the agent has mitigated his loss or has failed to perform. In addition the regulations provide that the grant of an indemnity will not prevent the agent from seeking damages. Where the agency contract is terminated by the principal, the principal will be liable to pay compensation to the agent for the damage he suffers as a result of the termination of his relations with his principal.

In particular damage shall be deemed to occur when the termination takes place in circumstances which:

- deprive the agent of the commission which proper performance of the contract would have procured for him, whilst providing his principal with substantial benefits linked to the activities of the agent;
- have not enabled the agent to amortise the costs and expenses incurred by him in performance of the agency contract on the principal's advice.

The regulations do not lay down rules for the calculation of compensation. As a result, there have been a large number of decisions seeking to establish rules for its calculation. These decisions culminated in a decision of the House of Lords (as it then was) in 2007 *Lonsdale v Howard & Hallam*. In this decision, the court held that under the regulations the damage in respect of which an agent is entitled to be compensated on termination was the loss of the value of the agency, including the goodwill attaching to it, on or immediately prior to termination.

The decision encourages agents to instruct accountants to produce a valuation of the agency, to be prepared on the basis that agency is being sold to a hypothetical third party purchaser. It is clear from the decision in *Lonsdale v Howard & Hallam* that an

agency will have a much lower value if the principal's business is in decline at the time of termination of the agency. This is on the basis that a prospective purchaser of the agency would be unlikely to wish to pay a large amount of money for the business if sales (and so commission levels) are likely to decline in the future. In contrast, if the principal's business is buoyant at the time of termination of the agency, the value of the agency to a prospective purchaser is likely to be greatly enhanced.

An indemnity or compensation will also be payable if the contract is terminated by the commercial agent as a result of any breach of contract by the principal or on the grounds of the agent's age, infirmity or illness, including death of the agent.

However, an indemnity or compensation will not be payable if the principal has terminated the agency contract out for breach by the agent justifying immediate termination. Similarly if the agent has assigned his rights and duties under the agency contract to another person with the principal's consent.

In order to obtain an indemnity or compensation, an agent has to notify his principal within one year of the termination.

The parties cannot contract out of the provisions in respect of an indemnity or compensation before the contract expires.

7. Restraint of Trade

A restraint of trade clause in an agency contract restricting the right of the commercial agent to act as such following its termination will be valid only if and to the extent that:

- it is in writing;
- it is limited to a two year period;
- it relates to the geographical area, customers and the kind of goods covered by the agency under the contract.

8. The Future

The European Council anticipated that there might be some uncertainty in implementing some of the provisions, in particular those concerning the compensation on termination of the agency contract. This has been apparent in the many, often conflicting decisions made to date. More information about the decisions that have

been made so far and the particular application of the regulations to agents and their principals is available in our briefing notes available on www.agentlaw.co.uk.

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9. Fox Williams LLP

Fox Williams LLP is an independent business law firm based in the City of London. We have a strong reputation for our core practice areas of corporate, employment, dispute resolution, commerce & technology, property and partnership. Operating as business partners with our clients, we have built a solid reputation for advising on complex legal and regulatory issues in our core areas of expertise. A distinguishing feature of Fox Williams LLP is that it is often first choice for referrals of work from other law firms when City expertise is required.

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We adopt a particular approach to our work, which involves making a special effort to understand the business needs of our clients, and delivering a fast, responsive service.

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