



Commercial agents Ending the relationship

Companies feeling the squeeze may consider terminating their contracts with commercial agents. However, this may prove an unexpectedly expensive exercise, even if done under contract. This is because commercial agents are protected above and beyond their contract terms by the Commercial Agents Directive (86/653/EEC) (the Directive) (implemented in Great Britain by the Commercial Agents (Council Directive) Regulations 1993 (SI 1993/3053) (GB Regulations)).

Why the termination trend?

The global downturn may lead to the termination of commercial agency contracts, and therefore an increase in related claims, for various reasons:

- A principal may decide to undertake its agents' roles itself, using staff surplus (and avoiding redundancies) and saving on commission payments. Its agents may already have compiled a substantial customer base which it can tap into.
- If a principal supplies a number of territories, it may decide to stop supplying those territories suffering most from the downturn and terminate the relevant agency contracts.
- A company may acquire a struggling business and try to increase margins by ceasing to use the target's agents in territories where the acquiring company already has a presence.
- A principal may reduce the number of territories in which its agents operate: this may induce the agents to terminate their contracts.

Regulatory protection

A commercial agent is a self-employed intermediary with continuing authority to negotiate the sale or purchase of goods on behalf of its principal, or to negotiate and conclude such transactions on behalf of and in the name of that principal (*regulation 2(1), GB Regulations*).

Such an agent is entitled to a compensation or indemnity payment on the termination of its contract by the principal for any reason other than a default of that agent justifying immediate termination. Crucially, this entitlement applies even if the principal terminates by notice under the contract.

An agent is also entitled to such a payment if it justifiably terminates on the basis of circumstances attributable to the principal, or if its contract is for a fixed term and comes to an end by effluxion of time (*regulations 17 and 18*).

Importantly, the parties cannot, before the agency contract expires, derogate from the payment entitlement to the detriment of the agent (*regulation 19*) (see box "The policy behind the protections").

Whether the agent is entitled to compensation or an indemnity depends on which EU member state's regulations apply. Under the GB Regulations, an agent will receive compensation unless the contract specifies entitlement to an indemnity (*regulation 17(2)*).

Compensation. This is designed to compensate for damage suffered as a result of a termination that both:

- Deprived the agent of commission which "proper" performance of the agency contract would have procured.
- Did not enable the agent to amortise costs and expenses it had incurred (*regulations 17(6)-(7)*).

So the emphasis is on loss suffered by the agent resulting from the termination (ignoring arguments that nothing was lost since the contract ended in accordance with its terms).

How compensation is quantified varies from one member state to another. The French courts tend to award around two years' commission. The English courts have dismissed any such "rule of thumb" and, until recently, based awards on various factors. Their approach has now changed following the groundbreaking decision in *Lonsdale (t/a Lonsdale Agencies) v Howard & Hallam Limited* ([2007] UKHL 32). The House of Lords ruled that the compensation should instead be quantified by asking what a willing buyer able to perform the contract would reasonably have paid, at the date of termination, for the rights the agent had been enjoying (see *News brief "Compensating commercial agents: real-world value"*, www.practicallaw.com/5-374-1964).

Indemnity. This is designed to reflect the extent to which:

- The agent brought the principal new customers, or significantly increased existing business, from which the principal continues to derive substantial benefits.

- Such a payment is equitable having regard to all the circumstances, including related lost commissions (*regulation 17(3)*).

In contrast to compensation, an indemnity focuses on the degree to which the principal has gained and continues to benefit post-termination from the agent's work (rather than on what the agent has lost). Quantification methods again vary from one member state to another: in England, there remains considerable uncertainty.

In all cases, an indemnity (unlike compensation) is capped at one year's average annual remuneration over the last five years (or over the duration of the contract, if shorter) (*regulation 17(4)*).

Grant of indemnity payments does not prevent the agent from seeking damages (*regulation 17(5)*). There is no equivalent provision for compensation, and it has been a matter of debate as to why that is, and the effect (if any) of its absence.

Options for the principal

It is not all bleak news for principals attempting to terminate agency relationships in the EU. Numerous arguments can be deployed when seeking to avoid the regulatory protections or to negate or minimise payouts. Also, many issues are still riddled with uncertainty; something which a principal can use to its advantage in settlement negotiations.

Definition of commercial agency. The principal may be able to show that:

- The "agent" was in fact an employee.
- The authorised role of the agent was not as the regulations require (according to the English courts, broadly a continuing authority either to negotiate and sell on behalf of the principal, or to actively promote or market, possibly coupled with the actual facilitation of transactions (*Parks v Esso Petroleum Company Ltd* [2000] Eu LR 25; *Tamarind International Ltd & Others v Eastern Natural Gas (Retail) Ltd & Another* [2000] Eu LR 708)).

- The contract concerned the supply of the principal's services, not goods, and so is not covered by the GB Regulations (*Gailey v Environmental Waste Controls* [2004] Eu LR 424; *Tamarind International*). However, the equivalent in other member states (for example, France) may cover such contracts too (although they were not required to do so by the Directive).
- The contract is one of distributorship, not agency (*AMB Imballaggi Plastici SRL v Pacflex Ltd* [1999] 2 All ER (Comm) 249; *Mercantile International Group v Chuan Soon Huat Industrial Group Ltd* [2002] 1 All ER (Comm) 788).

Scope of EU protections. A principal might argue that the relevant connection(s) with the EU required to trigger the regulations are not met.

Scope of agent's activities. It may be that only some of the agent's activities fall within the relevant regulations; for example, if the contract concerns the supply of goods and services, or only some of the agent's activities have requisite EU connection(s).

Failure to claim. An agent will be unable to claim a post-termination payment if, within one year following termination, it fails to notify the principal of its entitlement (*regulation 17(9)*).

Capped payment. If a principal is to make an indemnity payment, it can take some comfort from the fact that the payment will be capped, thereby setting the parameters for any claim or negotiation. This is often seen as an advantage of having expressly stated, in a contract subject to the GB Regulations, that an indemnity, rather than compensation, will be payable on termination.

Economic circumstances. A principal may even be able to draw on the "doom and gloom" of the economic downturn to minimise the quantum of any payments. So, if the reason for termination was that there was no longer a demand for the goods in the agent's territories, the principal may argue that:

The policy behind the protections

The protections under the Commercial Agents Directive (86/653/EEC) were introduced to redress a perceived imbalance of power between commercial agents and principals. In the UK, this was a considerable departure from both the common law principle of freedom of contract and the idea that liability under a contract flows only from breach.

The rules still come as a surprise to many UK companies, which commonly consider their commercial agents to be more than capable of negotiating contracts that adequately protect their interests. The idea that such agents may benefit from protections over and above their negotiated contract terms is also completely alien in other common law jurisdictions, such as the US. Consequently, entities based in those countries but marketing and selling worldwide often come unstuck when engaging agents in the EU.

- Any indemnity payment should be nil or insignificant, since the principal will not continue to benefit substantially from the agent's activities and/or a contrary order would not be equitable.
- Following *Lonsdale*, any compensation payment ordered by an English court should be minimal, since the rights enjoyed under the agency contract would have minimal worth.

However, such arguments will not be available if the commercial agent's sales remained considerable, and the termination was instead designed to allow the principal (or a company acquiring it) to reduce costs.

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