Termination payments for commercial agents clarified

In 1993, the Commercial Agents (Council Directive) Regulations were made in order to implement in the UK the European Council Directive of 1986 on the law relating to commercial agents. The Directive and the European Regulations, and subsequent case law define commercial agents as individuals or companies which have continuing authority to negotiate the sale of goods for a principal or principals. Commercial agents cannot be employees – they are independent contractors. Commercial agents are also distinct in law from distributors. Distributors purchase product and resell it. Agents solicit custom for direct sales by their principals to the customer.

The Directive and UK Regulations provide important rights for commercial agents, some of which may not be contracted out of. The most notable right is for the agent to receive a compulsory payment on termination of the agency agreement. This right applies on any termination other than where (i) serious breach by the agent justifies immediate termination by the principal or (ii) the agent chooses to terminate for his own reasons. So a termination payment is triggered at the expiry of a fixed term contract, on termination by the principal on contractual notice, on the retirement of the agent due to age or ill health, on the death of the agent or on termination by the agent due to circumstances attributable to the principal. A provision in an agency contract that the agent will not be entitled to a termination payment is invalid. (In addition to a termination payment, the agent is entitled to notice or payment in lieu and to commission on orders made prior to termination and for a reasonable period afterwards).

The UK Regulations give a choice of two methods of calculation of termination payments. Under the indemnity method, the agent is essentially paid for the goodwill he has created over the term of the contract for his principal. By law, the indemnity cannot exceed one year’s average commission. If the parties do not opt in writing for this method, the compensation method applies as the default option. Under this method, the agent is compensated on termination for loss of the agency. It is the calculation methodology for the compensation option which has been clarified by the English House of Lords in Lonsdale v Howard & Hallam.

The key points clarified by the House of Lords (and which the House of Lords has declined to refer to the European Court of Justice) are:

- the agent's entitlement to compensation on termination of an agency contract is in an amount which is equal to the value of the agency at termination, or in other words, the amount a third party would be prepared to pay for the transfer of the agency to him on the basis that the agency would continue in accordance with its current terms
- the judgment also states that where the agency is terminated because the principal is closing down the relevant business, no compensation should be paid because the value of the agency would then be nil.
- the agent's entitlement to compensation on termination is in an amount which is equal to the value of the agency at termination, or in other words, the amount a third party would be prepared to pay for the transfer of the agency to him on the basis that the agency would continue in accordance with its current terms
- where the agent is not under a post termination non-compete obligation, the value of the agency to a hypothetical third party buyer, and therefore the amount of compensation, should be reduced.
- the value of the agency and therefore compensation should be determined in accordance with net, not gross commission
- given that the agent will be the claimant of any compensation payment, it is for the agent to prove, if necessary by independent valuation, the value of his agency.

Prior to Lonsdale, most principals had preferred to include an election for the indemnity in agency contracts, given the certainty of the one year commission cap mentioned above. Many agents had also been content to accept this as a reasonable valuation method. Until some further case law develops demonstrating the implementation of the valuation method provided for in Lonsdale, both principals and agents may well be likely to continue to prefer the relative certainty of the indemnity method. In the short to medium term, the Lonsdale judgment is also likely to promote settlement of claims made by agents following termination of an unwritten contract, or of one which does not contain an election for the indemnity (in other words, where the compensation method applies). Agents may be deterred from litigation by the additional expense and trouble of having to obtain a professional valuation of the hypothetically continuing agency.

Antitrust, Competition, Regulatory Litigation & EU Law

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