

LICENSING YOUR PRODUCT-3 TERMINATION OF AGENCY AGREEMENT

By
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In the last issue I touched briefly upon termination of an agency agreement. You may recall that principals appoint commercial agents to license their goods and this is governed by the Commercial Agency Regulations (“the Regulations”). In this article, I provide an overview on the legal issues surrounding the termination of an agency agreement. In any commercial arrangement, parties regularly terminate agreements. However, in agency arrangements the agent would be entitled to ‘compensation’ or an ‘indemnity’ (except in certain circumstances), when a principal terminates the agreement, writes Dr Rosanna Cooper.

Introduction

Termination of an agency arrangement is a complex area and principals must ensure that they get it right. It is important to know under what circumstances ‘compensation’ or an ‘indemnity’ would be payable to an agent.

Compensation

An agent is entitled to compensation “*for the damages he suffers as a result of termination of relations with the principal.*” The agent’s entitlement to damages arises in circumstances where the agent has not been paid commission or has been unable to recover reasonable costs and expenses incurred in the performance of the agency agreement. There is no maximum amount of compensation payable to an agent.

What level of compensation is payable?

The benchmark for the level of ‘compensation’ that can be awarded **is the equivalent of the last two years’ total gross earnings**. This can amount to thousands of pounds payable to an agent if the principal has not got it right and may put a principal in financial difficulties. Unlike employment cases, the agent is not required to mitigate his losses. However, the courts have been moving away from awarding agents such high levels of ‘compensation’. In some recent cases the courts have held that awarding two years’ gross commission would result in an injustice to a principal and an excessive windfall to the agent (in some cases way above the value of the agency). The courts will **now** take into account the non-exhaustive list of factors below in assessing the level of ‘compensation’ payable to an agent:

- the period of the agency as provided for in the contract
- the actual duration of the agency up to termination
- the terms and conditions of the agency agreement
- the nature and history of the agency and the market in question
- the nature of the client base and the kind of contracts (‘one-off’ or repeat business, for example)
- whether the appointment by the principal was exclusive or non-exclusive
- whether the agent had agreed not to handle competing products or not to act for other principals
- whether or not there was a post termination restriction on the agent
- the reasons for the termination
- the financial contributions of the agent and principal to the goodwill of the agency during its life
- the extent of any losses caused by breach of contract or breach of duty

Despite the fact that the level of compensation payable to an agent may be reduced when the above factors are considered, principals must still adopt risk management measures such as putting in place well drafted agreements when appointing agents.

Indemnity

An agent’s entitlement to indemnity on termination arises where:

- the agent has brought the principal new customers/significantly increased the volume of business with existing customers, to which the principal continues to benefit substantially; and
- the payment of indemnity is 'equitable' having regard to all circumstances and, in particular, any commission lost by the commercial agent from contracts generated with such customers.

The maximum amount an agent can receive from an indemnity is **capped** at one year's commission (taking the agent's average annual remuneration over the five years prior to termination or the whole life of the agreement if shorter). The grant of an indemnity to an agent does not prevent the agent also seeking damages and such damages can normally arise in two circumstances where:

- the principal deprives the agent of commission which "proper performance" of the contract would have given him (whilst providing "substantial benefits" linked to his activities); or
- the principal has not given the agent the chance to absorb the reasonable costs and expenses that he had incurred in performance of the agency contract (on the principal's advice).

An agent has to notify the principal of his intention to bring a claim for indemnity or compensation within one year of termination of the agreement.

As principal, you must agree with the agent the basis upon which an agent would be paid in the event of termination before entering into such arrangements (assuming the agent would be entitled to payment).

When does the right to compensation or indemnity arise?

The right to compensation or indemnity arises in several circumstances where:

- an agency agreement for a fixed term expires;
- the agent retires;
- the principal terminates because of the agent's serious illness;
- the agent dies;
- the principal assigns the agency agreement;
- the principal terminates without any breach by the agent;
- the principal terminates because the agent made an incidental breach and the breach does not justify termination;
- the agent terminates because of circumstances attributable to the principal;
- the principal terminates because the agent is insolvent or has gone into liquidation or administrative receivership; or
- the agency agreement terminates because of force majeure (things outside his control such as act of god).

When is commission payable?

Commission is payable to an agent usually as a percentage of the net invoice price of the products sold through the agent or of the cash received by the principal from those sales. A lower commission may also be granted in respect of sales made by the principal to customers in the agent's territory which were not concluded through the agent.

Commission on transaction payable during the term of the agreement

An agent is entitled to commission payable on transactions **concluded during the agency contract**. The agent is entitled to commission from such transactions concluded:

- as a result of the agent's action;
- with a third party whom the agent had previously acquired as a customer for transactions "of the same kind"; or

- with a customer ‘belonging’ to any specific geographic area/ group of customers to which the agent has been given an exclusive right under the agency agreement.

When is the meaning of a transaction ‘concluded’ for this purpose?

This almost certainly means when the sale contract between principal and customer is made i.e. when an order is placed.

What is the meaning of ‘As a result of the agent’s actions?’

It may be difficult for an agent to prove that a transaction was concluded as a result of his actions i.e. whether the agent single-handedly ‘brought in’ new customers or whether the agent had contributed to a joint initiative between the principal and agent, for example, by contacting customers on a list given to him by the principal.

Commission on transaction concluded after the agency contract is terminated

An agent would be entitled to commission on **transaction concluded after his agency agreement is terminated** if either:

- the transaction is “*mainly attributable*” to the agent’s efforts (during the period of the agency agreement) and the deal was entered into ‘*within a reasonable period*’ after the agency contract terminated; or
- the order of the customer reached the agent or the principal prior to termination of the agency agreement but the order was only accepted after the agency agreement had been terminated (always assuming that, if the agreement had not been terminated, commission would have been payable to the agent).

In order for commission to be payable both requirements ‘*mainly attributable*’ and ‘*within a reasonable period*’ have to be satisfied.

‘Mainly Attributable’

The term ‘mainly attributable’ means there is a link between the agent’s activities and the principal placing the order.

What has to be established in order for an agent to successfully claim ‘compensation’ or an ‘indemnity’?

If an agent is claiming ‘compensation’ or an ‘indemnity’ through the courts, the principal would have to produce sales records as a result of transactions before termination of the contract to determine whether or not they were attributable to the agent in anyway.

Conclusion

Principals should take steps to protect their businesses because making a claim for ‘indemnity’ or ‘compensation’ does not stop an agent’s entitlement to commission already earned.

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