

# Agency Contribution: UNITED KINGDOM



Stringer Saul





# 1 Introduction

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## *English Law Chapter*

**Before** 1994, there was little case law in England and Wales dealing with the conduct of agents. Of the small amount that there was, most tended to deal with protection of principals rather than agents (on the basis that principals could in certain circumstances be bound by the acts of their agents even if such acts were beyond the scope of their authority).

Prior to implementation of the Commercial Agents Directive, entitlement to damages or compensation at the end of an agency agreement was a matter of contract. Damages for termination for breach of contract were payable (in the same way as for any other contract or relationship) but contractual limitations and exclusions were enforceable – subject to legislation relating to unfair contract terms.

This area of law remains fluid and subject to change. There have been a number of important cases in the past year alone, one at which at least is subject to further appeal.

A note on the laws of the United Kingdom

The United Kingdom has three separate legal jurisdictions: England and Wales; Scotland; and Northern Ireland. Subject to certain (mainly domestic) areas devolved to regional parliament and assemblies, legislation is made by Parliament in London, which applies to one or all jurisdictions. Legislation may be primary (statute, or Acts of Parliament) or secondary (statutory instruments, or Regulations – not to be confused with Council Regulations). Regulations are often used to implement or clarify particular aspects of primary legislation and can be used to give flexibility to such legislation (for instance sentencing tariffs could be

# 1. Introduction

changed by Regulation) and are also used, as in the case of the subject of this chapter, to implement EC Directives into domestic law. As with other member states, domestic legislation implementing a particular EC Directive must be construed in such a way as to give effect to that Directive<sup>1</sup>.

The jurisdictions within the United Kingdom are common law jurisdictions and therefore case law of the courts is itself a source of law. Case law primarily interprets legislation and such interpretation becomes binding unless and until overruled by a decision of a higher court. In England and Wales first instance decisions are appealable to the Court of Appeal with permission. The Court of Appeal may, after giving judgment, give permission for appeal to the House of Lords, which is the highest court of England and Wales (although there may be rights of further appeal to European courts).

While legislation may cover more than one jurisdiction (for example, Scotland together with England and Wales), case law of one jurisdiction does not bind the courts of another. For example, decisions made by the Scottish courts do not bind the English Courts, although one jurisdiction may look to another's case law for guidance. This can lead to the same piece of legislation being interpreted differently in different jurisdictions within the United Kingdom.

The Directive was not implemented in Northern Ireland by the Regulations (as further described below) but was implemented separately. Therefore, for ease of reference, the term "United Kingdom" or "UK" is used in this chapter to mean England, Wales and Scotland. However, this chapter does not purport to reflect the law except insofar as it applies in England and Wales.

The law is stated as at 29 August 2006.

<sup>1</sup>*Litster v Forth Dry Dock & Engineering Co. Ltd (1990) 1 AC 546*

## 2 Indemnity and/or compensation



**Direc**tive 86/653/EEC was implemented into UK law on 1 January 1994 by The Commercial Agents (Council Directive) Regulations 1993 (SI 1993/3053)<sup>2</sup> as amended by SI 1993/3173<sup>3</sup> (a minor correction to Regulation 18) and SI 1998/2868<sup>4</sup> (amending the provisions relating to territorial scope) (“the Regulations”). The Regulations apply to all qualifying agency arrangements whether or not they were entered into after 1 January 1994 and are therefore retrospective.

<sup>2</sup> [http://www.opsi.gov.uk/si/si1993/Uksi\\_19933053\\_en\\_1.htm](http://www.opsi.gov.uk/si/si1993/Uksi_19933053_en_1.htm)

<sup>3</sup> [http://www.opsi.gov.uk/si/si1993/Uksi\\_19933173\\_en\\_1.htm](http://www.opsi.gov.uk/si/si1993/Uksi_19933173_en_1.htm)

<sup>4</sup> <http://www.opsi.gov.uk/si/si1998/19982868.htm>

## 2 Indemnity and/or compensation

The Regulations follow closely the layout of the Directive. A broad summary of the structure of the Regulations is set out below:

### Part I *General*

**Regulations 1 and 2** Commencement, applicable law, interpretation, application and extent.

### Part II *Rights and Obligations*

**Regulations 3 to 5** Respective duties of agent to principal, principal to agent and prohibition on derogation therefrom (corresponding to Articles 3 to 5 of the Directive).

### Part III *Remuneration*

Each Regulation in this part corresponds to the Article of the Directive with the corresponding number.

### Part IV *Conclusion and Termination of the Agency Contract*

Each Regulation in this part corresponds to the Article of the Directive with the corresponding number save as set out below.

**Regulation 15** – Minimum periods of notice for termination of agency contracts (fixed at a maximum of three months – the UK did not opt to have longer notice periods as permitted by Article 15(3) of the Directive).

**Regulation 17** – Regulation 17 (1) provides for the entitlement of the commercial agent to an indemnity or compensation on termination of agency contract. Regulations 17(3) to 17(5) set out the position in relation to the entitlement to an indemnity. Regulations 17(6) to 17(7) set out the position in relation to the entitlement to compensation. See further below.

**Regulation 18** – Grounds for excluding payment of an indemnity or compensation under Regulation 17. See further below.

**Regulation 19** – Prohibition on derogation from Regulations 17 and 18.

## 2 Indemnity and/or compensation

### Part V **Miscellaneous and Supplemental**

**Regulations 21 to 23** – Disclosure of information, service of notices etc and transitional provisions.

The UK is unique within the EU in that Regulation 17 provides that the parties have the choice of entitlement to an indemnity or to compensation upon termination of an agency relationship. In the absence of a specific contractual provision on this point, the default position is that the agent will be entitled to compensation.<sup>5</sup> Therefore, it is almost certain that all agency agreements entered into before the Regulations came into force provide the agent with an entitlement to compensation. It may well be the case that since the Regulations came into force, relatively few agreements specifically elect for an indemnity. This may be because it was considered that compensation would be cheaper for the principal than compensation, see below.

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<sup>5</sup> Regulation 17(2)



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## 3 Scope of regulations

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### *Circumstances in which an agent is not within the Regulations*

**Before** considering the specific circumstances in which a commercial agent may claim either compensation or an indemnity, it is worth summarising the various situations in which the Regulations will not apply at all, as follows:

1. Genuine distributors (looking at the form of the relationship, rather than what it is called) are excluded from the scope of the Regulations (see section 5 below for further discussion).
2. An agency for the supply of services is excluded from the Regulations.<sup>6</sup> Therefore, it is assumed that travel agents and insurance brokers are not considered to be commercial agents for the purposes of the Regulations. However, mixed supplies (i.e. of both goods and services) are more difficult and it is not clear whether the Regulations would apply to the whole supply or only the supply of the goods. Further, case law has classed supplies of gas and electricity as supplies of goods rather than services.<sup>7</sup>
3. Partners and officers of companies or associations are excluded from the definition of “commercial agents” under the Regulations.<sup>8</sup>
4. Certain “commercial agents” as defined in the Regulations are then excluded from their application: unpaid commercial agents<sup>9</sup>; commercial agents operating on commodity exchanges<sup>10</sup>; Crown agents<sup>11</sup>; and agents whose activities “are to be considered secondary<sup>12</sup>” are all excluded.



### 3 Scope of regulations

#### Secondary Activities

The Directive gives Member States the choice of including within the regime agents whose activities are secondary. Parliament chose to exclude such agents from the Regulations. However, as noted above, the law in relation to agents was not substantially developed prior to the implementation of the Regulations and no consideration had previously been given to what activities might be considered secondary (and indeed secondary to what). The approach taken to resolve this uncertainty was to list in a Schedule to the Regulations factors which establish, or indicate, that the agent's activities are secondary. Unfortunately, some would say the Schedule raises as many questions as it answers and contains factors which do not immediately have a bearing on whether the agency is secondary. Indeed such a view has been expressed by the courts.<sup>13</sup>

#### Sales/Marketing Agents

There has been some debate over whether the Regulations apply to all types of commercial agents. The debate stemmed from the definition of a commercial agent in Regulation 2(1) as “a self-employed intermediary who has continuing authority to negotiate the sale or purchase of goods...” (contentious wording highlighted). It is clear that where the “agent” conducts no negotiation whatsoever, he does not fall within the scope of the Regulations<sup>14</sup>. However, what is the meaning of “negotiate”?

Two types of commercial agent had come to be distinguished: the sales agent (widely considered to mean an agent who negotiates a sales contract on its principal's behalf and who may even commit its principal to the terms thereof); and the marketing (or introducing) agent (widely considered to mean an agent who “merely” markets its principal's business, refers orders, or makes introductions). Some had taken the view that the marketing agent, by the nature of its appointment, does not “negotiate” on behalf of its principal and that therefore the Regulations did not apply to him. Certainly, it was common in England and Wales to appoint agents on this latter basis in an attempt to avoid the Regulations. However, an important recent case<sup>15</sup> has adopted a wide interpretation of the word “negotiate” to capture both sales and marketing agents. It stated:

“the purpose of the Directive... was to provide protection to agents by giving them a stake in the goodwill which they have generated for the principal and as a result the courts should avoid a limited or restricted interpretation of the word “negotiate” that would exclude agents who have been engaged to develop the principal's business in this way”

## 3 Scope of regulations

(“This way” being “effecting crucial introductions” and “playing a significant role in persuading the contractor to be interested in the [principal’s] products”.)

This case clearly focused on whether the agent had contributed to the goodwill of the business, rather than the scope of the agent’s duties, when considering whether the Regulations applied. This was a first instance decision before the High Court and may be subject to appeal.

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<sup>6</sup> Regulation 2 (1)

<sup>7</sup> *Tamarind International Ltd and others v Eastern Natural Gas (Retail) Ltd and Eastern Energy Limited* [2000] CLC 1397

<sup>8</sup> Regulation 2(1)(i) and (ii)

<sup>9</sup> Regulation 2(2)(a)

<sup>10</sup> Regulation 2(2)(b)

<sup>11</sup> Regulation 2(2)(c)

<sup>12</sup> Regulation 2(3)

<sup>13</sup> *AMB Imballagi Plastici SRL v Pacflex Limited* [1999] 2 All ER (Comm) 249

<sup>14</sup> *Parkes v Esso Petroleum Co Ltd* [1999] CMLR 455

<sup>15</sup> *PJ Pipe and Valve Co Ltd v Audco India Ltd* [2005] EWHC 1904 (QB)

## 4 Conditions of Indemnity and/or compensation

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Entitlement to compensation or an indemnity upon termination or cessation of an agency agreement is in addition to, and not instead of, other entitlements provided by the Regulations; i.e.

- a. commission on transactions concluded as a result of the agent's efforts<sup>16</sup> during the period of the agency contract – including commission during the notice period imposed by the Regulations<sup>17</sup> (or a corresponding amount payable by way of damages where such notice period has not been observed),
- b. commission on transactions concluded within a reasonable period after the termination date which were mainly attributable to the agent's efforts<sup>18</sup> or where an order was received by the principal prior to termination but not accepted until after<sup>19</sup>,
- c. a share of an incoming agent's commission where it is equitable in the circumstances to receive the same<sup>20</sup>.

## 4 Conditions of Indemnity and/or compensation

In addition, there may also be common law remedies available to the agent which are separate and distinct from those provided by the Regulations (if, for instance, the termination constitutes a breach of contract).

A commercial agent can claim compensation (or where specified in the agreement, an indemnity) under the Regulations in the following situations:

**1** Where the principal terminates the agency prior to the end of its contractual term.

The exception to this is that no compensation/indemnity will be due where the principal terminates for breach or failure by the agent, where such breach or failure would justify summary termination at common law. Crucially, this exception does not apply if the principal merely allows the agreement to expire because of a breach by the agent (based on a strict interpretation of Regulation 18(a) which refers specifically to “termination<sup>21</sup>”).

**2** Where the principal allows an agency agreement to expire by not renewing it on its terms.

For these purposes, and unlike the situation referred to above under Regulation 18(a), “termination” for the purposes of Regulation 17 includes expiry.<sup>22</sup>

**3** Where the agent dies.<sup>23</sup>

An agent cannot claim compensation (or where specified in the agreement, an indemnity) under the Regulations in the following situations:

**1** The agent terminates the agreement himself.

This in itself is subject to exceptions. Entitlement to compensation (or where applicable indemnity) is not lost where:

- a** the agent terminates because of “circumstances attributable to the principal”; or
- b** where termination is justified on the grounds of age, infirmity or illness of the agent in circumstances where he cannot reasonably be expected to continue his activities.<sup>24</sup>



## 4 Conditions of Indemnity and/or compensation

- 2 As above, where the principal terminates due to breach or failure of the agent.
- 3 The agent assigns the agency business with the agreement of the principal.<sup>25</sup>
- 4 Where the agent is time barred.

Regulation 17(9) provides that the agent loses his entitlement to an indemnity or compensation if he has not notified his principal that he intends pursuing his entitlement within one year following termination of his agency contract. This wording falls short of requiring the agent to actually issue proceedings; mere notification which would convey to an “objectively reasonable” reader that the agent intends to claim under the Regulations is sufficient to preserve his position – whether or not he specifies that such claim will be for compensation or indemnity<sup>26</sup>

While a number of entitlements under Regulations 7, 8, 9 and 10(1) are generally considered to be not mandatory and therefore capable of being contracted out of to the agent’s detriment, it is not possible to avoid by contract the agent’s entitlement to compensation or to an indemnity.

However, as noted above, the UK allows the possibility, effectively, of the principal “avoiding” the agent’s entitlement to compensation by electing to pay an indemnity instead. Whether or not such a possibility is, in fact, a useful one depends upon which entitlement is actually more beneficial to the agent.

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<sup>16</sup> Regulation 7(1)

<sup>17</sup> Cf Regulation 15

<sup>18</sup> Regulation 8(a)

<sup>19</sup> Regulation 8(b)

<sup>20</sup> Regulation 9

<sup>21</sup> *Cooper, Watkins and Bartle v Pure Fishing (UK) Ltd* [2004] EWCA Civ 375

<sup>22</sup> *Tigana v Decoro Limited* [2003] EWHC 23 (QB)

<sup>23</sup> Regulation 17(8)

<sup>24</sup> Regulation 18(b)

<sup>25</sup> Regulation 18(c)

<sup>26</sup> *Hackett v Advanced Medical Computer Systems Ltd* [1999] CLC 160

## 5 Calculation of indemnity and/or compensation

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**Before** considering how the courts have tackled the calculation of compensation and an indemnity under the Regulations, it should be noted that such terms for the purposes of the Regulations have a different meaning (or nuance) to their meaning in English common law. Traditionally, “compensation” is payable upon breach of contract or duty where damage has been caused. In order for compensation, or damages, to be paid, the breach must be proved, a causal link between the breach and the damage must also be proved, and the claimant is under a duty to mitigate its loss (and therefore the claimant’s actions and prevailing circumstances after termination are relevant). An indemnity, on the other hand, does not give an action in damages but instead is a contractual debt under which the claimant can claim all losses relating to the breach and has no duty to mitigate loss. In either case, there is no restriction on limiting or capping liability except in limited circumstances.<sup>27</sup>

An indemnity under English law is considered to be more onerous on the party giving it than merely risking paying damages for breach. While liability under an indemnity can be capped, the nature of the indemnity and the remedy it is intended to provide means that one would not usually expect a low liability cap. Contrast this with the Regulations, which do not set a cap for compensation but do provide for a relatively low upper cap for payment under the indemnity – see below. Therefore, contrary to the common law position, it came to be considered that the indemnity route was preferable for a principal under the Regulations (although whether this was considered the case at the time of their implementation, when it was agreed that both should be available but that compensation should be the default position in absence of contractual provision, is far from clear).

## 5 Calculation of indemnity and/or compensation

The way in which indemnity or compensation is calculated has recently been considered by the Court of Appeal in *Graham Lonsdale v Howard & Hallam Limited*.<sup>28</sup> (“Lonsdale”). The case is instructive because the court reviewed most of the previous relevant case law (in both England and Wales and Scotland) and provided guidance for calculation in future cases. While this chapter explains the current position after this decision, it should be noted that in June 2006 permission was granted for appeal to the House of Lords which may overrule the Court of Appeal.

### 1 Calculation of Compensation *the position before Lonsdale*

The position in relation to the courts’ approach to compensation prior to this case can be summarised as follows. Firstly, for a considerable number of years the courts had regard to the French system’s “two years (gross) commission rule” in assessing compensation. The first case to refer to it<sup>29</sup> was a Scottish case which has been referred to in cases in England and Wales. It was noted that the French approach was essentially backwards looking (insofar as it took into account only what happened prior to termination) and as such did not appear to provide for mitigation. Further, it was noted that the French approach to compensation is to calculate the value of the goodwill in the agency to a third party purchaser at the date of termination – a concept not really recognised in the UK prior to the Regulations.

While the two years commission rule had been referred to as a benchmark, or starting point, in any consideration of quantum of damages, it was not adopted as a strict “rule” in the UK. Certainly, in some cases, the two years commission approach was specifically rejected or a figure based on net, rather than gross, earnings awarded. In one case,<sup>30</sup> the judge listed fourteen separate (non-exhaustive) factors, which he suggested were likely to require consideration when assessing compensation.

Clearly, a common approach to assessment of compensation had not been consistently applied. However, a number of themes could be discerned. Firstly, in most cases the courts had taken into account the nature and duration of the agency and the commission the agent generated as a basis for assessment of compensation (although a couple of cases did have regard to future earnings potential as a basis for calculation). Secondly, it had been generally accepted that the common law concept of mitigation had no part to play in the exercise (although, as noted in the Lonsdale decision, the basis for such general acceptance was not entirely clear). Thirdly, a “broad approach” had been adopted by the courts when assessing compensation. Fourthly, the courts had proceeded on the basis that they must make an award that is just and equitable in all the circumstances rather than an award that compensates the agent.

## 5 Calculation of indemnity and/or compensation

### The Decision in *Lonsdale*

It was noted in the decision that neither the Directive nor the Regulations give explicit guidance as to the amounts of compensation an agent is entitled to receive. The court considered the previous cases, as above, and decided that the differing approaches to assessing compensation were due to a failure to apply the wording of the Directive and the Regulations.

The court stated that the correct interpretation of Regulation 17(6) (corresponding to Article 17(6) of the Directive) should be that it provides the agent with “a right to receive compensation for any damage he has suffered” rather than to “provide for him to receive an amount that is fair and reasonable in all the circumstances”. This is in marked (and on the wording of the Directive and the Regulations, presumably deliberate) contrast to the entitlement to indemnity, where the relevant provision specifically provides for an indemnity limited in amount if, and to the extent that, a payment is equitable having regard to all the circumstances of the case – see below.

The court held that the damage suffered by the agent for the purposes of the Regulations extends beyond merely damages for breach of contract or duty (for which, as noted above, there are common law remedies in any event) and should be considered in the widest sense. However, the common law approach should not be completely disregarded – and certainly not in favour of a different approach (for example, the French one).

The court considered that the agent’s loss under the Regulations is that of the goodwill attaching to the agency business at the date of termination, and the amount of loss should be calculated accordingly. If, as was indicated in earlier judgements, such goodwill is akin to a species of property, then what the agent does after the agency ends, and any concept of mitigation, would be irrelevant. This is not a concept recognised at common law but would be consistent with a claim being possible under the Regulations upon termination due to old age or infirmity of the agent, and with Regulation 18(c) which prevents an agent bringing a claim upon the sale of its business – as then it would be reasonable to assume he would recover the value of the agency business from the sale proceeds. The court held that losses should not be limited to the value of goodwill, however, and specifically said that compensation should be available also for unamortized expenses the agent has incurred in setting up the agency.

The court specifically stated that compensation should not extend to losses arising from the principal’s wrongful repudiation of the contract.

In calculating the value of the goodwill in the business at the date of termination, the following should be noted:



## 5 Calculation of indemnity and/or compensation

- 1 The state of the principal's business at the date of termination is relevant.

The court grappled with the concept of mitigation and whether it could take into account matters occurring after the agency terminated when considering the agent's loss and it appears that the total disregard of the concept in earlier judgments was not entirely favoured. The court noted that earlier judgments had distinguished the situation under compensation and indemnity, noting that entitlement to an indemnity hinges upon the principal continuing in business (see below) and that there is no such prerequisite for compensation. In the end, the court held that the value of the agency business at the date of termination must be affected by the perception of the way in which the agency business would be likely to develop. Therefore, if the principal's business is in serious decline, or indeed if such business ends, then this should affect the value of the agent's business.

- 2 A purposive interpretation of the Regulations must be made in certain situations; for instance where the agency ends by effluxion of time; i.e. where it simply expires rather than is terminated. In that case, the agent would have nothing to sell and therefore no value in the agency upon which compensation could be calculated. However, case law<sup>31</sup> clearly provides for compensation in such a situation and the court justified this on the basis that while there was no value in any agency business (such business having ended), any value that there had been would upon cessation pass to the principal.

### *The following factors were regarded as irrelevant:*

- 1 The value of benefits obtained by the principal prior to termination.
- 2 The duration and quality of the agent's performance (this would be relevant if the court could consider what would be fair and equitable in the circumstances but as above the court considered that the Regulations did not allow that).
- 3 The French approach and the two year rule – while the court acknowledged that a broad approach is useful to avoid an unnecessary evidential burden on agents seeking to establish loss, the two year rule was rejected on the simple basis that it would allow the court to award compensation wholly unrelated to actual damage suffered. Further, the Directive is a piece of Community legislation in its own right and does not itself reference the French approach nor does it refer to two years.

## 5 Calculation of indemnity and/or compensation

4 Any specific terms of the agency – for instance whether it was exclusive, the nature of the market, and the manner of termination. Again these would be relevant if considerations of fairness and equity applied.

The court's emphasis on the state of the principal's business at termination and the disregard for the years of service provided by the agent (and the commission it received during those years) is an important shift in the approach to calculating compensation. By way of illustration, in *Lonsdale* the agency was terminated when (the evidence suggested) the principal's business was in serious decline. The agent had received annual commission of around £18,000 five years prior to termination, dropping to around £7,000 in the year of termination. The principal paid the agent £7,500 and the agent claimed a further £19,000 in total. The first instance judge awarded only £5,000 and the Court of Appeal therefore did not consider this to be unreasonably low given the circumstances. It considered that the duration of the agency (13? years) was not necessarily an important factor.

The court expressly acknowledged that expert evidence might be needed in the future when assessing compensation.

## 2 Calculation of an Indemnity

In contrast to the situation with respect to compensation, the approach to calculating an indemnity is relatively straightforward, in no small part due to the clarity in the Regulations. They state that the agent is only entitled to an indemnity where he has brought the principal new customers or has significantly increased the volume of business from existing customers and (importantly) where the principal continues to derive substantial benefits from such business<sup>32</sup> (the provision relied upon to distinguish the treatment of post-termination events when considering entitlement to compensation) and where the payment is equitable having regard to all the circumstances (particularly taking into account the commission lost by the agent).<sup>33</sup>

Crucially, the Regulations provide that the indemnity is capped at an amount equal to the agent's average annual commission over the previous five years (or shorter period if the agency does not go back that far).

The leading case for the calculation of indemnity is *Moore v Piretta*<sup>34</sup>. The court considered what the phrase "brought the principal new customers" meant and the extent to which those new customers arrived at the principal's door as a result of the work of the agent. It held that the agent's involvement need not be substantial in order to be entitled to an indemnity.

## 5 Calculation of indemnity and/or compensation

When it came to calculating the indemnity, the court considered the amount of commission the agent would have received had the relationship continued, referring to sales made by the principal to customers whom the agent had introduced, together with sales to customers whose sales the agent had increased in the period from the termination of the agency to the date of trial. The court then deducted the expenses the agent would have incurred to achieve such commission and then made a further deduction (in this case 8%) to reflect the fact that there would be an accelerated lump sum payment. The resulting figure exceeded the cap of one year's average commission and therefore the award was reduced to that figure. It should be noted that this method of calculating an indemnity is not the approach usually taken in the UK courts. Also, although the court referred to the German approach, it does not in fact reflect that approach.

### 3 Summary

As should be clear from the above, the case of *Lonsdale* has changed the way in which entitlement to compensation is to be approached in the future. As stated above, however, it is subject to appeal to the House of Lords whom apparently anticipate referring questions to the European Court of Justice as they have asked the parties to seek to agree questions to be referred to it. Therefore the approach to assessing compensation is far from settled. Given that continued uncertainty, it is very difficult to provide clear guidance as to how compensation will be calculated and it may well be advisable from a principal's point of view to insist upon an indemnity provision to have relative certainty and a relatively low cap.

## 6 Indemnity and/or compensation for distributors and franchisees

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**The** Regulations apply to agents only; not distributors or franchisees. There is no regime similar to that contained in the Regulations for the protection of distributors or franchisees in the UK. The distinction is (relatively) clear in English law. In an agency arrangement, the supplier instructs the agent to seek business on its behalf – either by way of introducing third party customers to it or by allowing the agent to actually negotiate and conclude terms. Any resulting sales contract with a third party customer is made with the principal, not the agent, and title in any product sold passes from the principal to the customer. The agent has no contractual relationship with the third party (but may, for the sake of completeness, have liability to both the principal and the third party in certain situations).

In a distribution or franchise arrangement, the supplier contracts with and sells product to the distributor, to whom property in the product passes. The distributor or franchisee then makes an onward sale to the third party customer. In this case, the seller has no contractual relationship with the third party (although again, for the sake of completeness, it may have other liability to the third party, for instance product liability).

Commercial considerations aside, the legal advantage for the supplier in appointing a distributor rather than an agent is obviously that the Regulations do not apply – the distributor must look to common law or the contract to enforce its rights. The disadvantage, from a legal perspective, of a distribution arrangement is that Article 81(1) of the EC Treaty (and corresponding domestic competition law governing agreements) will apply to their relationship, being an agreement between undertakings. An agency relationship does not fall within Article 81(1) and corresponding domestic legislation because the agent and the princi-



## 6 Indemnity and/or compensation for distributors and franchisees

pal are regarded for such purposes as the same entity and therefore their relationship does not constitute an agreement between undertakings. As such, a supplier may impose restrictions on its agent that it would not be able to impose on its distributor.

As the distinction is so important, inevitably the question of whether a party is an agent or not has come before the Court of Appeal twice. However, as the distinction is quite clear in the UK, the cases have either been fairly straightforward (the first case) or unusual on their facts (the second case).

In *AMB Imballaggi Plastici SRL v Pacflex Limited*<sup>35</sup>, AMB offered Pacflex the choice of being either a distributor or agent. The arrangement they entered into was unwritten and a dispute arose as to which role, in fact, Pacflex had chosen. The Court of Appeal held that it had chosen to be a distributor. Two factors were paramount in making this decision: firstly, the goods in question were offered to Pacflex on a sale or return basis (as above, title to goods does not pass to an agent); and secondly, nothing in the arrangement gave any indication that Pacflex had the authority to act on behalf of AMB.

In the second case<sup>36</sup>, a Singaropean manufacturer of timber contracted with a seller of timber to retailers in the UK. The manufacturer confirmed each retailer's order to the seller before a contract was entered into and the manufacturer was stated to be a party to every such contract. One might therefore consider such facts as indicative of an agency arrangement. However, the manufacturer relied on two important aspects of its relationship in arguing that it was, in fact, a distribution arrangement. Those aspects were that the manufacturer quoted a price (x) for each contract to the seller but the seller in fact charged the retailer (x) plus its mark up. The manufacturer never saw what that mark up was. Further, the seller always paid for the goods before being paid by the retailer. Each of those aspects would *prima facie* indicate a distribution arrangement.

The court eventually decided, taking into account that the manufacturer accepted that the seller purported to act as an agent and that the contracts described the seller as such, that the seller was indeed an agent. It further went on to state that the mark up it received constituted its remuneration, and that it was not relevant to the question of whether an agency arrangement existed that the agent did not receive commission.

As has been noted above, the real debate in England and Wales has been perhaps not so much whether an individual is an agent or distributor, but rather whether introducing agents fell within the Regulation's scope. Subject to further case law on this point, that question appears to have now been settled<sup>37</sup>.







## CONTACT

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- \* Establishment of long term and broadly based client relationships
- \* A healthy work/life balance
- \* Team working
- \* Friendly and co-operative atmosphere

From February 2007 Stringer Saul will change its name to Fasken Martineau Stringer Saul Llp, due to its merger with Fasken Martineau Dumoulin Llp, a top Canadian law firm with offices across Canada and in New Cork, London and Johannesburg.

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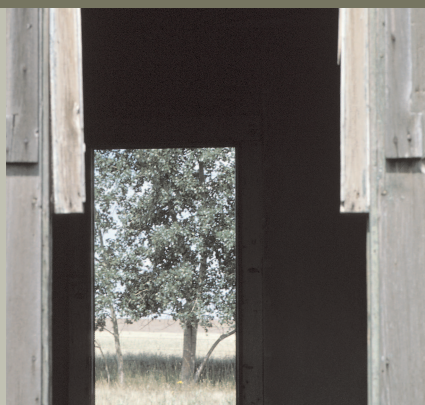
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