The Consequences of terminating Commercial Agency Agreements and Distribution Agreements under English and German law

Some reflections post-Brexit

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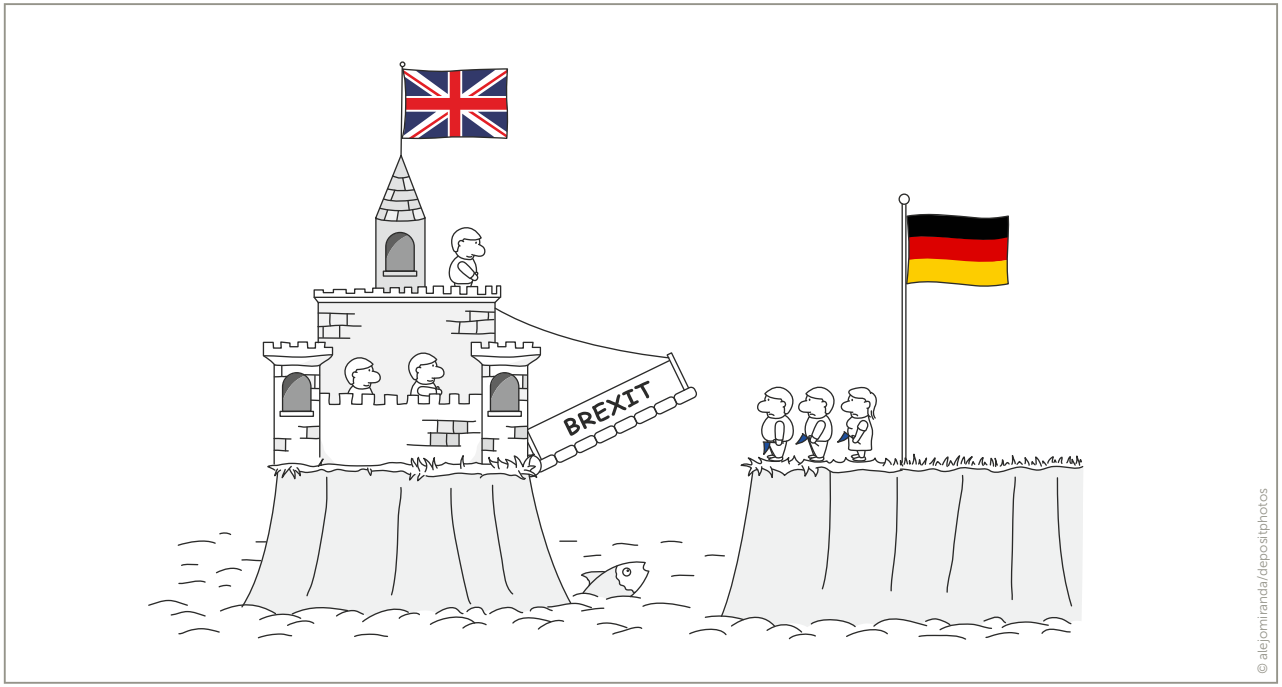

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Even in these times of increasing digitalisation, the sale and marketing of goods without the support of intermediaries, in particular commercial agents and distributors, is unthinkable. In order to achieve commercial success across a variety of industries, it is essential to have the personal engagement and commitment of intermediaries.

There are certain important features relating to the sale of goods and services between Germany and the UK – including those that have arisen following Brexit – of which businesses should take note. At present, the rules relating to commercial agents in both countries are based on the **EU Commercial Agents Directive 86/653/EEC** of 18 December 1986. The rules have been incorporated into German law in the Commercial Code; and into English law by the Commercial Agents (Council Directive) Regulations 1993 ('**CAR**'). It is, however, entirely possible that English law will be amended to deviate from the EU rules in the future.

By contrast, there are no specific legal rules applicable to distributors either in Germany or in the UK. This has resulted in a number of different expressions for this type of agreement, including Distribution Agreements and Reseller Agreements. Whatever it is called, this category

of agreement is common in both countries and the law relating to distribution has been developed through case law (as opposed to statute).

In Germany, parts of the law of agency are applied by analogy to distributors. An example of this is the determination of the applicable notice period which a distributor must be given. These are often too short, and fail to take into account the material investment which the distributor may have made.

The most important difference between the two legal systems is that, under German law and subject to the fulfilment of certain conditions, a distributor may have a claim for a payment when his agreement is terminated, which is analogous to an agent's claim for an indemnity. Under English law, a distributor would at best only have a claim in damages, if he could show that the principal had acted in breach of contract. Distributors are often surprised and disappointed when they realise that they have not provided for this in the agreement itself.

What are the differences between a commercial agency agreement and a distribution agreement?

A commercial agent is a self-employed intermediary who has continuing authority to negotiate the sale or purchase of goods on behalf of a principal or to negotiate and conclude the sale and purchase of goods on behalf of and in the name of that principal. He only negotiates sales for the principal and does not buy and resell the principal's goods in his own name. The agent earns a commission which the principal pays to him in relation to the contracts that are entered into as a result of his efforts. Commission is paid to the agent gross. By contrast, if the principal employs a salesman to perform similar duties, the principal will have to pay the employee a regular salary (possibly with an element of commission) and is responsible for deducting income tax and social security contributions at source.

In German law, the agency rules in the commercial code which protect the agent apply not just to the promotion of the principal's goods but also the services the principal offers. Under English law, the CAR only apply to the sale of goods. Goods are not defined in the CAR but the definition of goods in s.61 of the Sale of Goods Act 1979 is considered to be a 'reasonable guide', if not a conclusive definition. The rights of a dealer who promotes anything other than goods will arise out of his agreement with the principal which will define his obligations and rights. Normal contractual principles will apply, meaning a breach of contract by the principal may entitle the agent to a claim in damages.

By contrast, a distributor is an independent businessman who is often, but not necessarily, integrated into the distribution network of the manufacturer. The distribution agreement will require him to buy the principal's goods in his own name and for his own account and to resell them and generally to promote their sale in a defined territory. A distributor may be distinguished from a mere reseller, i.e. someone who simply buys the principal's goods and resells them without having any ongoing duties to the principal. The distributor makes his living from the difference between the price at which he buys the goods and the marked-up price at which he resells them.

The consequences of termination of an agency agreement

By far the most legal disputes between manufacturers of goods and their sales intermediaries arise when the agreement is terminated. An agreement can be terminated lawfully, in accordance with its terms, or summarily, if the other party repudiates it.

Termination in accordance with the agreement

A well drafted agreement will specify the notice period which one party must give the other to terminate it. If the agreement is silent, under German law, the minimum statutory periods of notice will apply. As a rule of thumb, the longer period applies. By contrast, English law will require reasonable notice to be given. What constitutes 'reasonable' notice will depend on all the circumstances surrounding the agreement.

Termination for breach

A party can terminate a contract for breach if he considers that the other party has breached the agreement in such a way that the terminating party cannot be expected to continue to be bound by it – for example, if the manufacturer fails to pay the commissions due despite demands having been made or if the agent breaches one of the agreed restrictions on competition. If this is so, the terminating party can terminate the agreement by notice in accordance with its terms.

Litigation will often arise between the parties if the agreement is terminated in this way, because the reasons

for termination are often given in order to bring the contractual obligations to a premature end.

Consequences of terminating an agency or a distribution agreement

Under English law

The UK government decided to give principals and agents the flexibility to decide how an agent should be compensated on the termination of the agency agreement. Under Regulation 17 CAR, the parties can choose whether the agent should be entitled to be "indemnified" or "compensated". In either case, the agent is well protected if the principal, on whom he is commercially dependent, terminates the agreement for whatever reason, including in accordance with its terms.

The terminology is confusing. "**Compensation**" is described in the CAR as "compensation for the damage [the agent] suffers as a result of the termination of his relations with his principal" (Reg. 17(6)). It is known as "**Schadensersatz**" in German law.

Where the parties have agreed that the agent should have the right to an "**indemnity**" on termination, the amount is an equitable amount to be awarded to the agent if he has introduced new customers or significantly increased the volume of business with existing customers, and the principal continues to benefit from that business. It is known as "**Ausgleich**" in German law. The amount is determined having regard to all the circumstances, in particular, the commission lost by the agent on the business transacted with such customers, and is capped at the average annual remuneration earned by the agent over the preceding five years. The right to an indemnity does not prevent the agent from also claiming any damages he suffers on termination.

The contract does not need to run for any minimum period before the agent can claim an indemnity or compensation. The parties cannot contract out of the CAR – any clause which purports to do this is void and the only circumstances in which no indemnity or compensation is payable are specified in the regulations.

The default rule is that a commercial agent within the meaning of CAR has a claim for "compensation" on termination of the agreement. He only has a claim for "indemnity" if the agency agreement specifically provides for it (Reg. 17(3) CAR).

Compensation under art. 17(6) CAR is meant to compensate the agent for the damage he suffers as a result of the termination of the agreement, i.e. for the loss of his commission under art. 8 and for the possibility to "amortize the costs and expenses he has incurred in the performance of the agency contract on the advice of his principal" (Art. 17(7) CAR).

However, the only circumstances in which the agent does not have a claim for an indemnity under art. 17 CAR are as follows:

- The principal terminates the agreement on the grounds of a material breach justifying immediate termination;
- The agent terminates the agreement himself otherwise than because of his age or ill-health or for reasons due to the principal;
- The agent has "assigned" his rights and duties under the agreement to a third party, with the principal's agreement.

(Art. 18 CAR)

Under Reg. 17(3) CAR, the agent is entitled to receive an indemnity if it is specified in the agency agreement and if and to the extent that he has:

- Brought the principal new customers or has significantly increased the volume of business with existing customers and the principal continues to derive substantial benefits from the business with such customers; and
- The payment of the indemnity is reasonable in all the circumstances and in particular the amount of commission that the agent has lost on the business transacted with such customers.

There is no limit to the amount of compensation that an agent can claim. By contrast, a claim for an indemnity is limited to the average annual commission earned by the agent over the previous five years (Reg. 17(4) CAR). The agent can claim the applicable amount of the indemnity and (where applicable) damages for any breach of contract by the principal.

Note that the agent will lose his entitlement to claim an indemnity or compensation if he does not notify the principal within one year of the date of termination of the agreement (Reg. 17(9) CAR.

An agent has a claim for commission on all orders received by the principal or the agent before the agency agreement is terminated (Reg. 7). In addition, under Reg. 8, an agent can claim commission on all contracts which are concluded by the principal within a reasonable time after termination of the agreement as a result of the agent's efforts during the term of the agency.

The CAR do not give the principal any right to damages if the agent terminates the agency agreement. Normal contractual rules apply if the agent has been in breach of contract.

Distribution agreements need to be analysed under prevailing competition laws. While the UK was a member of the EU, EU competition law took precedence over domestic competition law. Post-Brexit, EU competition law will continue to apply to distribution agreements which have an effect within the EU. However, if the agreement is not to have effect in any EU member state, English competition law only will apply and a supplier will have more freedom to restrict its distributors from making active and passive sales from the UK to the EU.

Under German law

Claims for damages

As with English law, an agency agreement is terminated without notice, the party giving notice will have a claim for damages against the other if the termination has been caused by his conduct (§89a(2) German Commercial Code). Typically, this will be a material breach of contract such as a breach of the restriction on competition. Because distribution agreements are not regulated by German law, any claim for damages upon termination of the agreement otherwise than in accordance with its terms will have to rely on the general principles of law and jurisprudence. Accordingly, one should always include a list of the grounds for termination in the agreement.

Claims for indemnity

Under German law, an agent is entitled to an indemnity on the termination of the agency agreement (§89b German Commercial Code), irrespective of whether the contract is terminated by the principal or on the expiry of an agreed term, and provided that the principal continues to do business with the customers obtained by the agent and the payment of the indemnity is reasonable. The burden of proof is on the agent, but he has a right to be given information and, if necessary, a right of access to the books of the principal.

The agent's right applies even if termination is by mutual agreement, the terms of which should be evidenced by an appropriate settlement agreement.

The right to an indemnity is excluded if the agent terminates the agreement himself or if the principal terminates it for a material reason attributable to the agent.

The amount of the indemnity is capped at the average yearly commission earned by the agent under the agreement over the previous five years or such shorter period in which the agreement has been in force. The parties cannot exclude the right to an indemnity in the contract and the agent must assert his claim to an indemnity within one year of the date of termination (§89b(4) German Commercial Code).

Unlike under English law, a distributor in Germany may in certain circumstances also have a right to an indemnity. This right was established by case law and only arises where the distributor is integrated into the manufacturer's organisation in such a way that, commercially, he is performing similar duties to those of agent – it will not arise where the parties are have a simple buyer/seller relationship. It is also conditional on the distributor being under a contractual duty to transfer his customers to the manufacturer to enable the latter to exploit the customer base immediately and unconditionally. Case law has already developed this analogous application of §89b for tenants of petrol filling stations and car dealers. This is because, in this industry, the principals often impose very strict requirements on the dealer at the commencement of the relationship – for example, a car dealer will be subject to restrictive requirements for the design of and layout of his showroom, and will be required to participate in advertising campaigns and sales, agree to minimum purchase volumes, and so on. Distributors in other industries will also be able to claim an indemnity on termination of their agreements, but the cases show that the evidential burden for the distributor of proving that he is integrated into the manufacturer's distribution structure is a difficult one.

If a court decides that a distributor does have a claim for an indemnity, the next step is to determine the amount of the claim. The distributor does not earn a commission; rather, he retains the margin between the price at which he buys the goods from the manufacturer and the price at which he resells them. Accordingly, the indemnity claim has to take into account a number of factors, including, for example, an estimate of the profit which

the distributor would have made over a particular period from regular customers if the agreement had not been terminated. The typical costs that a distributor would incur – such as administration, warehousing and marketing – would need to be calculated, so that the commission that an agent would have earned can be compared with the margin that the distributor makes.

Furthermore, the distributor's right to an indemnity cannot be excluded in the agreement, and the distributor, like an agent, must make a claim for payment of the indemnity within one year of termination.

Summary and Conclusions

The fundamental principle is that both agency and distribution arrangements should be made in writing. This ensures that reasonable periods of notice of termination are guaranteed. The parties should also not underestimate the importance of specifying the proper law of the agreement and the courts which will have jurisdiction over any disputes. In practice, these clauses are very important as disputes often arise over the questions of the applicable law and the courts which have jurisdiction to hear a dispute.

One of the direct consequences of Brexit is that, from a German law perspective, principals and manufacturers can now exclude the right to an indemnity for their agents and distributors who operate in the UK. This is certainly something worth considering.

Shortly before the general election in England in July 2024, the government issued a consultation proposal to deregulate the Commercial Agents Regulations so that they would no longer apply to commercial agents agreements entered into after the date on which the legislation would be introduced. This would mean that the relationship between a principal and his commercial agent would be governed by the common law rules of agency which do not provide much protection for the agent. At the time of writing the new government has not issued a timetable for the implementation of this rule. We will be monitoring this and will issue an update when more is known.

This article is for general guidance only. The law is stated as at 1 December 2024. For specific advice, please contact your usual contact at MEUM Law or BUSE.

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