



## Agency compensation: do £20k agencies have any value?

by **Thom Vaughan** of E.A.D. Solicitors L.L.P. and **Adrian Pym** of RSM Tenon

In the 2007 case of *Lonsdale* the House of Lords confirmed that in calculating the compensation payable to a commercial agent on termination or expiry of its agency under the Commercial Agents (Council Directive) Regulations 1993, the court should award the value of the agency business at the date of termination.

In some quarters this was seen as a bitter blow for commercial agents who had previously enjoyed sending written demands for the equivalent of 2 years commission following termination of their agencies.

*Lonsdale* changed all of that and in the intervening period a trend is beginning to emerge, which broadly suggests that high value agencies with, say, gross commission income of £50,000 and above continue to result in lucrative payments (in some cases more than pre-*Lonsdale*) whereas the run of the mill £20,000 agencies are facing real difficulties when it comes to demonstrating they have a value which results in any compensation.

One reason for this can be attributed to a line in *Lonsdale*, which reads, "If the agent would have had to incur expense or do work in earning his commission, it cannot be assumed that the hypothetical purchaser would have earned it gross or without having to do anything." Effectively the court appears to indicate that a notional employment cost should be taken into account.

In practice what has followed is that when valuing agencies some experts have indeed deducted a notional employment cost of the agent and this is further supported by the later High Court case of *Fryer v Firth* (2008), which states,

"£14,100 per annum for an average 40 hour week is on any view a modest salary and is very much less than the 2005 New Earnings Survey figure for sales representatives which produced average earnings of £521.70 per week gross, £27,128 per annum. Almost anyone could obtain an income at that level in an unskilled job without paying a premium for it. No hypothetical purchaser would in my opinion be willing to pay a substantial sum for the opportunity of earning that amount through his own labour unless the prospects of increasing the return for approximately the same amount of effort were considerable."

The deduction of a notional employment cost in cases involving the smaller agency may result in only a small profit or even no remaining profit, as in the case of *Fryer*.

Experts will value a commercial agency on the basis of a multiple of annual profits after the notional employment cost of the agent, an approach common to the valuation of any business. The assessment of the multiple is very subjective. In the case of non-agency businesses the multiple is normally based on those achieved in sales of similar businesses. In the case of commercial agencies there is no real market for the sale or purchase of agencies so the expert is faced with a lack of comparables.

The multiple is a measure of the risk of investing in a business. As a general rule a strong business with good prospects for growth or continued strong profits will attract a higher multiple as the risk to the hypothetical purchaser is lower. A weaker agency with declining profits will be perceived as a greater investment risk and therefore carry a lower multiple.

This was recognised in *Lonsdale* which stated "if the market for the products in which the agent dealt was rising or declining, this would have affected what a hypothetical purchaser would have been willing to give. He would have paid fewer years' purchase for a declining agency than for one in an expanding market."

Therefore unless an agent is able to show that his £20k agency requires only a small amount of work (perhaps it is one of many agencies he carries) or he can show that he expected it to grow rapidly (with evidence in support) then he faces an uphill struggle to demonstrate that it has any value to a hypothetical purchaser, and therefore recover a worthwhile amount of compensation.

As an Agent, one really has to ask if this fits in with the intention of the European Council's Directive and the grand aim of protecting the "downtrodden race" of agents. However, it appears that this is where we are post - *Lonsdale*: social and equitable principles have given way to strictly commercial principles.

As a Principal, perhaps you would like agents to ask themselves what they would pay for a £20k agency taking into account their expense overheads and hours worked and then compare this to what they are seeking as compensation. This is an eminently sensible starting point and will force the parties to get to grips with the valuation process both practically and conceptually.

Adrian Pym is Director of Forensic Accounting for business valuation experts RSM Tenon.



## RSM Tenon

**Head Office: Charterhouse,  
Legge Street, Birmingham B4 7EU  
Tel: 0121 333 3100  
www.rsmtenton.com**

Thom Vaughan is a solicitor with E.A.D. Solicitors LLP and specialises in commercial agency matters.



**e a d** solicitors

**Head Office: Prospect House,  
Columbus Quay, Liverpool L3 4DB  
Tel: 0151 735 1000  
www.eadsolicitors.co.uk**

Disclaimer: This column does not contain legal advice and is for general guidance only. Agentbase, E.A.D. Solicitors, RSM Tenon and the writer accept no liability in connection with the general guidance given in this column.