



Regulation 17 Compensation – a Practical Overview and How You Can Negotiate the Correct Amount

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When Mr Graham Lonsdale took exception to the Oxford County Court's decision to award him a mere £5,000 for the loss of his agency business his further legal action triggered a radical overhaul of the approach to Regulation 17 compensation that we are still coming to terms with.

As any bookish principal or agent will know the House of Lords, the highest court in the land, determined that the so called "French rule", which provided for compensation payments of around 2 year's commission income, was not applicable on these shores and the correct approach was to assess the open market value of the agency at the date of termination taking account of all relevant factors. Many welcomed this clarification and it was originally thought that victory had gone to the principals because they could no longer be beaten with the "two year rule" stick by agents with weak agencies looking for generous pay offs. However, the outcome is more nuanced than this as is explained below and each case must be approached squarely on its merits.

Lonsdale was a curious case to travel all the way to the House of Lords because his agency was in such an evidently bad way. It is worth recalling that in 1997–1998 Mr Lonsdale's gross commission income was almost £17,000 but by 2002–2003 it had fallen to £9,621. The backdrop to all of this was that his principal's shoe business was in terminal decline because like many UK shoe manufacturers at the time they were unable to compete on style and price. On this basis the Judge noted that he had been provided with no evidence as to the value of the agency and doing the best that he could arrived at a figure of £5,000. Mr Lonsdale wanted more.

In fact, he claimed for £19,670, an amount that was roughly equal to two years' gross commission calculated by reference to the average of the last five years of his agency. He appealed unsuccessfully to the Court of Appeal and then finally to the House of Lords who gave him very short shrift. It was found that Mr Lonsdale enjoyed net commission income of around £8,000 only and yet he claimed that his loss was comfortably more than twice this amount, even in circumstances where sales were falling off a cliff. It is hardly surprising that the law Lords were not with him on this and instead they determined that compensation should be equal to the open market value of the agency at the time of termination.

This is the mindset that agents and principals must now adopt in seeking to come to a final figure where the right to compensation arises. Applying this analysis to Mr Lonsdale's agency business the £5,000 awarded appears to be a reasonable assessment of its value at termination: after all, who would pay much more for a business vehicle generating just £8,000 net p.a. on a reducing basis with no sign of recovery and where work had to be undertaken? Would you? Conversely, there are other agencies generating net yearly income of, say, £10,000 and above, which, if their merits are properly presented and analysed will be seen to have a buoyant open market value. Further, it is possible to say that great agency businesses will have a better outcome than pre-Lonsdale, in some cases far better.

The main factors to consider when analysing an agency are as follows:

1. What is the gross commission income received?
2. Is this level of commission sustainable?
3. What are the business overheads attributable to the agency, i.e. the costs of running the agency such as petrol, hotel stays?
4. How many other agencies are carried and what expenses are attributable to each?
5. Is the agency time intensive and how many hours are worked?
6. Is the agency business on an upward curve and are there positive business trends identifiable?
7. Conversely, is business bad and are, for instance, cheap imports forcing the industry into "remorseless decline"?
8. Is a positive or negative business trend a mere blip or an indication of long term prospects?
9. Is the agency stable and in a good industry?

These considerations should be the first step in getting a rough feel for the value of the agency and thereafter the parties can choose to appoint a valuation expert to value the business. You should be aware that appointing a valuer will cost money and for lower value agencies the agent and principal should make real attempts to settle the matter between them rather than wasting disproportionate costs.

Once a valuer is instructed he will most often prepare a written report for the benefit of both parties and which may be used at court if necessary. He will generally establish the net income figure, the level of work required and the state of the business and then apply a multiplier of anywhere from 0 to 8 to arrive at the value. Clearly a higher multiplier is given where there is evidence of buoyancy and good things to come.

It is evident that there can be a great degree of variance in the approach to be taken and some valuers refer to "gut instinct" in choosing a multiplier, which is obviously not the most scientific approach. It is no wonder that agents, principals and even lawyers struggle at times to sensibly conclude how much an agency is worth.

This degree of variance also causes real practical difficulties and the writer recalls receiving two reports from separate experts in respect of the same agency and based on very similar facts and figures where the first valuation was under £100,000 and the second was over £1,000,000. This is, of course, very unsatisfactory and not what the House of Lords anticipated when it said that after a period of experience in such valuations the court could take judicial notice of what would be the going rate in the standard case, namely an agency which has continued for some time and in which the net commission figures are fairly stable.

It is not clear that this position has been reached and there is no indication that it will. For instance, the simplicity of the two year rule, which resulted in some haggling but eventual agreement in most cases, is a thing of the past. The uncertainty as to the correct approach to valuation can be seen in the reported cases post Lonsdale where expert valuation evidence has been rubbished and totally disregarded by Judges. The lesson from this is that even if you obtain a written report from an expert the judge in any given case retains discretion to disregard it and use it for guidance only.

In this sea of uncertainty it is suggested that agents and principals should cooperate together fully by objectively analysing an agency's value at an early stage after termination and exchanging their sensible views in order that progress can be made, settlement achieved and both parties can carry on with what they do best, albeit not together.

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