LEGAL SURGERY

From agentbase THE UK SALES AGENT REGISTER

ISSUE 202
OCTOBER 2012

Question:
How much for your agency?
Answer:
It depends!

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In the oft quoted case of Lonsdale –v– Howard & Hallam Ltd [2007], Lord Hoffman optimistically suggested that "once it is firmly understood that the compensation is for the loss of the value of the agency, relatively few cases will go to court ... small comparable businesses are bought and sold every day and it should not be difficult for the parties, with the benefit of advice about the going rate for such businesses, to agree on an appropriate valuation."

The reality has been somewhat different and this note seeks to make some helpful observations on the way in which the "going rate" for these curious, hypothetical agency businesses should properly be valued.

The case of Camm –v– Seac is a fine example of the radically different valuations given by parties' accountants and the reaction of the High Court Judge HHJ Behrens QC who ignores both. In this case the agent accrued average gross commissions of £50k per annum. The agent's expert said that the agency must surely be worth between £145k and £200k using a multiple of 5 – 7. The principal's expert was having none of this and suggested it would fetch no more than a nominal sum. Judge Behrens allowed £35k for compensation without really appearing to engage in the valuation process on the face it.

So how is an agent or principal supposed to gauge the value of a compensation payment?

In the first hearing in the lower courts the Judge in the Lonsdale case said, "If it is kept in mind that the damage for which the agent is to be compensated consists in the loss of the value or goodwill he can be said to have possessed in the agency, then it can be seen that valuation ought to be reasonably straightforward." However, no evidence was put before the Court on the value of commercial goodwill.

The most commonly adopted definition of goodwill is "the benefit and advantage of the good name, reputation, and connection of the business. It is the attractive force which brings in custom. It is the one thing which distinguishes an old established business from a new business at its first start."

In simple terms Goodwill is the amount by which the value of the entire business exceeds the value of its net tangible assets. In valuation terms goodwill can be identified as attaching to a business and its products, a location from which the business trades or to the individual who operates the business.

In the case of say a manufacturing company the goodwill might attach to the product manufactured; for a restaurant business it might attach to the location of the restaurant. A football player will have a value (their transfer value) that is entirely personal.

With commercial agents goodwill will attach to the agent who is "employed" to sell a principal's product into their database of customers and contacts (or to go out and establish a database of customers). The principal is buying the individual's sales ability within a commercial agency relationship. The products being sold are also likely to have a goodwill element but that is separate from the goodwill attaching to the agent personally. The ability to sell the goodwill will obviously be easier where it relates to a product or location as the owner of the business is not as relevant. However, in the case of personal goodwill this cannot be sold for value as it cannot be transferred at the date of sale.

Therefore with Agents there is an added factor of personal goodwill that impacts upon the choice of multiple. Even assuming that the business is saleable ("standing in the shoes of") a willing buyer will see the business as a personal relationship business and identify the risks that go with such a business. This reduces the multiple achievable in comparison to a "normal" business. Also, with say a manufacturing business there will be value in the underlying assets such as the plant and machinery used to manufacture the products. A commercial agent is likely to have minimal tangible asset backing, and therefore there is little or no security. A buyer of a manufacturing business will at least have some assets that can be redeployed on other products, or sold if the sales fail to continue for the existing product.

Therefore in the writers' experience the multiples commonly adopted in commercial agency cases are generally in the range of 1 to 3 and ultimately up to 5. The figure 3 might be applied to those businesses which show strong sales growth historically and continuing sales growth potential in the future. Such sales growth being independent of the agent and related to the popularity of the brand or product.

For example the recent sales of Pandora jewellery, which itself featured in a commercial agent compensation claim. Multiples beyond 3 would suggest remarkable growth prospects, a very strong product range and the expectation of real stability / durability. There is very little case law that provides guidance on profit multiples, especially in commercial agents cases.

The Pandora jewellery case was not a helpful case on multiples because of the existence of a distribution agreement that could be cancelled on 12 months notice. Given this external risk factor the Judge awarded compensation based on one year's earnings, despite the meteoric rise in sales of Pandora jewellery.

In the case of Nigel Fryer Joinery Services Limited –v– Ian Firth Hardware Limited the jointly appointed accountant initially valued the agency at 5 times its post tax maintainable earnings.

Following cross examination the accountant produced a revised post tax profit figure of £14,100 and a valuation of £35,000 to £50,000. This implied a profit multiple in the range of 2.5 to 3.5. The Judge commented on the revised valuation range "...but I regard even this as unrealistic".

The reason for rejecting the revised valuation was not specific to the multiplier but related to the net earnings of £14,100. The Judge commented that "No hypothetical purchaser would in my opinion be willing to pay a substantial amount for the opportunity of earning that amount through his own labours unless the prospects of increasing the return for approximately the same amount of effort were considerable".

In summary the multiples on commercial agents cases will generally be lower than those experienced on "normal" companies because of the differences between the two. Commercial agents compensation can be viewed as similar to compensation for loss of employment in that the regulations compensate agents for a lack of employment rights. They cannot compensate them for what they could have sold their agency for as there is no market for agencies in the UK.

Perhaps in assessing damages Judges will still ultimately refer back to their own instinctive assessment of what "feels" reasonable as HHJ Behrens appears to have done in both Camm and McQuillan, leaving lawyers and accountants shaking their heads. What is clear is that the idea of parties being able to confidently reach agreement between themselves will remain a pipedream until clearer judicial guidance is given.

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