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Commercial agents and the sale of licences for software, digital content and online

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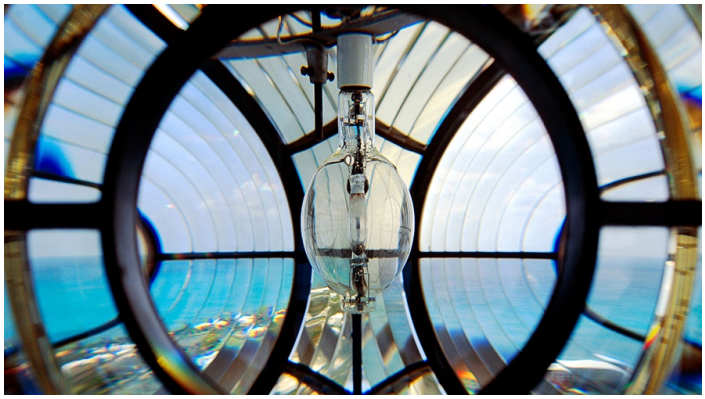

We have been advising a number of clients on the implications of The Commercial Agents (Council Directive) Regulations 1993 (the 'Regulations') and how they impact arrangements with agents engaged to sell licences in relation to software, digital content and online memberships.

The Regulations (which implement the EU's Commercial Agents Directive) govern the relationship between a 'commercial agent' – defined as a person who is 'self-employed' and who has the 'continuing' authority to negotiate and/or conclude sales or purchases of goods on behalf of another person – and a 'principal'.

The Regulations are implied into all relevant commercial agency arrangements – whether written or oral, formal or informal – and impose wide ranging good faith obligations on principals and agents, as well as mandatory provisions which cannot be contracted out of by parties, such as the obligation on principals to make a compensatory payment to the agent at the termination of the arrangement.

The recent case of *Software Incubator Ltd V Computer Associates UK Ltd [2016] EWHC 1587* has clarified that the sale of software licences through agents may be a 'good' and therefore caught by the Regulations, and subsequently organisations need to be aware of the impact this may have on their business.

In the case, it was noted that while the software in question was intangible, and not provided via any tangible medium (ie a CD or memory stick) the fact the software was treated identically to other 'tangible' goods in the agency agreement meant it should be interpreted the same way. Judge Waksman commented that the mode of delivery of the software does not alter its essential classification: "the essential characteristics of a piece of software like the [Product] cannot depend on its mode of delivery any more than the nature of tangible goods depends on whether they are transported by rail, sea or air". There was no reason to require the 'product' to be tangible or a 'chattel' in the traditional sense, especially when installed so as to operate in a physical (ie hardware) environment.

The software in Software Incubator was licensed on a perpetual basis and in the form of an electronic download giving the purchaser "the unfettered ability to use it forever". How the decision impacts the categorisation of software that is not licensed on a perpetual basis remains unclear. This is significant as increasingly software is provided through the internet in the form of Software as a Service (Saas) with access licensed on a subscription basis without ever leaving the vendor's computer server. Arguably such licensing models are more akin to a service than an outright sale of goods. The decision in Software Incubator does not consider this type of situation. Consequently, in instances where the sole means of supply is access on a fixed-term licence or on a subscription basis, the position still needs careful consideration.

What do you need to do?

As a result of Software Incubator, if you engage agents to sell software licenses that may include UK customers you are advised to review existing agency contracts and check if any are subject to the Regulations which you had previously assumed would not be.

In particular, principals should be aware that the Regulations:

- impose extensive obligations of good faith
- set out minimum periods of notice for terminating an agreement which is continued beyond its fixed term
- in some circumstances, entitle agents to one of two types of compensatory payment following the termination of the arrangement: 'Indemnity' or 'Compensation' (see below for more information)

- may affect the terms on which you pay commission to your agents and require you to provide information to your agents about concluded business and any expectations of a significantly lower value of transactions

Compensation or indemnity

The Regulations state that 'except where an agency contact otherwise provides', a commercial agent shall be entitled to be compensated rather than indemnified. The distinction is important because of the different economic consequences that each concept gives rise to on termination of the agency.

An 'indemnity' payment may be claimed if provided for in the agency agreement and calculated by reference to the increase in business generated by the agent from which the principal continues to derive substantial benefits. The key point is that the maximum indemnity paid to the agent will usually be limited to the equivalent of one year's remuneration, calculated by finding the average annual remuneration received by the agent from the principal over the previous five years (or the number of years of the agreement, if less than five years).

A 'compensation' payment is calculated by reference to the loss the agent has suffered as a consequence of the expiration of the agency arrangement. Case law indicates that the UK courts will calculate the sum of the compensation payment by valuing the income stream which the agency relationship would have generated and 'the amount which the agent could reasonably expect to receive for the rights to stand in his shoes, continue to perform the duties of the agency and receive the commission which he would have received'. The total amount payable will be based on the amount the notional third party purchaser would pay for the agency if the agency had continued and was available for sale on the open market, though there is no definitive formula. Crucially, unlike an indemnity, there is no maximum cap on the amount which may be paid out in compensation.

As a result of the above, it is usually advisable for a principal appointing a commercial agent with any activities in the UK to expressly specify that any payment on termination of the agency relationship will be made on an 'indemnity' basis, rather than in the form of 'compensation'.

On the other hand an agent will usually be seeking to claim compensation on termination in accordance with the Regulations. If the business in question is successful, the sum awarded to the agent in compensation may be large. On the other hand, where compensation applies it can mean that in some cases where the business concerned is declining, the court may be justified in awarding nothing.

Summary

In all cases, principals need to bear in mind that anyone classed as a self-employed 'commercial agent' by the Regulations is entitled to benefit from the no-fault, automatic protection of the indemnity or compensation provisions which even the most sophisticated contract drafting cannot avoid and this may lead to considerable costs when arrangements come to an end.

Software vendors using commercial agents to sell licences in relation to software, digital content and online memberships ought to check any existing arrangements to see whether they will be affected by the Software Incubator ruling.

Furthermore if you are looking to appoint agents in a number of jurisdictions, you should be aware that the laws governing agents are materially different across Europe. For instance, in France and Italy, the equivalent laws implementing the same EU Directive cover services as well as goods.

As with all EU based law, there is a 'Brexit' angle to consider. However, while the UK might ultimately elect to opt out of the Commercial Agents Directive regime, for the time being, abolition of the UK Regulations does not seem to be a priority and software vendors with EU agents should assume that the UK Regulations will continue in force for the foreseeable future.

For more specific advice, please get in touch with one of the contacts listed on the right.

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