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## AGENCY AND DISTRIBUTION AGREEMENTS IN SCOTLAND

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### **Introduction:**

Scotland is a separate legal jurisdiction within the UK and European Union with a devolved Parliament and its own Courts. Although many rules are applied across the European Community and within the UK in a similar fashion, and many legal agreements contain virtually identical terms, care should always be taken by business to consider Scots Law in matters of property, litigation and interpretation and enforcement of contract, where the place of the asset or performance of contract or choice of law is Scotland.

Scotland is a good location in which to do business and from which to trade; its system as with the rest of the UK gives general freedom of contract subject as below and there is no need to register agreements unless they contain significant or sector wide restraint of trade provisions. That said, setting up a branch or place of business requires formal procedures beyond that of appointing agents or distributors.

The terms Distribution and Agency are widely recognized in international trade. Commercial Agency (for goods only) is impacted by the Commercial Agency Regulations. Distribution is impacted by the Sale of Goods Act. The UK does not have the concept of a commissionaire (agent for undisclosed principal) as with many continental jurisdictions in Europe. The choices for marketing and sales are similar to that in the US, and may include an employee representative bringing with it all of the social and employment regulations that apply in the UK or for seconded employees. This commentary is restricted to Distribution and Commercial Agency.

### **Freedom of Contract:**

There is no uniform commercial code in Scotland or the UK. Under Scots common law, parties generally have freedom to agree the terms of their agency or distribution contracts. However, this freedom of contract is subject to the restrictions imposed by legislation, including competition rules, and public policy.

### **Exceptions:**

The **Commercial Agents (Council Directive) Regulations 1993** (“the Regulations”) apply to commercial agents in the UK who sell or buy goods on behalf of the principal. They apply to any commercial agent – whether an individual, partnership or a company – and to all such agency contracts, even if they predate the Regulations. The Regulations do not apply to a distribution contract or to an agency for the supply of services.

It is important to note that the Regulations introduced rights of agents to compensation or indemnity on termination of the agency contract. These are payable to the agents regardless of whether the principal is in breach of contract or not and even if the agent has no right to damages at common law in respect of the termination.

The Regulations provide for both alternatives – compensation and indemnity – but stipulate that, in the absence of agreement between the parties on this point, the agent would be entitled to compensation and not indemnity. While the indemnity alternative is capped at a sum of one year’s commission based on the agent’s average annual remuneration over the preceding five years (or the period of the agreement, if shorter), no maximum amount is specified for the compensation alternative.

Courts have recently clarified that the measure of compensation is the value of the agency at the time it was terminated, calculated by reference to what a hypothetical purchaser would have paid for it.

The **Unfair Contract Terms Act 1977** applies to contractual clauses which seek to exclude or limit liability. For example, any exclusion or limitation of liability for death or personal injury

caused by negligence is unlawful. For negligence giving rise to other types of loss, any exclusion or limitation of liability is enforceable only to the extent that it is considered reasonable.

A distribution contract will be subject to the **Sale of Goods Act 1979**, which contains provisions that would be implied into any such contract e.g. that the goods shall conform to their description, shall be reasonably fit for purpose and shall be of satisfactory quality.

Under the **Consumer Protection Act 1987**, liability for the supply of defective products is imposed, in the first instance, on manufacturers, suppliers of 'own-label' products and importers into the European Community, regardless of fault. If these persons are not identified, then the further suppliers of such products (e.g. distributors or agents) have secondary liability and it is not possible to exclude this liability by contract.

Business to Business trade is not subject to the same impact of Consumer legislation (largely driven by Europe) as is Business to Consumer trade.

### **Absent or Ambiguous Terms:**

It is important to note that terms which have not been expressly agreed by the parties may be implied into the contract by the courts, based on evidence of intent or local custom or trade usage with respect to matters which are not referred to in the contract. Courts tend to follow the least restrictive interpretation.

### **Oral Contracts:**

As a general rule, a commercial contract does not have to be in writing and does not necessarily require price or consideration to be binding. Although oral contracts, or a course of dealing, are legally enforceable, it is prudent to have a written contract to record the terms agreed between the parties which can then be used for evidential purposes if necessary.

### **Competition:**

Following recent reform of EC and UK law in this area, agency or distribution contracts raise fewer competition issues than was previously the case. Issues of dominance (generally above 25%), collusion or restraint of trade may give rise to competition rules applying.

Exclusive agency or distribution contracts raise further competition law issues. A well drafted block exemption compliant agreement will work however provided the spirit of the contract is also followed in practice. Certain *de minimis* thresholds of activity and turnover may exempt the arrangements.

Post termination non-compete clauses (restrictive covenants) are difficult to enforce. Price controls are prohibited.

## **Tax Considerations:**

A non-resident company (i.e. not incorporated in the UK) is chargeable to income tax on income arising in the UK, subject to certain exceptions relating to bank interest and to the provisions of any applicable double taxation convention. The question to consider is: “where do the operations take place from which the profits in substance arise?”

In cases where the non-resident principal uses a marketing agent, this fact alone is unlikely to cause the tax authorities to regard it as trading within the UK, since the agent is unlikely to have authority to enter into contracts on its behalf. The use of an agent may have implications and the setting up of a place of business in the UK can be construed from the facts of the arrangements.

The use of an independent distributor will not of itself render the overseas manufacturer/supplier chargeable to UK income or corporation tax.

## **Other Issues:**

Choice of law:

Parties are free to choose the system of law which is to govern their contract. However, mandatory provisions of Scots law (i.e. provisions which expressly or by implication apply, irrespective of the choice of some other system of law) will override the choice of law clause.

In the absence of an express choice of law clause, the applicable law is the law with which the contract is most closely connected (which, if the agent or distributor is based in Scotland and performs the contract there, is most likely to be Scots law).

So far as commercial agents are concerned, it is suggested that the initial assumption should be that the Regulations apply to the activities of commercial agents in the UK. If the agent is performing its activities in the UK then the fact that the agency agreement is expressed to be governed by the law of say, California, is immaterial.

Parallel imports:

Recent decisions by the European Courts on the application of the EC Trade Marks Directive have demonstrated that, in some circumstances, suppliers can rely on the protection afforded by their trade marks in preventing distribution of their products within the European Economic Area (the European Union and certain affiliated countries) (“EEA”) without their clear consent.

However, in EC law, the principle of exhaustion laid down in the Trade Marks Directive does prevent the trade mark proprietor from relying on the exclusive rights conferred by the trade mark where goods bearing that mark have been placed on the market within the EEA by the proprietor himself or with his consent. In other words, once the proprietor of the trade mark

has consented to the marketing of the products within one EEA state, he cannot use his trade mark rights to prevent parallel imports of the same products into other states within the EEA.

International conventions:

All European Community treaties apply, as do the regulations, directives and decisions of the Council of Ministers, the Commission and the European Court of Justice.

The UK is not, however, a party to the United Nations Convention on Contracts for the International Sale of Goods.

Human rights:

The UK has imported into UK law the European Convention on Human Rights by the Human Rights Act 1998. This important legislation enables British Citizens, including corporate bodies, to raise issues relating to the compatibility of legislation in UK Courts.

#### **Resources:**

- Business Gateway – International Trade ([www.bgateway.com/internationaltrade](http://www.bgateway.com/internationaltrade))
- Department for Business Innovation and Skills ([www.bis.gov.uk/about](http://www.bis.gov.uk/about))
- Envirowise ([www.envirowise.gov.uk](http://www.envirowise.gov.uk))
- Highlands & Islands Enterprise ([www.hie.co.uk](http://www.hie.co.uk))
- Office of Fair Trading ([www.oft.gov.uk](http://www.oft.gov.uk))
- Scottish Enterprise ([www.scottish-enterprise.com](http://www.scottish-enterprise.com))
- Scottish Government – Business and Industry ([www.scotland.gov.uk/topics/business-industry](http://www.scotland.gov.uk/topics/business-industry))

#### **Firm Description:**

Gillespie Macandrew LLP's practice covers Scots, English, UK and European laws, and has over 20 partners and around 100 fee-earners. Recognised as one of Scotland's pre-eminent property, investment and personal and family law firms, serving private clients, domestic and global businesses, charities and non-governmental organizations, the firm has particular strengths in:

- Energy and environment (including onshore and offshore renewables);
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- Business structures, mergers, acquisitions and disposals;
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- Rural business, countryside management and strategic land; and
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