Five Ways Agents Can Trap Value

Written by: *Neil Ende, Managing Partner at Emspire*

Unlike most business relationships, where the party with the direct relationship controls the customer, telecom agents do not have this luxury. To the contrary, because the role of a telecom agent typically is limited to acquiring customers for the carrier, an agent generally does not have any proprietary interest in the customer or control over the customer relationship.

An agent's rights are purely derivative and only exist to the extent granted in the agent agreement. And, because agent agreements often limit the time period in which commission payments are paid to the term of the agreement itself, an agent may forego long-term commission income even when the carrier's relationship with the customer, and the income flowing from that relationship, continues well beyond that term.

Even worse, many agent agreements contain restrictive non-compete terms that prevent the agent from communicating with, let alone seeking to sell other services to these customers both during and for years beyond the term of the agreement. The combination of strict limitations on commission payments to the term of the agreement and aggressive non-compete terms can wall off an agent from the opportunity to derive a long-term revenue stream and/or obtain the full value of its customer base.

However, there are a number of business and legal tools that can be employed to enhance the opportunities for agents to maximize their opportunity to greatly enhance these revenues and value.

1. Evergreen Clause

Evergreen clauses are the most common mechanism used to extend the period in which an agent obtains commission payments. Although these clauses come in various forms, as a general matter, they provide that commission payments will continue to be made on revenues obtained from customers brought in by an agent following the expiration or termination of the agent agreement.

In considering an evergreen clause, it is essential to be vigilant not only that the words of the clause itself accurately set forth the agreed upon terms but also that the intended effect of the clause is not jeopardized by other provisions of the agreement. Thus, for example, it is critical that the clause specifically provide that, while an event of termination may permit the carrier to refuse to take on new customers from the agent, it does not void the obligation to pay commissions under the evergreen clause on revenues derived from existing customers. The evergreen clause also should carefully define the period in which commission payments will continue to be made, address the obligation to pay commissions on additional and/or new services ordered by the customer following termination as well as the impact of the expiration of any term commitment and/or renewal of the underlying customer agreement.

If written correctly, and contained in a properly crafted overall agreement, evergreen clauses can increase substantially the period in which commission payments are received and thus the value of the customer base both in the near and long terms.

2. Profit Sharing Arrangements

Profit-sharing arrangements are the distant cousins of commission-based compensation arrangements. The advantage of profit-sharing arrangements can be the right to profits is generally not restricted to the term of the agent

agreement and an allocation of a percentage of the profit can be substantially more lucrative than a percentage commission payment.

Unfortunately, like commission arrangements that are based on "net revenues," the calculation amount of the "profit" to be "shared" can be a difficult exercise. Indeed, while gross revenues generally can be established directly from the carrier's accounts receivable records, "profit" can be based on a number of cost and operational factors, including varying methods of determining and allocating cost and overhead that are hard to define and can be manipulated to limit the revenues classified as "profit."

Moreover, profit-based arrangements are subject to the risk that services are provided at a "profit." Thus, while a "profit-sharing" model can offer the prospect of longer term and greater revenue flows, the difficulties of calculation and proof along with the risk of manipulation and that a profit will not be achieved, cast doubt on the value of these arrangements. Further, to the extent that these arrangements normally do not include a right of ownership, the agent also does not share in the value of the customer base itself or any increase in that value at the time of sale.

3. Equity Arrangements

Equity arrangements allow the agent to obtain an ownership interest in the entity providing service to its customers. Thus, equity arrangements, unlike any of the above payment methodologies, do allow the agent to share directly in the value of the customer base itself and in any increase in that value at the time of sale.

These advantages, however, come with a number of practical challenges. First and foremost is the need to establish an initial value for the customer base and a mechanism for adjusting that value over time and as the customer number and mix changes. Associated with this process is the need to establish the equity share

to be allocated to the agent initially and over time.

In terms of recurring revenues to the agent, equity arrangements also can suffer from the cost allocation and "profit" issues described above, particularly where the carrier is using the same staff and other resources to run numerous different equity- based arrangements. Moreover, to the extent the agent is not likely to be the controlling shareholder, great care is required to assure the agent's rights are properly protected.

Thus, while equity arrangements do offer the opportunity for the agent to participate directly in the appreciation of the asset it has brought to the enterprise, careful thought is required to balance the long-term benefits of ownership against the risks and uncertainties associated with achievement and calculation of profit and with the agent's status as a minority equity holder.

4. Buyback Arrangements

Buyback arrangements can be an attractive hybrid of a standard commission arrangement and an equity arrangement. These arrangements generally give the agent the right to buy back some or all of its client base from the carrier either at a predetermined price or at a price that will be determined at the time of sale based on a set of agreed criteria. The potential value of these arrangements is that they provide the agent with the ability to obtain an ownership interest in its client base, thereby taking part in the long-term appreciation of the asset it has brought to the carrier. As with any arrangement of this nature, the actual value to the agent will depend on the specific circumstances in which the buyback can occur, the valuation/discount model that will be applied and the associated rights, terms and conditions.

Properly structured, buyback arrangements can offer an added measure of flexibility to the agent's business operations and exit strategy as well as a real

opportunity for the agent to participate in the long-term appreciation of its customer base and to continue to derive revenue long after the end of the original agency agreement.

5. Sale of Commission Stream

In contrast to the above, if your desire is to have the right to exit from your agency arrangement through the sale of the commission revenue stream, it is generally not problematic but will depend in part on the assignment provision in the agreement. Most agent agreements contain "assignment" clauses setting forth each party's authority to assign its rights and/or obligations to others. These clauses take various forms: sometimes they flatly prohibit one or both parties from assigning any right or obligation without the prior express written consent of the other; sometimes they allow such assignments with prior consent of some kind; and sometimes assignment is allowed without limitation. Thus, absent an absolute prohibition on assignment, it is generally possible to realize the market value of your customer base by selling to a credible third party for either a one-time or recurring payment over time.

The playwright, Oscar Wilde once said that "[I]t is better to have a permanent income than to be fascinating." With thought and attention you can take real steps toward obtaining "permanent income" from your agent agreements; becoming "fascinating" may be a bit more challenging.