Neutral Citation Number: [2014] EWHC 47 (QB)
Case No: 2012 FOLIO 1329
IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
LONDON MERCANTILE COURT

Royal Courts of Justice*
Strand, London, WC2A 2LL
22/01/2014

Before :

HIS HONOUR JUDGE MACKIE QC

Between:

CHARLES SHEARMAN
(trading as Charles Shearman Agencies)
Claimant
and
HUNTER BOOT LIMITED

Oliver Segal QC (instructed by Fox Williams LLP) for the Claimant Ian Mill QC and Shane Sibbel (instructed by Mishcon de Reya) for the Defendant
Hearing date: 1st November 2013

* Material taken from the Approved Judgment of High Court of Justice – Queen's Bench Division (Case No. 2012 FOLIO 1329), SHEARMAN v. Hunter Boot Limited.

Judgement

The Defendant (" Hunter "), a well known boot and shoe company, resists a claim by its former agent Mr Shearman under the Commercial Agents (Council Directive) Regulations 1993 ("The Regulations"). Hunter has, quite close to trial, applied for summary judgment claiming that any entitlement that Mr Shearman has under Regulation 17 is to an indemnity and not to compensation. I declined to determine the application so close to trial for practical and case management reasons but informed the parties that if the opportunity arose I would decide the point as the answer might facilitate settlement, and would shorten the trial and prevent the need for the argument to be repeated.
The background detail is not directly relevant to the point in issue. Mr Shearman 's agency came to an end and he claims compensation under Regulation 17. Hunter says that the agency ended because it accepted his allegedly repudiatory conduct. If it is right Mr Shearman will get no compensation. If Hunter fails in that claim the question is whether Mr Shearman is entitled to an indemnity (under Regulation 17(3)-(5)), as opposed to compensation (under Regulation 17(6) and (7)). It is common ground that the value of compensation is greater than that of an indemnity in this case, that that will not be true in every case and that the parties will often not know which basis will be higher prior to termination, the time at which the entitlement under Regulation 17 is assessed.
The relevant Regulations

The Regulations were made under section 2(2) of the European Communities Act 1972 in order to implement EC Directive 86/653 on the coordination of the laws of the Member States relating to self-employed commercial agents. ("The Directive").
Regulation 17 is headed "Entitlement of commercial agent to indemnity or compensation on termination of agency contract", and provides as follows:
'(1) This regulation has effect for the purpose of ensuring that the commercial agent is, after termination of the agency contract, indemnified in accordance with paragraphs (3) to (5) below or compensated for damage in accordance with paragraphs (6) and (7) below.
(2) Except where the agency contract otherwise provides, the commercial agent shall be entitled to be compensated rather than indemnified.
(3) Subject to paragraph (9) and to regulation 18 below, the commercial agent shall be entitled to an indemnity if and to the extent that—
(a) he has brought the principal new customers or has significantly increased the volume of business with existing customers and the

principal continues to derive substantial benefits from the business with such customers; and
(b) the payment of this indemnity is equitable having regard to all the circumstances and, in particular, the commission lost by the commercial agent on the business transacted with such customers.
(4) The amount of the indemnity shall not exceed a figure equivalent to an indemnity for one year calculated from the commercial agent's average annual remuneration over the preceding five years and if the contract goes back less than five years the indemnity shall be calculated on the average for the period in question.
(5) The grant of an indemnity as mentioned above shall not prevent the commercial agent from seeking damages.
(6) Subject to paragraph (9) and to regulation 18 below, the commercial agent shall be entitled to compensation for the damage he suffers as a result of the termination of his relations with his principal.
(7) For the purpose of these Regulations such damage shall be deemed to occur particularly when the termination takes place in either or both of the following circumstances, namely circumstances which—
(a) deprive the commercial agent of the commission which proper performance of the agency contract would have procured for him whilst providing his principal with substantial benefits linked to the activities of the commercial agent; or
(b) have not enabled the commercial agent to amortize the costs and expenses that he had incurred in the performance of the agency contract on the advice of his principal. …
Regulation 19 is headed "Prohibition on derogation from regulations 17 and 18" and provides that 'the parties may not derogate from regulations 17 and 18 to the detriment of the commercial agent before the agency contract expires.'
The Agreement

The relevant clauses of the Agreement between the parties are clauses 14.4 and 14.5, which provide under the heading "Effect of termination";
14.4. Upon termination of the Agreement the Agent shall not be entitled to compensation but shall be entitled (subject to clause 14.5) to be indemnified ….
14.5. The Agent will not be entitled to the indemnity referred to in clause 14.4 but will be entitled to compensation for the damage it suffers as a result of the termination of its relations with the Agent [sic] if the amount of such compensation would be less than the amount payable by way of indemnity.
14.6 If as a matter of English law it is not mandatory that the Agent be paid an indemnity or compensation then clauses 14.4 and 14.5 shall not apply.'

Although of course any clause in a contract needs to be read in its context I do not set out any other provisions as the meaning of Clause 14 is clear. Clause 14 needs of course to be read as a whole and Hunter 's submission that the parties have contracted and agreed that only an indemnity is payable is disingenuous. The meaning of Clause 14, under the English approach to contractual construction, is that the Agent receives an indemnity, unless compensation would be lower in which case he gets compensation.
The question is, in the light of Regulation 19, what is the effect of Regulation 17(2) on a commercial agency contract, drafted by the Principal, which provides for the Agent to be paid the lower in value of an indemnity or compensation payment?
Why the difference between compensation and indemnity matters in this case.

Following the decision of the House of Lords in Lonsdale v Howard & Hallam [2007] 1 WLR 2055, compensation is calculated by reference to the value of the agency depending on the circumstances actually existing at the time of termination, including what its earning prospects had been and what people would have been prepared to pay for it. Mr Shearman claims that this will amount to 'a sum not less than £1,454,400.' Under Regulation 17(4) any indemnity will be capped at an amount equivalent to Mr Shearman 's average annual commission income over the last five years of his agency which Hunter says will be no more than £204,000. So there is a big gap.
Defendant applicant's submissions

Mr Mill QC and Mr Sibbel for Hunter put their position as follows. Regulation 17(2) provides that on termination an agent shall be entitled to be compensated rather than indemnified, 'except where the agency contract otherwise provides.' This gives the parties a contractual discretion to provide for circumstances on termination of a contract where the agent will receive an indemnity rather than compensation. There is nothing in the wording of Regulation 17(2) which prohibits the system set out under Clauses 14.4 to 14.6, or which prohibits contracts providing for indemnities to be paid in some instances of termination and for compensation to be paid in respect of others.
It is a well-established principle of statutory interpretation that a rule of the common law is not extinguished by a statute unless the statute makes this clear by express provision or by clear implication (R (Rottman) v Commissioner of Police for the Metropolis [2002] 2 AC 692 at ¶75 per Lord Hutton. Equally parties are free to contract as they see fit (see e.g. Suisse Atlantique Societe d'Armement Maritime SA v NV Rotterdamsche Kolen Centrale [1967] 1 AC 361 at 399 per Lord Reid);

The principle of freedom of contract has also been recognised as a general principle of European Union law, which is 'inseparably linked to the freedom to conduct a business' under article 16 of the EU Charter of Fundamental Rights (per A.G. Kokott in Case C-441/07 European Commission v Alrosa Co Ltd [2010] ECR I 5949 at AG ¶225. It follows that, absent any EU obligation requiring it to be construed otherwise Regulation 17(2) must be read as leaving the parties with a general freedom to contract in respect of the payment of an indemnity rather than compensation on the termination of the Agreement which must include the freedom to provide for an indemnity in certain circumstances and compensation in others.

Hunter also points to the Department of Trade and Industry Guidance Notes on the Commercial Agents (Council Directive) Regulations 1993 ("the DTI Guidance") issued in 1994 following the enactment of the Regulations which includes the following;

'The Regulation deals with entitlement to indemnity/compensation upon termination of the agency contract. It is for the two parties to choose which of these options they would wish to include in their contract with the backstop of compensation should no choice be indicated. There is however, nothing to preclude the two parties from agreeing to use the compensation provisions in some cases and indemnity ones in others when terminating a particular contract…'

Hunter argues that its construction of Clause 14 of the Agreement and Regulation 17(2) is also consistent with the purpose of the Regulations, which is to implement the framework for the coordination of the laws of Member States relating to self-employed commercial agents laid down by the Directive. Article 17(1) of the Directive provides that:

'Member States shall take the measures necessary to ensure that the commercial agent is, after termination of the agency contract, indemnified in accordance with paragraph 2 or compensated for damage in accordance with paragraph 3.'

Commercial agents will receive the level of protection envisaged under the Directive if they receive either an indemnity or compensation on termination.

European Commission Report

Hunter relies on the European Commission's Report on the Application of Article 17 of Council Directive 86/653 made on the basis of responses to a questionnaire which was sent by the Commission to 'organisations representing agents and principals, chambers of commerce and federations of industry and legal practitioners specialising in agency law. The authorities of Member States were also invited to contribute with their views and experience.' The Commission Report surveys the manner in which the Directive has been implemented in the various member states, and notes under the heading "Position in Member States" that:

'With the exception of France, the UK and Ireland, Member States have incorporated the indemnity option into their national law. The UK has permitted the parties to choose the indemnity option, but if they fail to do so, the agent will be entitled to compensation. Ireland has failed to make any choice at all in its legislation and accordingly the Commission has opened Article 169 proceedings. The Commission has also opened infraction proceedings against Italy for failure to implement Article 17 of the Directive correctly.' The Commission further notes in Annex B to the Report, under the heading "United Kingdom", that 'The UK has opted for its own particular system in that under Regulation 17 of Statutory Instrument No 3053 of 1993 [the Regulations] the parties may choose whether an agent will have the right to an indemnity or compensation. It is only in default of a contractual provision that the law requires compensation to be paid.'

Mr Mill submits that the European Commission is therefore aware that the choice between indemnity and compensation has been left to the parties' freedom of contract in the UK and must have no objection to the system under Clause 14 of the Agreement in this case.

It is however common ground that Mr Shearman 's only remedy in the event that Clause 14 of the Agreement were found to be permissible under the Regulations but to provide inadequate protection under the Directive would be to bring a Francovich claim for damages against the state for failing adequately to implement the Directive in the Regulations. So I do not deal with this issue further.

Claimant's submissions

Mr Segal QC for Mr Shearman submits that the exception provided for in Regulation 17(2) does not apply, and that his client is therefore entitled to be compensated rather than indemnified.

In the first case that went to the UK Courts under the Regulations, Page v Combined Shipping and Trading Co Ltd [1997] 3 All ER 565, CA, Staughton LJ, commenting on the underlying purposes of the Directive, observed (569f-h): "… The second objective [of the Directive] is one which appears to be a motive of social policy, that commercial agents are a down-trodden race, and need and should be afforded protection against their principals. Those reasons seem to be to point fairly strongly to an intention to depart from the domestic legal provisions of the various countries in the Community … That is particularly emphasised by reg 19, which says 'The parties may not derogate from regulations 17 and 18 to the detriment of the commercial agent before the agency contract expires.' These are regulations to protect and improve the position of commercial agents."

Mr Segal adds a sort of 'floodgates' argument. He says that in the 19 years since the Regulations have been in force, to the knowledge of the specialist lawyers representing Mr Shearman , no Principal has sought

to rely on a clause such as clause 14 so as to entitle it to have the best of both worlds under the regime for compensation/indemnity – which, if it were lawful in the way Hunter argues, would presumably become standard in all contracts drafted by principals.

Honyvem

In Honyvem Informazioni Commerciali Srl v Mariella De Zotti Case C-456/04 the European Court of Justice considered an Italian collective agreement which provided for the calculation of an indemnity in a manner contrary to the calculation criteria laid down in Article 17(2) of the Directive. The agreement was thus derogation from the framework established under Article 17. The ECJ held that such a derogation was prohibited, under Article 19, unless it could be established that the application of such an agreement guaranteed the commercial agent, in every case, an indemnity equal to or greater than that which results from the application of the calculation criteria laid down in Article 17.

Mr Segal relies in particular on paragraphs 24-27:

24. As regards Article 19 of the Directive, it must be recalled, first of all, that, according to settled case-law, the terms used to establish exceptions to a general principle laid down by Community law, such as that resulting from the indemnity scheme provided for by Article 17 of the Directive, are to be interpreted strictly (Case C-150/99 Stockholm Lindöpark [2001] ECR I-493, paragraph 25).

25. Next, it must be observed that Article 19 of the Directive provides for the parties to be able to derogate from the provisions of Article 17 before the contract expires, provided that that derogation is not unfavourable to the commercial agent. It is clear, therefore, that the issue of whether or not that derogation is unfavourable must be determined at the time the parties contemplate it. The latter cannot agree on a derogation if they do not know whether at the end of the contract it will prove to be favourable or detrimental to the commercial agent.

26. That interpretation is also supported by the aim and the character of the system established by Articles 17 and 19 of the Directive, as set out in paragraphs 19 and 22 of this judgment.

27. Therefore, it must be concluded from the foregoing considerations that Article 19 of the Directive must be understood as meaning that a derogation from the provisions of Article 17 may be accepted only if, ex ante, there is no possibility that at the end of the contract that derogation will prove to be detrimental to the commercial agent.

Mr Segal submits therefore that a contractual method of quantifying compensation/indemnity constitutes a void derogation, unless it can be shown that the contractual method is known, at the time of contracting, to be not unfavourable to the agent. Clause 14 purports to achieve precisely the opposite. Hunter sought to establish a way of quantifying

the termination payment which was bound to be unfavourable to Mr Shearman . Clause 14 thus cannot constitute a valid election for an indemnity in all circumstances. It thus falls foul of Regulation 17(2) read with Regulation 19. His client is therefore entitled to a compensation payment (in so far as he has any entitlement under Regulation 17).
Mr Mill says that Honyvem is no authority for the proposition that the Regulations and/or the Directive prohibit the system chosen by the parties in Clause 14 which effects a choice permitted under Regulation 17 to provide for an indemnity in some situations and compensation in others. In all cases under Clause 14 the indemnity is calculated according to the criteria laid down in Regulation 17(4) (and Article 17(2) of the Directive).
Hardie Polymers

In Hardie Polymers Ltd v Polymerland Ltd [2001] ScotCS 243, 2002 SCLR 64 the Outer House of the Court of Session decided on the construction of an agreement, the terms of which were described as unusual and odd, with the result that the clause in issue was held to entitle the Pursuer to an indemnity.
Mr Mill is right to say that Hardie deals with the construction of a clause headed "compensation" but held by the Court actually to provide for an indemnity. Mr Segal however cites remarks at paragraph 27, "a provision making the election in favour of indemnity, viewed against the background of the provision in regulation 17(2) that the agent's entitlement is to be to compensation 'Except where the agency contract otherwise provides', requires clarity in the expression of the parties' intention". The more so, Mr Segal contends, where the clause has been drafted by the principal, with the sole intention of minimising the agent's entitlements. He says there is no such 'clarity' in this case.
Mr Segal says that one needs only read "otherwise provides" as requiring a non-contingent provision for indemnity, at least in any given circumstance of termination; that is, a provision for indemnity such that the parties have agreed it will apply in those circumstances, not that it might apply depending on whether that is more favourable to the principal (which Mr Shearman says is the natural meaning of the words of Reg. 17(2)). Mr Segal says that the authorities would clearly sanction such a purposive construction-see for example Vodafone2 v Revenue and Customs [2010] Ch 77.
Decision

Mr Mill and Mr Segal argue what is essentially the one important difference between them in a variety of attractive ways. Is Regulation 17(2) to be read so as to permit the Principal to impose on the Agent either contribution or indemnity, whichever is cheaper for the Principal?
I am not, as I have already said, concerned with the Francovich issues.

The views of the DTI, as it then was, as to the meaning of the Regulations are not in my view relevant.
Neither Honyvem nor Hardie directly relate to the point in issue. Honyvem does at paragraphs 26 and 27 require that there must be no possibility that at the end of the contract that derogation will prove to be detrimental to the commercial agent, an indication that the ECJ attaches importance to the protection of that agent. Hardie emphasises that a provision to have an indemnity rather than compensation needs to be clear given the requirement that the right is to compensation rather than indemnity unless the parties agree otherwise. That seems to me a traditional approach to construction, albeit one that recognises the importance of protecting the Agent. The remarks of Staughton LJ in Page confirm, what is often emphasised, that the background to the Regulations was a concern for the position of Commercial Agents who were seen to be vulnerable when dealing with their principals.
I have already suggested that on an English law approach the meaning and effect of Clause 14 is quite clear. The principles of interpretation of contract and statute relied on by Mr Mill are not controversial. So the question is whether construction of the Regulations consistently with Community law obligations produces a different result. It is common ground that the approach is summarised in the judgment of Sir Andrew Morritt in Vodafone2 v Revenue and Customs [2010] Ch 77 at 37 to 39 and I quote only the summary approved by the Court of Appeal;
"In summary, the obligation on the English courts to construe domestic legislation consistently with Community law obligations is both broad and far-reaching. In particular: (a) it is not constrained by conventional rules of construction (per Lord Oliver of Aylmerton in the Pickstone case, at p 126b); (b) it does not require ambiguity in the legislative language (per Lord Oliver in the Pickstone case, at p 126b and per Lord Nicholls of Birkenhead in Ghaidan's case, at para 32); (c) it is not an exercise in semantics or linguistics (per Lord Nicholls in Ghaidan's case, at paras 31 and 35; per Lord Steyn, at paras 48-49; per Lord Rodger of Earlsferry, at paras 110-115); (d) it permits departure from the strict and literal application of the words which the legislature has elected to use (per Lord Oliver in the Litster case, at p 577a; per Lord Nicholls in Ghaidan's case, at para 31); (e) it permits the implication of words necessary to comply with Community law obligations (per Lord Templeman in the Pickstone case, at pp 120h-121a; per Lord Oliver in the Litster case, at p 577a); and (f) the precise form of the words to be implied does not matter (per Lord Keith of Kinkel in the Pickstone case, at p 112d; per Lord Rodger in Ghaidan's case, at para 122; per Arden LJ in the IDT Card Services case, at para 114)." Supplemented by;
"The only constraints on the broad and far-reaching nature of the interpretative obligation are that: (a) the meaning should 'go with the grain of the legislation' and be 'compatible with the underlying thrust of

the legislation being construed': see per Lord Nicholls in Ghaidan v Godin-Mendoza [2004] 2 AC 557, para 33; Dyson LJ in Revenue and Customs Comrs v EB Central Services Ltd [2008] STC 2209, para 81. An interpretation should not be adopted which is inconsistent with a fundamental or cardinal feature of the legislation since this would cross the boundary between interpretation and amendment (see per Lord Nicholls, at para 33, Lord Rodger, at paras 110-113 in Ghaidan's case; per Arden LJ in R (IDT Card Services Ireland Ltd) v Customs and Excise Comrs [2006] STC 1252, paras 82 and 113); and (b) the exercise of the interpretative obligation cannot require the courts to make decisions for which they are not equipped or give rise to important practical repercussions which the court is not equipped to evaluate: see the Ghaidan case, per Lord Nicholls, at para 33; per Lord Rodger, at para 115; per Arden LJ in the IDT Card Services case, at para 113."

A purposive construction presupposes a purpose. Hunter contends that the purpose is freedom of contract and Mr Shearman that it is protection of agents in their vulnerable position, both along the lines I have summarised above. The answer as I see it is a bit of both. Contractual choice is permitted if not encouraged provided that the Agent receives the protection afforded by the Regulations as a whole. The Directive exists primarily to protect Agents not Principals.

I bear in mind, what was not mentioned at the hearing but is well known, that a choice between compensation and indemnity was provided in the Directive because it was decided to permit two different systems, indemnity from Germany and compensation mainly from France, to co-exist. The reasons for this were pragmatic. The choice is not the product of some overall intellectual structure requiring compensation or indemnity to apply to particular special circumstances.

I recognise that the right to choose may permit not only choice between the systems but also election of one where the termination is for one reason and the other where it is for another. Clause 14 does not provide for different systems in different situations, visible at the time of the agreement such as death or bankruptcy (as envisaged by, for example, the DTI guidance). It provides for different systems to apply in an eventuality not capable of being specified at the time of the Agreement, namely whichever system turns out at termination to be cheapest for the Principal. This does not seem to me to give effect to the choice which the Directive and the Regulations permit. The Clause does not give the Agent, in a real sense, the 'Entitlement' (as it is described in the heading to the Regulation) to either compensation or, alternatively, indemnity.

The floodgates argument that if the structure of Clause 14 were permitted it would soon become standard, given what is usually the Principal's bargaining power, does not help an English contractual analysis. But I do see it as relevant in the sense that it is improbable that the framers of the Directive intended to permit a category of choice

which would frequently, if not invariably, lead to the Agent having the worst of both worlds.

I therefore conclude that the regime created by Clause 14 is not consistent with or permitted by the Regulation. It is not compatible with the underlying thrust of the legislation. I read "except where the contract provides otherwise" in Regulation 17 (2) as not permitting a provision of the kind in issue on this application. That does not however answer the question of how my conclusion affects the contract. Mr Segal argues that the whole of Clause 14 should be struck down leaving his client with compensation as that is the measure if there has been no choice otherwise. It appears from Paragraph 43 of Mr Mill's skeleton that Hunter accepts that in such an event that consequence would follow. It is apparently not argued that the parties have opted for indemnity, which they are free to do, and that the offending provision, Clause 14.5, can be simply severed. Subject to being corrected on this point I therefore conclude that the whole of clause 14 falls away.

Conclusion

My conclusion is expressed for the limited purpose I described at the outset and I will hear the views of the parties, preferably jointly but in any event in writing within ten days of today, before deciding how and when, if at all to hand down this decision. I am concerned to keep costs down and not to distract the parties from their trial preparation. Subject to that my conclusion is as follows.

The structure of Clause 14 is not consistent with the Regulations and, following what appears to be a concession by Hunter , the entire clause falls away so that, if the Claimant is entitled to anything, it is to compensation not indemnity.

POST SCRIPT. After this draft was circulated one party asked me hand down judgment and the other wished to postpone this until after the trial. I decided to hand down judgment. I understand that the case has now settled although no order has yet been drawn up.