Neutral Citation Number: [2015] EWHC 3143 (QB)

Case No: LM-2014-000084

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
MERCANTILE COURT

Royal Courts of Justice
Rolls Building, 7 Rolls Buildings
Fetter Lane, London EC4A 1NL

Date: 02/11/2015

Before :

MR. JUSTICE TEARE

- -

Between :

BRAND STUDIO LIMITED	**Claimant**
- and -	
ST JOHN KNITS, INC	**Defendant**

- -
- -

Oliver Segal QC (instructed by **Rosenblatt Solicitors**) for the **Claimant**
Philip Moser QC (instructed by **Harbottle & Lewis LLP**) for the **Defendant**

Hearing date: 26 October 2015

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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MR. JUSTICE TEARE

Mr. Justice Teare :

1. This is the trial of a preliminary issue in an action in which a commercial agent has sought compensation from his principal on the termination of his agency. The issue to be tried is as follows:

> "Whether the Claimant is entitled to compensation (as opposed to an indemnity) pursuant to clause 6.3(a) of the EU Agency Agreement executed by the Claimant and the Defendant on or about 9-14 December 2009, referred to in the statement of case as the "EU Agreement", (as defined in the Amended Particulars of Claim dated 6 March 2015) and pursuant to Regulation 17 of the Commercial Agents (Council Directive) Regulations 1993 (as amended)."

The background

2. The Defendant is a Californian fashion company designing, manufacturing and retailing luxury women's clothing. The Claimant is a UK sales agency. Between 2009 and 2014 the parties were in a contractual relationship whereby the Claimant sold the Defendant's clothing to retailers in the EU and elsewhere for commission. The "EU Agreement" between the parties is governed by English law.

3. Pursuant to the Commercial Agents Regulation a commercial agent is entitled to an indemnity or compensation on termination of the agency. Unless otherwise agreed the agent is entitled to be compensated rather than to be indemnified. Regulations 17 and 19, so far as material, provide as follows:

> "17(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.
>
> 17(2) Except where the agency contract otherwise provides, the commercial agent shall be entitled to be compensated rather than indemnified.
>
> ……..
>
> 19. The parties may not derogate from regulations 17 and 18 to the detriment of the commercial agent before the agency contract expires."

4. The agreement between the parties provides as follows, so far as material:

> "6.3(a) Upon expiry or termination of this Agreement for any reason:
>
> (a) If and to the extent that the ….Regulations apply, [the Claimant] shall (if and to the extent so entitled in accordance with the provisions of the Regulations) have the right to be

> indemnified as provided for in regulation 17 of those Regulations. For the avoidance of doubt, [the Claimant] shall have no right to any compensation under those Regulations upon termination or expiry of this Agreement provided that if the amount payable by way of indemnity under this Clause would be greater than the amount payable by way of compensation, [the Claimant] shall ….have the right to receive compensation instead of an indemnity under the regulations ….
>
> 7.5 In the event that any provision of this Agreement is held to be invalid or unenforceable, such provision will be deemed to have been severed from the Agreement, while the remained of the Agreement will remain in full force and effect."

5. In *Shearman v Hunter Boot Ltd* [2014] EWHC 47 (QB) HHJ Mackie held that similar provisions in the agency contract before him did not amount to a valid "agreement otherwise" and so was unenforceable. At paragraph 35 he said:

> "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."

6. It is common ground that that analysis applies to clause 6.3(a) of the agreement between the parties in the present case.

7. Mr. Segal QC, on behalf of the Claimant, submits that there being no valid "agreement otherwise" the Claimant is entitled to compensation pursuant to Regulation 17. Mr. Moser QC, on behalf of the Defendant, submits that the offending proviso in clause 6.3(a) can be severed leaving the rest of the clause in place with the result that the Claimant is entitled to an indemnity, not compensation. The question of severance was left open in *Shearman* because, although the judge raised the point, it was not argued. It now falls to this court to determine the question.

8. Mr. Segal submits that the severance argument is misconceived for two reasons. First, it is said that the question does not arise. Lest I misrepresent this argument I shall set it out as it appears in Mr. Segal's skeleton argument:

> "The question must first be answered whether the EU Agreement "otherwise provides", within the meaning of the

> regulations, for an entitlement to an indemnity. Only if the answer to that question is Yes does it become material whether the second sentence of clause 6.3(a) can be severed as a matter of English common law. The answer to that question in this case is No; therefore the issue of severance is a red herring."

9. The second argument is that, if it is relevant to consider severance, it is not permissible to sever the offending proviso pursuant to the common law rules on severance which it is common ground are the relevant rules to apply.

10. Mr. Moser submits that the proviso can be severed, leaving the lawful choice of an indemnity in the first part of the clause.

Does severance arise at all ?

11. Mr. Segal's submission is that since, for the reasons given by HHJ Mackie, clause 6.3(a) does not "otherwise provide", the Claimant is entitled to compensation upon termination of the agency agreement pursuant to Regulation 17 and no question of severance can arise. I was not persuaded that this is the correct approach. The assumption underlying the submission is that when determining whether the agency agreement "otherwise provides" the court construes the agreement and does not consider, in the event that it determines that a clause, or part thereof, is invalid and unenforceable, whether it can properly be severed. I consider that the court should consider the question of severance before finally determining whether the agreement "otherwise provides", particularly in this case where clause 7.5 of the agreement itself expressly contemplates severance in the event that any provision of the agreement is held to be invalid. If the court considers that the invalid clause can be severed then the court can finally determine whether the agreement "otherwise provides".

Severance

12. In *Beckett Investment Management Group v Hall* [2007] 1 ICR 1539 Maurice Kay LJ, with whom Sir Anthony Clarke MR and Carnwath LJ agreed, said that the threefold test formulated in *Sadler v Imperial Life Assurance* [1988] IRLR 388 "should be adopted". I must therefore adopt that test when considering the question of severance. That test is a follows:

> "… a contract which contains an unenforceable provision nevertheless remains effective after the removal or severance of that provision if the following conditions are satisfied:
>
> (1) the unenforceable provision is capable of being removed without the necessity of adding to or modifying the wording of what remains;
>
> (2) the remaining terms continue to be supported by adequate consideration;
>
> (3) the removal of the unenforceable provision does not so change the character of the contract that it becomes 'not the sort of contract that the parties entered into at all'."

13. In the present case it is common ground that tests (1) and (2) are satisfied. The dispute concerns the third test.

14. The removal of an unenforceable provision will inevitably change the agreement which the parties purported to make. The mere fact that the removal will change the agreement is not enough to bar severance. The removal of the unenforceable provision must "*so change* the character of the contract that it becomes not the sort of contract that the parties entered into at all" (emphasis added). So the court must exercise its judgment as to the extent of the change and its effect.

15. Mr. Moser submitted that the first part of clause 6.3(a) contained a valid election by the agent to accept an indemnity rather than compensation. The proviso was invalid in that the agent nevertheless agreed to accept compensation when the amount payable by way of an indemnity would be greater than the amount payable by way of compensation. Removal of the invalid proviso would have the effect that the valid election to accept an indemnity remained such that the character of the agreement had not changed. It remained the sort of contract that the parties entered into.

16. Mr. Segal submitted that the two parts of clause 6.3(a) are, in substance, interwoven: the agent gets an indemnity subject to compensation being less valuable; it gets compensation subject to an indemnity being less valuable. He said that where two parts in fact constitute one covenant or two interdependent covenants (or, as he put it orally) two covenants one of which is dependent upon the other, no severance is permissible, even though one part, viewed in isolation, is unobjectionable. He said that the court should have regard to substance rather than to form (or, he said, to the syntax) of the clause. He relied in particular on *Kenyon v Darwen Cotton Manufacturing Company* [1936] 2 KB 193 and *Marshall v NM Management* [1997] 1 WLR 1527.

17. There is undoubted force in Mr. Segal's submission that in substance the effect of clause 6.3(a) is that the agent gets an indemnity provided that compensation is not less, in which case he gets compensation. I further accept, as was stated by Millet LJ in *Marshall v NM Management* at p.1532 that one must have regard to substance rather than form, though Millett LJ added that the structure and language of the contract are of prime importance. However, when considering the substance or "character" of the clause it does seem to me important to bear in mind that the Regulation permits an agent to agree to accept an indemnity. That is what the first part of clause 6.3(a) purports to do. It is a concession by the agent who would otherwise be entitled to compensation. The proviso amounts to a further concession by the agent, namely, that where compensation proves to be less than an indemnity he will be entitled to compensation only. That is an invalid and unenforceable concession. It is true that it affects the operation of the otherwise enforceable concession so that one is dependent upon the other. But the question for the court is not whether the enforceable part of the clause is dependent upon the unenforceable part of the clause. The question for the court is whether the removal of the unenforceable part so changes the character of the contract that it becomes "not the sort of contract that the parties entered into." The sort of contract into which the parties entered into was one in which the agent purported to accept an indemnity rather than compensation in the event that the agency was terminated. Had that been the effect of the clause as a whole the agent's acceptance of an indemnity would have been valid and enforceable. However, because of the proviso, that was not the effect of the clause as a whole. The proviso had the effect that the agent only agreed to accept an indemnity so long as the measure of an indemnity was less than the measure of compensation. If it was greater

then he had to accept the lesser amount of compensation. To remove the proviso certainly changes the meaning of the clause as a whole but I am not persuaded that it so changes the character of the contract that it becomes not the sort of contract that the parties entered into. Before severance of the proviso it was an agency contract in which the agent had purported to accept an indemnity but had in addition agreed to accept compensation if that was a lesser sum. After severance it is an agency contract in which the agency has agreed to accept an indemnity whether or not compensation would be a lesser sum. In my judgment the contract remains, after severance, "the sort of contract that the parties had entered into".

18. I have considered the decision in *Kenyon v Darwen Cotton Manufacturing Company* upon which Mr. Segal relied in support of his submission that where two parts of a contract were one covenant or two interdependent covenants no severance is permissible. In that case there was an arrangement between a company and an employee whereby the employee subscribed for shares in the company and paid for them out of the employee's wages so that the employee received only the net amount of her wages. She signed two documents; the one requesting the allotment of shares and the other agreeing that the shares should be paid out her wages. The Truck Act 1831 provided that wages must be paid in the current coin of the Realm. Section 1 provided that if a contract contravened its provisions "the contract shall be and is hereby declared illegal null and void." Section 25 provided that "contract" was to be given a wide definition to include "any agreement understanding, device, contrivance, collusion or arrangement whatsoever on the subject of wages." The employee's wages had not been paid in full in coin of the Realm and so she claimed for what had not been so paid to her. The court of appeal held that there had been a violation of the Truck Act and that the employee was entitled to recover so much of her wages as had not been paid in the coin of the Realm. The court of appeal further held that the company's counterclaim for payment of the shares failed. The county court judge had held that the contract to purchase the shares was severable from the illegal contract. The court of appeal disagreed. Slesser LJ said that the two documents signed by the employee were the terms of one contract and not to regard them as such would be entirely artificial. To enforce the obligation to purchase shares would be enforcement of an illegal and void contract. He referred to the wide definition of "contract" and said that it was clearly wide enough to cover the whole of the arrangements which had been made. Scott LJ referred to the "extraordinarily wide and all embracing" definition and noted that it was "whole network of agreements, understandings, devices, contrivances, collusions whatsoever on the subject of wages" which was made illegal. He concluded that the agreement to take and pay for shares was avoided by the wide operation of the Act. It is therefore clear that no question of common law severance of the agreement to buy shares from the agreement to receive only the employee's net wages could arise. I therefore do not consider that this case assists or supports Mr. Segal's submission.

Conclusion

19. Once the proviso is severed from clause 6.3(a), as I consider it should be, the clause contains only the valid concession by the agent that in the event of termination of the agency agreement the agent will be entitled to an indemnity rather than compensation. For the purposes Regulation 17 the agency contract therefore "otherwise provides."

20. For the reasons I have given the answer to the preliminary issue is No.