Covenants: the pitfalls of

The Drafting Problem

The drafting of "potboiler" clauses in agreements is a difficult art. It is difficult because, at the time of the agreement, parties do not really know what they want. Often enough they just want "some sort of" a "restraint clause" or "some sort of" an "arbitration" clause. Solicitors may well discuss the elements of a "restraint clause" (for how long and for how far?) or the elements of an arbitration clause (These are the pros and cons of an arbitration. Do you want an arbitration clause or not?). However, there is more to it than this. The conclusion from the two cases discussed in this article is that solicitors should seek more specific instructions than simply canvassing the general elements of "restraint" and "arbitration" clauses and should, in any event, carefully consider just what should be the wording of their "potboiler" word processor precedents.

The first case considers a "restraint of trade" clause and the important difference found by the Court between the very similar words "carry on or be engaged or interested in a medical practice" and the words "engage in practice as a medical practitioner".

The second case involves an analysis of arbitration clauses and the importance of the precise words used in them. Apparent minor variations in wording will mean, on the one hand, that all disputes between the parties will be arbitrated, whether they arise under the agreement between them or involve misleading of deceptive conduct claims under the *Trade Practices Act* whilst, on the other hand, this may not occur. If the purpose of an arbitration clause is to have all issues arbitrated, a clause which fails to include *Trade Practices Act* claims in the arbitral proceedings will probably result in the worst of all worlds, ie contractual issues will be arbitrated whilst akin misleading or deceptive conduct issues will be litigated. Such a clause will bifurcate the issues between the parties and set up two arenas in which the parties may wage war. Surely any one arena, be it litigation or arbitration, is a better situation. Yet, because of their wording, it is undoubtedly the case that many arbitration clauses do not achieve their generally understood purpose of having all relevant issues made the subject of one arbitration.

Drafting 'Restraint of Trade' Covenants

Drafting Restraint of Trade Covenants has its own specific problems. If the covenant is not drafted widely enough, it is likely to be ineffective. On the other hand, the courts have interpreted such covenants strictly and, when the covenants have been excessive either in time or scope of restraint, they have been invalidated. In New South Wales sometimes the *Restraints of Trade Act* 1976 has been able to be used to validate a restraint otherwise invalid but no similar legislation exists in other states.

The case of *Lu v Lim* (1993) ATPR 41-237, a decision of Young J of the Supreme Court of NSW, illustrates, however, yet another drafting minefield.

The parties were in partnership in a medical practice.

The relevant clause which was the subject of the litigation stated that if a partner retired from the partnership, that partner would not directly or indirectly "carry on or be engaged or interested in any medical practice within a radius of 5 kilometres from...where the present partnerhsip is carrying on business for a period of three years from the date of the termination of the partnership..."

There was no doubt that the defendant partner intended to become involved in a medical practice but this paractice was situated outside the five kilometre limit. Further, the retiring partner did not intend to solicit former patients but he did desire to be at liberty to attend to patients in their homes in the area which was included within a circle whose radius was five kilometres from the former practice.

The question for determination in the case was one of construction. In relation to the construction of the covenant, the two relevant issues were: (1) the meaning of the word "retires"; and (2) the meaning of the words "carry on or be engaged or interested in any medical practice".

His Honour held that "retires" meant leaving the partnership whether that meant complete termination of the partnership or not. This particular element of the case was not one of difficulty and was not crucial to the Court's decision.

It was the meaning of "engaged in medical practice" which was crucial to the decision. In this regard, the Court drew a distinction between the present covenant and a covenant considered in a prior case (*Lyne-Pirkis v Jones* [1969] 3 All ER 738).

The covenant in Lyne-Pirkis said that a doctor should not for five years after retirement "engage in practice as a medical practitioner". This restraint prohibited any type of practice as a medical practitioner whether in the premises of the parties, the surgery of the parties or elsewhere. However, the present case made the distinction between a covenant involving a restriction of practice (as in *Lyne-Pirkis*) and a covenant which was referred to as a "brass plate" covenant.

A "brass plate" covenant is one which merely prevents a doctor from establishing a surgery in an area. The real question was whether the covenant in the case could be classified as a "brass plate" covenant or a covenant of a wider kind.

The Court held that the covenant was a "brass plate" covenant. The covenant referred to a "medical practice" and that the practice had a particular location. Also, the parties in their evidence referred to "the practice" as referring to the entity, rather than the practising of medicine. This suggested to the Court that the retiring partner was not to be engaged in medi-

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by WARREN PENGILLEY*

cal practice in the sense that this constituted a business, rather than that the retiring partner should not engage in the practice of medicine. Relying on prior authority, the Court found that the prime purpose of the covenant was to protect the goodwill of the medical practice and that this goodwill was attached by reason of things done or carried out at or in a particular place. The present covenant was of this kind. The covenant did not prohibit the retiring partner from practising medicine at all and accordingly it followed that the defendant medical practitioner could attend to patients in their homes in the area included within five kilometres from the former practice.

Drafting Those 'Restraint of Trade' Covenants

Paper Products Pty Ltd v Tomlinson (Rockdale) Limited [Federal Court, French J, 23/7/93] involved a dispute as to the arbitration of certain issues under an agreement which provided: "Any dispute between the parties hereto arising under this agreement which is not settled in a friendly manner shall be finally settled under the rules of Conciliation and Arbitration of the International Chamber of Commerce, Paris, by three arbitrators appointed in accordance with the said Rules."

The question in dispute was whether a claim for misleading of deceptive conduct and a claim in relation to certain alleged false representations under the *Trade Practices Act* had to be arbitrated under the above clause or whether such claims were outside the clause.

The Court found that there had been a significant attitudinal change in recent years to arbitration claims. There was thus no reason, in principle, why a *Trade Practices Act* claim could not be arbitrated. The real question depended upon whether the clause in question encompassed the arbitration of such a claim.

French J carefully analysed prior cases. The result of his analysis showed the following (the first being case reference and wording of convenant in the case, the latter being the decision as to whether Trade Practices claim or other misrepresentation claim could be arbitrated):

(1) *IBM Australia Ltd v National Distributions Services* (1991) 100 ALR 361.
Agreement provided for arbitration of all issues "related to this agreement or breach thereof".
Held: Trade Practices issues could be arbitrated as the words "in relation to" are of the widest import and should not, in the absence of compelling reason, be read down.

(2) *Main Electrical Pty Ltd v Civil & Civic Pty Ltd* [1978] 19 SASR 34.
Agreement provided for arbitration as to moneys payable "or in respect of anything done or purporting to be done or omitted to be done or arising in any other manner whatsoever under or by reason of any of the terms and provisions of this order."
Held: The Arbitration power extended to something done "by reason" of the order in question. The decision of Bray CJ (on appeal) would not extend arbitration to claims for misleading conduct under the *Trade Practices Act* as these were not matters "by reason" of the Order. The decision of Mitchell J at trial would have permitted arbitration on the basis that the clause was wide in scope.

(3) *Mir Bros. Development Pty Ltd v Atlantic Constructions Pty Ltd* (1985) 1 BCL 80.
Agreement provided for arbitration of "all disputes and differences arising out of the contract or concerning the performance or the non-performance by either party of his obligations".
Held: A dispute about the existence of an agreement, independent of and separate from the contract, could satisfy neither limb of the arbitration clause and accordingly could not be arbitrated.

(4) *Allergan Pharmaceuticals Inc v Bausch & Lomb Inc* (1985) AJPR 40-636.
Agreement provided for arbitration of "any controversy or claim arising out of or relating to this agreement".
Held: *Trade Practices Act* claims for misleading conduct exist independently of contract. Thus a *Trade Practices Act* claim cannot be characterised as "a controversy or claim arising out of or relating to (the) agreement".

(5) *Ashville Investments Ltd v Elmer Contractors Ltd* (1988) 3 WLR 867.
Agreement in question referred to the arbitration of all disputes "as to the construction of this contract or as to any matter or thing of whatsoever nature arising thereunder or in connection therewith".
Held: Claims for misrepresentation and negligent misstatement were disputes which arose "in connection with" the contract.
The Court specifically noted, however, that the reason for its conclusion was that the misstatement etc was a matter "in connection with" the contract and was able to be arbitrated only because of the inclusion of these words, which were words of wide import.
A misrepresentation or misstatement was not a dispute as to the construction of the contract nor a dispute as to any matter arising under the contract.

French J, after analysing the above cases, said that "case citations and examples could be multiplied but there is little point". He concluded that when the parties have agreed on a limited arbitration power and arbitration is to be only in relation to matters arising ex contractu, there is little room for movement. His Honour thus concluded that neither the *Trade Practices Act* claims nor the claims in relation to negligent misstatement were

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cally recorded, or at all.

Although the prisoner's friend had been present, he was not in a position to advise the accused if he had sought advice, as for much of the time he was well separated from the accused.

(5) The admission of guilt by the accused to the watchhouse commander upon being formally charged was inadmissible because it had not been electronically recorded.

Section 142 applies to admissions made before and during questioning. At the time when this admission was made, the accused had been invited to say anything if he wished, in respect of the charge. This was a questioning in the relevant sense; his reply should have been electronically recorded.

His Honour was not satisfied that it would be in the interests of justice to admit this admission pursuant to s 143.

Application pursuant to s 26L of the *Evidence Act.*

J Lawrence, instructed by NAALAS, for the applicant/accused.

R Wallace, instructed by the DPP, for the respondent/Crown.

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within the arbitration clause in question.

His Honour observed that he reached this conclusion with some regret because he had no doubt that there would be much evidence in the arbitration proceedings (for breach of contract) which would also be relevant in any court proceedings involving *Trade Practices Act* claims or claims in relation to misleading representations.

Lessons from the Cases

It is clear enough that "potboiler" clauses merit far greater attention than is traditionally given to them.

The aforementioned cases illustrate this point.

It is thus necessary for lawyers to ascertain just what clients wish to restrain in "restraint clauses".

Perhaps it is more important for lawyers to examine their standard "arbitration" precedents.

The writer is in strong agreement with the views expressed by French J.

An arbitration clause which gives rise to a dual forum of dispute resolution is not a situation which many clients would welcome and, if this does occur, clients will, no doubt, and quite rightly, blame their lawyers for it.

If this situation results and the covenant in quesiton has not been worded to accord with a client's specific instructions, it is not beyond possibility that a lawyer drafting such a covenant may find herself or himself liable for his or her client's costs in resolving the dispute in one or other of the forums.

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Mediation for AAT

The President of the Administrative Appeals Tribunal, Justice O'Connor, has extended the Tribunal's mediation programme to all jurisdictions from this month.

Justice O'Connor said she proposes to carry out a full evaluation of the programme in the middle of next year.

Mediation is available within the Tribunal for the juristictions of social security and customs in all registries and for taxation cases on a trial basis.

Other mediation services will be provided in jurisdictions or registries where mediation is requested and the Tribunal is in a position to provide the service(s).

ILSAC lives

The federal Attorney-General, Michael Lavarch, has re-established the International Legal Services Advisory Council (ILSAC).

ILSAC's charter is to promote the export of Australian legal services and to develop closer legal co-operation in the Asia Pacific region.

Appointed to ILSAC for three years were: Sir Laurence Street (Chair), Elizabeth Nosworthy (ex-officio as representative of the Australia-Indochina Legal Co-operation Programme), David Bailey, Patrick Brazil, Philip Clark, Michael Ahrens, Catherine Walter, James Creer, Prof Michael Pryles (private practitioners), Prof David Flint, Prof Malcolm Smith (university reps), Peter Levy (Law Council of Australia), and representatives from five government departments.