

# IT BYTES

## ANSWERING YOUR COMMON IT CONTRACT LAW QUESTIONS

# WHAT IS THE DIFFERENCE BETWEEN AN ASSIGNMENT AND A NOVATION?



## WHEN DOES THIS QUESTION TEND TO ARISE?

**A contract can be both an asset and a liability for a company, containing both rights to which the company is entitled and obligations which the company must perform. Like any other asset or liability, the company may from time to time wish to deal with those rights and obligations. A classic example is where the company wishes to sell part of its business, and for the purposes of the sale either wishes to share the benefit of a particular contractual arrangement with the buyer or else transfer the contract as part of the business to the buyer. But will that be possible?**

## WHAT DOES THE LAW SAY?

As a starting point, it is necessary to understand the difference, from a legal perspective, between an assignment and a novation:

### Assignment

An assignment involves the transfer of rights or benefits that the assignor has under a contract to the assignee. This does not make the assignee party to the contract, nor does it create a new contract between the assignee and the other party to the contract. The assignment may need to be recorded in writing and notified to the counterparty to be effective. However, the counterparty's consent is not required as a matter of law. In other words, an assignment can be effected unilaterally by the assignor, though importantly the assignor's obligations under the contract will not be affected (so the assignor will remain liable to the counterparty for fulfilling its obligations under the contract).

Despite the position that applies at law, a contract will frequently impose its own conditions for an effective assignment. For example, the contract may say that an assignment is not allowed without the counterparty's consent. Or, in a more nuanced position, the contract may say that an assignment is not allowed without the counterparty's consent other than to certain pre-approved entities (such as related bodies corporate). In either case, consent may be required to effect an assignment.

### Novation

A novation involves substituting a new contract for an existing one on the same terms except for the replacement of one party. In effect, the continuing party and the departing party agree to discharge their contract, while the continuing party and the incoming party agree to enter a new contract on the same terms, with the incoming party thereby assuming the position of the departing party. The incoming party will have the same rights and obligations under the contract as the departing party did. This results in an apparent 'transfer' of both rights and obligations to the incoming party, though in fact the rights and obligations of the incoming party are the result of the new contract created by the novation. Because a new contract is created, the consent of both the continuing party and the incoming party is required.

Consent to a novation can be given in advance by the original parties to the contract. For example, in *Leveraged Equities Ltd v Goodridge* (2011) 191 FCR 71 it was found that the following term was effective in pre-authorising a novation:

*The Bank may assign, transfer, novate...any of its rights, remedies, powers, duties and obligations under this Agreement to any person, without the consent of the Borrower.*

Indeed, the courts have started to blur the lines between assignment and novation by finding that where there is a sufficiently clear intent to pre-authorise transfer of obligations, not merely rights, a pre-authorisation will be effective even where the action is wrongly described as an 'assignment' rather than a 'novation'. This was the case in *CSG Ltd v Fuji Xerox Australia Pty Ltd* [2011] NSWCA 335, where the NSW Court of Appeal found that the following clause was effective to record a prospective consent to novation:

*Fuji Xerox may by notice to the Dealer assign its rights and obligations under this Agreement (in whole or in part) to any related corporation without [CSG's] consent.*

Accordingly, while it is still the case at law that the burden of a contract cannot be unilaterally assigned, a party to a contract may nonetheless agree in advance that a third party can later assume the obligation to perform the contract, so that no further consent is required to authorise that action.



## WHAT ARE THE PRACTICAL IMPLICATIONS FOR YOUR CONTRACT?

When entering a contract it is important to think ahead about the level of flexibility each party should retain to deal with their interests under the contract.

If you wish to prevent the other party from assigning rights under the contract without your consent, you should say so explicitly in the contract. If an assignment is to be permitted in certain circumstances without consent (e.g. in the case of a sale of business or where the assignment is to a related body corporate) that should also be explicitly stated. To the extent consent is required, it is also prudent for the contract to indicate whether the ability to withhold consent is to be subject to any qualifications (such as that it must not be 'unreasonably' withheld) or whether the intent is to grant the relevant party an unlimited discretion.

On the other hand, if you may in the future need flexibility to deal with your interests under the contract without having to seek further consent from the counterparty, then it is important to ensure that the contract includes an appropriate pre-authorisation to facilitate that outcome. If you wish to be able to transfer the burden of the contract, then ideally you will include a clause that specifically deals with 'novation,' though at a minimum you must make clear that the intent is to permit the transfer of relevant 'obligations' under the contract without consent. This type of pre-authorisation may be easier to negotiate if, as suggested above, it is limited to certain defined circumstances, such as in the case of a sale of business. In a complex arrangement, even if there is pre-authorisation, it may still be preferable to record a novation in a separate agreement to ensure that all parties are clear on the terms, including as to how existing liabilities arising before the date of termination are to be allocated between the parties.

As always, it is also important to consider the position of the other party and where their interests may lie in any future dealing with rights and obligations under the contract. While a reciprocal position may seem superficially attractive, it is not always appropriate and the differing interests of each party should be carefully considered when negotiating the terms of any pre-authorisation.

## KEY CONTACTS



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