

Novation and assignment: current case law update

LegalTalk Alert

28 January 2011

pwc

*What would
you like to grow?*

Novation and assignment – current case law update

Authors: Andrew Wheeler and Jensen Li

On 30 April 2010 PwC published a [LegalTalk article](#) providing commentary on the case of *Goodridge v Macquarie Bank Limited* [2010] FCA 67 (12 February 2010) (Original Decision) which had important implications towards novation and assignment, particularly in the sale of financial assets. On 18 January 2011, the Full Court of the Federal Court of Australia reversed the Original Decision in the appeal *Leveraged Equities Limited v Goodridge* [2011] FCAFC 3 (Appeal Decision).

In summary, the Appeal Decision concluded that:

- in relation to novation, a contract may authorise one party to that contract to substitute another party in its place without the need for a further tripartite agreement, and
- in relation to assignment, rights under the margin loan agreement were not personal rights, and as such they were capable of assignment.

The facts

Goodridge entered into a margin loan facility with Macquarie Bank. Relevant terms of the facility agreement were as follows:

- the agreement purported to allow Macquarie Bank to novate the contract to any new party that it chooses in the future without the prior consent of Goodridge. In that regard, clauses 21.2 and 21.4 of the facility agreement respectively provided as follows:

“[Macquarie Bank] may assign, transfer, novate ... and can otherwise deal in any manner [with] all or any part of the benefit of this Agreement and any of its rights, remedies, powers, duties and obligations under this Agreement to any person, without the consent of the Borrower ...”

...

“Without limiting the previous provisions of this Clause 21, [Macquarie Bank] ... is entitled to assign its rights and novate its obligations ... to any trustee or manager of any securitisation programme.”

- Macquarie Bank as lender had the power to value the security for the loan from time to time and, where the value of the security was sufficient (as per the Macquarie Bank valuation), Goodridge had the right to draw down further funds under the facility. As with a typical margin loan, if the value of the security was insufficient, the lender could require the borrower to provide additional security by way of a margin call.

Macquarie Bank then purported to novate the facility agreement to BNY, who in turn purported to novate it to Leveraged Equities. Leveraged Equities then purported to make a margin call on Goodridge. Goodridge did not comply with that purported margin call prompting Leveraged Equities to sell the underlying security. Goodridge then challenged the validity of the calls on several bases, including that the purported novations were not valid.

Original Decision

The Original Decision held that there was no novation of Mr Goodridge’s margin loan, nor assignment of the rights under that loan.

In relation to novation, Rares J held that clause 21 referred to an unidentifiable future transaction on uncertain terms and scope such that it would merely constitute an unenforceable agreement to agree.

“The nebulous words of cll 21.2 and 21.4 ... were merely agreements to agree with no contractual effect. Both cll 21.2 and 21.4, to the extent each dealt with novation, referred to a non-existent future transaction on uncertain and unidentified terms.”

Regarding assignment, Rares J explained that rights that are personal or inextricably linked with obligations cannot be assigned.

In the case’s circumstances, the rights were personal as a borrower might have a real interest in the identity of his lender as lenders may have differences in valuation methodologies. Further, Rares J also reasoned that because the right/power of valuation was inextricably linked with the obligation for further lending, that right/power was not capable of assignment and it would be unworkable where Macquarie Bank was bound to make further loans to Goodridge while Leveraged Equities enjoyed the benefit (as the result of the assignment) of receiving the payment from those advances.

Appeal Decision

The Full Court was unanimous in allowing the appeal by Leveraged Equities and Macquarie Bank.

The Full Court disagreed with Rares J’s conclusion that the purported novation was ineffective and clause 21 amounted to an unenforceable agreement to agree. Authorities from Australia, United Kingdom (which criticised the Original Decision as “wholly uncommercial”) and United States were cited before the Full Court concluded that Rares J was in error in forming the view that it was not possible for a contracting party to prospectively authorise a novation to be made by another party unilaterally. The Full Court went on to state clause 21 was sufficiently clear in that, Goodridge as the

borrower, was giving prospective consent to all the elements required to give effect to a novation:

“There was therefore no uncertainty about the terms and conditions of the new contract to which Mr Goodridge consented to be party”.

The Full Court did however emphasise the importance of clear drafting if the parties sought to cater for a pre-approved novation. Reference was made to the case of *Argo Fund Limited v Essar Steel Limited* [2005] 2 Lloyd’s Law Reports 203 in which the contract in question clearly and expressly set out the means for how the pre-approved novation was to take place and for the assumption of liabilities by the new party and the release of the outgoing party.

The Full Court accepted the general proposition that a benefit of a contractual obligation cannot be assigned where the identity of the person to whom the obligation is owed is a matter of importance to the person on whom the obligation rests. However, in the current circumstances, whether the benefit was assignable is a question of construction of contract. That is, even if rights are not otherwise assignable, the contract may expressly permit the assignment of such rights. The Full Court confirmed that rights under the margin loan agreement were not personal rights incapable of assignment.

The Full Court also disagreed with Rares J in that the rights under the margin loan agreement were incapable of assignment because they were inseverable from Macquarie Bank’s obligation to make further advances. To the contrary, the Full Court suggested that there was a clear division between the rights of Macquarie Bank and Leveraged Equities and saw “no real difficulty in the proposition that Macquarie retained the obligation to lend further funds ... while Leveraged Equities held the right to ... exercise the power of sale on default”.

Conclusion

The Appeal Decision appears to have sided with the weight of legal authority on the subject of novation and assignment and serves as reminder that when drafting or reviewing novation or assignment clauses, clear language should be used such that there can be no doubt as to the intention of the parties. It remains to be seen whether Goodridge will appeal the Full Court decision to the High Court.

For further information, please contact your usual PwC contact or:

Andrew Wheeler

Partner

+61 (2) 8266 6401

andrew.wheeler@au.pwc.com

John Cannings

Partner

+61 (2) 8266 6410

john.cannings@au.pwc.com

Stephen Moulton

Partner

+61 (3) 8603 4788

stephen.moulton@au.pwc.com