



## Novation and Assignment: Current Case Law

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The case of *Goodridge v Macquarie Bank Limited* [2010] FCA 67 (12 February 2010) gives rise to some important points that should be considered when drafting assignment/novation clauses in agreements and/or effecting an assignment or novation of a contract.

The Federal Court of Australia's decision is currently being appealed and we will provide an update once the outcome of that appeal is known. In the meantime, the judgment of Rares J still serves as a useful reminder of some important considerations regarding assignment and novation that lawyers and their clients should keep in mind.

### 1. 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 the bank to novate the contract to any new party that it chose without Goodridge's prior consent. In that regard, clause 21.1 of the facility agreement provided:

*"[Macquarie] 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".*

- The bank also had apparent power to value the security for the loan from time to time and, where that value was sufficient, 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.

As part of the sale of its margin lending business, Macquarie attempted to novate the facility agreement (via Bank of New York) to another margin lender, Leveraged Equities. Leveraged Equities then made a margin call on Goodridge. Goodridge did not comply with that call prompting Leveraged

Equities to sell the underlying security. Goodridge then challenged Leveraged Equities' capacity to make the margin call on several bases, including that the novation of the agreements was not valid.

### 2. Novation

Regarding novation, the issue in question was whether a party to a contract can prospectively authorise a novation to be made by another party unilaterally and without any further involvement or knowledge of the first party. Rares J (who delivered the sole judgment) held that, if any such clause refers to an unidentifiable future transaction on uncertain terms, it would merely constitute an agreement to agree. In this case, there was no mechanism in the facility agreement by which the terms of the future novation would be determined, and the Court therefore held that clause 21.1 was too uncertain to be enforceable and merely constituted an agreement to agree.

The Court confirmed that novation involves the creation of a new contract that extinguishes and replaces an earlier one and, in respect of prior authorisation of future novations, held:

*"It is one thing for the Bank to seek to deal with its rights (that are assignable rights) without its borrower's involvement. It is another for the Bank to create and impose a new contract between its borrower and a third party in circumstances where the borrower has no participation in, or knowledge of, the formation of that "agreement". The concept of such an "agreement" is somewhat oxymoronic."*

Rares J held that clause 21 could be taken to serve as an authorisation by Goodridge for Macquarie Bank to bind him to a new contract without him needing to execute a new document:

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*“By expressing his consent under cl 21 ... Mr Goodridge can be taken to have authorised the Bank to act on his behalf to bind him to a novated contract with the third party in much the same way as the technique of agency has been used in a Himalaya clause context in the law of agency.”*

However, in this case, the scope of the consent was too uncertain to be enforceable:

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

Rares J further explained that, in the absence of advance clarification of the terms of the future novation (or mechanics for making determining them in the future), there will be no presumption that the future novation will create a new contract on identical terms as the existing one.

Accordingly, in order to authorise a potential future novation, the terms of the novation (or mechanics for determining them in the future) will need to be clearly defined at the time of such authorisation.

### **3. Assignment**

Leveraged Equities argued that, even if the facility agreement was held not to have been validly novated to them, Macquarie Bank’s rights under the facility agreement – including the right to make margin calls – were validly assigned to them. Novation is required in order to effect a transfer of obligations, but rights (that are assignable) can be transferred, without the need for a wholly new contract, by way of assignment. The issue here was whether Macquarie Bank’s rights under the facility agreement were in fact “assignable” rights.

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

In this case, Goodridge’s ability to draw down under the facility depended upon the lender’s valuation of the underlying security. The Court held that:

*“In such circumstances, a borrower might have a real interest in the identity of his lender, which suggests that the rights sought to be dealt with in this way were personal rather than proprietary and were not capable of assignment.”*

The Court’s views in this regard were based not only upon the potential differences in valuation that different lenders might adopt, but also on the potentially different creditworthiness of different lenders.

If there had been a valid assignment, the right/power to value the underlying security would have passed to Leveraged Equities but the obligation to lend further funds in respect of further draw-downs would have remained with Macquarie Bank. Rares J held that it would be unworkable for Macquarie Bank’s further lending obligations to depend upon valuations undertaken by Leveraged Equities. Accordingly, because the right/power of valuation was inextricably linked with the obligation for further lending, that right/power was not capable of assignment. In that regard, Rares J said:

*“such “rights” or, rather powers and duties, are not capable of assignment because they were inherent and necessary to both the Bank’s rights and its obligations under the whole loan and security agreement, i.e. the “rights” or powers and duties not just in the enforcement of the borrower’s debt, but in the creation of further debts”*

### **4. Conclusion**

In summary:

- When drafting or reviewing any clause that purports to permit future novations, be mindful that the terms of the future novation, or mechanics for determining them, will need to be clearly defined in advance.



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- Do not presume that all rights under an agreement are capable of assignment. Rights that are personal in nature will not be assignable. In addition, rights that are inextricably linked with obligations will not be severable from those obligations and therefore also cannot be assigned.

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