

ASSIGNMENT, NOVATION AND OTHER DEALINGS BOILERPLATE CLAUSE

Need to know

This clause regulates the manner in which the rights (benefit) and/or obligations (burden) under a contract can be transferred to a third party. Including this clause in a contract encourages parties to follow a best practice process in order to minimise informal assignments and novations and, in turn, bring certainty to any agreed changes to the contract. The underlying benefit of this clause is that it is likely to protect parties against casual and unfounded allegations that assignments, or any other dealings under the contract, have been made.

THE SAMPLE CLAUSES

Option 1 – Assignment, novation and other dealings – consent required

A party must not assign or novate this [deed/agreement] or otherwise deal with the benefit of it or a right under it, or purport to do so, without the prior written consent of each other party [which consent is not to be unreasonably withheld/which consent may be withheld at the absolute discretion of the party from whom consent is sought].

Option 2 – Assignment, novation and other dealings – specifies circumstances in which consent can reasonably be withheld

- (a) *[Insert name of Party A] may not assign or novate this [deed/agreement] or otherwise deal with the benefit of it or a right under it, or purport to do so, without the prior written consent of [insert name of Party B], which consent is not to be unreasonably withheld.*
- (b) *[Insert name of Party A] acknowledges that it will be reasonable for [insert name of Party B] to withhold its consent under this clause if:*
 - (i) *[Insert name of Party B] is not satisfied with the ability of the proposed assignee to perform [insert name of Party A]'s obligations under this [deed/agreement];*
 - (ii) *[Insert name of Party B] is not satisfied with the proposed assignee's financial standing or reputation;*
 - (iii) *the proposed assignee is a competitor of [insert name of Party B]; or*
 - (iv) *[Insert name of Party B] is in dispute with the proposed assignee*

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1 What is this clause and why is it used?

1.1 General

There may be a variety of reasons why the rights and or obligations under a contract may need to be transferred to another party. However, there are two main legal tools available to achieve this, namely:

- assignment, for the transfer of benefits (rights); and
- novation, for the transfer of rights and obligations (burdens).

Each has unique features that must be taken into account when deciding which is the preferred option.

1.2 What is the purpose of this clause?

The purpose of an '*assignment, novation and other dealings*' clause is to set out the requirements which the parties agree are needed to effect a future change to the contract and/or its parties and thereby preclude all, or at the very least minimise the incidence of, transfers which are not made in accordance with those formalities. The clause is concerned with retaining control over the assignment of, or any other dealing with, the contract.¹

A contracting party at common law has a general right to assign its rights without any necessary consent or approval from the other party. An '*assignment, novation and other dealings*' boilerplate provision is included in a contract to exclude or limit this common law right.² The purpose of the clause is to ensure that the obligor has contractual dealings only with the obligee – eg an obligor might have a personal preference for dealing with the obligee rather than with a third party assignee. In order for the assignment of rights by one party not to be exercised unilaterally without the knowledge of the other party, it is common for contracts to include a provision that a party can only assign its rights under the contract with the consent of the other party.

At common law, the obligations under a contract can only be novated with the consent of all original contracting parties, as well as the new contracting parties, because the novation extinguishes the old contract by creating a new contract. Including one of the sample clauses in an agreement is designed to prevent oral consent to a novation, or consent being inferred from a continuing party's conduct.

2 How effective is it?

2.1 Effectiveness of a non-assignment clause

General

If the contract contains non-assignment provisions, they are generally effective provided they have been clearly drafted. Contracts commonly provide for assignment with the consent of the other party and such provisions usually provide that consent must not be unreasonably withheld.³ A purported assignment that contravenes such contractual restriction (including failure to comply with a clause which expressly requires consent to be obtained) constitutes a breach of contract (possibly resulting in a right to terminate depending on construction of the clause in the context of the contract as a whole) and may result in an ineffective assignment.⁴

However, in practice, purported assignors often do not comply with strict contractual provisions and serve a notice of assignment on the other party in the hope that the other party will accept the assignment through confirmation or conduct that is consistent with acceptance. It is prudent to always record acceptance in writing.

After assignment, the assignee is entitled to the benefit of the contract and to bring proceedings (either alone or by joining the assignor) against the other contracting party to enforce its rights. As assignment only transfers existing rights and does not create new ones, the assignee cannot enforce rights that the assignor did not have.

The assignee does not become a party to the contract with the promisor. Therefore, if A assigns its rights under a contract with B to C, the contract is still between A and B.⁵ As the burden

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or obligations of the contract cannot be assigned, the assignor remains liable post assignment to perform any part of the contract that has not yet been performed.

Assignment of the 'whole' contract

As a general principle, an assignment of the 'whole contract' will not extend further than assignable contractual rights (ie it will not extend to the obligations or burden of the contract).

Declarations of trust

If a contract is not able to be assigned because it contains, for example, non-assignment provisions, it may still be possible for a contracting party to declare a trust in favour of a third party over the benefit of the contractual rights.

2.2 Effectiveness of a novation clause

Similar to non-assignment provisions, contracts commonly provide for novation with the written consent of the other party and such provisions usually provide that consent must not be unreasonably withheld. A novation that contravenes such contractual restriction which requires consent in writing may constitute a breach of contract (possibly resulting in a right to terminate depending on construction of the clause in the context of the contract as a whole) and will often result in an ineffective novation. In any event, novation requires the consent of all the parties to the original contract (outgoing and continuing parties) and the new incoming party. The consent may be given in advance by the original parties – see *Leveraged Equities Ltd v Goodridge* (2011) 191 FCR 71 (**Goodridge**). However, 'written' consent is not specifically required as a matter of contract law.

3 Drafting and reviewing the clause

3.1 Should I always include it, and what happens if I don't?

When drafting a commercial contract, you need to consider how the parties intend to deal with circumstances in which the contract is to be assigned, novated or otherwise dealt with. The

standard way of dealing with assignment, novation or other dealings is to prohibit them, either entirely or without the other parties' consent. This makes commercial sense as it ensures the parties know who they will be contracting with over the lifetime of their agreement. This is particularly important when the counterparty to the contract is material to the giving of the contract, which is especially the case in banking and finance agreements.⁶

The underlying benefit of the clause is that it is likely to protect parties against casual and unfounded allegations that assignments, or any other dealings, have been made. An 'assignment, novation and other dealings' clause is evidence of the parties' intention that the contract was not intended to be assigned or novated unless done in accordance with the clause.

If you do *not* include an 'assignment, novation and other dealings' clause in your contract, then the parties would be free to assign the benefit of the contract without consent which is consistent with general common law principles and statute.

As stated above, a contract may only be novated with the consent of all parties to the novation (ie both outgoing and incoming parties). Consent to a novation may be written, oral or 'inferred by conduct' in accordance with general contract law principles. If you choose to include the sample boilerplate provision which deals with novation, parties are limited to providing their consent to any such novation in writing.

3.2 What are the sample boilerplate clauses?

There are two standard sample 'assignment, novation and other dealings' clauses:

- **Option 1:** This is a standard 'assignment, novation and other dealings' clause which incorporates the requirement for prior written consent. In this clause, you need to select whether such consent should be qualified by requiring consent not be unreasonably withheld or, on the other hand, unqualified by allowing each party to exercise absolute discretion when providing consent. Opt for 'not to be unreasonably withheld' when acting for the

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party likely to need consent. Opt for 'absolute discretion' when your client requires flexibility over the exercise of this right and concede that the right be available to both parties only when negotiation positions are evenly balanced.

- **Option 2:** This alternative version of the 'assignment, novation and other dealings' clause stipulates the circumstances when withholding consent will be reasonable. It should be used when acting for the party who is likely to require consent. It also adds certainty in the event of dispute over whether the party exercising the right has done so justifiably.

The meaning, effect and duration of a non-assignment/novation provision will depend on its terms. Where the sample clause requires consent to assignment and novation, but provides that consent may not be withheld unreasonably, there is no valid assignment or novation unless written consent has been granted or the court has declared that the consent has been unreasonably withheld/refused.⁷

3.3 When, if ever, should I amend the clause?

There may be times in which the sample boilerplate clause should be amended. As mentioned above, the *Goodridge* case held that it is possible to consent in advance to a novation, even where the identity of the new contracting party is unknown.

The *Goodridge* case provides both opportunities and challenges for drafters and reviewers of agreements:

- if you are acting for a party who wishes to take advantage of a flexible novation arrangement, then prospective consent from the other side will be something to include or pursue during negotiations. This might be particularly important if the existing commercial terms are favourable and you wish to avoid re-opening negotiations at the time of the novation. The remaining party may seek a guarantee by the outgoing party for the performance of the new entity.

- if you are acting for a party who wishes to retain authority over any incoming contracting party, do not amend the boilerplate provision to include prospective agreement to novation. It will also be worth checking the 'Interpretation' clause which may include language consistent with a prospective novation clause such as: *references to any party to this agreement includes references to its respective successors and permitted assigns*. The *Goodridge* case alerts lawyers to the importance of reviewing such boilerplate clauses with extra care.

ENDNOTES

¹ However, see *Leveraged Equities Ltd v Goodridge* (2011) 191 FCR 71, concerning assignment of benefits and related burdens.

² Australian Encyclopaedia of Forms & Precedents – Commentary to Boilerplate Clauses, para 63-75.

³ It is also possible for a court to imply a restriction on the exercise of the discretion to provide consent, providing it would not be inconsistent with the rest of the contract. Including reference to "absolute discretion" provides a basis for a party saying that an implied term would be inconsistent.

⁴ See generally *Re Turcan* (1888) 40 Ch D 5; *Anning v Anning* (1907) 4 CLR 1049. See Carter on Contract – Part IV – Parties to the Contract – Chapter 17, 'Exceptions' to the Privity Doctrine. For further analysis on whether an assignment in contravention of a contractual restriction is valid, please refer to Seddon, N, Bigwood, R, Ellinghaus, M, *Cheshire and Fifoot Law of Contract*, 10th ed, 2012, Lexis Nexis at 358-362 and Tolhurst, 'The Efficacy of Contractual Provisions Prohibiting Assignment; (2004) 20 *Syd L Rev* 161. The law in this area is unsettled.

⁵ Carter JW, *Contract Law in Australia*, 6th ed, 2013, LexisNexis Butterworths at p357.

⁶ Martin Lovell and Brian Vuong, 'Goodridge Appeal- Legal Principles Governing Assignment and Novation of Contracts' (March 2011) *Australian Banking & Finance Law Bulletin* 118.

⁷ *CEP Holdings Ltd and CEP Claddings Ltd v Steni AS* [2009] EWHC 2447 See *Fulham Partners LLC v National Australia Bank Ltd* [2013] NSWCA 296 for discussion of "unreasonably withholding consent" and the factors that can legitimately be considered by a party whose consent is sought at paragraphs [38]-[59].