

## Novation and assignment of contracts

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Commonwealth entities encounter a variety of situations where contractual rights and obligations may need to be transferred from one legal entity to another. This can arise where a supplier is restructuring its operations or as part of a sale of a business. In these situations, there are 2 legal tools available to achieve a transfer of rights or obligations: novation and assignment. This note sets out some key considerations for Commonwealth entities when considering a novation or assignment.

While this note looks at novation and assignment of contracts generally, additional issues can arise in the context of interests in land, such as leases – these issues are beyond the scope of this note.



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### What is the difference between novation and assignment?

The following table compares the general principles that distinguish novation from assignment.<sup>1</sup>

**Table 1: Differences between novation and assignment**

<i>Novation</i>	<i>Assignment</i>
Both rights and obligations are being transferred.	Only intangible rights are being transferred.
The original contract is terminated.	The original contract remains unchanged.
A new contract or a deed must be made.	It is not necessary to make a new contract.
Consent must be obtained from all parties to the original contract.	At law, there is no need to obtain consent from the other parties to the original contract, although many Commonwealth contracts include a clause requiring consent.

## Novation

A novation is the mechanism by which a contract is terminated and a new contract is made between different or additional parties.<sup>2</sup> The new contract is generally on the same terms as the original contract. A novation has the effect of substituting one party for another party without necessarily changing the rights and obligations under the original contract. The rights and obligations under the original contract can be transferred to the new party.

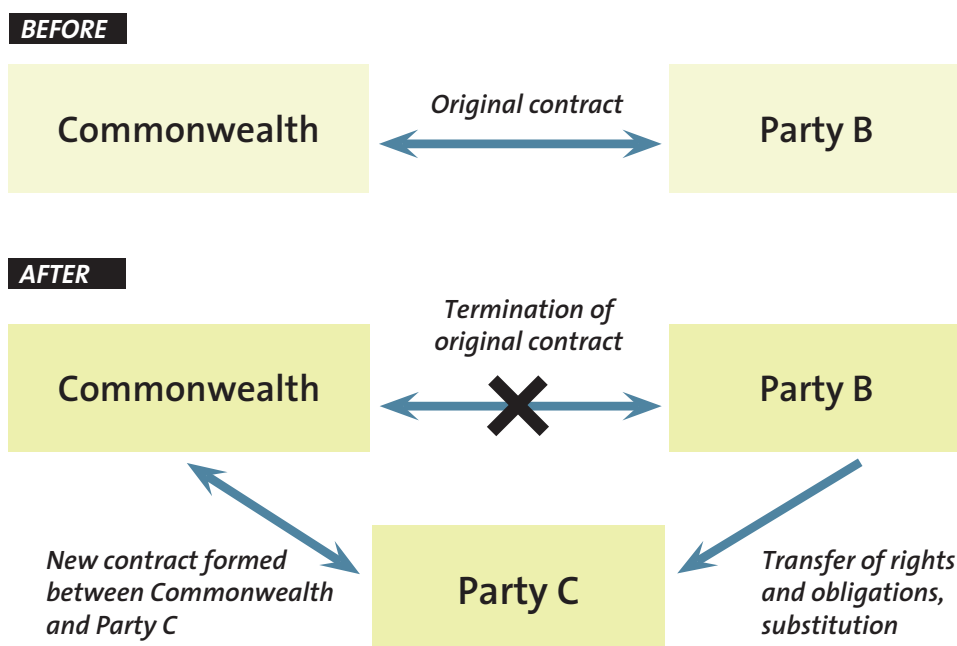
A novation requires the consent of all the parties to the original contract as well as the consent of the new party.<sup>3</sup> It is a tripartite agreement between the original parties and the new party. Consent of all the parties to enter into the agreement is therefore crucial.<sup>4</sup> A novation usually takes the form of a deed.

### Example of novation

The Commonwealth and B have a contract under which B provides certain services. B is proposing to sell its business to C. C is prepared to take on B's obligation under the contract with the Commonwealth. The Commonwealth undertakes its due diligence and agrees to the substitution of B with C. For the substitution to occur, a novation is needed. Once the novation is signed, C is responsible to the Commonwealth for the services under the contract.

The following diagram demonstrates this novation.

**Diagram 1: Transfer of both rights and obligations**



## Assignment

An assignment is the mechanism by which a party to a contract (the assignor) transfers its existing rights and benefits under that contract to a third party (the assignee).<sup>5</sup> Importantly, the assignor cannot transfer its burdens, obligations or liabilities to the assignee through an assignment.<sup>6</sup> This means that the assignor is not released from its obligations under the contract. Further, the assignee does not become a party to the original contract but can enforce their right to receive the assigned benefits.

An assignment does not require a new contract. The assignor must only record the assignment in writing,<sup>7</sup> sign it and provide written notice of the assignment to the other party to the contract. At law it is possible for an assignment of rights to take place without the consent of the other party to the contract.<sup>8</sup> This can

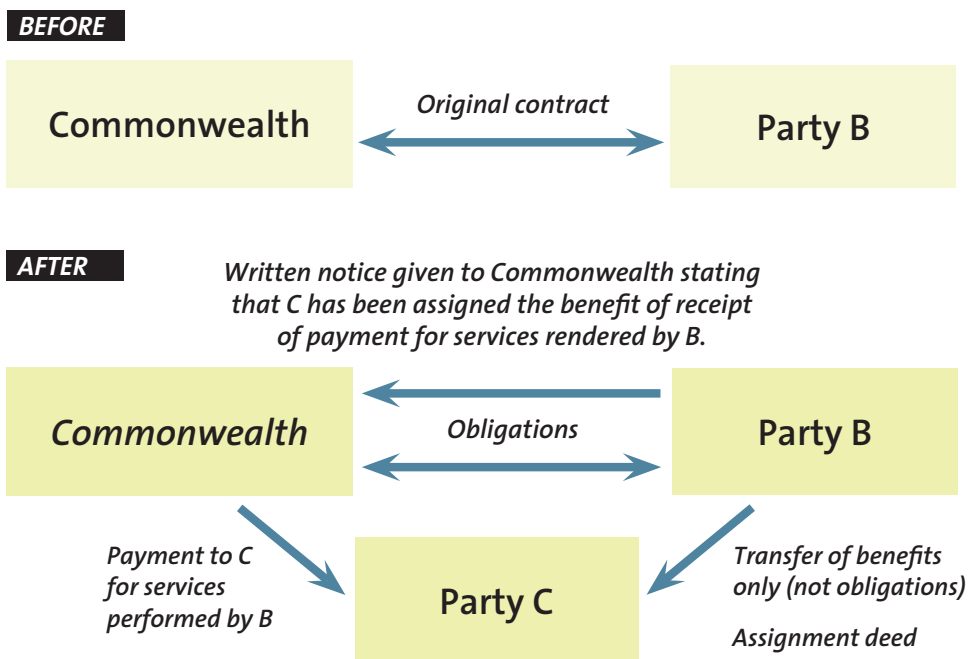
be problematic if the other party to the contract prefers to deal with the assignor rather than the new third party. For this reason, most Commonwealth contracts contain a clause which prevents the contractor from assigning its rights under the contract, in whole or in part, without first obtaining the written consent of the Commonwealth. Sometimes the contract will also provide that the Commonwealth is not obliged to give its consent. Sometimes, this clause will refer to the consent not being ‘unreasonably withheld’.

### Example of assignment

The Commonwealth and B have a contract under which B provides consultancy services to the Commonwealth. B wants to transfer its right to receive payment for the services to a third party, C. For this to occur, B can assign its rights to receive payment under the contract to C. This can be achieved through a deed of assignment between B and C. At law, the assignment can occur without any involvement of or consent from the Commonwealth. Importantly, B continues to remain a party to the contract with the Commonwealth, so B is still obliged to perform the services and B’s contractual liabilities remain unchanged. However, the third party, C, will have a legally enforceable right to receive the Commonwealth’s payment for the services that B performs. Although C is not made a party to the original contract between the Commonwealth and B, the practical result of the assignment is that C can enforce the right to receive payment under the contract against the Commonwealth.

The following diagram demonstrates this arrangement.

**Diagram 2: Transfer of rights only**



## When is a novation or assignment required and which one do you use?

Commonwealth entities are often asked to consider requests to novate or assign agreements. These requests can arise with funding agreements, contracts for goods and services and other agreements for a variety of reasons.

Where a change to the underlying contractual arrangements is requested, the Commonwealth entity will need to consider whether the proposed change is acceptable and determine whether a novation or an assignment is most appropriate.<sup>9</sup>

**Do I use a novation or an assignment?**

Is the new party taking over **both rights and obligations**, with the existing contractor not to have an ongoing role under the contract?

- a **novation** will usually be required.

Is the new party taking over **contractual rights only**, with the existing contractor continuing to be responsible for performing obligations?

- an **assignment** will usually be required.

The table below outlines some common situations in which the question of novation or assignment might arise.

**Table 2: Circumstances that may result in a novation or assignment**

<i><b>Novation</b></i>	<i><b>Assignment</b></i>	<i><b>Contractual change not usually required<sup>10</sup></b></i>
A company sells its business to another company.	A company wants to transfer to a third party its rights to receive payments under the contract.	A company changes its name but remains the same legal entity.
The contract is to be performed by a different company in the same company group.		There is a change in the shareholders.
The head contractor withdraws and the Commonwealth is going to be dealing directly with a subcontractor.		The contract is performed by a different division/branch of the same legal entity.

**Issues to consider when deciding whether to agree to a novation or assignment**

**General**

When an agency is considering whether to agree to a novation or assignment, there will be a range of matters that will need to be addressed. In some cases, it may be appropriate to terminate the existing contract and undertake a new procurement or funding process.

First, the terms of the existing contract should be considered. The contract may include provisions dealing directly with novation or assignment. Many Commonwealth contracts prohibit novation or assignment without the consent of the Commonwealth entity. This allows the Commonwealth entities to carefully select their suppliers, contractors, funding recipients and other parties that they are dealing with. It is common for these contractual provisions to specify that the Commonwealth will not unreasonably withhold approval for novation or assignment. Conversely, the contract may include a standing consent<sup>11</sup> by the Commonwealth to certain kinds of novation or assignment (for example, within the same corporate group). Even in this case, a formal deed of novation will usually still be required.

Second, when an agency is deciding whether to agree to a novation or assignment, it may need to consider a range of approval processes and risk management requirements that apply to this commitment of relevant money. It may be necessary to check the *Public Governance, Performance and Accountability Act 2013* (in particular, s 15, s 16 and ss 25–29), the *Public Governance, Performance and Accountability Rules 2014* (in particular, rule 18), the accountable authority instructions and other applicable legislation that may specifically apply to the contract.

Third, although strictly not directly relevant to the novation or assignment, it is common for variations to the contract to be raised at the same time. Agencies should approach any request for a variation as part of a novation or assignment in the same way they would at any other point in the contract period.

## Due diligence

The information you need will vary from case to case but might include the following.

### Background entity information on the new party

- What is the organisational capacity and corporate structure of the body? For example:
  - What are the management capabilities of the entity?
  - Has the Commonwealth previously dealt with the entity?
- What type of body are you dealing with? For example:
  - Is the body a foreign entity? If so, advice may be required as to whether it has executed a binding contract.
  - Is the body a partnership or unincorporated association? If so, who will be bound by the contract following the novation?
  - Is the body the trustee of a trust? If so, does the trustee have the requisite authority under the trust deed?
- Do you have information on any relevant ‘fit and proper person’ considerations?

‘... when an agency is deciding whether to agree to a novation or assignment, it may need to consider a range of approval processes and risk management requirements ...’

### Financial status information

- How does the financial status of the new contractor compare with that of the existing contractor?
- Should you seek a parent guarantee or other security (is the body a \$2 company)?
- Do you require independent financial advice on any figures that the new party has provided?
- Can the new party meet the insurance requirements specified in the contract?

### Evidence of the company’s ability to perform the contract

- What is happening to any key personnel under the contract? Are they moving to the new party?
- Will the new party have access to all relevant facilities and specialist equipment?
- Does the new party hold all relevant licences and registrations?
- Do you have evidence that the company will satisfy the conditions or requirements of the contract – for example, will it hold funding in a special account or satisfy milestone requirements or any relevant eligibility criteria for funding?

## Proposed transitional arrangements

If it is decided that a novation or assignment will be agreed to then it may be necessary to put transitional arrangements in place. Matters that may need to be considered will include the following:

- What are the interim arrangements for performance of the activity (for example, arrangements between the time the novation is agreed to and the deed of novation is executed)?
- Is there a transition plan?
- What resources will be needed to manage the transition? Who will bear the cost?

## Novations: matters to consider

- Is the Commonwealth satisfied that the new contractor can perform the obligations under the contract and manage risk? Is the new contractor an acceptable entity to contract with in terms of due diligence process on probity issues, financial viability and capability?
- Who will be liable for past performance or defaults before the new contractor takes over? Will the existing contractor remain liable for its performance or will the new contractor take on responsibility for any problems with the original contractor's performance?
- Will the novation have any impact on subcontracts or other contracts – for example, contracts with other parties working on the same site?
- Are there any issues with the existing contractor's performance that should be addressed and finalised before agreeing to the deed of novation? Make sure that you do not inadvertently make unintended amendments to the contract. For example, an acknowledgement of correspondence about a proposed novation which mentions a related delay in delivery may be taken to be acceptance of the delay.
- Are there specific issues for the particular type of contract? For example, where a grant agreement deals with assets purchased with the grant, you may need to ensure those assets are being transferred to the new contractor (unless otherwise agreed).
- Are there any existing securities or financial arrangements under the original contract that need to be replaced or updated? For example, even if both the existing and new contractor are subsidiaries of the same parent entity, an existing parent guarantee or other security may need to be amended to cover the new contractor. There may also be Personal Property Security Register entries that need to be updated.
- At what point will the new contractor take over from the existing contractor: the date the novation deed is signed or a different date?
- Are there any additional costs and who will bear these costs? Usually the party that is seeking the novation is required to meet the other party's costs.

## Assignments: matters to consider

- If the assignor has assigned its rights to receive payment to the assignee:
  - Is the Commonwealth satisfied that the assignor can continue to perform its obligations under the contract without receiving payment?
  - Does the assignor have financial viability issues? Has the assignor sold its right to receive payment from the Commonwealth as part of a settlement of a debt with a creditor?
- What is the underlying reason for the proposed assignment?
- Is the proposed assignment detrimental to the Commonwealth?
- Does the contract between the Commonwealth and the proposed assignor propose to create a confidential relationship or an enduring relationship? Does the Commonwealth want to have any engagement with the proposed assignee?

## Executing the novation or assignment

Once an agency has decided to accept a novation or assignment, the new arrangements must be recorded. The original contract may establish the form of instrument required to execute the novation or assignment.<sup>12</sup> In any event, the instrument may need to reflect the following.

**'Once an agency has decided to accept a novation or assignment, the new arrangements must be recorded.'**

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## Novation

A deed of novation will typically:

- substitute one party for another
- include mutual release of future obligations under the original contract between the Commonwealth and the original contractor
- clearly specify responsibilities and liability of the original contractor and the new contractor for the pre-novation period – often supported by indemnities
- include representations and warranties with respect to the power of the original contractor and the new contractor to enter into the deed of novation
- include an agreement as to costs that the parties will bear in connection with the preparation, execution and completion of the novation – it is common for the other parties to pay the Commonwealth's costs.

## Assignment

A deed of assignment will typically:

- unconditionally transfer the relevant benefit to the assignee, giving the assignee complete control of that benefit, including the right to take legal action to enforce it
- clearly specify whether there will be a redemption or reassignment in the future – for example, upon repayment of a loan
- confirm arrangements for the ongoing performance of the contract by the assignee
- include agreement as to costs to be borne by the parties in connection with the preparation, execution and completion of the assignment – it is common for the other parties to pay the Commonwealth's costs.

<sup>1</sup> See generally *Olsson v Dyson* (1969) 120 CLR 365, 388.

<sup>2</sup> See *Olsson v Dyson* (1969) 120 CLR 365, 388.

<sup>3</sup> See *Olsson v Dyson* (1969) 120 CLR 365, 388. Note that, in *Leveraged Equities Ltd v Goodridge* (2011) 191 FCR 71, the Full Federal Court held that it is possible for a contracting party to prospectively authorise a novation to be made by another party unilaterally. See also *CSG Ltd v Fuji Xerox Australia Pty Ltd* [2011] NSWCA 335,134.

<sup>4</sup> See *Fightvision Pty Ltd v Onisforou* (1999) 47 NSWLR 473, 491–492; and *Vickery v Woods* (1952) 85 CLR 33, 345.

<sup>5</sup> *Norman v Federal Commissioner of Taxation* (1963) 109 CLR 9, 26.

<sup>6</sup> *ALH Group Property Holdings Pty Ltd v Chief Commissioner of State Revenue* (2012) 245 CLR 338, 346 [12].

<sup>7</sup> This is a legislative requirement in each state: see, for example, *Property Law Act 1958* (Vic) s 134.

<sup>8</sup> See *Olsson v Dyson* (1969) 120 CLR 365, 388.

<sup>9</sup> In *CSG Limited v Fuji Xerox Australia Pty Ltd* [2011] NSWCA 335, [133], Sackville AJA (Bathurst CJ and Campbell JA agreeing) observed that the end result in a case of novation and a case of assignment may be similar.

<sup>10</sup> In some cases the contract may require agency approval to some of these changes or other amendments to the contract. This is different from a novation or assignment.

<sup>11</sup> See note 3.

<sup>12</sup> In *Leveraged Equities Ltd v Goodridge* (2011) 191 FCR 71, the Court stressed the importance of drafting novation and assignment clauses in the original contract clearly to avoid ambiguity when one or more parties later seek to novate or assign.

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