

PART 24 - NOVATION AGREEMENTS

Novation Agreements

[In this Part 24 we comment on two forms of Novation Agreement. The first form which appears at \[24.02\] has been in this guide for many years and is widely used in the Australian market. The second form is the 2002 ISDA Novation Agreement.](#)

[\[24.01\] provides commentary on the AFMA Novation Agreement. In \[24.03\] we comment on the ISDA Novation Agreement.](#)

[24.01] At [24.02] we have set out a suggested form of novation agreement. Before using this suggested form you should carefully read the following comments:

- (a) A novation involves a substitute party assuming both the rights and obligations of the retiring party. A novation cannot take place without the consent of the continuing party. A novation should be distinguished from an assignment, which involves a third party becoming entitled to rights of another party but not assuming any obligations of that party. Subject to contractual prohibitions (the ISDA Master Agreement prohibits assignments) it is possible to assign rights under a contract without the consent of the other party.

Accordingly, a novation must always involve three parties: the retiring party, the substitute party and the continuing party.

- (b) The novation agreement has been drafted to permit the novation of one or more Transactions.
- (c) The agreement assumes that the Substitute Party and the Continuing Party have previously (this may occur concurrently with the signing of the novation agreement) entered into an ISDA Master Agreement with the intention that the novated Transactions are to be governed by the terms of that ISDA Master Agreement rather than the “Original Master Agreement” (defined in recital B) between the Retiring Party and the Continuing Party.

If this assumption is not correct (ie the Substitute Party is agreeable to taking the Transactions on the terms of the Original Master Agreement), then:

- (i) if you are the Substitute Party, you should carefully review the terms of the Original Master Agreement to ensure they are satisfactory;
- (ii) you should make the following amendments to the suggested novation agreement:
- delete “or the New Master Agreement” in line 3 of clause 1
 - delete the definition of “New Master Agreement” in clause 1
 - delete the first line of clause 2(b) (ie “subject to clause 2(c):”)

- replace “; and” at end of clause 2(b) with “.”
- delete clause 2(c)
- Add a new clause as follows:

“The reference to the address for service in the Original Master Agreement in relation to the Retiring Party is to be deemed to be a reference to the following address of the Substitute Party:

Party:

[address]
 Attention
 Telex (answerback)
 Facsimile”

- (d) If the Transactions to be novated have been documented under more than one master agreement, we consider that it would be preferable to enter into a separate novation agreement for each Original Master Agreement. Otherwise, some quite substantial amendments would be required to the wording of the novation agreement.
- (e) Recital A contemplates that you will describe each Transaction in the schedule. Some participants prefer simply to refer to Transactions identified in attached copies of confirmations. To follow this approach replace “specified in the schedule” in recital A with “evidenced by the Confirmations, copies of which are annexed and marked ”A“ - ”[]“”
- (f) Recital B contemplates that the Transactions are governed by a master agreement. Appropriately amend if this is not the case. For example, if the Transactions are FRAs governed by the ABAFRA terms you could replace “a master agreement entitled [] entered into on [date]” with “the ABAFRA Terms”. However, you should still define these terms as the “Original Master Agreement” because the term is used throughout the novation agreement.
- (g) Take care if you describe each Transaction in the schedule. It may be desirable, although not essential, to attach copies of the original Confirmation for each novated Transaction as annexures to the novation agreement.

Here is some suggested wording for describing Transactions in the schedule (add the square bracketed words if the confirmation is to be attached as an annexure):

“Interest rate swap

Retiring Party reference no:

Continuing Party reference no:

Trade Date:

Notional Amount:

[as evidenced by the Confirmation a copy of which is annexed and marked ”A][“]

- (h) Carefully check whether the terminology used in the original Confirmations for the novated Transactions matches the terminology applicable to an ISDA Master Agreement. For example, there will not be a matching of terminology if you are

novating swaps originally governed by the AIRS Terms on the basis that they are now to be governed by an ISDA Master Agreement. If there is not a matching in terminology, you should produce replacement Confirmations for the novated Transactions which use the correct terminology and refer to the relevant ISDA Definitions which are to govern (presumably the ~~1991~~2000 ISDA Definitions).

In that case we suggest that you add a new clause 2(d) as follows (replacing ” at the end of paragraph (c) with ”; and“:

”(d) the Confirmations governing each Transaction are the Confirmations, copies of which are annexed and marked “[]” - “[]”.

- (i) Check that the terms “Confirmation”, “Event of Default” and “Potential Event of Default” (see clause 1) are defined in the Original Master Agreement and the New Master Agreement.
- (j) We have prepared the novation agreement on the basis that the Continuing Party will retain no rights against the Retiring Party in relation to anything which occurs before the Novation Date (see clause 2(a)). Given the nature of Transactions to be novated under the novation agreement, it is difficult to foresee circumstances where the Continuing Party would want or need to retain such rights. There are unlikely to be claims for damages which would flow from Transactions and it is difficult to see how payments or deliveries under Transactions could give rise to preference claims. Before agreeing to a novation you should carefully check the accuracy of the representations to be made under clause 3.
- (k) The tax and stamp duty implications of the novation should be considered.
- (l) It is most important that each person who signs the novation agreement on behalf of each party is properly authorised to do so. Each party should follow its normal procedure for satisfying itself that a person signing on behalf of the other party has that authority.
- (m) See [U2.04] for commentary on a 9 March 2001 recommendation from AFMA’s Documentation Committee that resulted in an amendment to clause 5.

Novation Agreement

THIS AGREEMENT is made on

BETWEEN: [name] (A.C.N.) of [address] (“**Retiring Party**”)

[name] (A.C.N.) of [address] (“**Substitute Party**”)

AND: [name] (A.C.N.) of [address] (“**Continuing Party**”)

BACKGROUND:

- A. The Retiring Party and the Continuing Party are parties to the transaction(s) specified in the schedule (each being referred to in this agreement as a “**Transaction**”).
- B. Each Transaction is governed by a master agreement entitled [] entered into on [date] (“**Original Master Agreement**”).
- C. The parties have agreed to a novation of each Transaction on the terms set out in this agreement under which the Retiring Party is to surrender its rights and be released and discharged from its obligations under each Transaction and the Substitute Party is to become entitled to equivalent rights and assume equivalent obligations.

AGREEMENT:

1. In this agreement:

“**Confirmation**”, “**Event of Default**” and “**Potential Event of Default**” have the same meaning as in the Original Master Agreement or the New Master Agreement.

“**New Master Agreement**” means a master agreement entitled [] entered into on [date] between the Substitute Party and the Continuing Party.

“**Novation Date**” means [].

2. With effect from and including the Novation Date:

(a) the Retiring Party and the Continuing Party have no further rights against each other or obligations to each other in connection with any Transaction; and

(b) subject to clause 2(c):

(i) the Substitute Party has the same rights against, and owes the same obligations to, the Continuing Party in connection with each Transaction; and

(ii) the Continuing Party has the same rights against, and owes the same obligations to, the Substitute Party in connection with each Transaction,

as if the Substitute Party had been named as a party to that Transaction instead of the Retiring Party.

(In this clause 2(b) a reference to the “same” rights or obligations is a reference to rights or obligations which are the same in nature and character as those rights or obligations rather than the same as to the person entitled to them or obliged to perform them); and

- (c) each Transaction ceases to be governed by the Original Master Agreement and instead is deemed to have been and is governed at all times by the New Master Agreement (and in this respect each reference to the Original Master Agreement in a Confirmation for a Transaction is deemed to be a reference to the New Master Agreement).
3. Each of the Retiring Party and the Continuing Party represents and warrants to the other parties that:
 - (a) no event has occurred which constitutes an Event of Default or Potential Event of Default with respect to itself and no other circumstance exists which would entitle the other party to terminate any Transaction; and
 - (b) the terms of each Transaction are accurately recorded in the Confirmation for that Transaction and there is no dispute or grounds for a future dispute between the Retiring Party and the Continuing Party as to the terms of or performance of obligations under each Transaction; and
 - (c) it has no right of cross claim or counter claim against the other party in connection with any Transaction.
4. References in any Confirmation for a Transaction to the Retiring Party's accounts for payment purposes are to be taken to be references to accounts of the Substitute Party as follows:
 - if payments are due in A\$: [account details]
 - if payments are due in USD: [account details]
 - if payments are due in [specify other currency/ies]:[account details]
5. Each party is to pay its own costs, charges and expenses (including, without limitation, legal expenses) in entering into this agreement.
6. Each party at its own expense must, at another party's request, execute and cause its successors to execute documents and do everything else necessary or appropriate to bind the Substitute Party and the Continuing Party and their successors under the Transactions in accordance with the intention expressed in clause 2(b).
7. This agreement is governed by the laws in force in []. Each party irrevocably submits to the non-exclusive jurisdiction of the courts of [] and courts of appeal from them.
8. This agreement may consist of a number of counterparts and the counterparts taken together constitute one and the same instrument.

SCHEDULE

[Particulars of each Transaction]

EXECUTED as an agreement.

Retiring Party: [name]

By:..... By:

Name of signatory:..... Name of signatory:

Title:..... Title:.....

Substitute Party: [name]

By:..... By:

Name of signatory:..... Name of signatory:

Title:..... Title:.....

Continuing Party: [name]

By:..... By:

Name of signatory:..... Name of signatory:

Title:..... Title:.....

[24.03] The 2002 ISDA Novation Agreement broadly contains the same provisions as the AFMA Novation Agreement. Novation is effected in the same manner under each document such that the legal effect of the documents is the same.

The only significant difference between the documents relates to payments or other obligations due or due to be performed on or prior to the Novation Date. As explained at [24.01](j) the AFMA Novation Agreement assumes that the Continuing Party will retain no rights against the Retiring Party in relation to anything occurring before the Novation Date. The ISDA Novation Agreement, on the other hand, contemplates that payments or other obligations due and payable or due to be performed on or prior to the Novation Date may be subsisting at the time of novation, and it specifically excludes such obligations from the scope of obligations which are to be “released and discharged” on the Novation Date.

As the legal effect of the ISDA Novation Agreement is the same as that of the AFMA Novation Agreement, we consider that the ISDA Novation Agreement is suitable for use in Australia. However stamp duty and tax implications must be carefully considered.