Linklaters

Memorandum

21 March 2003

To	Kimberly Summe International Swaps and Derivatives Association, Inc
From	Simon Firth
Direct Line	020 7456 3764

Partial novations

You asked me to let you have my views about whether the partial novation of a transaction is possible under English law and whether there are any impediments to the enforceability of such an arrangement.

"Novation" is a term of art under English law. It has been judicially defined as an arrangement where a new contract is substituted for an existing contract, either involving the same or different parties, the consideration being the discharge of the old contract (*Scarf v Jardine* (1882) 7 App Cas 345, 351). The effect of a novation is therefore to terminate the existing contract.

It follows from this that the idea of a "partial novation" is strictly a contradiction in terms as it suggests the continuation of the existing contract, albeit on different terms, as well as the creation of a new contract between one of the parties and another person. That said, when construing the terms of a contract, the courts will try to understand what the parties meant by the words they used and will seek to give effect to that meaning. If it is clear what they wished to achieve, the fact that they used words differently from the way in which they would normally be used is immaterial. I therefore see no reason why an agreement involving the "partial novation" of a transaction should not be enforceable. Similar issues arise in relation to agreements referring to the "partial termination" of a transaction, a phrase which is frequently seen in the derivatives market. This is also a contradiction in terms, yet such an agreement would be enforceable if its meaning is clear.

A separate question, however, is whether the use of the term "partial novation" amounts to good drafting practice. This cannot be answered in isolation as it depends on the nature and, in particular, the complexity of the transaction. In some contexts it might be entirely clear what the parties meant, so that the phrase is no more than a convenient shorthand to communicate their common intention. In others, it may be unclear precisely what rights and obligations are involved. In the latter case, a better approach would be for the parties to enter into an agreement (a) amending the existing contract, and setting out precisely the variations to its terms that have been agreed and (b) providing for the formation of a new contract on terms which are expressly set out in the agreement. Alternatively, these two limbs could be contained in separate agreements.