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NOTE ON NOVATION OF CONTRACT

A. Novation: Meaning -

1. According to Black's Law Dictionary, 'Novation' means "*substitution of new contract between same or different parties...It requires a previous valid obligation, an agreement of all the parties to a new contract, the extinguishment of an obligation and the validity of the new one.*"
2. While The Indian Contract Act, 1872 (for short "**the Act**") does not define the term novation, but section 62 of the Act deals with its effect along with rescission and alteration of contract.
"62. If the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract, need not be performed."
3. From the section, the best possible meaning that can be inferred for novation is substituting a new contract for an original contract where the original contract need not be performed anymore.
4. However, there must be a complete substitution of new contract in place of the old one and only in this situation, the original contract does not have to be performed. [Lata Construction vs. Rameshchandra Ramniklal Shah (2000) 1 SCC 586, Pr. 9 & 10.]
5. There must be agreement between the parties as to extinguishing the obligations under the original contract to form a new contract. [Ramdayal vs. Maji Devdiji AIR 1956 Raj 12, Pr. 8, 9, 10, 11, 15]

B. Novation: Kinds -

1. "*A novation may take place by the introduction of new parties or new terms into the contract. The test, therefore, is what was the intention of the parties, or, in other words, whether they intended to bring about a new or altered contract between themselves.*" [Ramdayal vs. Maji Devdiji AIR 1956 Raj 12, Pr. 10]
2. Novation could be of two kinds, (a) introduction of new parties and (b) introduction of new terms.

When the parties in the new contract were also parties in the old contract but the liabilities as regards each party changed in the new contract, it would be termed as novation. [Godan Namboothiripad vs. Kerala Financial Corporation, Vellayambalam AIR 1998 Ker 31, Pr. 5 & 6]

C. Novation: Essentials -

1. "*In order to constitute a "novation of contract", it is necessary to prove, in the first place, that the contract is in existence and second, such contract is substituted by a new contract either by the same parties or different parties with a mutual consideration of discharge of the old contract.*" [Sasan Power Ltd. vs. North American Coal Corporation (2016) 10 SCC 813, [Pr. 23, 24, 70, 71, 72, 73]]
2. The basic idea behind novation of a contract is that a new contract is entered into between the parties and hence it must satisfy the essentials of a contract as contemplated under the Act in addition to the fact that an old contract was already in existence before the new contract was entered into.
3. Novation cannot be done unilaterally by one party, there must be consensus between parties as to novation. [Knowledge Podium Systems Pvt. Ltd. vs. S.M. Professional Services Pvt. Ltd. 2021 SCC OnLine Del 136, Pr. 18, 22, 23]
4. Novation is allowed only expressly by renegotiation [State of Rajasthan vs. Ferro Concrete (2009) 12 SCC 1, Pr. 32, 33, 34]
5. Mere non-performance of new contract may not by itself revive the earlier contract [RN Kumar vs. RK Soral (1988) 2 SCC 508, Pr. 4]
6. The unconditional acceptance of modified contract can't be disputed later, since the principle of estoppel would apply in such cases. [Shyam Telelink Limited vs. Union of India (2010) 10 SCC 165, Pr.



Amit Meharia

Managing Partner, MCO Legals

Solicitor

(Supreme Court of England & Wales)

Expertise:

Corporate Due Diligence & Corporate/Commercial Arbitration

✉ amit.m@mcolegals.co.in



Paramita Banerjee

Associate, MCO Legals

B.A., LLB (Hons.)

School of Law, Christ University

Bangalore

Expertise:

Litigation and Arbitration

✉ paramita.b@mcolegals.co.in

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D. What is not Novation?

1. If right under old contract were kept alive even after second agreement, it would not amount to novation. [HR Basavaraj vs. Canara Bank (2010) 12 SCC 458, Pr. 18, 19, 20, 21]]
2. Each term and condition under a contract are not a separate contract, therefore changing of a term would not mean novation of a contract. [RS Amarnath Mehra & Co vs. Union of India 1993 SCC OnLine Del 436, Pr. 13, 14, 15, 16, 17, 22, 23, 24 & Purbanchal Cables & Conductors (P) Ltd. vs. Assam SEB (2012) 7 SCC 462, Pr. 81, 82]]
3. Settling the meaning of terms in the contract would not be novation of contract. [Mukul Sharma vs. Orion India Private Limited (2016) 12 SCC 623, Pr. 6, 8]]

E. Novation & Alteration: Difference -

1. Section 62 of the Act also covers 'Alteration of a contract'.
2. In alteration, a new contract is not entered into but merely the terms of the contract are changed while the original contract subsists.

3. Test to distinguish - to determine whether the original contract was altered in such a manner that performance under it is at an end. [Chrisomar Corporation vs. MJR Steels Pvt. Ltd. (2018) 16 SCC 117, Pr. 34, 35, 36, 37, 38, 39, 40, 41, 42, 47, 48, 49, 50]]

F. Novation & Rescission: Difference -

1. Rescission refers to cancellation or termination of a contract.
2. A contract may be rescinded when there has been failure to perform the contract or the parties mutually agree to terminate the contract. [Union of India vs. Kishorilal Gupta AIR 1959 SC 1362, Pr. 5, 6, 8, 9]]
3. Difference – is in the fact that under novation a new contract is entered into while in case of rescission the termination of the contract may or may not lead to a new contract.