Doctrine of Novation, recession, alteration, Accord and Satisfaction

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Things to be discussed!

- What is executed contract and what is executory contract?
- It is competent for both parties to an executory contract by mutual agreement without any satisfaction to discharge the obligation of a contract. This principle is very common in English Law.
- But an executed contract cannot be discharged except by the performance of the obligation.
- What we will discuss in the present session is the intention of the law-makers to alter the rule of common law principle and it has been recognised in several Indian cases. One of them is *Monohur Koyal v. Thakur Das Naskar* (1888).
Introduction

• There are several ways in which parties can discharge their contractual obligations. One of them is accord and satisfaction.

• The doctrine of accord and satisfaction allows parties to discharge their contractual obligations by performing certain modified obligations or by novating or rescinding the existing contract [National Insurance Company Limited v Boghara Polyfab Private Limited [(2009) 1 SCC 267].

• The 'satisfaction' is the discharge of the substituted obligations.

• Central to this is the consent and mutual agreement of all parties involved. To overcome this issues, the legislator draft these two sections so that there is no any overlap to each other.
Section 62: Effects of Novation, alteration and rescission of contract

• This section starts with the word assent of both the parties in respect of so and so.

• However, unilateral novation, alteration or rescission can also take place if this was either mentioned in the original contract or if the novation, alteration or rescission is accepted sub-silentio i.e. there is an implied acceptance through silence. [BSNL v. BPL Mobile Cellulor Ltd. (2008) 13 SCC 597]

• The words “original contract need not be performed” means the old original contract is discharged completely and is not performed.

• You now have to look upon the new or altered contract. That’s it!
Novation

- Novation has been defined by the House of Lords: “that, there being a contract in existence, some new contract is substituted for it either between the same parties or between the different parties, the consideration mutually being the discharge of the old contract”.

- For instance, where upon the retiring of one of the partners the person who are going to continue in business agree and undertake as between themselves and the retiring partner, that they will assume and discharge the whole liabilities of the retiring partners and in that case, they give notice of that agreement to a creditor and ask for his accession to it and there becomes a contract between the creditor who accedes the new liability instead of the old liability.
Thus, we can say that Substitution of one debtor for another or extinction of an existing debt by the creation of new one is treated as Novation.

In other words we can say that Novation is of two kinds:

1. Novation in terms of change in the terms of a contract [Illustration (b) to Section 62].

2. Novation in terms of change in the parties to the contract [Illustration (c) to Section 62].
Change in the term of Contract

- In *Salima Jabeen v. National Insurance Co. Ltd. AIR 1999 J&K 110*, the appellant entered into a contract of insurance of her property against fire, with the respondent company. The insured sum was Rs. 23 lakhs. Her property was set on fire by the militants causing substantial damage to the property.

- The assessment of damage was made by two surveyors. The appellant accepted the compensation of Rs. 6,61,772 by way of full and final satisfaction of her claim on the basis of the report submitted by the surveyors. The said amount was paid by the insurance company and received by the appellant.

- It was held that by accepting the said compensation and agreeing not to make any further claim, the appellant has released the insurance company from contractual obligations. She, therefore, was not entitled to claim any further compensation from the insurance company.
Change in the parties to the contract

- In the case of *Godan Namboothiripad v. Kerala Financial Corporation*, the respondent (Kerala Financial Corporation) sanctioned loan to one Gopinath for purchasing a transport vehicle which was to be paid in instalments. He defaulted in making the payments and as a result of that, the respondent seized the vehicle. After that, the appellants executed an equitable mortgage confirmed to repay the balance amount. The court held that it was a novation of contract because the appellants took the liability to pay the dues and the original debtor (Gopinath Menon) ceased to be the debtor.
Also, there is no novation when the creditor does not accept the new debtor for the original one.

Where A owes B Rs. 300, A transfers the whole of his property by a registered instrument to C. The consideration for the transfer is Rs. 2000 out of which C agrees to pay Rs. 300 to B. Question is whether section 62 will be applicable in this case or not? Here there is no novation, for there is a contract between A, B and C that B shall accept C as his debtor instead of A. Thus B is entitled to recover the debt from A.

The case name is *Debnarayan Dutt v. Chunilal Ghose*, *(1914) 41 Cal 137.*
Rescission of Contract

• To rescind means to cancel or revoke.

• Rescission under contract law means a party to the contract can cancel or terminate the contract. In this, the parties legally terminate a contract by mutual consent.

• Under Section 62, a party is allowed to rescind a contract but such rescission should only be in bilateral terms.

• Question is when rescission may be allowed?

• In *Union of India v. Kishorilal Gupta and Bros*, the Calcutta High Court held that a contract under Section 62 of the Indian Contract Act can be rescinded only after there has been a breach.
Question?

• The term recession used in Section 62 and Section 64 are similar things or different?
• Is Novation happens after the breach or before the breach of contract?
Alteration in terms of a Contract

- Alteration in terms of contract happens when the parties enter into a contract and one of the parties wants to modify or change certain terms of the contract with the assent of the parties. Hence, once the parties sign the contract they cannot alter its term except in the case where all parties by the mutual consent agree to the alteration.

- For instance, change in the date or place of delivery in a contract of sale of goods between parties.
Is Assignment and Novation similar things or different?

• The assignment of a debt operates as an effective transfer of a debt without the consent of the debtor.

• A novation is effective if the debtor is a consenting party.

• In Re United Railways of the Havana & Regla Warehouse Limited., (1960), it was held that assignment there is a transfer of property and in novation there is annulment of one debt and the creation of a substituted debt in its place.
Effects

• New enforceable contract: An attempted novation which fails to produce a new enforceable contract may put an end to the original contract if it was the intention of the parties to rescind it in any event. However such intention must be clearly proved [Morris v. Baron (1918)].

• A fresh contract which required to be compulsorily registered was not registered and hence it was held not to operate as a novation. [Abdul Kayam v. Bahadur (1912)].
Section 63: Promisee may dispense with or remit performance of promise

• Dispense: Manage, Waive, Drop-off, etc.

• As we already discuss that an executed contract cannot be discharged except by the performance of the contract, however, sometimes the obligations may be discharged by mere waiver also.

• As under Section 62, the agreements affects more or less to both the parties whereas under Section 63 it affects the rights of only one parties.
• The last part of the Section deals with the accord and satisfaction.

• Accord means a new agreement wherein the parties mutually agree a new consideration, forfeiting their right of action against their previous contractual obligations. *Payan Reena Saminathan v Puna Lana Palaniappa* [(1913-14) 41 IA 142]

• The 'satisfaction' is the discharge of the substituted obligations. Illustration (b) to Section 63.
This section permits a party, who is entitled to the performance of a contract to:

1. Dispense with or remit, either wholly or in part, the performance of the contract or,

2. Extend the time of performance, or

3. Accept any other satisfaction instead of performance.
Dispensing with or remitting performance

- The promisee has been authorized by Section 63 to remit or dispense with the performance of the contract without any consideration. He may fully forego his claim, or may agree to a smaller amount in full satisfaction of the whole amount.

- In *Kapur Chand Godha v. Mir Nawab Himayatali Khan [(1963) 2 SCR 168]*, B had executed a promissory notes in favour of A. A was offered a sum of Rs. 20 lakhs in full satisfaction of his claim of Rs. 27 lakhs under the aforesaid promissory notes. It was made clear to A that unless he recorded full satisfaction, payment would not be made to him. After some initial protests, A agreed to accept the sum of Rs. 20 Lakhs in full satisfaction of his claims and duly discharged the endorsement on the promissory notes indicating full satisfaction of his claim. A then sued B to recover the balance of Rs. 7 Lakhs. It was held that the case was completely covered by section 63 and illustration (c) thereof. A having accepted the payment in full satisfaction of his claim was not entitled to sue B for the balance.
Union of India v. Gangaram Bhagwandas
[AIR 1977 MP 215]

- In this case it was held that acceptance of payment under protest may not mean accord and satisfaction under Section 63.
- In this case, certain goods sent through central railway got damaged for which the respondents claimed compensation from the Railway. The Railway sent cheque along with letter stating that the said “Payment was in full and final satisfaction of the claim and the cheque should be sent back if it is not acceptable to you.
- The claimants accepted the cheques under protest as part payment and they communicated the protest to the Railway, stating that if the Railway have any objection to the cheque being accepted as part payment, they should inform the claimant within 10 days. The railway did not reply and then the cheques were enhanced.
- It was held that encashment of cheques in such a case did not amount to accord and satisfaction under section 63 and therefore, the claimants were entitled to claim the balance amount of compensation.
Accepting performance from a third party

• The promisee, if he so likes, may accept performance from a third party and while accepting such performance, he may agree to forego his claim in part. Once the promisee accepts a smaller amount in lieu of the whole of his claim, the promisor would be thereby discharged. This is clear from illustration (c).

• A owes B 5,000 rupees. C pays to B 1,000 rupees, and B accepts them, in satisfaction of his claim on A. This payment is a discharge of the whole claim.
Kapur Chand Godha v. Mir Nawab Himayatali Khan [(1963) 2 SCR 168]

- The position was considered by the Supreme Court to be similar to that contained in illustration (c) to Section 63. In this case, the plaintiff had a claim of Rs. 27 lakhs against the defendant, the Prince of Berar. In 1949 there was a Police Station and Hyderabad was taken over by the military. The Princes Debt Settlement Committee set up by the Military Governor decided that the plaintiff be paid Rs. 20 lakhs in full satisfaction of his claim of Rs. 27 lakhs. The plaintiff accepted the sum of Rs. 20 lakhs from the Government in full satisfaction of his claim. He thereafter brought an action against the defendant to recover the balance of Rs. 7 Lakhs. It was held that the position was fully covered by Section 63, and the plaintiff having accepted the payment from a third person, i.e. the Government, in full satisfaction of his claim, had no right to bring an action against the defendant for the balance.
Extending the time of performance

• Section 63 permits the promisee to grant extension of time for the performance of the contract and no consideration is needed for the same. The extension of time must be by a mutual understanding between the parties. A promisee cannot unilaterally extend the time of performance for his own benefit.

• For a valid extension of time, the agreement between the two parties should be there.

• In *M/s Venkateswara Minerals v. Jugalkishore*, the buyer wrote to the seller extending the time of performance and the seller neither replied to that letter nor did he supply the goods within the extended time. It was held that by a mere letter from the buyer the time of supply of goods did not extended.
Accepting any other satisfaction instead of performance

- Section 63 permits the promisee to accept any other satisfaction in lieu of agreed performance and this would discharge the promisor.
- Illustration (d) to Section 63: A owes B, under a contract, a sum of money, the amount of which has not been ascertained. A, without ascertaining the amount, gives to B, and B, in satisfaction thereof, accepts, the sum of 2,000 rupees. This is a discharge of the whole debt, whatever may be its amount.
- Accepting some other satisfaction instead of actual performance is known as the principle of accord and satisfaction and this results in the discharge of obligations under contract.
What factors should be considered to establish whether the doctrine of accord and satisfaction applies in the context of obtaining consent via fraud, coercion or undue influence?

• establishing the existence of unequal bargaining power.
• in cases of insurance claims, examining the difference between the settlement amount and the amount claimed.
• determining whether the applicant has suffered financial duress.
Whether these two words i.e. Accord and Satisfaction apply simultaneously or concurrently?

• Accord and satisfaction is the purchase of the release from an obligation, whether arising under contract or tort by means of any valuable consideration not being the actual performance of the obligation itself. The accord is the agreement by which the obligation is discharged. The satisfaction is the consideration which makes the agreement operative. The consideration may be executory.

• Under English law, an accord without satisfaction is of no effect. In Indian law, an accord is an agreement, there must be consensus ad idem; its validity liable to be judged by the general law of contract quite apart from the provisions of sections 62 and 63 of the Indian Contract Act, 1872.
Necessity of satisfaction in a contract:

• In 1903, the High Court of Bombay had held in Abaji Sitaram Modak v. Trimbak Municipality that a dispensation or remission under this section involved a promise as defined by section 2(b) or an agreement within section 2(e), so that 'there must be a proposal of the dispensation or remission which is accepted': in technical terms, that the effect of the section is only to allow an accord to be good without satisfaction.
Views of the Privy Council:

• The principle of accord and satisfaction has been stated by the Privy Council as a principle of substituted agreement thus in the cases of *Reena Saminathan v. Puna Lana Palaniappa*:

• "The 'receipt' given by the appellants and accepted by the respondent, and acted upon by both parties proves conclusively that all the parties agreed to a settlement of all their existing disputes by the arrangement formulated in the 'receipt'. It is a clear example of what used to be well-known in common law pleading as 'accord and satisfaction by a substituted agreement'. 
To constitute an accord and satisfaction, there must have been a genuine dispute that is settled by a meeting of the minds with an intention to compromise. Where there is an actual controversy, an accord and satisfaction may be used to settle it. The controversy may be founded on contract or tort. It can arise from a collision of motor vehicles, a failure to deliver oranges ordered and paid for, or a refusal to finish constructing an office building, etc.