

NOVATIONS, RESCISSION AND ALTERATION OF CONTRACTS

Section 63 of the Contracts Act 1950 provides that –

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.

The marginal note refers to this section as 'effect of novation, rescission and alteration of contract'. 'Novation' under English law is

a contract between a debtor creditor and a third party that the debt owed by debtor should henceforth be owed to third party.¹

Therefore a variation of a term or substitution of a new contract between the original parties is not novation. Illustrations (a) and (c) to section 63 appear to cover cases of novation under English law. Where however, the parties to the contract rescind or vary the original contract then, there is rescission or variation of the contract. As Treitel points out,

The object of rescission is to release the parties from the contract. The object of variation is to alter some terms of the contract.²

The difference between rescission of an agreement and a variation of an agreement is as follows –

It is a rescission if it alters the original agreement in some essential way; but if it does not go 'to the root of the original contract', it is only a variation.³

Section 63 appears, therefore, to cover cases of novation, rescission and variation. However, the illustrations to the section do not clearly indicate the scope of rescission and variation

¹ Treitel, *The Law of Contract*, 5th Ed. at page 498

² *Ibid.* at page 77

³ *Ibid.* at page 132

under section 63. The problem created by section 63 is highlighted in the recent case of *Government of Malaysia v. Adnan bin Awang & Ors.*⁴

The first defendant as principal and two other defendants as sureties entered into an agreement with the Government of Malaysia under which the first defendant agreed to undergo a course of training for 2 years. On completion of the course, the first defendant agreed to serve the Government for a period of five years as a teacher. On completion of his training, the first defendant was appointed as a temporary teacher. Subsequent to this, the Ministry of Education offered him a new post as a teacher on a higher scale. The Public Service Commission, too wrote to him making a formal offer of permanent and pensionable appointment. Under both the offers, there was a condition which provided that the services of the first defendant may be terminated by one month's notice or a month's salary in lieu. Soon after accepting the offer from the Ministry, the first defendant gave a month's notice to resign from his post, and requested that he be released of his obligation under the agreement. The Government then commenced the present proceedings to recover a sum of \$5,400.

The brief judgement of the High Court, as reported does not make it clear whether the offer from the Ministry also gave the defendant the right to terminate the contract by one month's notice and also how the figure of \$5,400 was arrived at. Furthermore, there was also no argument as to the application of the Contracts (Amendment) Act, 1976,⁵ dealing with scholarship agreement. The only argument raised by the defendant was that

by incorporating the clause enabling each party to terminate the 1st defendant's service by one month's notice in both the offers made on October 2, 1972 and May 28, 1973, the plaintiff had substituted the original agreement with a new one and that by reason of section 62 (sic) of the Contracts Act the defendants need not perform their obligations under the original contract.⁶

⁴[1980] M.L.J. 291

⁵The Contracts (Amendment) Act, 1976 is retrospective in its application.

⁶[1980] M.L.J. 291, 292

The report of the case does not indicate whether the argument was based on novation, rescission or variation. However, Wan Yahaya J. made the following observation on section 63:

For the operation of this section, as I understand it, the party claiming such a relief must not only show the intention to novate or that the terms of the subsequent contract are so inconsistent with the former one as to imply that intention but he must also prove that all parties to the former contract have consented to the terms of the subsequent one.⁷

His Lordship, appears to have addressed his mind to the question of novation alone in holding that the consent of all parties is required for the application. His Lordship again stressed that

it was essential for the principle of novation to apply that there must be the mutual consent of all the parties concerned.⁸

Though this may well be true in cases of novation,⁹ it is submitted that the facts of the present case was not based on novation but on rescission. There was no question of substitution of parties in this case. It was a case of rescission or variation.¹⁰

It is further submitted that even if his Lordship was using the term 'novation' in a wider sense, there is still no need for the consent of the sureties. It is only the agreement between the first defendant and the Government which was being substituted and not the agreement of suretyship. The consent of sureties is not required in all cases of alteration of agreement between the debtor and creditor. As Anson points out: it is only

in the exceptional cases of contract of suretyship which is a contract *uberimae fidei* that the surety is entitled to be informed of any subsequent agreement which alters the relation between the creditor

⁷ *Ibid.*

⁸ *Ibid.*

⁹ See Anson's *Law of Contract*, 25th Ed. at page 442

¹⁰ Compare views of *Cheshire and Fifoot, Law of Contract*, 9th Ed. at page, 508 and the dicta of Lord Selborne in *Scarf v. Jardine* (1882) 7 App. Cas. 345, 351.

and debtor or any circumstances which would give him a right to withdraw his guarantee.¹¹

If there are any variations to the contract between the debtor and the creditor, without the consent of the sureties, then section 86 of the Contracts Act will be more relevant:

Any variance, made without the surety's consent in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance.

Section 86, however only envisages a variation which will impose further liabilities on the sureties. If the variation as a whole is for the benefit of the sureties too, it is unlikely that the sureties will attempt to discharge their liabilities under section 86 of the Contracts Act.¹² In any case, the learned judge made no reference to this section in the instant case.

Finally, it may be pointed out, that the learned judge's misunderstanding of the difference between novation and rescission/variation is made clear by his Lordship's reliance on the two Indian decision which dealt with novation and not rescission/variation. In the first case referred to by his Lordship, *Turner Morrison & Co. Ltd. v. Hungerford Investment Trust Ltd.*¹³ the issue before the Court was whether a new party to a contract may be substituted without the consent of all the parties concerned. This is a classic example of novation and the Calcutta High Court following the Supreme Court decision of *Khardah Co. Ltd. v. Raymon and Co. (India) Private Ltd.*,¹⁴ held that for the application of section 62 of the Indian Contract Act (section 63 of the Malaysian Act), the consent of all parties must be given if it was to be a valid novation under section 62. Similarly, in the second case referred to by the learned Judge, *Appukuttan Panikar v. Athappa Chettiar*,¹⁵ the Kerala High Court was also concerned with the issue of change of parties, that is, novation. The High Court of Kerala pointed

¹¹ *Ibid* at page 267

¹² See *Chitty on Contracts, Specific Contracts, 24th Ed, para. 4840*

¹³ A.I.R. 1969 Cal. 238

¹⁴ A.I.R. 1962 S.C. 1810

¹⁵ A.I.R. 1966 Kerr 303

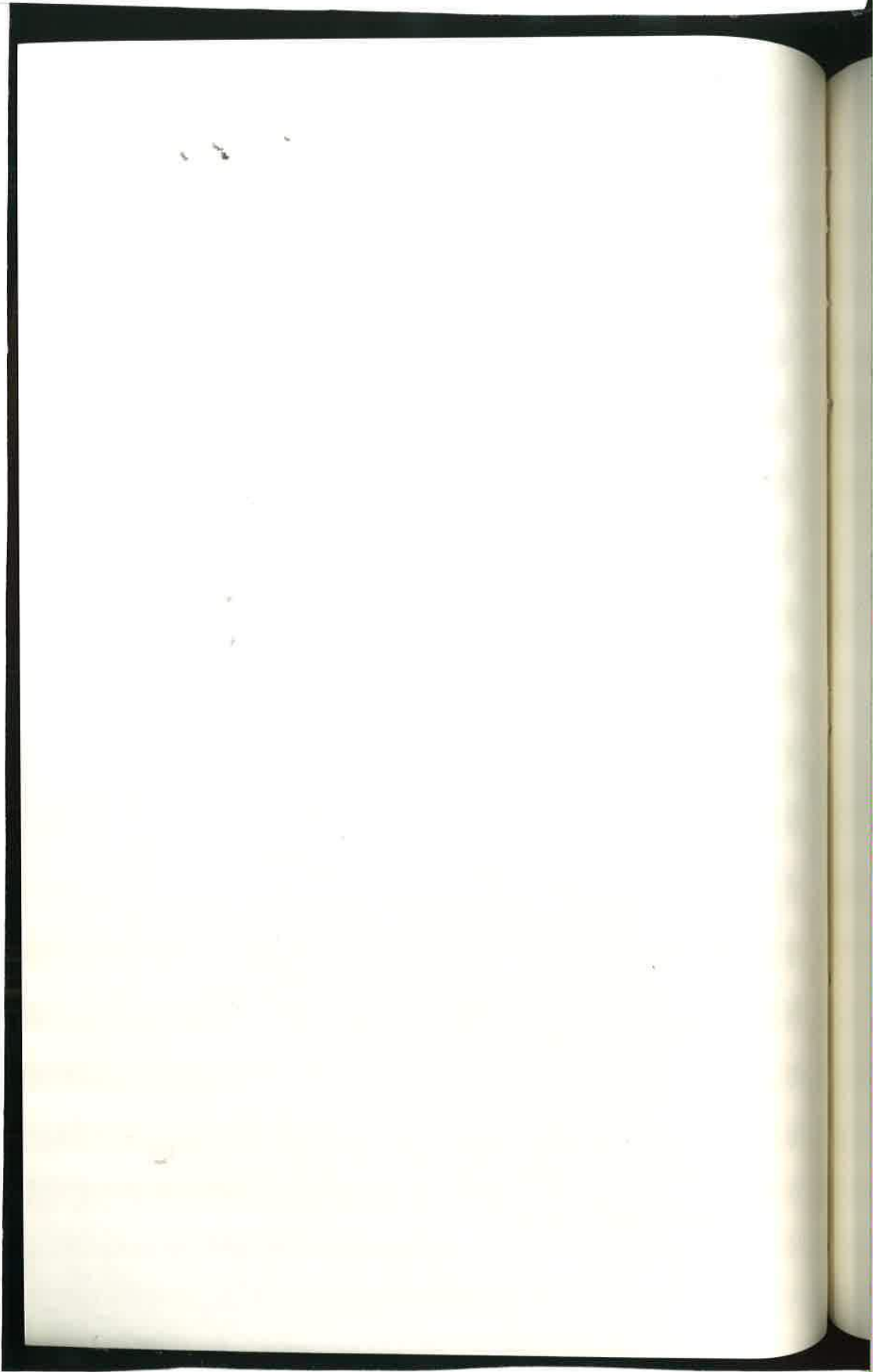
out, that in such cases where consent of all the parties have not been obtained:

It would be impossible to come to the conclusion that there has been a novation, which means the extinguishment of the terms of an earlier contract and the creation of another between *new persons* at least one of whom was a stranger to the original contract and it is essential for the principle of novation to apply that there must be the mutual consent of all parties concerned.¹⁶

It is therefore submitted that the decision in *Government of Malaysia v. Adnan and Ors.* is wrong to the extent that the High Court held that for the application of section 63 of the Contracts Act, all parties must consent to the alteration of the agreement. It is only in cases of novation that such consent of all the parties is necessary. As the present case was not a case of novation but rescission or variation, consent of all the parties is not required.

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¹⁶ Emphasis added, at page 305



LEGISLATION

The following list of Acts passed in Malaysia is a continuation of the list of Federal Acts contained in Vol.6, Part 2 [1979] J.M.C.L. 361-362

FEDERAL ACTS PASSED

<i>Bil. Akta Act No.</i>	<i>Tajuk Ringkas/Short Title</i>
224	Akta Kewangan (Duti Harta Pesaka), 1980. Finance (Estate Duty) Act, 1980.
225	Akta Majlis Peperiksaan Malaysia, 1980. Malaysian Examination Council Act, 1980.
226	Akta Taman Negara, 1980. National Parks Act, 1980.
227	Akta Pencen, 1980. Pensions Act, 1980.

FEDERAL AMENDMENT ACTS

<i>Bil. Akta Act No.</i>	<i>Tajuk Ringkas/Short Title</i>
A470	Akta Perbekalan, 1980. Supply Act, 1980.
A471	Akta Cukai Pendapatan (Pindaan), 1980. Income Tax (Amendment) Act, 1980.
A472	Akta Cukai Pendapatan Tambahan (Pindaan), 1980. Supplementary Income Tax (Amendment) Act, 1980.
A473	Akta Galakan Pelaburan (Pindaan), 1980. Investment Incentives (Amendment) Act, 1980.
A474	Akta Perbekalan Tambahan (1979), 1980. Supplementary Supply (1979) Act, 1980.