DISCHARGE BY NOVATION

Among the various ways of discharging one's liability under a contract, one distinctive method is by novation. In Roman law, from which the name is borrowed,[1] novation seems to have been more of a general term for the usual forms of discharge, such as the substitution of an old by a new agreement or the formal release taking the form of a *stipulatio*.[2] In English law, novation has a much more specialised meaning, largely confined to the discharge of a contractual liability by the intervention or substitution of (almost invariably) a new debtor. However, the larger problems of novation are by no means familiar.

To clarify matters, four situations should be distinguished. One where D (defendant) owes a debt to P (plaintiff), the parties then arranging that D should be replaced by a new debtor. A second situation raising broadly the same problem but translated to partnership; and a third situation more particularly connected with the transfer of a business. A fourth case of novation raises questions not in relation to debtors but in relation to (vicarious) performers; but these need not here detain us.[3]

We then begin with the case where D suggests to P that he (P) might recover his money from a new debtor and that, moreover, P is happy to adopt this arrangement, especially where the new debtor seems financially worthier than the old one. The question is what are the precise effects of this arrangement: in particular, does the arrangement mean that D's (the old debtor's) liability to P is henceforth extinguished? This question is not important if the new debtor does pay off P, for the debt is then entirely satisfied: this under the rule that even payment by a stranger will discharge the main debtor.[4] But suppose that the new debtor does not make the payment: what is now D's position? It is clear that D cannot simply say that his liability has ceased under the new arrangement, for to this P's reply would be that, as far as he was concerned, the arrangement was certainly not meant to expose him to additional risks of non-payment. It follows that for D's liability to cease there has to arise a contract that not only burdens the new debtor with the new liability but also discharges the old debtor.

But what sort of contract? At one time the surprising notion was that any such agreement between the three parties would never be more than *pactum nudum*, simply because under this arrangement

1. See Ames, *Novation*, (1892) 6 Harv. L.R. 184.
2. See Schulz, *Classical Roman Law* (Oxford 1951) 483, 486, 626.
3. See these discussed in Cheshire & Fifoot, *The Law of Contract* (5th ed. 1960) 434.
4. *Hirachand Punamchad v. Temple* [1911] 2 K.B. 330.

the plaintiff would fail to give a *quid pro quo* to the new debtor.[5] When assumpsit took over from debt one might have expected that the new doctrine of consideration would make this point even more strongly. Curiously this did not happen; on the contrary, it began to be thought that the three parties could effect an enforceable novation by express contract between them. And it is this idea that is given formal approval in the well-known dictum of Buller J.'s: "Suppose A owes B £100, and B owes C £100, and the three meet, and it is agreed between them that A shall pay C the £100: B's debt is extinguished, and C may recover the sum against A."[6]

This dictum, needless to say, still left the major question quite unanswered. While it asserted that a tripartite agreement would be effective, it did not say on what basis such a contract would be binding: what, in particular, is here the consideration for the contract? The question is even more intriguing when we consider the resulting relationships. As between P and the new debtor, one can hardly say that the situation reveals any new consideration. Certainly P furnishes no new consideration, while the debtor is merely discharging an already existing obligation. Indeed, the latter's duty to pay P is rather quasi-contractual than contractual: P has an action in money had and received as he would against other such fundholders.[7] Then as between P and the old debtor, the presence of consideration appears even more dubious. Is it to be regarded as sufficient consideration for a debtor to say to his creditor: "Please discharge me. Somebody else will pay you?" Yet precisely this is what the usual explanations relying on consideration here amount to.[8]

These comments, to be sure, are not intended to deny the established effects of an express novation; rather are they meant to show that its validity cannot really depend on consideration. In other words, what transpires is that we have here just another instance of a valid contract even without consideration; in short, it is a contract that takes effect solely by virtue of the parties' express agreement. This analysis is further supported when we turn from the express to the implied novation. Suppose that D merely tells P that C, who is indebted to D, will pay P what D owes him. Suppose, furthermore, that the parties do not in any way expressly agree upon the substitution of their obligations; hence the effective position is that P, while not objecting to D's suggestion that C might pay him, nevertheless says nothing that might be construed as an intention to

5. (1432) Y.B. 11 Hen. 6, f. 35, pl. 30, (at f. 37). The relevant extract is translated in Ames, *op. cit.*, 184-5.
6. *Tatlock v. Harris* (1789) 3 T.R. 174, 180.
7. *Israel v. Douglas* (1789) 1 H.Bl. 239.
8. For such an explanation see *Scarf v. Jardine* (1882) 7 App. Cas. 345.

discharge D. Now the law will of course regard D's liability as extinguished where C, in fact, pays P.[9] However, what happens if C does not pay? The rule is as clear as it is drastic: not only is D not discharged, but P cannot sue C either. Thus in *Liversidge v. Broadbent*,[10] C was indebted to D who was indebted to P in £113. D's debt became due, but he was unable to pay, whereupon it was suggested that C might pay P in substitution. It was held that P had no action against C since the intermediate debt was not extinguished.[11] This result shows that for a novation to occur, P has to evince a clear intention to discharge his original debtor. Concomitantly, this result also shows that a novation depends on words expressing deliberate agreement, not on the dubious discovery of a true consideration. Indeed, if any such consideration really existed, the result would be very different; for then the facts always would be such as to make relatively easy to imply an intention on the part of P to see the relevant debt extinguished.

Our second type of novation has to do with partnership as regards which the position is considerably more confusing. Suppose that when a partner retires from a firm, the continuing partners (to whom he sells or transfers his own share in the business) undertake to carry his existing liabilities. What is the position of this retiring partner: what remain his liabilities? The general answer is that he continues liable unless he is absolved by a novation.[12] But what sort of novation? One sort would be for all parties to meet, the creditor together with the retiring, continuing and (if any) new partners, and at this meeting to extinguish old as well as create the new liabilities.[13] Yet such meetings only seldom happen, and where the partnership is numerous are not even practical. Can, then, a novation be implied from the relevant circumstances?

The cases reveal a distinction between situations where, upon a partner's retirement, new partners are introduced, and situations where there are no new partners. The distinction emerges from *David v. Ellice*,[14] a case that left its imprint on later thinking. The facts were that one partner retired, while the other partners continued the business. Not at all perturbed, the creditor wrote to express

9. *Hodgson v. Anderson* (1825) 3 B. & C. 842.
10. (1859) 4 H. & N. 604.
11. And to some effect, see *Cuxon v. Chadley* (1824) 3 B. & C. 591; *Wharton v. Walker* (1825) 4 B. & C. 163.
12. *Smith v. Patrick* [1901] A.C. 282.
13. In *Lyth v. Ault* (1852) 7 Exch. 569 there was such an express meeting, but doubts were raised if there could be a valid novation without the introduction of new partners. These doubts are no longer well-founded, if only because (as we shortly see) it is now established that a novation is impliable, even where there are no new partners, provided the creditor's intentions are clearly evidenced. It follows that where the novation is express the required intention to discharge becomes unmistakeable.
14. (1826) 5 B. & C. 196.

his complete confidence in the continuing firm. Nevertheless the retiring partner was held to remain liable. To discharge him, the court said, there had to be some consideration: the creditor had to get some new security (e.g. the introduction of a new partner), as otherwise the creditor would "get nothing".[15] This view, however, was shortly challenged. In *Thompson v. Percival*[16] two partners dissolved their partnership, yet agreed that the business should be carried on by the other. A creditor then applied for payment and accepted a bill from the continuing partner. When this bill was dishonoured, the creditor sued the retired partner, on the ground that there had been no consideration to support any agreement to discharge him. The court now held that the taking of a separate bill did constitute both a new security and a new consideration.

Though superficially distinguishable, the latter decision is far from compatible with the former. More particularly, to say that the creditor here obtained a new security was surely vast exaggeration. Instead of money, the creditor got only a conditional payment, indeed a payment subject to dishonour. In fact, the creditor got something less than the absolute payment to which he was entitled; and it would therefore be very strange to say that he got something genuinely "different" within the rules of accord and satisfaction. Nor was it any truer to say, what Denman C.J. suggested,[17] that the liability of one partner can be more beneficial than that of several persons. There would be some truth in this suggestion were the creditor to get an additional debtor and thus additional security. But how can one partner's liability be more beneficial, when the partner referred to has anyhow been liable all along together with the retiring partner.

In any case, the particular ideas advanced in *Thompson v. Percival* had no lasting influence. Still, one must say that the decision did help to modify the earlier view to this extent: that from now on it began at least to be admitted that a novation was possible even

15. *Ibid.* at 205. It was also said that the retired partner might show consideration by showing some prejudice, on account of leaving funds in the hands of his former partners, for the purpose of discharging his liabilities. But this suggestion was never made much use of. One should mention that though *David v. Ellice* was foreshadowed by *Bedford v. Deakin* (1818) 2 B. & Ald. 210 and *Lodge v. Dicas* (1820) 3 B. & Ald. 611, some earlier cases had been very different. As Lord Kenyon said in *Evans v. Drummond* (1801) 4 Esp. 89, 92: "Is it to be endured, that when partners have given their acceptance, and where perhaps one of two partners has made provision for the bill, that the holder shall take the sole bill of the other partner, and yet hold both liable? I am of opinion, that when the holder chooses to do so, he discharges the other partner". And similarly *Reed v. White* (1804) 5 Esp. 122, which also puts the retiring partner's discharge on policy, not on consideration, quite unlike *Thompson v. Percival*, infra.
16. (1834) 5 B. & Ad. 925.
17. *Ibid.* at 934. A similar argument was advanced in *Lyth v. Ault* (1852) 7 Exch. 669.

in a situation without new partners. Moreover, whether there was a novation or not began to be put not on some alleged consideration, but on the creditor's intention. So it was said that a creditor's merely continuing to deal with one or two partners does not disclose an intention to discharge a debtor.[18] Nor, as was insisted in *Harris v. Harwell*,[19] is the accepting of a security by itself evidence of such an intention. Again in *Rouse v. Bradford Banking Co.*[20] four partners had been jointly liable to a bank for an overdraft. One partner retired, selling his share to the others who continued the firm. The bank was entirely aware of what had happened; indeed, they had opened a new account, leaving the old debt in a separate account. One might perhaps have thought this to be conduct from which an agreement to discharge could be inferred, but the Court of Appeal was of different opinion. Said Lindley L.J.:

> "Considering that in the present case the old debt was always kept separate and distinct, that no new partner became liable for it, that no new security was ever obtained for it, and that there is really nothing like proof of any intention to release the Plaintiff, as distinguished from an intention to obtain payment, if possible, from his co-debtors, I am of opinion that the Plaintiff fails to establish that he has been discharged by any agreement, express or implied, by the bank to look to the new firm, and to the new firm only, for the payment of the old debt."[21]

In short, while we can say that an implied novation, a novation implied from facts, is here possible in principle, while we know that this implication will depend on the showing of intention, of *animus novandi*,[22] it is nevertheless extremely difficult to say, even in general terms, what precisely it is that will be accepted as proof positive that the creditor did intend to discharge the retiring partner.[23]

18. *Winter v. Innes* (1838) 4 My. & C. 101.
19. (1851) 15 Beav. 31, 35, where the creditor continued to bank with a firm one of whose partners had died: the latter's estate was not discharged. See also *Re Head* [1893] 3 Ch. 426.
20. [1894] 2 Ch. 32; aff'd: [1894] A.C. 586.
21. *Ibid.* at 54-5.
22. *Wilson v. Lloyd* (1873) L.R. 16 Eq. 60, 74.
23. Nor is it very clear whether the rule in *Oakeley v. Pasheller* (1836) 4 C. & F. 207 will here apply. The Rule drawn from suretyship, is that where a creditor deals separately with one of two debtors, giving him extra time to pay, the second debtor may be discharged, provided the debtors have agreed that one should be primarily, the other only secondarily liable for the debt. The theory is that the second debtor here becomes more like a surety, and therefore is discharged by any possibly prejudicial dealings between the creditor and the principal debtor. However, in *Rouse v. Bradford Banking Co.* it was held that though the continuing partners had agreed to indemnify the retiring partner, so that he became only secondarily liable, the agreement specifically provided that the continuing partners could obtain time from the creditor. In the court's view this excluded any application of *Oakeley v. Pasheller*.

Next consider the situation where, upon the retirement of one, the firm introduces new partners. This case is as much a substitution of debtors as the classical instance of novation we discussed as our first type. Moreover, on the principle of *David v. Ellice*[24] this is clearly a situation disclosing sufficient consideration, simply because the creditor here obtains additional security. Even so, far from being interested in this presence of consideration, the relevant cases were rather more interested in whether or not the creditor had impliedly agreed to accept the new man, and thus to discharge the retiring partner. For this purpose it became of the first importance whether the creditor knew the incoming partner. In *Kirwan v. Kirwan*[25] it was said that whether or not the creditor had this knowledge was a question for the jury. But this could sometimes be far from an easy question as is shown in *Hart v. Alexander*.[26] Here one Hart, in India, deposited in 1815 money with Alexander & Co., a banking partnership carrying on business in Calcutta. In 1818 Alexander came to England, and in 1822 he withdrew from the firm, his place being filled by a new partner. It was the practice of the bank to notify customers of any partnership changes; yet there was no evidence that any such notice ever reached Hart. Alexander, it is true, had published in the newspapers certain statements that he had withdrawn from his Indian interests, but of this too there was no evidence that Hart had any knowledge, apart from the fact that some of these newspapers were taken in at the reading-room of the town in which Hart later resided. Hart received his accounts annually from 1817 to 1832, and in 1831 he even executed a power of attorney to the Calcutta bank to enable them to collect the effects of a testator in India. In 1832 the bank failed. Was Alexander still liable to Hart as a retired partner? Abinger C.B. thought that the plaintiff did know of Alexander's retirement, regarding the evidence for this as "cogent", while Baron Parke merely thought that it was "by no means improbable" that he knew. Baron Bolland, on the other hand, was convinced there was not sufficient evidence, as Hart could not be presumed to have looked at the relevant newspapers.

If the case again shows how much the discharge of a retired partner had become a matter of factual evidence, evidence as to the creditor's knowledge and intentions, the case also reveals the conflict between two policies. For if, on the one hand, there was much to be said for absolving the retired partner, especially after a long lapse of time or after the original firm had changed its character, the fact

24. *Supra.*
25. (1834) 3 C. & M. 617. Only a little earlier, in *Bleaw v. Wyatt* (1832) 5 C. & P. 397, it was still thought that mere knowledge would not be enough, that it needed an agreement to discharge the retiring partner.
26. (1837) 2 M. & W. 484.

remained that, on the other hand, the creditor had very superior interests. This is a conflict, however, which can only be resolved in one of two ways: either by allowing the courts to say from case to case whether or not a creditor "really" intended to discharge the debtor, or by the infusion of some more or less arbitrary criterion such as a specific time-limit or public notice.[27]

A third type of novation has to do with the transfer of a business (usually an insurance company). If company D transfers its business to company C, what is the liability of D company? The whole problem is well put by *Re International Life Assurance Society*.[28] Here B, the holder of a life assurance policy in International Life received a letter informing him that the society had been dissolved and its business taken over by another society, Hercules Life, and that B was entitled to have his policy exchanged for a new one with Hercules. B agreed, and Hercules returned the policy to him charging the funds and property of Hercules with the payment of the sum assured. B also paid a premium to Hercules. It was held that B had accepted the new Hercules liability not merely as a guarantee, but as a complete novation, thus releasing International Life from all further liability. Malins V.C. saw his task as no more than discovering B's true intention: "I must therefore regard the whole transaction as shewing to my mind most conclusively that Mr. Blood intended deliberately, at the time of the option being tendered to him, to accept the liability of the Hercules, not as an addition alliability, but a substituted liability."[29] In *Re Times Life Assurance Co.*[30] the facts were similar except that the policyholder never sent his policy to be endorsed by the new company, though he paid his premiums to it and also accepted a bonus. Again it was held that there had been quite sufficient evidence of a novation. The policyholder, the court said, was virtually asked whether he would accept the responsibility of the new company, and the policyholder by his conduct (by paying the premiums without a word of protest) said Yes.[31]

It follows negatively that no novation is implied if sufficient evidence of consent is lacking. In one case[32] where a policyholder was never explicitly informed of the transfer of the business, it was impossible to say that he in fact knew of the new company, for though he continued his payments, and even took receipts that were in the name of the latter, he might have thought them to be just

27. See e.g. Partnership Act, 1890, s. 36.
28. (1870) L.R. 9 Eq. 316.
29. *Ibid.* at 323. And see also *Re National Provincial Life Assurance Society* (1870) L.R. 9 Eq. 306.
30. (1870) 5 Ch. App. 381.
31. *Ibid.* at 395. And see to same effect: *Re Anchor Assurance Co.* (1870) 5 Ch. App. 632.
32. *Re Manchester & London Life Ass.* (1870) 5 Ch. App. 640.

acting as agents. In another case,[33] Mrs. C. had insured her life with the Wellington Society which transferred its business to the British Nation Society. A circular letter was sent informing policy-holders that the two societies had decided to unite their business; yet a little later the British Nation Society transferred its business to the European Society. Mrs. C never had her policy exchanged or endorsed, and continued to pay her premiums to the same local agents. On these facts, she was held not to have relinquished her rights against the Wellington. The question is, said Mellish L.J., whether Mrs. C "had, *ex animo*, intended to take, and agreed to take, the liability of the British Nation in lieu of the liability of the Wellington, and I do not believe that a jury would be found in all England who on this evidence would turn round in the box for the purpose of considering whether they had agreed to any such substitution."[34]

The result is that the whole question has turned on whether an intention to accept a substitution could be inferred from the circumstances. Unlike the previous cases, moreover, little attention was now paid to consideration. On one occasion,[35] it is true, the lack of consideration was strongly pleaded; but the plea was rejected on the ground that there would always be consideration in the contract with the transferee company, provided there was a new contract. This very obviously begged the very question; for it was (as it still is) far from clear why a contract to continue business with a transferee should relieve the transferor entirely. Be this as it may, virtually all the cases show, whether those relating to transfers or to partnership or to ordinary debtors, that the true basis of novation must, and indeed can only, be found in intention and consent, not in consideration. Or putting this differently, novation is contractual in the sense of constituting a factual agreement for a special purpose, not in the sense of constituting a genuine exchange or bargain.

SAMUEL STOLJAR*

33 *Re European Assurance Society* (1875) 1 Ch. D. 334.

34 *Ibid.* at 345. For the same reason an annuity-holder, who merely continued to receive payments, was held not to have accepted the complete substitution of the transferee-company: *Re Family Endowment Society* (1869) L.R. 5 Ch. 118.

35 *Re United Ports & General Insurance Co.* (1873) L.R. 16 Eq. 354.

*LL.B., LL.M., Ph.D., of Gray's Inn, Barrister at Law; Professorial Fellow in Law in the Australian National University, Canberra.