

## DISCHARGE OF CONTRACT BY NOVATION

*Devanshi Rakeshbhai Brahmhatt<sup>551</sup> & Trisha<sup>552</sup>*

The moment rights and obligations cease to exist, that is, performance of the contract occurs the contract is said to be discharged. There are various ways in which a contract can be discharged one of them being Novation.

Novation in simple words mean that the parties to a contract by way of mutually agreeing and consenting substitute the original contract with a new one. Here, the rights and obligations of the original contract cease to exist, that is, they get discharged and in its place, a new contract with new rights and obligations comes into existence.

### INTRODUCTION

According to the Indian Contract Act, 1872, Discharge of Contract means the termination of contractual relationship between the parties. Thus, a contract is said to be discharged once it ceases to operate that is, when the rights and obligation which have been created by it come to an end.<sup>553</sup>

Following are the numerous ways in which a contract may get discharged<sup>554</sup>:

- By performance or tender:
  - (a) Actual Performance  
When the parties to a contract perform their promise.
  - (b) Attempted Performance or tender  
There is only an offer to perform the obligation under the contract.
- By impossibility of performance which can further be divided into two parts namely:
  - (a) inherent impossibility
  - (b) subsequent impossibility
- By promise failing to offer facilities for performance.
- By operation of law (such as: by death, by merger, insolvency or by the unauthorised alteration of terms of a written document)

<sup>551</sup> 2nd year BCOM LLB Student, Institute of law, Nirma University

<sup>552</sup> 2nd year BCOM LLB Student, Institute of law, Nirma University

<sup>553</sup> Retrieved on <http://www.slideshare.net/>

<sup>554</sup> *Ibid* 4

- By lapse of time
- By breach
- Discharge by mutual consent or agreement

In discharge by mutual consent or agreement, a contract can be terminated or discharged by mutual express or implied agreement between the parties in any of the following ways according to sections 62-64 in Indian Contract Act, 1872<sup>555</sup>:

- Novation, Rescission, Alteration
- Remission
- Waiver

Out of all these ways, the paper shall focus particularly and exclusively on discharge of contract by Novation expressly mentioned in section 62 of Indian Contract Act, 1872 which as follows:

*“Effect of novation, rescission, and alteration of contract- 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.”<sup>556</sup>*

Novation in layman’s language refers to that situation where when the parties to a contract agree to substitute the existing contract with a new contract<sup>557</sup>. It has been defined in The Indian Contract and Specific Relief Acts, Pollock and Mulla as *“that, there being a contract in existence, some new contract is substituted for it either between the same parties (for that might be) or between different parties, the consideration mutually being the discharge of the old contract. Novation of a contract comprises two elements: the discharge of one debt or debtor or a substitution of a new debt or debtor.”<sup>558</sup>*

Thus, from the above statements, novation can be done in roughly two ways:

1. **A novation involving change of parties.**<sup>559</sup>

In simple terms, a novation may involve the change in parties where one of the parties gets discharged from its obligations and this obligation then shifts to another party. For example, A (debtor) owes B

<sup>555</sup> Ibid 4

<sup>556</sup> Indian Contract Act, 1872 pg-29 Universal Law Publishing C. Pvt. Ltd. 2015

<sup>557</sup> Singh Avtar, Law of Contract pg-432 10<sup>th</sup> edition Eastern Book Company Lucknow

<sup>558</sup> Pollock and Mulla *Supra* note 3

<sup>559</sup> Singh Avtar *Supra* note 8

(creditor) a certain amount of money. Now B in place of A agrees to accept the same amount from C. Here, the original contract between A and B comes to an end.<sup>560</sup>

This can further be elaborated and divided into three ways:

- The debtor and creditor remain the same, but a new debt takes the place of the old one<sup>561</sup>
- The debt remains the same, but a new debtor is substituted<sup>562</sup>
- The debt and debtor remain, but a new creditor is substituted<sup>563</sup>

## 2. **A novation involving substitution of a new contract in place of the old one**<sup>564</sup>.

This happens when the parties to the contract mutually agree to substitute a new contract for the original one and the original contract gets discharged and need not be performed anymore. One of the important and necessary points to be noted is that the application of this principle that the original contract must be subsisting and unbroken.

Also, for novation to take place there must be an irreconcilable incompatibility between the old and the new one. While changing the object or principal conditions, it is a requisite that these changes must be declared in unequivocal terms.<sup>565</sup> Alternatively, the old and the new obligations must be incompatible in each and every point with each other as mere or slight modifications only do not constitute novation.<sup>566</sup>

Another way in which a contract can get novated is as follows:

## 3. **A novation involving subrogating a third person in the rights of the creditor**<sup>567</sup>:

In subrogation of a third person in the rights of the creditor, a third person acquires the rights of the creditor against the debtor.<sup>568</sup> Subrogation may either be legal or conventional. A legal subrogation is required to be clearly established for it to take effect as the same is not presumed unless expressly provided by law.<sup>569</sup> On the other hand, conventional subrogation requires the consent of the original parties and of the third person.<sup>570</sup>

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<sup>560</sup> Indian Contract Act, *Supra* note 7

<sup>561</sup> Retrieved on <http://indiankanoon.org/doc/1242279/>

<sup>562</sup> *Ibid* 12

<sup>563</sup> *Ibid* 12

<sup>564</sup> Singh Avtar, *Supra* note 8

<sup>565</sup> Retrieved on <http://www.legalaspects.ph/432/novation/>

<sup>566</sup> *Ibid* 16

<sup>567</sup> *Ibid* 16

<sup>568</sup> *Ibid* 16

<sup>569</sup> *Ibid* 16

<sup>570</sup> *Ibid* 16

## INGREDIENTS OF NOVATION:

Novation in terms of obligation, refers to the extinguishment of an obligation by the substitution or change of the obligation by a subsequent one which extinguishes or modifies the first either by changing the object or principle, or by substituting another in place of the debtor, or by subrogating a third person in the rights of the creditor.<sup>571</sup>

For novation to take place, the following requisites can be identified:

- 1) There must be a previous valid obligation<sup>572</sup>- this implies that the previous or the old contract must have a valid consideration or obligation and not a void one as only then will it be possible for novation (new/substituted) to come into existence..
- 2) The parties concerned must agree to a new contract<sup>573</sup>- the consent of the parties play a paramount role for the constitution of novation as the parties to the contract should have the intention and should come to the consensus of substituting the new contract.
- 3) The old contract must be extinguished<sup>574</sup>- For novation to come into existence, the old contract must be put an end to. This is critical and essential because only when the obligations of the old contract get extinguished i.e., by changing the object or principal conditions and making them incompatible,(it means when the two obligations cannot stand together, each one having its independent existence. If the two obligations cannot stand together, the latter obligation novates the first<sup>575</sup>) only then will the parties become free from their obligation and undertake new obligation as mentioned in the new/ substituted contract
- 5) There must be a valid new contract<sup>576</sup>- Finally, the novated contract must be a valid contract and should not in any way be contrary to any law or any provision of law as it would altogether cease to be valid contract in the first place and there would be no question of novation.

## INTENTION IN NOVATION

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<sup>571</sup>Retrieved on <http://attylaserna.blogspot.com/2011/07/novation-not-present-gr-no-165487.html>.

<sup>572</sup> *Ibid* 22

<sup>573</sup> *Ibid* 22

<sup>574</sup> *Ibid* 22

<sup>575</sup> Retrieved on <http://sc.judiciary.gov.ph/jurisprudence/2012/june2012/159709.htm>

<sup>576</sup>*Supra* note 22

Intention is an essential and pre-requisite element in novation. Whether there is novation or not depends on the intention of the parties and this can be substantiated with the fact that if there is no intention to rescind the prior contract altogether, there is no substitution, and the original contract is still enforceable.<sup>577</sup>

In *Morris v. Baron & Co.* 1918<sup>578</sup>, Morris entered into written contract (A) with Baron to supply him with certain no. of pieces of cloth.<sup>579</sup> The dispute arose between the parties as Morris demanded payment of supplied pieces of cloth while Baron claimed damages for breach of contract out of delay in supplying rest of the pieces.<sup>580</sup> Parties thereafter, by parole, made an arrangement (B) by which they both decided to withdraw legal proceedings, and Morris agreed to give 30 pounds as damages to Baron for not supplying in time.<sup>581</sup> Further, three months were given to Baron to pay Morris due amount, and also an option to demand delivery of the remaining goods, if he pleases.<sup>582</sup> The suit was filed by Morris when Baron consistently refused to pay the due amount while insisting on the delivery of the remaining goods.<sup>583</sup>

Issue was whether parties rescinded contract A and substituted wholly new contract B for it?<sup>584</sup>

It was held by Lord Dunedin that “*whether there has been rescission or mere variation of terms must depend upon the intention of the parties and the nature of the new contract itself.*<sup>585</sup> while in case of novation /substitution, parties could sue on the second contract alone and the first contract is extinguished either by express words or because second dealing with the same subject matter or having the same legal effect as the first but in a materially different way.<sup>586</sup>

*An attempted novation which fails to produce a new enforceable contract may also put an end to the original contract, if it was the intention of the parties to rescind it in any event.*<sup>587</sup>

In present case, both the parties mutually intended and agreed not merely to vary the original contract but to set it aside and substitute another for it.

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<sup>577</sup>Pollock and Mulla, *Supra* note 3

<sup>578</sup>Retrieved on <https://indiancaselaws.wordpress.com/2013/02/05/morris-v-baron-co/>

<sup>579</sup>*Ibid* 29

<sup>580</sup>*Ibid* 29

<sup>581</sup>*Ibid* 29

<sup>582</sup>*Ibid* 29

<sup>583</sup>*Ibid* 29

<sup>584</sup>*Ibid* 29

<sup>585</sup>*Ibid* 29

<sup>586</sup> *Ibid* 29

<sup>587</sup>Pollock and Mulla, *Supra* note3

In *Producers' Fruit Co. v. Goddard*<sup>588</sup>, the plaintiff and defendant entered into a written contract for the purchase and sale of fruit at stipulated prices.<sup>589</sup> Subsequently an oral contract was made by the parties with the understanding that the oral agreement should be substituted for the prior written agreement.<sup>590</sup> For two years the vendor delivered fruit in accordance with the terms of the oral contract.<sup>591</sup> The vendee refused to pay the market price, which was higher than the price stipulated in the written agreement, whereupon the vendor refused further performance.<sup>592</sup> The vendee sued for breach of the first agreement.<sup>593</sup>

It was held that the oral agreement was effective as a discharge of the written agreement.<sup>594</sup> The court held that the oral agreement constituted an entirely new contract because it was made with the intention that it should be substituted for the written contract and so extinguish the written contract are propositions which seem to afford no ground for legitimate discussion.<sup>595</sup> The agreement is itself evidence evincive of an intention by both parties that it should constitute a novation, or as our law defines such a transaction, the substitution of a new obligation for an existing one.<sup>596</sup>

On observing the case, it is noted that the case forms proper instruction for the judges to deal with cases like these in future. The instructions to the jury are as follow:

"The question of whether or not the second contract rescinded the first is one of intent.<sup>597</sup> If you find that the parties did not intend to destroy the first contract without establishing a new enforceable contract in its place, the second contract, which is unenforceable, did not rescind the first, and you will find for the party relying on the first contract as a cause of action or defense.<sup>598</sup> If the parties entered into the second agreement with the intention of rescinding the first in any event, the first contract was rescinded though the second was unenforceable, and you will find against the party relying on the first contract.<sup>599</sup>"

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<sup>588</sup>Retrieved on <http://www.jstor.org/stable/3475841>

<sup>589</sup>*Ibid* 39

<sup>590</sup>*Ibid* 39

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<sup>592</sup>*Ibid* 39

<sup>593</sup>*Ibid* 39

<sup>594</sup>*Ibid* 39

<sup>595</sup>*Ibid* 39

<sup>596</sup>*Ibid* 39

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<sup>598</sup>*Ibid* 39

<sup>599</sup>*Ibid* 39

In *LalaBunseedhur v Government of Bengal*,<sup>600</sup> the government of Bengal filed a law suit against the defendant as surety for the treasurer of a collectorate on four surety bonds executed by the defendant.<sup>601</sup> The collector after examining the account struck the balance as correct, and on each event the defendant executed a new bond without giving up or cancelling the old bond. The Privy Council held that mere execution of new bond does not constitute novation.<sup>602</sup>

Here there was no mutual intention to annul the old contract and substitute it with a new one. Thus mere action of defendant to execute a new bond does not constitute novation because for novation to occur, intention to rescind the prior contract is needed.

## ASSIGNMENT AND NOVATION

A contractual assignment is whereby a right or obligation under a contract of one person is transferred to another person.<sup>603</sup>

Novation effectively means to replace or to substitute.<sup>604</sup> Accordingly novation in contract law is a mechanism whereby one party transfers all of their obligations and benefits under a contract to a third party.<sup>605</sup>

Thus, to explain briefly, in assignment there is transfer of property and in a novation one debt is annulled and then substituting debt is created.<sup>606</sup>

In *Turner Morrison and Company Ltd. v Hungerford investment trust Ltd* it was stated that “A party to the contract cannot transfer his liability under it without the consent of the other part, which can be transferred only by a tripartite contract, amounting to novation”.

Similarly in *Khardah Co. Ltd. v Raymon & company*,

The defendant entered into a contract for supply of goods to plaintiff.<sup>607</sup> A notification was issued by Central Government prior to formation of the agreement, which made all forward contracts for sale-purchase of those

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<sup>600</sup>Pollock and Mulla, *Supra* note 3

<sup>601</sup>Pollock and Mulla, *Supra* note 3

<sup>602</sup>Pollock and Mulla, *Supra* note 3

<sup>603</sup>Retrieved on <http://www.inbrief.co.uk/contract-law/notvation-and-assignment-contracts.htm>

<sup>604</sup>*Ibid* 54

<sup>605</sup>*Ibid* 54

<sup>606</sup>Pollock and Mulla, *Supra* note 3

<sup>607</sup>Retrieved on <https://indiancaselaws.wordpress.com/2013/02/01/khardah-company-ltd-v-raymon-co-india-private-ltd/>

goods except non-transferable specific delivery contracts (i.e. those contracts under which rights or liabilities are not transferable) as illegal.<sup>608</sup> Plaintiff filed a suit alleging default of defendants by not supplying the goods.<sup>609</sup>

Here the issue was whether the buyers and sellers are entitled to assign their right to get the goods on payment and receive payment on delivery of the goods respectively.<sup>610</sup>

It was held that obligation under the contract cannot be assigned except with the consent of the promisee and only then will it amount to novation resulting in substitution of liabilities.<sup>611</sup>

Rights under a contract are assignable with the consent of the parties unless the contract is personal in its nature or rights are incapable of assignment either under law or expressly or impliedly under the agreement between the parties.<sup>612</sup>

Unless contrary intention appears from the agreement between the parties or such assignment is expressly prohibited by law in contracts for sale and purchase of goods, there is nothing personal such that the rights are assignable.<sup>613</sup>

The license which authorized plaintiffs to import the goods expressly prohibited them from assigning the same.<sup>614</sup> Further, goods so received couldn't be sold to any other party but were to be utilized for manufacturing in license holder's factory.<sup>615</sup> Hence, clearly the right of plaintiffs to receive the goods couldn't be assigned.<sup>616</sup> Under the same license, on application by plaintiff, letter of authority to deliver the goods to the former was issued in name of defendant.<sup>617</sup> Further, Court construed the intention of the parties from the express provisions of the contract making the contract non-transferrable.<sup>618</sup>

## CONDITIONS OF NO NOVATION

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<sup>608</sup>*Ibid* 58

<sup>609</sup>*Ibid* 58

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<sup>615</sup>*Ibid* 58

<sup>616</sup>*Ibid* 58

<sup>617</sup>*Ibid* 58

<sup>618</sup>*Ibid* 58



For novation to be complete and valid, it should meet all the requisites mentioned in chapter 2. If anyone of the requirement is not met then the new contract will not be enforceable in court of law. We can infer this through various case laws.

In *Country Banker Insurance Corporation v. Antonio Lagman*<sup>619</sup>, the main issue raised was whether or not the 1990 bond issued by Country Banker novated the 1989 bonds.<sup>620</sup> The Trial Court had held Lagman (surety) and Reguine (co-signer) jointly and severally liable to pay country bankers.<sup>621</sup> Lagman then filed an appeal before the Court Of Appeals which then set aside the decision of the Trial Court and reversed it by ordering the dismissal of the complaint against Lagman stating that the Bond of 1990 superseded and novated the 1989 Bond after which Country Banker assailed the decision of Court of Appeal to Supreme Court of Philippines for review on certiorari.<sup>622</sup> The Supreme Court then set aside the decision of the Court appeals and granted the petition of Country Banker thereby reinstating the Trial Court's decision.<sup>623</sup> According to the Supreme Court, the 1989 Bond shall remain in force unless cancelled only by the oblige which is the Administrator of National food Authority, by the Insurance Commissioner and by the court. Therefore, Lagman would be bound by the Indemnity Agreement in the 1989 Bonds which is still in force and not cancelled by the 1990 Bond.<sup>624</sup>

In another case, *Narciso Degaños v. People of the Philippines*<sup>625</sup>, according to Justice Bersamin, novation requires an irreconcilable incompatibility between the old and the new obligations and there would be no novation in case of only slight modifications; hence, the old obligation would prevail.<sup>626</sup> Thus, in his ruling, he said that novation did not transpire because no irreconcilable incompatibility existed between the promissory note and the receipt.<sup>627</sup>

Similarly, in *R.S. Amarnath Mehra & Co. v Union of India and Others*, the respondents had invited tenders and in response to the tender enquiry, the appellant submitted its tender to the railways which was accepted.<sup>628</sup> Later, the appellants received a letter of communication stating that the contract entered into earlier between the parties to be kept in abeyance and thereafter fresh quotations were invited by the respondents in respect of the work that was covered by the contract with modifications and minor variation in the terms and conditions, otherwise the contract remained the same.<sup>629</sup> The appellants continued to work according to the terms and conditions of the

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<sup>619</sup> Retrieved on <http://sc.judiciary.gov.ph/jurisprudence/2011/july2011/165487.htm>

<sup>620</sup> Retrieved on <http://www.scribd.com/doc/159609352/Country-Bakers-v-Lagman#scribd>

<sup>621</sup> *Ibid* 71

<sup>622</sup> *Ibid* 71

<sup>623</sup> *Ibid* 71

<sup>624</sup> *Ibid* 71

<sup>625</sup> *Supra* note 26

<sup>626</sup> *Supra* note 26

<sup>627</sup> *Supra* note 26

<sup>628</sup> *Supra* note 12

<sup>629</sup> *Supra* note 12

original contract and on a later date, the respondent by communication of letter rescinded the whole contract which resulted in filing of a suit and hence the petition.<sup>630</sup> The appellants pleaded that the earlier contract had come to an end and fresh contract was arrived at under which there was no right with the respondents to cancel any item covered by the schedule or to cancel the entire contract.<sup>631</sup> On the other hand, the respondents argued that since there were only minor changes in the contract with almost similar terms, they had full authority to either stop or cancel the contract in respect of all or any of the items covered by the contract.<sup>632</sup> They also contended that mere or slight variations in terms of contract did not cancel or discharge the previous contract.<sup>633</sup>

The apex court was also of the opinion that there was no question of a new or fresh agreement coming into existence.<sup>634</sup> The correspondence exchanged between the parties makes it amply clear that the intention of the parties was basically to seek revision of rates in the earlier concluded contract and not to enter into a fresh contract.<sup>635</sup> What is to be noted here is the intention of the parties as well because it is clear that the intention of the parties was basically to seek revision of rates in the earlier concluded contract and not to enter into a fresh contract as this can be inferred from the fact that the appellant, continued to perform the contractual obligation and the respondents acted upon the same terms and conditions that had been entered into.<sup>636</sup> Novation, in this case did not take place as the new contract did not discharge the obligations of the old contract, hence the old contract would remain enforceable.<sup>637</sup>

Thus, through these cases following are the conditions in which novation would not take place:

- Mere variation or modifications in the contract do not amount to novation.
- As it has been emphasised earlier, the intention of the parties should be present to actually carry out the obligations imposed on them by the new contract. If it is comprehended impliedly or through expressed terms that the intention of the parties is otherwise, then the original contract shall prevail and there would be no scope for novation to take place.

## **NOVATION IN CONTEMPORARY WORLD**

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<sup>630</sup> *Supra* note 12

<sup>631</sup> *Supra* note 12

<sup>632</sup> *Supra* note 12

<sup>633</sup> *Supra* note 12

<sup>634</sup> *Supra* note 12

<sup>635</sup> *Supra* note 12

<sup>636</sup> *Supra* note 12

<sup>637</sup> *Supra* note 12

Under the English and Irish law, novation refers to the replacement of one contract by another.<sup>638</sup> It occurs between the same parties or by substitution of a third person as a party to a contract in place of an existing party.<sup>639</sup>

In French laws, one of the ways of novation is when a new debtor is substituted for the old one who is discharged by the creditor.<sup>640</sup>

Spanish laws: under the general heading of novation, it provides that an obligation may be modified by substituting another person for the debtor.<sup>641</sup>

In Finland and Scotland also, novation is referred to as substitution of new debtor for the old one, the old being discharged.<sup>642</sup>

Danish law: there is a legal instrument called “*debitorskifte*” meaning “change of debtors” and these concepts indicate substitution of the old debtor by a new one.<sup>643</sup>

In American contract law, for novation to take place, an agreement between the existing original parties and the assignee is required.<sup>644</sup> The novation may not occur without the mutual assent of all the three parties therefore the intention of the parties to novate is very much crucial.<sup>645</sup> The result of novation is that one of the original parties to the contract is removed from the transaction and the newcomer is substituted in the place.<sup>646</sup>

Thus from an overview of the meaning of novation in contemporary world, it can be concluded that novation in other countries and in India do not differ and conveys the same meaning.

## CONCLUSION

Through various chapters in this research paper, it has been constantly emphasised and reiterated that the role of intention in determining whether novation has taken place or not is highly critical and crucial. The intent of the parties is required to be quite explicit i.e. *animus novandi*.<sup>647</sup> The intention of novation and consequently discharge

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<sup>638</sup>Retrieved on <https://books.google.co.in/books?isbn=9041119612>

<sup>639</sup>*Ibid* 89

<sup>640</sup>*Ibid* 89

<sup>641</sup>*Ibid* 89

<sup>642</sup>*Ibid* 89

<sup>643</sup>*Ibid* 89

<sup>644</sup>Retrieved on <https://books.google.co.in/books?isbn=9004150412>

<sup>645</sup>*Ibid* 95

<sup>646</sup>*Ibid* 95

<sup>647</sup>Retrieved on <https://books.google.co.in/books?isbn=0857930451>

Kern Alexander, Rahul Dhumale, Research Handbook on International Financial Regulation, Edward Elgar Publishing, pg- 220

of contract must be clearly deduced.<sup>648</sup>The question of whether or not a later contract will constitute a novation of a prior contract should always be determined in accordance with the intention of the parties.

This can be substantiated through numerous case laws as seen in the case of *Morris v. Baron & Co.* where Lord Dunedin observed that the question whether the contract had mere variations or a new contract is dependent and determined by the intention of the parties also an attempted novation which fails to produce a new enforceable contract may also put an end to the original contract, if it was the intention of the parties to rescind it in any event.<sup>649</sup>

In *Producers' Fruit Co. v. Goddard*, the court held that an oral agreement could be effective in discharge of the written agreement and can very well form an entirely new contract if it was made with the intention of substituting the written contract and extinguishing its obligations.<sup>650</sup>

*Lala Bunseedhur v Government of Bengal*<sup>651</sup>, there was no mutual intention to annul the old contract and substitute it with a new one. Thus, mere action of defendant to execute a new bond does not constitute novation because for novation to occur, intention of both the parties to rescind the prior contract is needed.

It was further observed in *R.S. Amarnath Mehra & Co. v Union of India and Others* that if it amply and impliedly clear that the parties had the intention of only making minor revisions in the terms and conditions and absolutely no intention of treating it as a fresh agreement then under no circumstances will the contract with minor variation be treated as a novated agreement.<sup>652</sup>

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<sup>648</sup>Retrieved on <https://books.google.co.in/books?isbn=9041132007>

Stathopoulos Michael, *Contract Law in Greece*, 2<sup>nd</sup> revised edition, (Kluwer Law International, 2009) pg-236

<sup>649</sup>Intention, footnote- 42 d

<sup>650</sup>S. C. S, *Novation: Statute of Frauds: Invalid Agreement as Discharge of Prior Valid Agreement*, Vol. 14 pg 408-411 (California Law Review 1926)

<http://www.jstor.org/stable/3475841>

<sup>651</sup>*Supra* note 3

<sup>652</sup>*Supra* note 12