

Discharge of a contract

Contents

- 1 Discharge of a contract
- 2 Discharge by performance
- 3 Discharge by agreement or by consent
- 4 Discharge by operation of law
- 5 Discharge by impossibility of performance
- 6 Discharge by lapse of time
- 7 Discharge by breach
- 8 Chapter review

Sir Naeem Baig

INTRODUCTION

Learning outcomes

The overall objective of the syllabus is to give students an understanding of the legal system and commercial laws; and build a knowledge base of corporate laws.

Discharge of a contract

- LO** **On the successful completion of this paper, candidates will be able to demonstrate knowledge of laws relating to discharge of a contract.**
- LO 2.11.1 Understand the meaning of discharge of contract
- LO 2.11.2 Identify modes of discharge of a contract: discharge by performance, by consent, operation of law, impossibility of performance, lapse of time and breach (actual and anticipatory)
- LO 2.11.3 Understand rules relating to discharge of a contract.

References to Legal Acts

Section number references embedded in the learning materials refer to the following legal acts unless otherwise stated:

Act	Chapters
Contract Act 1872	3-16
Partnership Act 1932	17
Negotiable Instrument Act 1881	18
Companies Act, 2017	19-27
Securities Act 2015	22

1 DISCHARGE OF A CONTRACT

Section overview

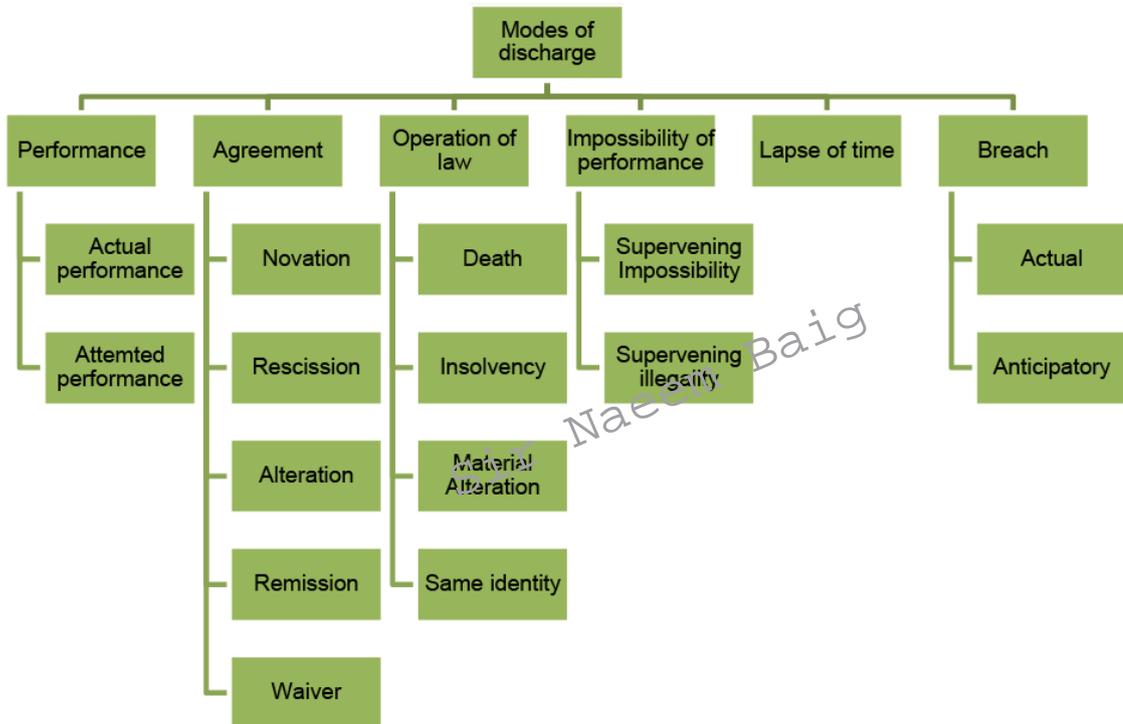
- Meaning of discharge
- Modes of discharge of a contract

1.1 Meaning of discharge

- A contract is said to be discharged when contractual relations between the parties to a contract are terminated or comes to an end.
- In other words, when the parties to a contract have either performed or are freed from the task of performing their respective obligations as arising from the contract.

1.2 Modes of discharge of a contract

The chart below shows the various ways in which a contract is said to be discharged:



2 DISCHARGE BY PERFORMANCE

Section overview

- Actual performance
- Attempted performance

Performance of a contract is one of the most common ways of discharging a contract. A contract can be discharged by performance in any of the following ways:

2.1 Actual performance

If the parties to the contract perform their respective promises in accordance with the terms of the contract then it is said to be discharged by actual performance. [Section 37]



Example: Actual performance

A contracted to deliver to B at his warehouse on 1st November, 500 bales of cotton of a particular quality. A brought the cotton of requisite quality to the appointed place on the appointed day during the business hours, and B took the delivery of goods. This is an actual performance.

2.2 Attempted performance

If the promisor has made an offer of performance as per the terms of the contract and the promisee refuses to accept the offer of performance then the promisor is said to be discharged by attempted performance. It is also known as tender. It is equivalent to actual performance. In this performance, the promisor offers to perform his obligation, but the promisee refuses to accept his performance. [Section 38]

Effect of tender is that the contract is deemed to be performed. Promisee is discharged from his liability of non-performance. His rights against the promisee are unaffected.



Example: Attempted performance

A contracted to deliver to B at his warehouse on 1st November, 500 bales of cotton of a particular quality. B refused to take the delivery of goods; it is a case of attempted performance because A has done what he was required to do under the contract.

3 DISCHARGE BY AGREEMENT OR BY CONSENT

Section overview

- Novation
- Rescission
- Alteration
- Remission
- Waiver
- Promisee's refusal / neglect

The rights and obligations created by an agreement can be discharged without being performed through formation of another agreement between the parties due to which the rights and obligations in the original agreement comes to an end. A contract can be discharged by mutual agreement in any of the following ways:

3.1 Novation

Novation means the substitution of a new contract for an old one. The new agreement extinguishes the rights and obligations that were in effect under the old agreement.

A novation ordinarily arises when a new individual assumes an obligation to pay that was incurred by the original party to the contract. In the case of a novation, the original debtor is totally released from the obligation, which is transferred to someone else. The nature of the transaction is dependent upon the agreement between the parties. A novation also takes place when the original parties continue their obligation to one another, but a new agreement is substituted for the old one. [Section 62]



Example: Novation

- A owes money to B under a contract. It is agreed between A, B and C that B shall now accept C as his debtor; instead of A. The old debt of A to B no longer exists and a new debt from C to B has been contracted.
- A owes B Rs.10,000. A enters into an agreement with B, and gives B a mortgage of his (A's) estate for Rs.5,000 in place of the debt of Rs.10,000. This is a new contract and extinguishes the old.

3.2 Rescission

Rescission is the cancellation of a contract by mutual agreement of parties. [Section 62]



Example: Rescission

A promises B to sell and deliver 500 Bales of cotton on 1st November at his godown and B promises to pay for goods on 1st December. A does not supply the goods. B may rescind the contract.

3.3 Alteration

Alteration means a variation made in the language or terms of a contract with mutual agreement. When this occurs the original contract is discharged and a new contract is created. The parties in alteration remain same. [Section 62]



Example: Alteration

X promise to sell and deliver 500 bales of cotton, on 1st November and Y promises to pay for goods on 1st December. Afterwards, X and Y mutually decide that the goods shall be delivered in five equal instalments at Z's godown. Here, original contract has been discharged and a new contract has come into effect.

3.4 Remission

Remission means accepting a less amount than the initial amount agreed. [Section 63]



Example: Remission

A owes B Rs.5,000. C pays to B Rs.1,000, and B accepts them in satisfaction of his claim on A. This payment is a discharge of the whole claim.

3.5 Waiver

Waiver is a unilateral act of one person that results in the surrender of a legal right. Thus, it amounts to releasing a person of certain legal obligation under a contract.

Example: Waiver

A promises to paint a picture for B. B afterwards requested A not to do so. A, if agreed is no longer bound to perform the promise.

3.6 Promisee's refusal / neglect

If any promisee neglects or refuses to afford the promisor reasonable facilities for the performance of his promise, the promisor is excused by such neglect or refusal as to any non-performance caused. [Section 67]

Sir Naeem Baig

4 DISCHARGE BY OPERATION OF LAW

Section overview

- Death
- Insolvency
- Material alteration
- Same identity

A contract may be discharged by operation of law in any of the following cases:

4.1 Death

On the death of the promisor a contract involving the personal skill or ability is discharged. In other contracts, the rights and liabilities of the deceased person pass on to his legal representatives.



Example: Death

A (an artist) promises to paint a picture for B by June 22, 2013 for Rs. 100,000. A dies before completing the picture. Here it is a contract involving personal skill and on death of A the contract will be discharged.

4.2 Insolvency

When a person's debts exceeds his assets, he is adjudged insolvent and his property stands vested in the Official Receiver or Official Assignee appointed by the court. Such person cannot:

- Enter into contracts relating to his property
- Sue
- Sued

Therefore, on declaration of a person as an insolvent person is discharged from his liabilities incurred prior to his adjudication.



Example: Insolvency

A took a loan from B amounting to Rs. 1 million payable in June 2013. On March 2013 A was declared as insolvent by relevant court. After the order adjudication he is discharged from his liabilities as the amount will be paid by the Official Assignee / Official Receiver.

4.3 Material alteration

A contract is discharged if the terms of the contract are materially altered without getting prior consent of parties. A material alteration is one which changes following in a significant manner:

- Legal identity of the contract; or
- Character of the contract; or
- Rights and liabilities of the parties to the contract

An alteration which is not material or which is made after getting prior consent does not affect the validity of the contract.



Example: Material alteration

A gives a promissory note amounting to Rs. 50,000 to B payable on August 16, 2013. B subsequently, endorses the same note in favour of C after altering the date from August 16, 2013 to August 23, 2013.



Example: Material alteration (continued)

Here, change of date is a material alteration and has discharged A from the instrument because it was made without his consent.

4.4 Same identity

When the promisor becomes the promisee, the other parties are discharged e.g. negotiation back in case of negotiable instrument i.e. creditor to himself becomes a debtor of the same loan.



Example: Same identity

A gives a promissory note to B. B endorses the note in favour of C who in turn endorses in favour of A. Here, A is both the promisor and the promisee and hence the other parties are discharged.

Sir Naeem Baig

5 DISCHARGE BY IMPOSSIBILITY OF PERFORMANCE

Section overview

- Supervening impossibility
- Grounds of supervening impossibility
- Not an excuse of supervening impossibility
- Supervening illegality

5.1 Supervening impossibility

When a contract is valid at the time of formation and becomes impossible to perform subsequently it is called effected by supervening impossibility.

Effects of supervening impossibility

The effects of supervening impossibility are as follows: [Section 56]

- A contract becomes void when an act becomes impossible after the formation of the contract.
- A contract becomes void when an act becomes unlawful by reason of some event beyond the control of promisor.
- A promisor is liable to compensate the promisee for any loss which arose due to non-performance of promisor when the promisor hides the impossibility of performance.
- A person is bound to restore any benefit received or compensated under a contract when such agreement or contract becomes void.



Example: Effects of supervening impossibility

A contracts to sing for B at a concert for Rs.10,000 which is paid in advance. A is too ill to sing. A must refund Rs.10,000 to B.

5.2 Grounds of supervening impossibility

A contract is discharged by supervening impossibility in the following cases:

Destruction of subject matter

If the subject matter of the contract is destroyed after the formation of the contract without any fault of either party then a contract is said to be discharged.



Example: Destruction of subject matter

A music hall was rented out for a series of concerts. The hall caught fire before the date of first concert. It was held, the contract has become void on the ground of supervening impossibility.

Death or personal incapacity (doctrine of frustration)

If a contract is of personal nature then on the death / incapacity / illness of a person a contract is said to be discharged.



Example: Death or personal incapacity (doctrine of frustration)

A agreed to sing on a specified day. A fell seriously ill and could not perform on that day. The contract was discharged.

Declaration of war

At the time of declaration of war the contracts with alien enemies are either suspended or declared as void.



Example: Declaration of War

X contracts to take in cargo for Y at a foreign port. X's government afterwards declares war against the country in which the port is situated. The contract becomes void when the war is declared.

Particular state of things ceases to exist or occur

The contract is discharged if that particular state of thing which forms the basis of a contract ceases to exist or occur.



Example: Particular state of things cease to exist or occur

A and B contract to marry each other. Before the time fixed for the marriage, A goes mad. The contract becomes void.

5.3 Not an excuse of supervening impossibility

Impossibility of performance is, as a rule, not an excuse from performance. It means that a person should perform his promise if he has promised to do so unless the performance becomes absolutely impossible.

A contract is not discharged by the supervening impossibility in the following cases:

Difficulty of performance

If the performance of a contract becomes difficult, more costly or less beneficial than that agreed at the time of its formation, a contract will not be discharged.



Example: Difficulty of performance

A agreed to supply gold within a specified time. He failed to supply in time because of government's restriction on the transport of gold from collieries. Here A will not be discharged because the gold was available in the open market from where A could have obtained it.

Commercial impossibility

When the contract becomes commercially unviable or non-profitable it is not said to be discharged.



Example: Commercial impossibility

A, a furniture retailer, agreed to supply certain furniture to B at an agreed rate. Afterwards, there was a sharp increase in the rates of the timber and rates of wages. Since, it was no longer profitable to supply at the agreed rate, A did not supply. A will not be discharged on the ground of supervening impossibility.

Default of a third party

On default of a third party, on whose work the promisor is relying, a contract is not said to be discharged.



Example: Default of a third party

A entered into a contract with B for the sale of goods to be manufactured by C, a manufacturer of those goods. C did not manufacture those goods. A will not be discharged and will be liable to B for damages.

Strikes, lockouts and civil disturbances

Unless otherwise agreed by the parties to the contract, a contract is not discharged on the grounds of strikes, lockouts and civil disturbances.



Example: Strikes, lockouts and civil disturbances

A agreed to supply to B certain goods to be imported from America. The goods could not be imported due to riots in that country. It was held that this was no, excuse for non-performance of the contract.

Partial impossibility

A contract is not discharged simply on the grounds of partial impossibility of some of the objects of the contract.

5.4 Supervening illegality

If the performance of the contract becomes unlawful due to a change in the law after the formation of the contract then the contract is said to be discharged.



Example: Change of law

A agreed to sell his land to B after the formation of the contract, the Government issued a notification and acquired the land. The contract was discharged.

Sir Naeem Baig

6 DISCHARGE BY LAPSE OF TIME

Section overview

- Limitation period

6.1 Limitation period

If a contract is not performed within the period of limitation then it is discharged as the parties cannot legally enforce their rights.

After the expiry of the limitation period, the debt becomes time barred and hence cannot be recovered through court of law.



Example: Limitation period

A sold goods to B amounting to Rs. 10,000 on a credit of 1 year on January 1, 2012. On due date i.e. December 31, 2012 B defaulted in payment.

In the given scenario A can file suit against B by December 31, 2015.

Sir Naeem Baig

7 DISCHARGE BY BREACH

Section overview

- Actual breach of contract
- Anticipatory breach of contract

If a party refuses or fails to perform his part of the contract then the contract is said to be discharged due to breach. A breach of contract may occur in the following two ways:

7.1 Actual breach of contract

Actual breach of contract occurs when a party to a contract refuses or fails to perform his part of the contract at the time fixed for performance. [Section 38]

Actual breach of contract occurs in the following two ways:

Due date of performance

If any party to a contract refuses or fails to perform his part of the contract at the time fixed for performance, it is called an actual breach of contract on due date of performance.



Example: Due date of performance

A agreed to sell to B 10 tons of wheat @ Rs.8,000 per ton to be delivered in two equal instalments on 20th November and on 21st November. On 20th November, A refused to deliver the goods. It is an actual breach of contract on due date of performance.

Course of performance

If any party has performed a part of the contract and then refuses or fails to perform the remaining part of the contract, it is called an actual breach of contract during the course of performance.



Example: Course of performance

A agreed to sell to B 10 tons of wheat @ Rs.8,000 per ton to be delivered in two equal instalments on 20th November and 21st November. On 20th November, A delivered 5 tons and refused to deliver remaining 5 tons. It is an actual breach of contract during the course of performance.

Consequences of actual breach

The consequences of actual breach depend upon whether the time was the essence of the contract or not. The consequences in both the cases may be summarized as follows:

Time is essence

In case of actual breach where time is of the essence, the breach will have the following consequences: [Section 55]

- Voidable at the option of promisee
- Promisee is entitled to claim compensation for any loss arising to him due to non-performance of the promise at agreed time where performance beyond the stipulated time is not accepted
- Promisee is not entitled to claim compensation for any loss arising to him due to non-performance of the promise at agreed time where performance beyond the stipulated time is accepted, unless the promisee gives notice to the promisor of his intention to claim damages.

Time is not essence

In case of actual breach where time is not essence the breach will have the following consequences: [Section 55]

- Not Voidable at the option of promisee
- Promisee is not entitled to claim compensation for any loss arising to him due to non-performance of the promise at agreed time where performance beyond the stipulated time is accepted, unless the promisee gives notice to the promisor of his intention to claim damages.



Example: Time is essence

A, a singer, enters into a contract with B, the manager of a theatre, to sing at his theatre two nights in every week for the next two months. B agrees to pay her Rs.100 for each performance. On the sixth night, A wilfully absents herself from the Theatre.

In this case, B has the following two options:

- B may rescind the contract and claim compensation for the loss occasioned to him by A's failure to sing on the sixth night.
- B may permit A to sing on the seventh night and claim compensation for loss from A by giving a notice to A of his intention to do so.

7.2 Anticipatory breach of contract

Anticipatory breach of contract occurs when before the performance is due the party acts in a way that the contract may not be performed. [Section 39]

A party may be intended not to perform the contract in the following two ways:

Refusal to perform promise

When a party to a contract has refused to perform his promise



Example: Refusal to perform promise

A, a farmer agrees to sell to B his entire crop of 10 tons of wheat @ Rs. 8,000 per ton to be delivered on 20th November. On 1st November, A informs B that he is not going to supply the goods. A has committed anticipatory breach of contract by express repudiation.

Disabled to perform promise

When a party to a contract has disabled himself from performing his promise in its entirety.



Example: Disabled to perform promise

A, a farmer agrees to sell to B his entire crop of 10 tons of wheat @ Rs. 8,000 per ton to be delivered on 20th November. On 1st November, A contracted to sell his entire crop to C @ Rs. 10,000 per ton. A has committed anticipatory breach of contract by implied repudiation.

Options to the aggrieved party

In case of anticipatory breach, the aggrieved party has the following two options:

Options to the aggrieved party	Calculation of damages
Rescind the contract and claim damages for breach of contract without waiting until the due date for performance or	Damages will be equal to the difference between the price prevailing on the date of breach and the contract price. [Section 73]
Treat the contract as operative and wait till the due date for performance and claim damages if the promise still remains unperformed	Damages will be equal to the difference between the price prevailing on the due date of performance and the contract price.

Consequences of treating contract as operative

If the aggrieved party treats the contract as operative and waits till the due date for performance, the consequences of anticipatory breach will be as follows:

- ❑ The promisor may perform his promise on or before the due date of performance and the promisee will be bound to accept the performance.
- ❑ The promisor may take advantage of the discharge by supervening impossibility arising between the date of breach and the due date of the performance and in such a case, the promisee shall lose his right to sue for damages.



Example: Consequences of treating contract as operative

A, a farmer agrees to sell to B his entire crop of 10 tons of wheat @ Rs. 8,000 per ton to be delivered on 20th November. On 1st November, A informs B that he is not going to supply the goods. B decided not to rescind the contract on 1st November and to wait till 20th November. On 19th November, the entire crop was destroyed by fire without the fault of either party. Since the contract becomes void on the ground of impossibility of performance, B had lost the right to sue A for damages.

Sir Naeem Baig

8 CHAPTER REVIEW

Chapter review

Before moving on to the next chapter check that you now know how to:

- Explain the various modes in which a contract may be discharged
- Discuss the doctrine of supervening impossibility
- Explain types of breach and their consequences

Sir Naeem Baig