NOVATION, ASSIGNMENT OR DISCHARGE? DETERMINING LIABILITY WHEN A CONTRACTING PARTY IS SUBSTITUTED

by Chan Mun Yew and Jessie Gan Ze Xin

The substitution of a contracting party is a common feature of commercial life, whether in the context of a group restructuring, a business transfer or a project handover. These changes may take place before any formal documentation is executed. If a dispute subsequently arises, liability will depend on whether the original contract was assigned or novated, or whether the original party has otherwise been discharged. The answer may lie as much in the parties' conduct as in the documents they have executed. This alert examines the distinction between assignment and novation, the requirements of a valid novation and the circumstances in which a novation may be implied from conduct. It also considers how the original party may be discharged without a novation and the practical steps parties can take to protect their positions.

DISTINCTION BETWEEN ASSIGNMENT AND NOVATION

An assignment transfers the benefits but not the burdens of a contract. The contractual obligations of a party cannot be transferred by assignment alone. A transfer of those obligations generally requires the consent of all parties concerned, usually through a novation. Without such consent, the original party remains bound by its obligations under the contract.[1]

Further, a legal assignment of a debt must be absolute, in writing under the hand of the assignor and notified to the debtor by express notice in writing.[2] The assignee takes the debt subject to any defences that the debtor could have raised against the assignor.[3] In addition, many commercial contracts prohibit any assignment or transfer without the other party's prior written consent. Such restrictions should be reviewed before any change is made.

By contrast, a novation extinguishes the original contract and replaces it with a new contract.[4] Pursuant to section 63 of the Contracts Act 1950 ("**CA 1950**"), a debt may be transferred from one debtor to another where the creditor, the original debtor and the new debtor agree that the creditor will accept the new debtor in place of the original debtor.[5] The original debtor is then released from its obligations under the original contract. As the Court will look at the substance of an arrangement rather than the labels used by the parties,[6] the description they adopt will not, by itself, determine its legal effect.

The distinction carries significant practical consequences. Following a novation, the creditor's rights in respect of the obligations replaced will generally lie against the new party under the new contract, subject to its terms and any rights expressly preserved. If the contract has merely been assigned or a third party has only agreed to assist with performance, the original party ordinarily remains liable for its obligations.[7] Identifying the correct party is therefore essential to any claim for recovery.

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[1] *Resolution Alliance Sdn Bhd v Binabaik Sdn Bhd & Anor* [2015] 3 MLJ 420, CA

[2] Section 4(3) of the Civil Law Act 1956

[3] *Boustead Trading (1985) Sdn Bhd v Arab-Malaysian Merchant Bank Bhd* [1995] 3 MLJ 331, FC

[4] *Housing and Development Board v Lee Sem Yoong Sdn Bhd* [1987] 2 MLJ 204, SC

[5] Illustration (a) to section 63 of the CA 1950

[6] *Dae Hanguru Infra Sdn Bhd v Baldah Toyyibah (Prasarana) Kelantan Sdn Bhd and another appeal* [2022] 4 MLJ 51, FC; see also *Nike Global Trading BV, Singapore Branch v Pemungut Duti Setem, Malaysia* [2026] 2 MLJ 221, CA

[7] *Puncak Alam Housing Sdn Bhd (formerly known as Bukit Cerakah Development Sdn Bhd) v Menta Construction Sdn Bhd & Anor* [2014] 1 MLJ 287, CA; see also *Housing and*

REQUIREMENTS OF A VALID NOVATION

A valid novation requires:[8]

(a) an intention to novate, namely that the new party is to take the place of the original party, rather than merely to assist in or secure its performance;

(b) consideration, which is commonly found in the creditor's release of the original party in exchange for the new party's undertaking; and

(c) the consent of all the parties concerned, namely the creditor, the original party and the new party.

Each of these requirements must be satisfied. The creditor's consent is particularly important, as a creditor cannot be compelled to accept a new debtor in place of the party with whom it originally contracted. Unless a valid novation has taken place, the original party's contractual obligations are not discharged merely because another party has become involved.

IMPLIED NOVATION BY CONDUCT

A novation may be implied from the conduct of the parties and need not be in writing.[9] A novation has been found even where a formal deed of novation was sent but never signed.[10] The absence of a signed novation agreement is therefore not, by itself, conclusive.

However, the burden lies on the party asserting a novation to prove both the intention to novate and the consent of all the parties. In practice, the Court will examine how the parties have performed and documented their dealings. Relevant considerations may include whether the original party has ceased to be involved in the contract and whether the creditor has, by words or conduct, agreed to look to the new party for performance in place of the original party.[11]

Accordingly, conduct which is equally consistent with the original contract remaining in force is unlikely to suffice. For instance, performance or payment by a new party may simply reflect an arrangement under which it assists the original party, without releasing the original party from its obligations.

DISCHARGE OF THE ORIGINAL DEBTOR WITHOUT NOVATION

Not every arrangement involving a third party amounts to an assignment or a novation. A third party may agree to pay another party's debt without releasing the original debtor, or may simply make payment on the original debtor's behalf. If a third party undertakes directly to the creditor to pay the debt, the creditor may also acquire a separate contractual right against the third party, depending on the terms and enforceability of the undertaking. However, the creditor cannot recover the same sum twice.[12]

The original debtor may nevertheless be discharged even where there has been no novation. Under section 42 of the CA 1950, if a promisee accepts performance of a promise from a third person, the promisee cannot subsequently enforce that promise against the promisor. Separately, section 64 of the CA 1950 permits a promisee to dispense with or remit performance, wholly or in part, or to accept instead of it any satisfaction which the promisee thinks fit.

Development Board v Lee Sem Yoong Sdn Bhd [1987] 2 MLJ 204, SC

[8] *Puncak Alam Housing Sdn Bhd (formerly known as Bukit Cerakah Development Sdn Bhd) v Menta Construction Sdn Bhd & Anor* [2014] 1 MLJ 287, CA; see also *Nike Global Trading BV, Singapore Branch v Pemungut Duti Setem, Malaysia* [2026] 2 MLJ 221, CA

[9] *Puncak Alam Housing Sdn Bhd (formerly known as Bukit Cerakah Development Sdn Bhd) v Menta Construction Sdn Bhd & Anor* [2014] 1 MLJ 287, CA; see also *Malaysian International Merchant Bankers Bhd v Datuk Mohd Salleh & Anor* [1988] 1 CLJ (Rep) 786, HC

[10] *H & R Johnson Tiles Ltd & Anor v H & R Johnson (M) Bhd* [1998] 4 MLJ 13, HC

[11] *Housing and Development Board v Lee Sem Yoong Sdn Bhd* [1987] 2 MLJ 204, SC*; see also Encorp Iskandar Development Sdn Bhd v Konsortium Ipmines Merz Sdn Bhd* [2024] 6 MLJ 821, CA

[12] *Chan Kok Sung & Anor v Accupro Sdn Bhd & Anor* [2024] MLJU 942, CA

In this respect, the Federal Court in *Kerpa Singh v Bariam Singh* [1966] 1 MLJ 38 observed that section 64 of the CA 1950 materially alters the English common law position, under which the payment of a lesser sum cannot discharge a larger debt. A debt may therefore be discharged where the creditor accepts a payment, including a lesser sum paid by a third party, in satisfaction of its claim.[13]

Whether the original debtor is released will depend on the terms on which the creditor accepted the payment. The key question is whether the creditor accepted the payment in full satisfaction of the debt, which is a question of fact. Acceptance need not be expressed in words, but the mere receipt or retention of a payment is not, by itself, conclusive.[14] If no agreement to accept the payment in full satisfaction is established, the payment will generally be treated as a part payment and the original debtor may remain liable for the outstanding balance.[15]

KEY TAKEAWAYS

Ultimately, the characterisation of an arrangement as a novation, an assignment or a discharge of the original party will turn on what the parties have agreed and how they have conducted themselves. To avoid uncertainty as to which party bears liability, parties ought to:

(a) decide at the outset whether a novation is intended and, if so, execute a tripartite novation agreement before performance is transferred;

(b) review any restrictions on assignment or transfer in the original contract and obtain any required consent in writing;

(c) where a novation is not intended, record expressly that the original party is not released and that all rights against it are reserved;

(d) ensure that any arrangement for a third party to perform an obligation or pay a debt states clearly whether the performance or payment is accepted in full satisfaction of the original obligation; and

(e) ensure that their conduct and correspondence remain consistent with what has been documented, as these may later be relied on as evidence of the parties' intention.

Taking these steps will place the parties in a far stronger position to establish who bears liability, rather than leaving the question to be inferred from their conduct after a dispute has arisen.

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[13] Illustration (c) to section 64 of the CA 1950
[14] *Ong Seow Lee v Lee Ee Foong* [2026] 5 MLJ 669, CA; see also *Mok Fwee v MUI Finance Bhd* [1997] MLJU 53, HC
[15] *Ngan Ching Wen, ex p Moscow Narodnay Bank Ltd* [1996] 2 CLJ 943, HC