Skillshort

Self-Study Preparation Pack

CA FOUNDATION

Paper 2: Business Laws

Chapter-wise Detailed Notes

For January 2027 attempt (useful for May 2027 too) · ICAI BoS Study Material (new scheme) + RTP · Check ICAI's "applicability of amendments" notice for your attempt VERIFY

100 marks · 3 hours | Descriptive (case-study + theory) | Q1 compulsory + any 4 of 5 | Pass: 40% paper, 50% aggregate

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This subject pack has 6 parts

1 Chapter-wise notes

2 Important topics & weightage

3 Past papers: trends & links

4 Mock tests + solutions

5 Chapter practice questions

6 Last-week plan & strategy

Prepared by Skillshort for self-study. Original explanations and questions; not an official ICAI/ICMAI/ICSI publication. Items marked VERIFY should be checked against the latest official material.

How to use these notes

These notes follow the **ICAI new-scheme syllabus order** (7 sections). Each chapter gives the law section by section, comparison tables, case-law names that ICAI's answers quote, and **"how to answer" frames** for the practical (case-study) questions that carry most of the marks.

File	Use it for
01 Chapter Notes (this file)	First reading and concept building
02 Important Topics & Weightage	Deciding what to study first
03 Past Papers – Trend Analysis & Links	Knowing how ICAI asks; download official papers
04 Mock Tests 1–2 with Solutions	Full 3-hour practice in exam pattern
05 Chapter-wise Practice Questions	Practice after each chapter
06 Last-Week Plan & Exam Strategy	Final revision and exam-day plan

Paper at a glance

Item	Detail
Marks / time	100 marks, 3 hours (+15 minutes reading time)
Pattern	Fully descriptive. Six questions of 20 marks (usually 7 + 7 + 6 or split parts). **Q1 compulsory**, attempt any **4 of the remaining 5**
Question style	About 55–60% **case-study / practical problems** ("Decide...", "Advise...", "Examine with reference to..."), rest theory ("Explain...", "Distinguish...")
ICAI weightage (issued 26-10-2023, ±5%)	I Regulatory framework **0–5%** · II Contract Act **20–30%** · III Sale of Goods **15–20%** · IV Partnership **15–20%** · V LLP **5–10%** · VI Companies Act **15–20%** · VII NI Act **10–15%**
Pass rule	40% in each paper and 50% aggregate of all four papers

STRATEGY **The 4-step answer frame for every practical question**

1. **Provision** – quote the section and state the rule in your own words.
2. **Facts** – restate only the facts that matter.
3. **Analysis** – apply the rule to the facts.
4. **Conclusion** – a clear one-line answer ("Hence, S is liable to pay ₹..."). Then answer any "what if" part separately.

NOTE **Step marks**

ICAI's suggested answers give marks separately for the provision and for the conclusion. A correct conclusion without the provision earns little; a correct provision with a wrong conclusion still earns about half.

Chapter 1: Indian Regulatory Framework

1.1 Meaning and sources of law

Law is a body of rules, recognised and enforced by the State, that regulates the conduct of persons in society. Laws give certainty, protect rights, settle disputes and set the framework within which business operates.

Source of law	Meaning
Customs	Long-standing, reasonable, certain and continuous practices accepted as binding (e.g., Hindu customary law). Must not be against public policy or statute
Judicial precedent	Decisions of higher courts bind lower courts (*stare decisis*). Supreme Court decisions bind all courts in India (Art. 141)
Legislation	Law made by Parliament / State legislatures – the most important modern source; includes delegated (subordinate) legislation – rules, regulations, notifications
Personal law	Religious texts and commentaries for personal matters (marriage, succession) – Hindu, Muslim law etc.
Equity, justice and good conscience	Where no law applies, courts decide on fairness

1.2 Types of laws in the Indian legal system

Type	Meaning / example
Constitutional law	The Constitution of India – the supreme law; all other laws must conform
Statutory law	Acts of Parliament / State legislatures (Contract Act, Companies Act)
Administrative law	Rules made and actions taken by government agencies and authorities; tribunals
Common law (case law)	Law developed by judges through decisions; based on precedents; originated in England
Criminal law	Offences against the State – Bharatiya Nyaya Sanhita, 2023 (replaced IPC from 1 July 2024)
Civil law	Disputes between persons – contracts, property, family matters

LEGAL PROVISION **Common law and principles of natural justice**

Common law is judge-made law based on precedents rather than statutes. Indian courts follow it where statutes are silent.

Principles of natural justice (asked May 2026): (i) **Nemo judex in causa sua** – no one should be a judge in his own cause (rule against bias); (ii) **Audi alteram partem** – hear the other side (no one should be condemned unheard); (iii) **reasoned decision** – the authority must give reasons for its decision.

1.3 Structure and functions of the judiciary

- **Supreme Court of India** (Art. 124) – apex court; original, appellate, advisory (Art. 143) and writ jurisdiction (Art. 32); its law binds all courts (Art. 141).
- **High Courts** (Art. 214) – highest court of a State; writ jurisdiction under Art. 226; supervision over subordinate courts (Art. 227).
- **District courts and subordinate courts** – District Judge / Sessions Judge (civil and criminal); below them civil judges and judicial magistrates.
- **Tribunals** – NCLT/NCLAT (company law, insolvency), ITAT (income tax), SAT (securities), NCDRC (consumer).
- **Functions:** interpreting laws, settling disputes, protecting fundamental rights, judicial review of laws and executive action, guardian of the Constitution.

1.4 Major regulatory bodies

Body	Set up under	Key functions
Ministry of Finance	Government of India	Five departments: Economic Affairs (budget, markets), Expenditure, **Revenue** (CBDT – direct taxes; CBIC – GST & customs), Investment & Public Asset Management (DIPAM), Financial Services (banks, insurance, pension)
Ministry of Corporate Affairs (MCA)	Government of India	Administers Companies Act 2013, LLP Act 2008, Competition Act 2002, IBC 2016 (with IBBI); Registrar of Companies (ROC), Regional Directors, Official Liquidators, SFIO, IEPF Authority
Ministry of Law and Justice	Government of India	**Department of Legal Affairs** (legal advice to ministries, litigation), **Legislative Department** (drafting of bills), **Department of Justice** (appointment of judges, judicial reforms)
SEBI	SEBI Act, 1992 (statutory body from 30-01-1992)	Protects investors in securities, develops and regulates the securities market, registers intermediaries, prohibits insider trading and fraudulent practices
RBI	RBI Act, 1934 (started 1 April 1935)	Monetary policy (inflation targeting), issue of currency, banker to Government and banks, regulator of banks and NBFCs, foreign exchange (FEMA), payment systems
IBBI	Insolvency and Bankruptcy Code, 2016 (est. 1 October 2016)	Regulates insolvency professionals, insolvency professional agencies and information utilities; frames regulations for corporate insolvency resolution and liquidation

EXAM TIP **ICAI has asked "Describe the regulatory bodies" in three of seven attempts (6 marks). Learn 4 functions each for SEBI, RBI and IBBI and the three departments of the Law Ministry.**

Chapter 2: The Indian Contract Act, 1872 – General Principles

2.1 Introduction

The **Indian Contract Act, 1872** came into force on **1 September 1872** and extends to the whole of India. It lays down the general principles of contract (Sections 1–75) and special contracts – indemnity, guarantee, bailment, pledge and agency (Sections 124–238). Sale of goods and partnership, originally part of the Act, are now governed by separate Acts.

2.2 Important definitions – Section 2

Section	Term	Meaning (in simple words)
2(a)	Proposal / offer	When one person signifies to another his willingness to do or not to do something, with a view to obtaining that person's assent
2(b)	Acceptance / promise	When the person to whom the proposal is made signifies his assent; a proposal when accepted becomes a promise
2(c)	Promisor and promisee	Person making the proposal is the promisor; person accepting is the promisee
2(d)	Consideration	Something done, abstained from, or promised at the desire of the promisor, by the promisee or any other person
2(e)	Agreement	Every promise and every set of promises forming consideration for each other
2(g)	Void agreement	An agreement not enforceable by law
2(h)	Contract	An agreement enforceable by law
2(i)	Voidable contract	Enforceable at the option of one party but not of the other
2(j)	Void contract	A contract which ceases to be enforceable

√x FORMULA Contract

Contract = Agreement + Enforceability by law

Agreement = Offer + Acceptance

REMEMBER **"All contracts are agreements, but all agreements are not contracts." Social and domestic agreements (e.g. promise to go to a movie) are not contracts because there is no intention to create legal relations.**

2.3 Essentials of a valid contract (Sec 10)

1. **Offer and acceptance** – two or more parties; lawful offer and lawful acceptance.
2. **Intention to create legal relations** – *Balfour v. Balfour* (1919): husband's promise to pay monthly allowance to wife was a domestic arrangement, not a contract.
3. **Lawful consideration** – something in return (Sec 23).
4. **Capacity of parties** – competent to contract (Sec 11).
5. **Free consent** – not caused by coercion, undue influence, fraud, misrepresentation or mistake (Sec 14).
6. **Lawful object** – not forbidden by law, fraudulent, injurious, immoral or against public policy.
7. **Not expressly declared void** (Secs 24–30, 56).
8. **Certainty of meaning** (Sec 29).
9. **Possibility of performance** (Sec 56).
10. **Legal formalities** – writing, registration where required by law.

2.4 Offer (proposal)

Types of offer

Type	Meaning	Example
Express offer	By words, spoken or written	Email offering to sell a laptop for ₹40,000
Implied offer	By conduct	Bus running on a route offers to carry passengers
Specific offer	Made to a definite person	A offers to sell his car to B
General offer	Made to the public at large; anyone fulfilling the conditions can accept	*Carlill v. Carbolic Smoke Ball Co.* (1893) – reward of £100
Cross offer	Two identical offers cross each other in post	No contract – no acceptance
Counter offer	Acceptance with changed terms	Rejects the original offer – *Hyde v. Wrench*
Standing / continuing offer	Open for a period; tender for supply as required	Supply of goods "as and when ordered"

Rules of a valid offer

- Must intend to create legal relations.
- Terms must be definite and certain.
- Must be **communicated** to the offeree – *Lalman Shukla v. Gauri Dutt* (1913): servant who found the boy without knowing of the reward could not claim it.
- Must be distinguished from an **invitation to offer** – price tags in shops, catalogues, advertisements, auction announcements, tenders, timetable (*Pharmaceutical Society v. Boots Cash Chemists*; *Harvey v. Facey*).
- May be conditional; but cannot say silence will amount to acceptance (*Felthouse v. Bindley*).

Lapse / revocation of offer (Sec 6)

By notice of revocation, lapse of prescribed or reasonable time, failure to fulfil a condition precedent, death or insanity of the offeror (if known to offeree before acceptance), counter offer, rejection, or subsequent illegality.

2.5 Acceptance

- Must be **absolute and unqualified** (Sec 7) – mirror image of the offer.
- Expressed in the usual and reasonable manner, or the prescribed manner.
- Must be **communicated** to the offeror; mental acceptance is not enough – *Brogden v. Metropolitan Railway* (acceptance by conduct).
- Given by the offeree or his authorised agent, while the offer is still in force.
- Cannot precede the offer.

Communication when complete (Sec 4)

Communication of	Complete as against the offeror	Complete as against the acceptor
Offer	When it comes to the knowledge of the offeree	–
Acceptance	When it is put in the course of transmission (posted)	When it comes to the knowledge of the offeror
Revocation	As against the person making it – when put in course of transmission; as against the recipient – when it comes to his knowledge	

Revocation of offer is possible before the communication of acceptance is complete against the offeror (i.e. before the letter of acceptance is posted). **Revocation of acceptance** is possible before acceptance reaches the offeror (Sec 5).

WORKED EXAMPLE **Postal rules**

A posts an offer to B on 1 March, received on 3 March. B posts acceptance on 4 March; it reaches A on 6 March.

A can revoke his offer before 4 March (when B posts). B can revoke acceptance before 6 March (by a faster means, e.g. phone). After 6 March, the contract is binding on both.

Electronic contracts are valid under the **IT Act, 2000** (Sec 10A); acceptance by email or click is complete when it enters the offeror's system.

2.6 Consideration

"Something in return" – *quid pro quo*. Consideration may be past, present or future.

Rules

- Must move at the **desire of the promisor** – *Durga Prasad v. Baldeo* (building a market at the Collector's desire, not the promisor's – no consideration).
- May move from the **promisee or any other person** – *Chinnaya v. Ramayya* (1882): consideration by a third person valid. (Different from English law.)
- Need **not be adequate**, but must be **real** and something of value in the eye of law (Sec 25, Expl. 2).
- Must not be illegal, immoral or opposed to public policy (Sec 23).
- Performance of an existing legal duty is not consideration.

Privity of contract

A stranger to the contract cannot sue (*Dunlop Pneumatic Tyre Co. v. Selfridge*, 1915), but a stranger to consideration can. **Exceptions**: trust beneficiary, marriage settlement/partition provisions, acknowledgement or estoppel, assignment, covenant running with land, agent.

No consideration, no contract – exceptions (Sec 25)

1. Agreement in writing and registered, made out of **natural love and affection** between near relatives.
2. Promise to **compensate a person** who has already voluntarily done something for the promisor (past voluntary service).
3. Written and signed promise to pay a **time-barred debt**.
4. Completed gift (Sec 25 explanation 1).
5. Agency (Sec 185) – no consideration needed to create agency.
6. Bailment without charge (gratuitous bailment).
7. Contribution to charity – where the promisee has acted on the promise (*Kedarnath v. Gorie Mohammed*).

LEGAL PROVISION **Exceptions to privity of contract (asked May 2026)**

A stranger to a contract cannot sue, **except**: (1) beneficiary under a **trust** or charge; (2) **marriage settlement, partition or family arrangement** providing for a person; (3) **acknowledgement or estoppel** – the promisor by conduct recognises the third party's right; (4) **assignment** of rights under a contract; (5) **covenant running with land** – a buyer of land with notice is bound by the covenant; (6) contracts entered into through an **agent**.

WORKED EXAMPLE **Natural love and affection – Sec 25(1)**

Abeer gives an iPhone to his friend Chhaya on her birthday. A **completed gift** is valid without consideration (Sec 25 Explanation 1). A *promise* to give without consideration is enforceable only if it is **written, registered** and made out of **natural love and affection** between parties standing in a **near relation** (husband–wife, parent–child), not between friends.

2.7 Capacity to contract

Every person is competent who is of the age of majority, of sound mind, and not disqualified by law.

Minor's agreements

A **minor** (below 18 years; 21 if a guardian appointed by court) – an agreement with a minor is **void ab initio** – *Mohori Bibee v. Dharmodas Ghose* (1903).

- No ratification on attaining majority.
- No estoppel against a minor – he can plead minority even if he lied about age.
- Minor can be a **promisee/beneficiary** (e.g. payee of a cheque).
- Liability for **necessaries** supplied to a minor – from his property, not personally (Sec 68).
- Minor can be admitted to the **benefits of a partnership** (Sec 30 of Partnership Act).
- Minor's parents not liable unless they authorised the agent.
- Restitution – if a minor obtains goods by fraud, court may order return of goods if traceable.

Persons of unsound mind (Sec 12)

A person who is usually of unsound mind but occasionally sound may contract when of sound mind; a usually sound person may not contract when temporarily unsound (drunk, delirious). Agreements are void.

Persons disqualified by law

Alien enemies (during war), foreign sovereigns and diplomats (cannot be sued without consent), convicts during imprisonment, insolvents, companies beyond MOA powers.

2.8 Free consent

Two persons are said to **consent** when they agree upon the same thing in the same sense (*consensus ad idem*). Consent is **free** when not caused by:

Factor	Section	Meaning	Effect
Coercion	15	Committing or threatening any act forbidden by the Indian Penal Code (now Bharatiya Nyaya Sanhita), or unlawfully detaining property, to make a person enter into an agreement	Voidable (Sec 19)
Undue influence	16	One party in a position to dominate the will of the other uses it to obtain unfair advantage (doctor–patient, guardian–ward, teacher–student)	Voidable (Sec 19A); court may set aside on terms
Fraud	17	Intentional false representation or active concealment to deceive	Voidable; can also claim damages
Misrepresentation	18	Innocent false statement believed to be true	Voidable; no damages
Mistake of fact – bilateral	20	Both parties mistaken about an essential fact	**Void**
Mistake of fact – unilateral	22	Only one party mistaken	Not voidable (generally valid)
Mistake of Indian law	21	Ignorance of law is no excuse	Valid
Mistake of foreign law	21	Treated as mistake of fact	Void (if bilateral)

REMEMBER Mere **silence** is not fraud, except where there is a duty to speak (e.g. insurance – ***uberrimae fidei***), or silence is equivalent to speech.

WORKED EXAMPLE **Coercion vs undue influence**

(a) A threatens to shoot B unless B sells his house to A for ₹5 lakh. → Coercion; B can avoid the contract.

(b) A spiritual guru persuades his devotee to gift all his property to the guru for "salvation". → Undue influence; contract voidable at devotee's option (*Mannu Singh v. Umadat Pandey*).

LEGAL PROVISION **Undue influence (Sec 16) and coercion (Sec 15)**

A person is deemed to be in a position to **dominate the will** of another where he (a) holds **real or apparent authority** (employer–employee, income-tax officer–assessee), (b) stands in a **fiduciary relation** (doctor–patient, lawyer–client, guardian–ward), or (c) contracts with a person whose mental capacity is affected by **age, illness or distress**. Burden of proof lies on the dominant party (Sec 16(3)) where the transaction appears unconscionable.

A **threat to commit suicide** has been held to amount to **coercion** (*Chikham Amiraju v. Chikham Seshamma*) – it is forbidden by law. Effect of coercion, undue influence, fraud and misrepresentation: contract is **voidable** at the option of the aggrieved party (Sec 19, 19A).

2.9 Void agreements

Section	Void agreement
24	Consideration or object unlawful in part
25	Without consideration (subject to exceptions)
26	In **restraint of marriage** (except of minor)
27	In **restraint of trade** – except sale of goodwill (reasonable local limits), partnership restrictions
28	In **restraint of legal proceedings** – except arbitration agreements
29	Uncertain agreements
30	**Wagering** agreements – except horse race prize contests above ₹500, crossword competitions involving skill, games of skill, insurance
36	Contingent on impossible events
56	Agreement to do an impossible act

Void vs voidable

Basis	Void agreement	Voidable contract
Validity	Void from the beginning	Valid until avoided by aggrieved party
Cause	Lack of essential element (consideration, object, capacity)	Lack of free consent (except mistake)
Enforcement	No one can enforce	Aggrieved party may enforce or rescind
Third party rights	No title passes	Third party in good faith gets title before rescission

LEGAL PROVISION **Agreements opposed to public policy (Sec 23)**

Trading with an enemy; trafficking in public offices; interference with the course of justice; stifling prosecution; maintenance and champerty (unfair funding of litigation); agreements tending to create interest against duty; marriage brokerage; restraint of parental rights; agreements to defraud creditors or revenue; unreasonable restraint of trade or of personal liberty.

2.10 Contingent contracts (Sec 31–36)

A **contingent contract** is a contract to do or not to do something, if some event, **collateral** to the contract, does or does not happen (Sec 31). Contracts of insurance, indemnity and guarantee are contingent contracts.

Section	Rule
32	Contract contingent on the **happening** of an uncertain future event – enforceable only when the event happens; void if it becomes impossible
33	Contingent on the event **not happening** – enforceable when its happening becomes impossible
34	If the event is the **future conduct of a living person**, it is deemed impossible when that person acts so as to make it impossible (A agrees to pay B if B marries C; C marries D – impossible)

Section	Rule
35	Event to happen within a **fixed time** – void if not happened by then; event not to happen within a fixed time – enforceable when the time expires
36	Contingent on an **impossible event** – void, whether or not the parties knew of it
Wagering vs contingent	A wager is void (Sec 30) – both parties only interested in winning/losing; a contingent contract is valid and the event is collateral

2.11 Quasi-contracts (Sec 68–72)

Obligations imposed by law to prevent unjust enrichment, even though there is no agreement.

Section	Situation	Effect
68	**Necessaries** supplied to a person incapable of contracting (minor, lunatic) or his dependants	Supplier reimbursed from the incapable person's **property** (no personal liability)
69	Payment by an **interested person** of money which another is bound to pay	Entitled to be reimbursed (e.g., paying arrears of land revenue to save one's own interest)
70	Lawfully doing a **non-gratuitous act** whose benefit another enjoys	The other must compensate or return the thing
71	**Finder of goods**	Same responsibility as a bailee
72	Money paid or thing delivered by **mistake or under coercion**	Must be repaid or returned

LEGAL PROVISION **Quantum meruit**

"As much as is earned". Where a contract is discharged by breach or becomes void after one party has done part of the work, he can claim **reasonable remuneration for the work actually done**. Conditions: the original contract is discharged/void, the claimant was not at fault, and the other party has received the benefit. Example: *Planche v. Colburn* – an author paid for chapters written though the publisher abandoned the series.

2.12 Performance and discharge of contracts

Performance

Parties must perform or offer to perform their promises (Sec 37). A valid **tender** (offer to perform) must be unconditional, at proper time and place, of the whole obligation (Sec 38). Joint promisors are jointly and severally liable (Sec 43).

Modes of discharge

Mode	Explanation
By performance	Actual performance or tender
By agreement (Sec 62–63)	**Novation** (new contract replaces old), **alteration**, **rescission**, **remission** (accepting less), **waiver**, merger
By impossibility (Sec 56)	Doctrine of **frustration** – destruction of subject matter (*Taylor v. Caldwell*), death or incapacity, change of law, outbreak of war, non-occurrence of contemplated event (*Krell v. Henry*)
By lapse of time	Limitation Act 1963 – usually 3 years
By operation of law	Death (personal contracts), insolvency, merger, unauthorised material alteration
By breach	Actual breach or anticipatory breach

Anticipatory breach (Sec 39)

When a party refuses to perform **before** the due date, the other party can treat the contract as ended immediately and sue for damages, or wait till the due date (*Hochster v. De la Tour*).

LEGAL PROVISION **Refusal to perform – Sec 39 (asked June 2024)**

When a party refuses altogether to perform, or disables himself from performing his promise in its entirety, the promisee may **put an end to the contract**, unless he has by words or conduct signified acquiescence in its continuance. Effects: (1) the promisee is excused from his own performance; (2) he can sue for **damages** (Sec 75); (3) if he elects to continue, he cannot later rescind on that ground.

2.13 Remedies for breach

Remedy	Explanation
Rescission	Aggrieved party treats the contract as ended and is freed from his obligations
Damages (Sec 73)	Compensation for loss which naturally arose in the usual course, or which parties knew was likely – *Hadley v. Baxendale* (1854). Remote losses not recoverable
Liquidated damages / penalty (Sec 74)	Only reasonable compensation up to the named amount
Quantum meruit	"As much as earned" – payment for work done when contract is ended
Specific performance	Court orders actual performance where damages are inadequate (Specific Relief Act 1963 – unique property)
Injunction	Court order restraining a party from doing an act

Kinds of damages

Ordinary (general), special (if known at contract time), exemplary/vindictive (rare – breach of promise to marry, dishonour of cheque), nominal (no actual loss), and damages for inconvenience.

WORKED EXAMPLE **Hadley v. Baxendale**

A mill's crankshaft broke and was given to a carrier for delivery to the maker. The carrier delayed. The mill stopped for want of the shaft. The carrier was **not** liable for loss of profit, because he was not told that the mill would remain idle – the loss was too remote.

EXAM TIP **In case-based questions, write: (1) the relevant section, (2) the rule in one line, (3) a decided case, (4) your answer. This 4-step format scores full marks.**

LEGAL PROVISION **Penalty vs liquidated damages (Sec 74) – asked May 2026**

1. **Liquidated damages** are a genuine pre-estimate of the loss; a **penalty** is a sum fixed *in terrorem* (to frighten) and is far above the probable loss.
2. Under Indian law the distinction is not strict: the court awards **reasonable compensation not exceeding the amount named**, whether it is called penalty or liquidated damages.
3. A stipulation for **increased interest from the date of default** may be a penalty.
4. Exception: bail bonds/securities given to Government – full amount recoverable.

Chapter 3: Special Contracts – Indemnity, Guarantee, Bailment, Pledge and Agency

3.1 Contract of indemnity (Sec 124–125)

A **contract of indemnity** is a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself or of any other person.

- **Indemnifier** – the person who promises to make good the loss.
- **Indemnity holder (indemnified)** – the person whose loss is protected.
- Indian definition covers only loss caused by **human agency**; fire and marine insurance (accidents) are covered by general law.

Rights of indemnity holder (Sec 125)

He can recover from the indemnifier: all **damages** he is compelled to pay in a suit, all **costs** of such a suit (if he acted prudently or with authority), and all sums paid under a **compromise** of such a suit (if not contrary to orders and prudent).

> **NOTE Life insurance and indemnity**
>
> A contract of **life insurance** is not a contract of indemnity – the insurer pays a fixed sum on death or maturity irrespective of the actual loss; the loss of life cannot be measured in money. Fire and marine insurance are contracts of indemnity.

3.2 Contract of guarantee (Sec 126)

A **contract of guarantee** is a contract to perform the promise, or discharge the liability, of a third person in case of his default.

Party	Role
Surety	Gives the guarantee
Principal debtor	Whose default is guaranteed
Creditor	To whom the guarantee is given

Essentials

Three parties and three contracts; primary liability of the principal debtor; consideration (anything done for the benefit of the principal debtor is sufficient – Sec 127); consent not obtained by misrepresentation or concealment; may be oral or written.

Indemnity vs guarantee

Basis	Indemnity	Guarantee
Parties	Two	Three
Contracts	One	Three
Liability	Primary liability of indemnifier	Secondary liability of surety (arises on default)
Object	Protection from loss	Security for creditor
Right to sue third party	Indemnifier can sue only after assignment	Surety gets rights of creditor (subrogation) after paying
Existing debt	Not necessary	Necessary

Kinds of guarantee

- **Specific guarantee** – for a single debt; ends when the debt is paid.
- **Continuing guarantee (Sec 129)** – extends to a series of transactions; can be revoked for future transactions by notice (Sec 130) or by death of surety (Sec 131).

Liability of surety (Sec 128)

Co-extensive with that of the principal debtor, unless otherwise provided. The creditor can sue the surety directly without first suing the principal debtor.

Rights of surety

- **Against creditor** – right to securities held by the creditor (Sec 141); right to claim set-off.
- **Against principal debtor** – right of **subrogation** (Sec 140) and right to **indemnity** (Sec 145).
- **Against co-sureties** – right to contribution equally (Sec 146) or in proportion to amounts guaranteed (Sec 147).

Discharge of surety

By revocation (notice/death), variance in terms without consent (Sec 133), release or discharge of principal debtor (Sec 134), compounding/giving time to principal debtor without consent (Sec 135), act or omission of creditor impairing surety's remedy (Sec 139), loss of security (Sec 141), guarantee obtained by misrepresentation or concealment (Sec 142–143).

WORKED EXAMPLE **Co-sureties**

A, B and C are sureties for D's loan of ₹3,00,000 for ₹50,000, ₹1,00,000 and ₹1,50,000 respectively. D defaults with ₹1,20,000 unpaid.

Under Sec 147, they contribute in proportion 1 : 2 : 3 → A ₹20,000, B ₹40,000, C ₹60,000 (each within his limit).

LEGAL PROVISION **Co-sureties – Sec 146 and 147 (asked Sept 2025)**

Co-sureties liable for the same debt contribute **equally** (Sec 146) unless otherwise agreed. Where they are bound in **different sums**, each pays an equal share **subject to the maximum of his own limit** (Sec 147).

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Debt ₹4,00,000; limits A ₹1,00,000, B ₹2,00,000, C ₹4,00,000 → equal share 1,33,333: A pays 1,00,000
(limit); balance 3,00,000 shared B 1,50,000 and C 1,50,000.
Debt ₹6,00,000: equal 2,00,000 – A 1,00,000; balance 5,00,000 → B 2,00,000 (limit), C 3,00,000.
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3.3 Bailment (Sec 148)

Bailment is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them.

- **Bailor** – delivers goods. **Bailee** – receives goods.
- Essentials: contract, delivery of **possession** (not ownership), purpose, return of the **specific** goods. Only **movable goods**; deposit of money is not bailment.

Types

Gratuitous or non-gratuitous; for the exclusive benefit of bailor, bailee, or mutual benefit.

Duties of bailor

Disclose known faults (Sec 150); bear extraordinary expenses (Sec 158); indemnify bailee for defective title; receive back the goods.

Duties of bailee

- Take **reasonable care** as a man of ordinary prudence would of his own goods (Sec 151); not liable for loss if he took such care (Sec 152).
- Not make **unauthorised use** (Sec 154).
- Not **mix** goods with his own (Sec 155–157).
- **Return** goods on accomplishment of purpose (Sec 160); liable if not returned in time (Sec 161).
- Return any **increase or profit** from the goods (Sec 163) – e.g. calf born to a bailed cow.

Rights of bailee

Right to necessary expenses, compensation, indemnity, and **particular lien** (Sec 170) – right to retain the goods until paid for services involving skill and labour. **General lien** (Sec 171) – bankers, factors, wharfingers, attorneys of

High Court, policy brokers can retain any goods for a general balance.

Finder of goods (Sec 71, 168–169)

A finder is treated as a bailee. He may retain the goods until compensated for expenses; may sue for a specific reward offered; may sell if goods are perishable, owner cannot be found, or lawful charges amount to two-thirds of value.

LEGAL PROVISION Termination of bailment

(1) On the bailee doing any act **inconsistent with the conditions** of bailment – voidable at option of bailor (Sec 153); (2) on **expiry of the period** or **fulfilment of the purpose**; (3) gratuitous bailment – any time by the bailor (Sec 159), or on the **death** of bailor or bailee (Sec 162); (4) destruction of the subject matter.

Rights of bailor against a wrongdoer (Sec 180–181): either the bailor or the bailee may sue a third person who wrongfully deprives the bailee of the goods or injures them; the amount recovered is shared according to their respective interests.

3.4 Pledge (Sec 172)

Pledge (pawn) is the bailment of goods as **security for payment of a debt or performance of a promise**. Bailor = **pawnor/pledgor**; bailee = **pawnee/pledgee**.

Rights of pawnee

- Retain goods for debt, interest and expenses (Sec 173–174).
- Extraordinary expenses (Sec 175).
- On default – sue the pawnor, retain goods as collateral, or **sell after reasonable notice** (Sec 176); shortfall recoverable, surplus to be returned.

Pledge by non-owners

Valid pledge by: mercantile agent in possession with owner's consent (Sec 178), person in possession under voidable contract not yet rescinded (Sec 178A), seller or buyer in possession after sale, co-owner in sole possession, and a person having limited interest (Sec 179).

Bailment vs pledge

Basis	Bailment	Pledge
Purpose	Any purpose (repair, safe custody)	Security for a debt
Use of goods	Bailee may use as agreed	Pawnee cannot use
Right to sell	No (only in specified cases)	Yes, after notice on default
Consideration	May be gratuitous	Always for consideration (the debt)

LEGAL PROVISION Duties of pawnee

Take reasonable care of the goods (Sec 151); not to use the goods; return the goods on payment of the debt; deliver any **accretion** (e.g., bonus shares) to the pawnor; on sale after default, account for any **surplus** to the pawnor (Sec 176).

3.5 Agency (Sec 182–238)

An **agent** is a person employed to do any act for another or to represent another in dealings with third persons. The person represented is the **principal**. The basic rule: *qui facit per alium facit per se* – he who acts through another acts himself.

- Any person of majority and sound mind can appoint an agent; a **minor can be an agent** (but is not personally liable to the principal) (Sec 184).
- No consideration is necessary (Sec 185).

Creation of agency

Mode	Example
Express (oral or written – power of attorney)	Appointing a broker in writing
Implied – by conduct, by estoppel (holding out)	Wife buying household necessaries (agency of necessity of wife)
Agency of necessity	Ship captain selling perishable cargo in emergency
By ratification (Sec 196)	Principal later adopts an act done without authority – must be in existence and competent at the time of act; whole act must be ratified; within reasonable time
By operation of law	Partners are agents of the firm; promoters for the company

Types of agents

General agent, special agent, universal agent, mercantile agents – **factor**, **broker**, **commission agent**, **del credere agent** (guarantees payment by third parties for extra commission), **auctioneer**, **banker**; sub-agent (Sec 191) and substituted agent (Sec 194).

Duties of agent

Follow principal's directions or customs (Sec 211), act with reasonable skill and diligence (Sec 212), render proper accounts (Sec 213), communicate with principal in difficulties (Sec 214), not deal on own account secretly (Sec 215–216), pay sums received (Sec 218), not delegate (*delegatus non potest delegare*), not disclose confidential information.

Rights of agent

Remuneration (Sec 219), retention of sums (Sec 217), **lien** on principal's property (Sec 221), indemnity for lawful acts (Sec 222) and acts done in good faith (Sec 223), compensation for injury caused by principal's neglect (Sec 225).

Termination of agency (Sec 201)

By revocation by principal, renunciation by agent, completion of business, death or insanity of either, insolvency of principal, expiry of time, destruction of subject matter, principal becoming alien enemy. **Irrevocable agency (Sec 202)** – where the agent has an interest in the subject matter (agency coupled with interest).

⚠ COMMON MISTAKE **A minor can be an agent but cannot be a principal (he cannot appoint an agent because he cannot contract).**

⚖ LEGAL PROVISION **Sub-agent vs substituted agent (Sec 191–194)**

A **sub-agent** is employed by and acts under the control of the original agent; no privity with the principal (except fraud/wilful wrong). A **substituted agent** is named by the agent on express/implied authority of the principal and becomes the **principal's own agent**. If A authorises B, who appoints C as substituted agent, and A revokes B's authority, C's authority **continues** – it was derived from A.

Personal liability of agent (Sec 230): an agent cannot personally enforce or be bound by contracts on behalf of the principal, except where (1) he contracts for a **foreign principal** (presumed), (2) the principal is **undisclosed**, (3) the principal **cannot be sued**, (4) he signs/acts personally, (5) **agency coupled with interest**, (6) **breach of warranty of authority**.

Chapter 4: The Sale of Goods Act, 1930

4.1 Contract of sale (Sec 4)

A **contract of sale of goods** is a contract whereby the seller **transfers or agrees to transfer** the property (ownership) in goods to the buyer for a price. It includes both a **sale** (property passes immediately) and an **agreement to sell** (property passes at a future time or on fulfilment of a condition).

Essentials

Two parties (buyer and seller), **goods** (movable property other than actionable claims and money – includes stock, shares, growing crops, grass), **price** (money consideration – barter is not sale), transfer of general property, and all essentials of a valid contract.

Sale vs agreement to sell

Basis	Sale	Agreement to sell
Transfer of property	Immediate	Future / on condition
Nature	Executed contract	Executory contract
Risk	Passes to buyer (risk follows ownership)	Remains with seller
Remedy on breach by buyer	Suit for price	Suit for damages
Insolvency of buyer	Seller must deliver goods (gets only a dividend in insolvency) unless he has a lien	Seller may refuse to deliver until paid
Resale by seller	Not valid (except for unpaid seller)	Valid – buyer can sue for damages only

Types of goods (Sec 6)

Existing (owned or possessed by seller – specific, ascertained, unascertained), **future** (to be produced or acquired after the contract – only an agreement to sell), and **contingent** goods (acquisition depends on an uncertain event).

LEGAL PROVISION **Sale vs hire-purchase (asked Sept 2025)**

Under **hire-purchase**, goods are delivered on payment of instalments as hire charges; the hirer has an **option** to buy on paying the last instalment. Differences: (1) **ownership** passes at once in sale, only on last payment in hire-purchase; (2) buyer is owner vs hirer is a **bailee**; (3) buyer **cannot return** goods vs hirer may return and stop paying; (4) risk of loss after sale on buyer; in hire-purchase the hirer is liable only for negligence; (5) buyer can pass good title to a third party; a hirer cannot; (6) sales tax/GST and price structure differ (hire charges include interest).

4.2 Conditions and warranties (Sec 11–17)

Basis	Condition (Sec 12(2))	Warranty (Sec 12(3))
Meaning	Stipulation **essential** to the main purpose of the contract	Stipulation **collateral** to the main purpose
Breach effect	Buyer can **reject the goods** and treat the contract as repudiated, and claim damages	Buyer can only claim **damages**; cannot reject
Conversion	Breach of condition can be treated as breach of warranty (Sec 13)	Warranty cannot become a condition

Implied conditions

1. **Title (Sec 14(a))** – seller has the right to sell (*Rowland v. Divall*).
2. **Sale by description (Sec 15)** – goods must correspond with the description.
3. **Sale by sample (Sec 17)** – bulk must correspond with sample; buyer has reasonable opportunity to compare; free from hidden defects.
4. **Sample + description** – must correspond with both.

5. **Quality or fitness for purpose (Sec 16(1))** – where buyer makes known the purpose and relies on seller's skill, goods dealt by seller (*Priest v. Last* – hot water bottle).
6. **Merchantable quality (Sec 16(2))** – where goods bought by description from a dealer.
7. **Wholesomeness** – eatables must be fit for human consumption (*Frost v. Aylesbury Dairy* – typhoid milk).

Implied warranties

Quiet possession (Sec 14(b)), freedom from encumbrances (Sec 14(c)), warranty to disclose dangerous nature of goods, and warranty of quality by trade usage (Sec 16(3)).

> LEGAL PROVISION **When breach of condition is treated as breach of warranty – Sec 13**
>
> (1) The buyer **waives** the condition; (2) the buyer **elects** to treat it as a warranty; (3) the contract is **non-severable** and the buyer has **accepted** the goods or part of them; (4) the fulfilment is excused by law (impossibility). In these cases the buyer can only claim damages and cannot reject the goods.

4.3 Caveat emptor (Sec 16)

Caveat emptor means "**let the buyer beware**". The buyer must examine the goods and satisfy himself; the seller is not responsible for their quality or fitness unless there is an implied condition.

Exceptions

- Fitness for buyer's purpose made known and reliance on seller's skill.
- Merchantable quality – goods bought by description from a dealer (unless defects are visible on examination).
- Usage of trade.
- Sale by sample, or by description and sample.
- Consent of buyer obtained by **fraud** or active concealment of defects.

> NOTE **Modern consumer law (Consumer Protection Act, 2019) has shifted the balance towards caveat venditor – "let the seller beware" – through product liability and unfair trade practices.**

4.4 Transfer of property (Sec 18–25)

Property means ownership; **possession** means custody. Rule: **risk passes with property** (Sec 26), whether or not delivery has been made.

Situation	When property passes
Unascertained goods (Sec 18)	Not until goods are ascertained
Specific goods in deliverable state (Sec 20)	When the contract is made – even if payment or delivery is postponed
Specific goods – something to be done to make deliverable (Sec 21)	When it is done and buyer has notice
Specific goods – to be weighed/measured for price (Sec 22)	When done and buyer has notice
Goods on approval / sale or return (Sec 24)	When buyer signifies approval, or retains the goods beyond the time fixed / reasonable time, or does an act adopting the transaction
Unascertained / future goods by description (Sec 23)	When goods are **unconditionally appropriated** to the contract with assent of the other party
Reservation of right of disposal (Sec 25)	When conditions are fulfilled

Transfer of title by non-owners – *nemo dat quod non habet*

"No one can give what he does not have." **Exceptions:** sale by mercantile agent, by one of joint owners, under voidable contract (before rescission), by seller in possession after sale, by buyer in possession, by finder of goods, by pawnee, estoppel.

LEGAL PROVISION **Reservation of right of disposal – Sec 25 (asked May 2026)**

The seller may reserve the right of disposal of goods until certain conditions (usually payment) are fulfilled; property does not pass until then, even if goods are delivered to the buyer or a carrier. The seller is **presumed** to have reserved it where (1) goods are shipped and the **bill of lading** is made out to the order of the seller or his agent; (2) the seller sends the bill of exchange with the bill of lading and the buyer does not honour the bill – the buyer must return the bill of lading, and if he wrongfully retains it, property does not pass.

LEGAL PROVISION **Sale on approval / "sale or return" – Sec 24**

Property passes to the buyer when he (a) signifies approval or does any act **adopting** the transaction (e.g., pledges the goods), or (b) retains the goods beyond the fixed time (or a reasonable time) without giving notice of rejection.

4.5 Performance of the contract – delivery and acceptance (Sec 31–44)

Section	Rule
31–32	Seller must deliver and buyer must accept and pay; delivery and payment are **concurrent conditions** unless otherwise agreed
33	Delivery may be **actual, symbolic** (keys of godown) or **constructive** (attornment by a person in possession)
34	Part delivery in progress of delivery of the whole has the effect of delivery of the whole
35	Seller is not bound to deliver until the buyer **applies** for delivery
36	Place – where goods are at the time of sale; time – reasonable time; expenses of putting goods in deliverable state – seller
37	**Wrong quantity:** less – buyer may reject or accept and pay pro-rata; more – reject all, accept contract quantity and reject the rest, or accept all at contract rate; **mixed** with goods of a different description – accept contract goods and reject the rest, or reject all
38	Buyer is not bound to accept delivery by **instalments** unless agreed
39	Delivery to a carrier is prima facie delivery to the buyer
41–42	Buyer has a reasonable opportunity to examine; acceptance by intimation, by act inconsistent with seller's ownership, or retention beyond reasonable time
43	Buyer is not bound to return rejected goods – notice of refusal is enough
44	Buyer liable for loss and charges if he neglects to take delivery after request

4.6 Unpaid seller (Sec 45–54)

A seller is **unpaid** when the whole price has not been paid or tendered, or a bill of exchange/cheque received as conditional payment has been dishonoured.

Rights against the goods

Right	When available
Lien (Sec 47–49)	Seller in possession: goods sold without credit, credit expired, or buyer insolvent. Lost by delivery to carrier without reservation, buyer's lawful possession, waiver
Stoppage in transit (Sec 50–52)	Seller has parted with possession, goods in transit, and **buyer becomes insolvent**
Resale (Sec 54)	Goods perishable, right of resale reserved, or after notice to buyer who does not pay within reasonable time

Rights against the buyer personally

Suit for price (Sec 55), suit for damages for non-acceptance (Sec 56), suit for repudiation before due date (Sec 60), suit for interest (Sec 61).

Buyer's remedies

Damages for non-delivery (Sec 57), specific performance for specific goods (Sec 58), remedy for breach of warranty (Sec 59), anticipatory breach (Sec 60), interest and special damages (Sec 61).

LEGAL PROVISION Right of resale – Sec 54 (asked Jan 2026)

The unpaid seller in possession may resell when (1) the goods are of a **perishable** nature; (2) he gives **notice of intention** to resell and the buyer does not pay within a reasonable time; (3) he has **expressly reserved** the right of resale in the contract. In (2) and (3) the seller can recover the loss on resale from the original buyer; if the goods are perishable or notice given, he keeps any profit. The new buyer gets a **good title**.

Specific performance (Sec 58): in a suit for breach of contract to deliver **specific or ascertained** goods, the court may direct delivery without giving the seller the option of paying damages – used where goods are unique (a painting, customised machine).

4.7 Auction sale (Sec 64)

Sale is complete when the auctioneer announces it by the fall of the hammer; bid can be withdrawn before that. Seller may reserve a right to bid (by notification); **pretended bidding** (by seller's agents to raise price) makes the sale voidable at buyer's option.

WORKED EXAMPLE Transfer of property and risk

Ravi buys a specific sofa from a shop on Monday, agreeing to collect it on Wednesday and pay then. The shop catches fire on Tuesday without the seller's fault.

The sofa was specific and in a deliverable state → property passed on Monday (Sec 20) → risk passed with property (Sec 26) → Ravi bears the loss and must pay the price.

Chapter 5: The Indian Partnership Act, 1932

5.1 Partnership – definition and nature

Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. Persons are individually called **partners** and collectively a **firm**; the name under which business is carried on is the **firm name**.

Essentials

1. **Agreement** – partnership arises from contract, not status (Sec 5) – an HUF business is not a partnership.
2. **Two or more persons** – maximum **50** partners (Companies (Miscellaneous) Rules, 2014 under Sec 464 of Companies Act 2013).
3. **Business** – a lawful business (includes trade, occupation, profession).
4. **Sharing of profits** – sharing of losses is implied but not essential to the definition.
5. **Mutual agency** – the business is carried on by all or any of them acting for all – the **true test** of partnership (*Cox v. Hickman*).

Partnership deed

A written agreement containing name of firm, names of partners, nature and place of business, capital contributions, profit-sharing ratio, interest on capital and drawings, salaries, rules for admission, retirement and dissolution, settlement of accounts. Stamp duty applies. If the deed is silent, the following rules of the Act apply.

Matter	Rule if no agreement
Profit sharing	Equal
Interest on capital	Not allowed (if allowed, only out of profits)
Interest on drawings	Not charged
Interest on loan by partner	**6% p.a.** (Sec 13(d))
Salary/remuneration	Not allowed

LEGAL PROVISION **Test of partnership – Sec 6**

Sharing of profits is **not conclusive** evidence of partnership. The real test is **mutual agency** – whether the business is carried on by all or by any of them acting for all (*Cox v. Hickman*). Co-owners sharing rent, a joint purchase of goods for resale on a single occasion without an agreement to share profits, or lenders/servants receiving a share of profit are not partners. A husband and wife can be partners if the essentials are present.

5.2 Types of partners

Type	Feature
Active / working partner	Takes part in management
Sleeping / dormant partner	Contributes capital, shares profits, does not take part; liable to third parties
Nominal partner	Lends only name; liable to third parties
Partner by estoppel / holding out (Sec 28)	Represents himself as a partner; liable to those who gave credit on that basis
Partner in profits only	Shares profits but not losses
Minor admitted to benefits (Sec 30)	Shares profits; liability limited to share in firm; within 6 months of majority must elect to become or not become partner (public notice)
Sub-partner	Shares his own share with an outsider; not a partner of the firm

LEGAL PROVISION **Minor admitted to the benefits of partnership – Sec 30 (asked Jan 2025, May 2026)**

A minor cannot be a partner, but may be **admitted to the benefits** with the consent of all partners.

Rights: share of property and profits as agreed; access to and copy of accounts (not books); sue for his share when severing connection; within **6 months** of attaining majority (or of knowing of his admission, whichever is later) elect by **public notice** to become or not to become a partner.

Liabilities (before majority): his **share** in the property and profits is liable for the acts of the firm; he is **not personally liable**. If he becomes a partner on majority he is personally liable for all acts from the date of his admission to benefits; if he elects not to, he is not liable for acts after the notice.

5.3 Rights, duties and liabilities of partners

- **Rights (Sec 12–13):** take part in business, be consulted, access books, share profits equally, interest on capital/advances, indemnity, prevent admission of new partner without consent, retire.
- **Duties (Sec 9–16):** carry on business to greatest common advantage, be just and faithful, render true accounts, indemnify for fraud and wilful neglect, not compete, account for personal profits.
- **Liability (Sec 25):** every partner is **jointly and severally liable**, without limit, for all acts of the firm done while he is a partner.
- **Implied authority (Sec 19):** a partner can bind the firm for acts done in the usual way of business; he **cannot** (without express authority) submit to arbitration, open a bank account in his own name, compromise a claim, withdraw a suit, admit liability in a suit, acquire or transfer immovable property, or enter into partnership on behalf of the firm.

LEGAL PROVISION **Mutual rights (Sec 12–13) and implied authority (Sec 19)**

Unless agreed otherwise: every partner may take part in business; differences decided by **majority** but change in nature of business needs **consent of all**; every partner may inspect and copy books; **no remuneration**; profits and losses shared **equally**; **no interest on capital** (if agreed, payable only out of profits); **interest on advances at 6% p.a.**; firm must **indemnify** a partner for payments made in the ordinary course or in an emergency; a partner must indemnify the firm for loss caused by his **wilful neglect**.

No implied authority (Sec 19(2)) to: submit a dispute to arbitration; open a bank account in his own name; compromise or relinquish a claim; withdraw a suit; admit liability in a suit; acquire or transfer **immovable property** of the firm; enter into partnership on behalf of the firm.

Holding out (Sec 28): a person who represents himself, or knowingly permits himself to be represented, as a partner is liable to those who gave credit on that faith. Exception: after a partner's death, the use of the old firm name does not make his estate liable.

Transfer of interest (Sec 29): a partner can transfer his share **without consent** only in the sense of assigning his right to profits; the transferee **cannot interfere** in business or inspect books; he may receive the share of profits and accept the account agreed by partners. On dissolution he gets the transferor's share of assets and may ask for an account from the date of dissolution.

5.4 Reconstitution of a firm (Sec 31–38)

Event	Rules
Introduction of a partner (Sec 31)	Needs **consent of all** existing partners; incoming partner not liable for acts done before he became a partner (unless he agrees)
Retirement (Sec 32)	With consent of all, as per agreement, or by notice in a partnership at will. Retiring partner remains liable to third parties for acts before retirement; and for acts after retirement until **public notice** is given
Expulsion (Sec 33)	Valid only if (1) the **power** is conferred by contract, (2) exercised by a **majority** of partners, (3) in **good faith** (notice and opportunity to be heard). Otherwise null and void. An expelled partner is not liable for acts after expulsion once public notice is given
Insolvency (Sec 34)	Insolvent partner ceases to be a partner from the date of adjudication; his estate not liable for later acts

Event	Rules
Death (Sec 35)	Estate of a deceased partner not liable for acts after death
Outgoing partner – competing business (Sec 36)	May carry on a competing business and advertise it, but may **not** use the firm name, represent himself as carrying on the firm's business, or solicit the firm's old customers. A **restraint agreement** (not to carry on similar business within specified period/local limits) is valid if reasonable
Share of subsequent profits (Sec 37)	If the continuing partners carry on business without settling accounts, the outgoing partner (or his estate) may claim at his option profits attributable to the use of his share **or interest at 6% p.a.** on it

5.5 Registration of firms (Sec 58–59, 69)

Registration is **optional** (not compulsory) but has important consequences. Application in the prescribed form to the Registrar of Firms with firm name, place of business, other places, date of joining of each partner, names and addresses, and duration.

Effects of non-registration (Sec 69)

- A partner cannot sue the firm or other partners.
- The firm cannot sue third parties for enforcing a contract.
- The firm cannot claim set-off above ₹100.
- But: third parties **can** sue the firm; partner can sue for dissolution and accounts; suits up to ₹100 and in areas exempt are allowed.

LEGAL PROVISION **Cases where non-registration does not affect rights (Sec 69(3)–(4)) – asked June 2024**

A partner of an unregistered firm may sue for **dissolution**, for **accounts** of a dissolved firm or for realising the property of a dissolved firm; the Official Assignee may realise property of an insolvent partner; the firm may sue/claim set-off for an amount **not exceeding ₹100**; suits arising otherwise than out of contract; firms with no place of business in the territories to which the Act applies; and **third parties** can always sue the unregistered firm. Non-registration bars: a partner suing the firm or co-partners, and the firm suing third parties or claiming a **set-off** exceeding ₹100.

5.6 Dissolution of firm (Sec 39–55)

Mode	Section
By agreement	40
Compulsory – all or all but one partner insolvent; business becomes unlawful	41
On happening of contingencies – expiry of term, completion of venture, death, insolvency of a partner (subject to contract)	42
By notice – partnership at will	43
By court – insanity, permanent incapacity, misconduct, wilful breach, transfer of interest, perpetual losses, just and equitable	44

Settlement of accounts (Sec 48): losses (including capital deficiencies) paid first from profits, then capital, then partners individually in profit ratio. Assets applied: (i) third-party debts, (ii) partners' advances, (iii) partners' capital, (iv) residue in profit ratio. *Garner v. Murray* rule – solvent partners bear the insolvent partner's capital deficiency in the ratio of their capitals.

LEGAL PROVISION **After dissolution (Sec 45–48) – asked May 2026**

Sec 45 – partners remain liable for acts done after dissolution until **public notice** is given. **Sec 46** – every partner (or his representative) may have the business **wound up** and property applied in payment of debts and the surplus distributed. **Sec 47** – authority of each partner continues so far as necessary to **wind up** the affairs and complete transactions begun but unfinished. **Sec 48 – mode of settlement:** (a) losses (including capital deficiency) paid first out of profits, then out of capital, then by partners individually in profit-sharing ratio; (b) assets applied in order: (i) debts to **third parties**; (ii) **advances** of partners; (iii) **capital** of partners; (iv) surplus in profit-sharing ratio.

Dissolution of partnership vs dissolution of firm: dissolution of *partnership* is a change in the relation between partners (retirement, death, admission) – the firm continues; dissolution of the *firm* ends the relation among **all** partners and the business is wound up.

Chapter 6: The Limited Liability Partnership Act, 2008

6.1 Meaning and essential features

An **LLP** is a **body corporate** formed and incorporated under the LLP Act, 2008, with **separate legal entity**, **perpetual succession**, and **limited liability** of partners. It combines the flexibility of a partnership with the limited liability of a company.

Key features

- Minimum **2 partners**; no maximum.
- At least **2 designated partners**, both individuals, and at least one **resident in India** (stayed 120 days or more in the previous financial year).
- Liability of partners limited to their agreed **contribution**; a partner is not liable for the wrongful acts of other partners.
- Governed by an **LLP agreement**; in its absence, **First Schedule** applies.
- Name must end with **"LLP"** or "Limited Liability Partnership".
- Incorporation by filing **FiLLiP** form with the Registrar (MCA portal); certificate of incorporation is conclusive.
- Annual filings: **Form 11** (annual return – within 60 days of close of FY) and **Form 8** (Statement of Account & Solvency – by 30 October).
- Audit compulsory when turnover exceeds **₹40 lakh** or contribution exceeds **₹25 lakh** (Rule 24).
- The LLP (Amendment) Act, 2021 decriminalised many offences and introduced **small LLP**.

6.2 Partners and designated partners

Provision	Rule
Who can be a partner (Sec 5)	Any **individual** or **body corporate**; not an individual of unsound mind, an undischarged insolvent or one who has applied to be adjudged insolvent
Minimum partners (Sec 6)	**Two**. If the number falls below two and the LLP carries on business for more than **6 months**, the sole partner who knows it is **personally liable** for obligations incurred after 6 months
Designated partners (Sec 7)	At least **two individuals**, of whom at least **one resident in India** (stayed in India for at least **120 days** during the financial year). If all partners are bodies corporate, their **nominees** act as designated partners. Must obtain **DPIN/DIN**; consent filed with the Registrar within 30 days
Liability of designated partners (Sec 8)	Responsible for compliance, filings and penalties under the Act
Changes in designated partners (Sec 9)	Fill vacancy within **30 days**; file with Registrar
Resident partner	A person who has stayed in India for not less than 120 days during the financial year

6.3 Incorporation (Sec 11–12) and name (Sec 15–17)

- Two or more persons associated for carrying on a **lawful business with a view to profit** subscribe their names to an **incorporation document** and file it with the Registrar. An LLP **cannot be formed for charitable purposes** (e.g., running a free school) – a Section 8 company or trust is the right vehicle.
- The incorporation document is filed with a **statement** by an advocate/CA/CS/CMA engaged in the formation **and** by anyone who subscribed his name, that all requirements have been complied with. The Registrar may accept this statement as **sufficient evidence** of compliance.
- On registration, the Registrar issues a **certificate of incorporation** within 14 days – it is **conclusive evidence** that the LLP is incorporated (Sec 12).
- **Name** must end with "Limited Liability Partnership" or "LLP"; must not be undesirable or identical/too nearly resembling an existing name or trademark.
- **Compulsory change of name (Sec 17):** where the Central Government is satisfied that the name is identical/too nearly resembles an existing LLP/company name or a registered trademark (on application within prescribed

time), it may direct a change; the LLP must comply within **3 months** and file the change with the Registrar. On default, the Central Government allots a **new name** and the LLP and designated partners are liable to penalty VERIFY.

- **Registered office (Sec 13):** every LLP must have a registered office in India for communications; it may change it by filing a **notice** with the Registrar. Contravention attracts a penalty on the LLP and every partner in default VERIFY.

6.4 Small LLP, foreign LLP and other points

- **Small LLP** (Sec 2(1)(ta), inserted by LLP Amendment Act 2021): contribution not exceeding **₹25 lakh** (or higher amount up to ₹5 crore as prescribed) **and** turnover of the preceding year not exceeding **₹40 lakh** (or higher up to ₹50 crore as prescribed); not formed under a special Act {v – check prescribed limits}.
- **Foreign LLP** (Sec 2(1)(m)): an LLP formed, incorporated or registered **outside India** which establishes a place of business within India.
- **Body corporate and artificial legal person:** an LLP has a separate legal entity, can own property, sue and be sued, and has perpetual succession; it acts through its partners.
- **Mutual agency:** every partner is an agent of the **LLP**, but **not** of the other partners (Sec 26). An LLP is not bound by acts of a partner who had no authority, if the third party knew it.
- **Conversion** into LLP is possible from a firm, a private company or an unlisted public company (Sec 55–58, Schedules II–IV).

6.5 Partnership vs LLP vs company

Basis	Partnership firm	LLP	Company
Law	Partnership Act 1932	LLP Act 2008	Companies Act 2013
Legal entity	No separate entity	Separate legal entity	Separate legal entity
Liability	Unlimited, joint and several	Limited to contribution	Limited to unpaid share value (limited company)
Registration	Optional	Compulsory	Compulsory
Members	2–50	Minimum 2, no maximum	Private: 2–200 (OPC 1); public: minimum 7
Perpetual succession	No	Yes	Yes
Audit	Only under tax law	Above ₹40 lakh turnover / ₹25 lakh contribution	Compulsory
Management	Partners	Designated partners	Board of directors

EXAM TIP **"Mutual agency" is the true test of partnership – mention it with *Cox v. Hickman* whenever you define partnership.**

Chapter 7: The Companies Act, 2013

7.1 Meaning and features of a company

Under **Sec 2(20) of the Companies Act, 2013**, a **company** means a company incorporated under this Act or under any previous company law. In general terms, a company is a voluntary association of persons formed for some common purpose, having a **separate legal entity**, **perpetual succession** and a **common seal** (optional now), with capital divided into transferable shares and the liability of members usually limited.

The **Companies Act, 2013** replaced the Companies Act, 1956. It has **470 sections** in 29 chapters and 7 schedules. The Act is administered by the **Ministry of Corporate Affairs (MCA)** through Registrars of Companies (ROC), Regional Directors and the **National Company Law Tribunal (NCLT)**, with appeals to the **NCLAT**.

Feature	Explanation
Incorporated association	Comes into existence only on registration with the ROC
Separate legal entity	Company is distinct from its members – *Salomon v. Salomon & Co. Ltd* (1897)
Limited liability	Liability of members limited to unpaid amount on shares (or guarantee)
Perpetual succession	Members may come and go, but the company continues; death or insolvency of members does not affect it
Artificial legal person	Can own property, sue and be sued in its own name, but acts through directors
Common seal	Earlier compulsory; now **optional** after the Companies (Amendment) Act, 2015 – documents can be signed by two directors or a director and the company secretary
Transferability of shares	Shares of a public company are freely transferable (Sec 44, 58); private company restricts transfer
Separate property	Members have no ownership right in company property – *Bacha F. Guzdar v. CIT* (1955)
Capacity to sue	Can sue and be sued in its own name
Separation of ownership and management	Shareholders own; Board of Directors manages

REMEMBER

***Salomon v. Salomon & Co. Ltd* (1897, House of Lords) – Salomon sold his business to a company in which he held almost all shares and was a secured creditor. On winding up, he was paid before unsecured creditors. The court held that the company is a person separate from its members, even if one person controls it.**

7.2 Company vs partnership

Basis	Company	Partnership
Law	Companies Act, 2013	Indian Partnership Act, 1932
Registration	Compulsory	Optional
Legal status	Separate legal entity	No separate entity from partners
Liability	Limited	Unlimited
Members	Private 2–200 (OPC 1); public minimum 7, no maximum	2–50
Transfer of interest	Shares transferable (public freely)	Not without consent of all partners
Management	Board of directors	Partners
Perpetual succession	Yes	No – may dissolve on death/insolvency
Audit	Compulsory	Not compulsory under partnership law
Agency	Members are not agents of the company	Every partner is an agent of the firm

7.3 Classes of companies

On the basis of liability

Type	Liability of members
Company limited by shares (Sec 2(22))	Limited to the amount unpaid on shares held
Company limited by guarantee (Sec 2(21))	Limited to the amount members undertake to contribute on winding up
Unlimited company (Sec 2(92))	No limit on liability of members

On the basis of number of members / public access

Type	Section	Key features
Private company	2(68)	Minimum paid-up capital as prescribed (no minimum now); AOA restricts transfer of shares; limits members to **200** (excluding employees and ex-employee members); prohibits invitation to the public to subscribe for securities. Minimum 2 members and 2 directors. Name ends with "Private Limited"
Public company	2(71)	Not a private company; minimum **7 members**, **3 directors**; shares freely transferable; can invite public. A private company that is a **subsidiary of a public company** is deemed a public company
One Person Company (OPC)	2(62)	Only **one member** (natural person, Indian citizen; resident or non-resident after 2021); must nominate a nominee; minimum 1 director; name followed by "(OPC) Private Limited"
Small company	2(85)	A private company (not a holding/subsidiary company, Section 8 company or company governed by a special Act) with paid-up capital not exceeding **₹10 crore** and turnover not exceeding **₹100 crore** (limits revised from ₹4 crore / ₹40 crore by MCA notification G.S.R. 880(E), effective 1 December 2025)
Listed company	2(52)	Any of its securities listed on a recognised stock exchange

OPC – further points

- Cannot carry on Non-Banking Financial Investment activities; cannot be incorporated as a Section 8 company.
- A natural person can be a member of only one OPC.
- From 1 April 2021 an OPC can convert into a private/public company at any time (the earlier paid-up/turnover limits for compulsory conversion were removed).
- Need not hold AGM; Board meeting at least once in each half of the year with a gap of at least 90 days.
- Annual return in **MGT-7A**; financial statements need not include cash flow statement.

Privileges of small company and OPC (common)

No cash flow statement; annual return signed by one director (or CS); only two Board meetings a year; abridged Board report; no mandatory rotation of auditors; lower fees and penalties (Sec 446B – half penalty); CARO not applicable; fast-track merger with another small company (Sec 233).

Other classes

Type	Meaning
Holding company (Sec 2(46))	A company of which another company is a subsidiary
Subsidiary company (Sec 2(87))	A company in which the holding company **controls the composition of the Board** or **exercises or controls more than one-half of the total voting power** (alone or with its subsidiaries)
Associate company (Sec 2(6))	The other company has **significant influence** – control of at least **20% of total voting power** or of business decisions under an agreement – but it is not a subsidiary; includes a joint venture company
Government company (Sec 2(45))	Not less than **51% of paid-up share capital** held by the Central Government, State Government(s), or partly by both; includes a subsidiary of a government company

Type	Meaning
Foreign company (Sec 2(42))	Incorporated outside India with a place of business in India (itself or through an agent, physically or electronically) and conducts business in India
Section 8 company	Promotes commerce, art, science, sports, education, research, social welfare, religion, charity, environment etc.; applies profits to objects; **no dividend**; licence from Central Government; may be limited by shares or guarantee
Dormant company (Sec 455)	Formed for a **future project** or to hold an asset or intellectual property, with **no significant accounting transaction**; may apply to the Registrar for dormant status. An **inactive company** is one which has not carried on business, or not filed financial statements and annual returns, for the last **two** financial years
Nidhi company (Sec 406)	Cultivating thrift and savings among members, borrowing and lending only among members
Producer company	Formed by primary producers (farmers etc.) – now governed by Chapter XXIA
Investment company	A company whose principal business is the acquisition of shares, debentures or other securities

WORKED EXAMPLE **Government company test (June 2024 type)**

XYZ Ltd: Central Government 30%, State Government 15%, a government company 15%, public 40%. Central + State = **45%** < 51% → not a government company on direct holding. Holding of another government company does not count under Sec 2(45) unless XYZ is its **subsidiary**. Holdings of LIC or of another government company are not counted. Answer: **not** a government company.

LEGAL PROVISION **OPC – death of the member and nominee**

On the death or incapacity of the sole member, the **nominee** becomes the member. The member may change the nominee by giving notice; the company files **Form INC-4** with the Registrar. Only a **natural person who is an Indian citizen and resident in India** (stayed in India for at least **120 days** in the previous financial year VERIFY) can be a member or nominee of an OPC; a minor cannot.

Private company whose two members die (June 2024): the company continues – **perpetual succession**; shares pass to legal representatives by transmission.

7.4 Lifting the corporate veil

The principle of separate legal entity creates a "veil" between the company and its members. In some cases the courts or the law **disregard** this veil and look at the persons behind the company, to prevent fraud or misuse.

Statutory provisions (under the Act)

Section	Situation
Sec 7(7)	Incorporation obtained by furnishing false information or fraud – Tribunal may order removal of name, winding up, or treat liability of members as unlimited
Sec 34–35	Misstatement in prospectus – criminal and civil liability of directors, promoters, experts
Sec 39	Failure to refund application money when minimum subscription not received
Sec 339	Fraudulent conduct of business during winding up – persons responsible personally liable
Sec 251	Fraudulent application for removal of name
Income-tax law	Directors of a private company jointly and severally liable for unrecovered tax (Sec 179 of 1961 Act)

Judicial grounds

Ground	Case
Fraud or improper conduct	*Gilford Motor Co. v. Horne* (1933) – company formed to evade a non-compete covenant
Determination of enemy character	*Daimler Co. Ltd v. Continental Tyre & Rubber Co.* (1916) – company controlled by Germans treated as enemy

Ground	Case
Evasion of tax	*Sir Dinshaw Maneckjee Petit* (1927) – companies formed only to split income and avoid tax
Avoidance of welfare legislation	*Workmen of Associated Rubber Industry* (1986)
Company acting as agent or trust of shareholders	Sham companies
Protecting public policy	Contracts with enemy aliens

EXAM TIP **In a 10-mark answer on corporate veil, give the meaning, the rule in *Salomon*, then two lists – statutory and judicial – with one case each. Conclude that lifting the veil is an exception, not the rule.**

7.5 Memorandum of Association

The **MOA** is the **charter** or constitution of the company. It defines the company's relationship with the outside world and the **scope of its activities**.

Clauses of MOA

Clause	Contents
Name clause	Name with "Limited" (public) or "Private Limited" (private); "OPC" for OPC; Section 8 companies may use Foundation, Forum, Association etc.
Registered office clause	State in which the registered office is situated
Object clause	Objects for which the company is incorporated and matters necessary for their furtherance
Liability clause	Liability of members – limited by shares / guarantee / unlimited
Capital clause	Authorised share capital and its division into shares
Association / subscription clause	Desire of subscribers to form a company, their names, addresses and shares taken
Nomination clause (OPC only)	Name of nominee who becomes member on death/incapacity of the sole member

Alteration of MOA (Sec 13)

Clause	Procedure
Name	Special resolution + approval of Central Government (ROC); no approval for adding/deleting "Private" on conversion
Registered office – within same city	Board resolution
Registered office – to another city in same State	Special resolution; within jurisdiction of another ROC – Regional Director approval
Registered office – to another State	Special resolution + Central Government (Regional Director) approval
Objects	Special resolution; company that raised money through prospectus and has unutilised money – also dissenting shareholders' exit option
Liability	Special resolution; increase of liability needs written consent of members
Capital	Ordinary resolution (Sec 61) – increase, consolidation, sub-division, cancellation of unissued shares

7.6 Articles of Association

The **AOA** contains the **rules and regulations for internal management** of the company – relationship between company and members and among members. It is subordinate to the MOA and the Act.

- Model forms are in **Schedule I – Tables F (company limited by shares), G, H, I, J**. A company may adopt Table F wholly or partly.

- Contents: share capital and rights, calls, transfer and transmission, forfeiture, general meetings, voting, directors' appointment and powers, dividends, accounts, winding up.
- **Entrenchment provisions (Sec 5(3))** – specified provisions can be altered only if conditions more restrictive than special resolution are met.
- **Alteration (Sec 14)** – by special resolution; conversion of public to private needs Tribunal (now Regional Director) approval.

MOA vs AOA

Basis	MOA	AOA
Nature	Charter – defines scope and powers	Rules for internal management
Relationship	Company and outsiders	Company and members, and among members
Position	Supreme document, subordinate only to the Act	Subordinate to MOA and the Act
Acts beyond	Ultra vires the MOA – void, cannot be ratified	Ultra vires the AOA – can be ratified by special resolution
Alteration	Difficult; some clauses need Central Government approval	Easier – by special resolution
Compulsory	Every company	Every company (can adopt Table F)

LEGAL PROVISION Effect of memorandum and articles – Sec 10

When registered, the MOA and AOA **bind the company and its members** to the same extent as if signed by the company and by each member; all money payable by a member to the company under them is a **debt** due from him. They do **not** bind the company to outsiders (*Eley v. Positive Govt. Security Life Assurance Co.*).

7.7 Doctrine of ultra vires

Ultra vires means "beyond the powers". An act of the company beyond the object clause of the MOA (and the Act) is **ultra vires** and **void ab initio**; it cannot be ratified even by all the shareholders.

- **Leading case: *Ashbury Railway Carriage & Iron Co. Ltd v. Riche* (1875)** – company formed to make railway carriages entered into a contract to finance construction of a railway in Belgium. Held ultra vires and void; even unanimous ratification could not validate it.

Consequences

- The company cannot sue or be sued on an ultra vires contract.
- Directors may be personally liable for breach of warranty of authority.
- Property acquired with company's money through ultra vires act is protected for the company.
- Injunction can be obtained by any member to restrain an ultra vires act.

Act	Effect
Ultra vires the Companies Act	Void; cannot be ratified
Ultra vires the MOA	Void; cannot be ratified
Ultra vires the AOA (but within MOA)	Can be ratified by altering AOA by special resolution
Ultra vires the directors (within company's powers)	Can be ratified by shareholders in general meeting

7.8 Doctrine of constructive notice

The MOA and AOA are **public documents** registered with the ROC and available on the MCA portal. Therefore every person dealing with the company is **presumed to have read** them and understood their contents. If a person enters into a contract contrary to the MOA/AOA, he cannot claim against the company. This doctrine protects the **company** against outsiders.

7.9 Doctrine of indoor management

An outsider dealing with the company is bound to see that the proposed transaction is consistent with the MOA and AOA, but is **not bound to inquire into the regularity of internal proceedings**. He may assume that all internal

formalities (resolutions, quorum, appointments) have been complied with. This doctrine protects **outsiders** against the company.

- **Leading case: *Royal British Bank v. Turquand* (1856)** – directors had power to borrow on bonds if authorised by a resolution of the general meeting. The bank lent without verifying the resolution, which was never passed. Held: the company was liable; the bank was entitled to assume the resolution was passed.

Exceptions to indoor management

- Outsider had **actual or constructive knowledge** of the irregularity (*Howard v. Patent Ivory Co.*).
- **Negligence** – suspicious circumstances which should have prompted inquiry (*Anand Behari Lal v. Dinshaw & Co.*).
- **Forgery** – a forged document is a nullity (*Ruben v. Great Fingall Consolidated*).
- Act **outside the apparent authority** of the officer.
- Acts **void ab initio** (ultra vires the MOA).

Constructive notice vs indoor management

Basis	Constructive notice	Indoor management
Protects	Company against outsiders	Outsiders against the company
Concerns	External position – contents of MOA/AOA	Internal irregularities
Presumption	Outsider knows MOA/AOA	Outsider can assume internal rules followed
Case	– (general rule from registration)	*Royal British Bank v. Turquand*

⚠ COMMON MISTAKE **Don't confuse the two doctrines. Constructive notice is a presumption against outsiders; indoor management is an exception in favour of outsiders.**

⚖ LEGAL PROVISION **Other points ICAI has asked**

- **Entrenchment (Sec 5(3)–(4)):** articles may contain provisions that can be altered only if conditions more restrictive than a special resolution are met. Made **on formation** or by amendment – in a **private company with the agreement of all members**, in a **public company by special resolution**; notice to the Registrar in the prescribed form.
- **Public financial institution (Sec 2(72)):** LIC, UTI (specified undertaking), institutions in Sec 4A of the 1956 Act, and institutions **notified** by the Central Government – for notification the institution must be established under a Central/State Act, or **not less than 51% of its paid-up capital must be held by the Central Government** (or by State Government(s)) VERIFY.
- **Common seal** is optional (Companies Amendment Act 2015): where a company has no seal, documents are authenticated by **two directors** or by **a director and the company secretary**.
- **Section 8 company and a partnership firm:** a firm **can be a member** of a Section 8 company, so membership of a firm is not a valid ground for action. But a Section 8 company **cannot transfer any part of its profits** to members; if it does, the Central Government may revoke the licence and direct **winding up**, conversion or amalgamation – that ground is sufficient.

7.10 Share capital – equity with differential rights vs preference shares

Basis	Equity shares with differential rights (DVR)	Preference shares
Meaning	Equity shares with **different rights** as to dividend, voting or otherwise (Sec 43(a)(ii))	Shares with **preferential right** to fixed dividend and repayment of capital on winding up (Sec 43(b))
Voting	Superior or inferior voting rights as per terms	Vote only on resolutions directly affecting their rights, or when dividend unpaid for **2 years** or more
Dividend	Variable, after preference dividend	Fixed rate, paid before equity
Repayment	After preference capital	Before equity on winding up
Redemption	Not redeemable	Must be redeemed within **20 years** (Sec 55)

Chapter 8: The Negotiable Instruments Act, 1881

A **negotiable instrument** means a promissory note, bill of exchange or cheque payable either to order or to bearer. It is a written document that entitles a person to a sum of money and is transferable by delivery (bearer) or by endorsement and delivery (order).

Characteristics

Freely transferable; holder in due course gets a **good title** even if the transferor's title is defective; holder can sue in his own name; presumptions (Sec 118) – consideration, date, time of acceptance, transfer before maturity, order of endorsements, stamp, holder in due course.

8.2 Promissory note, bill of exchange and cheque

Basis	Promissory note (Sec 4)	Bill of exchange (Sec 5)	Cheque (Sec 6)
Nature	Unconditional **promise** to pay	Unconditional **order** to pay	Bill drawn on a specified **banker**, payable **on demand**
Parties	Two – maker, payee	Three – drawer, drawee, payee	Three – drawer, drawee bank, payee
Acceptance	Not required	Required (except on-demand bills)	Not required
Payable to bearer	Cannot be made payable to bearer	Cannot be made payable to bearer on demand	Can be payable to bearer
Liability of maker/drawer	Primary	Secondary (drawee primary after acceptance)	Primary (if bank dishonours)
Grace days	3 days (time instruments)	3 days (time instruments)	No grace
Crossing	Not possible	Not possible	Possible
Stamp	Required	Required (except on-demand bills)	Not required

A cheque includes an **electronic image of a truncated cheque** and a cheque in electronic form. Cheques are valid for **3 months** from the date of issue (RBI direction).

LEGAL PROVISION **Essentials of a valid promissory note (asked Jan 2026)**

(1) In **writing**; (2) an express **promise** to pay (mere acknowledgment of debt – "I owe you ₹500" – is not a promissory note); (3) promise **unconditional**; (4) **signed** by the maker; (5) maker must be a **certain** person; (6) payee must be **certain**; (7) sum payable must be **certain**; (8) payable in **money** only; (9) not payable to bearer (Sec 31 RBI Act); (10) duly **stamped**.

Additional features of a cheque that distinguish it from a bill: always drawn on a **specified banker**; always payable **on demand**; no acceptance needed; no grace days; may be crossed; no stamp needed; drawer is not discharged by delay in presentment unless he suffers loss.

8.3 Classification by manner of making (asked Sept 2025)

Class	Section	Meaning
Inland instrument	11	Drawn or made in India and payable in, or drawn on a person resident in, India
Foreign instrument	12	Any instrument which is not inland
Demand instrument	19, 21	Payable on demand, at sight, on presentment, or where no time is specified
Time instrument	21	Payable after a fixed period, after sight, or on a specified date
Ambiguous instrument	17	Can be construed either as a promissory note or a bill (e.g., drawer and drawee same person) – the **holder may treat it as either**, and once chosen it is treated so thereafter
Inchoate (incomplete) instrument	20	A signed stamped paper delivered blank or incomplete – gives *prima facie* authority to the holder to complete it for any amount up to the stamp's coverage
Bearer / order instrument	13	Payable to bearer (by delivery) or to order (by endorsement + delivery)

8.4 Maturity and days of grace (Sec 21–25)

- Every time instrument is due on the **third day after** the day on which it is expressed to be payable (3 days of grace) – Sec 22. No grace for demand instruments.
- If the maturity date is a **public holiday**, the instrument is due on the **preceding business day** (Sec 25).
- "**Months after date/sight**" – maturity is the corresponding date of the month (or last day of the month) + 3 days (Sec 23). "**Days after date/sight**" – exclude the day of the instrument/presentment (Sec 24).
- A bill payable "after sight" – time runs from the date of **acceptance** or of noting/protest for non-acceptance.

8.5 Parties, holder and holder in due course

- **Holder (Sec 8)** – person entitled in his own name to possession and to recover the amount.
- **Holder in due course (Sec 9)** – a holder who obtained the instrument **for consideration**, **before maturity**, and **in good faith** without notice of defect in title. Privileges: gets title free of defects (Sec 53), every prior party is liable to him until paid (Sec 36), no defence of incomplete instrument (Sec 20), estoppel against denying validity (Sec 120–122).

8.6 Negotiation, endorsement and crossing

- **Negotiation (Sec 14):** transfer so as to make the transferee the holder. Bearer instrument – by **delivery** (Sec 47); order instrument – by **endorsement and delivery** (Sec 48). Delivery is essential – an instrument endorsed but not delivered is not negotiated (Sec 46).
- An instrument **cannot be negotiated** where it is (i) restrictively endorsed ("pay A only"), (ii) drawn with words prohibiting transfer, (iii) already **discharged** by payment at or after maturity (Sec 60), or (iv) crossed "not negotiable" – transferable but transferee gets no better title.

Types of endorsement

Blank/general (only signature), special/full (names endorsee), restrictive ("pay A only"), partial (part amount – invalid as negotiation), conditional ("pay A on arrival of ship"), *sans recours* (without recourse to endorser), facultative (waiver of notice).

Crossing of cheques (Sec 123–131)

Crossing	Form	Effect
General	Two parallel transverse lines, with or without "& Co."	Payable only through a bank account
Special	Name of a banker written across	Payable only through that banker
Restrictive ("Account Payee")	"A/c Payee only"	Collecting bank must credit only the payee's account
Not negotiable	Words "not negotiable" with crossing	Transferable, but transferee gets no better title than transferor

8.7 Presentment and dishonour

Rule	Detail
Presentment for acceptance (Sec 61)	Bills payable after sight must be presented to the drawee for acceptance within a reasonable time
Presentment for payment (Sec 64)	Must be presented for payment, otherwise prior parties are discharged
Presentment unnecessary (Sec 76)	Maker/drawer/acceptor intentionally prevents presentment; place of business closed on due date; no person at the place to pay; cannot be found after due search; party has engaged to pay notwithstanding non-presentment; presentment waived; drawer could not suffer damage from non-presentment
Dishonour by non-acceptance / non-payment (Sec 91–92)	Drawee refuses to accept within 48 hours; or maker/acceptor defaults in payment

Rule	Detail
Notice of dishonour (Sec 93)	Holder must give notice to all prior parties he wants to make liable
Notice unnecessary (Sec 98)	Dispensed with by the party entitled; drawer has countermanded payment; party charged could not suffer damage; party cannot be found; omission due to unavoidable circumstances; acceptor is also the drawer; promissory note is not negotiable; party entitled promises to pay with knowledge of the facts

LEGAL PROVISION Compensation on dishonour – Sec 117

The holder can recover from the drawer/endorser: (a) the **amount due** with **expenses** of presentment, noting and protest; (b) where the person charged resides at a different place from where the instrument was payable – the sum at the **current rate of exchange** between the two places; (c) an endorser who has paid can recover the amount paid with **interest at 18% p.a.** from the date of payment until realisation, plus expenses; (d) re-exchange charges where the bill is drawn on a foreign country.

8.8 Dishonour of cheque – Section 138

Dishonour of a cheque for **insufficiency of funds** (or exceeding arrangement) is a **criminal offence**, if:

1. The cheque was issued for discharge of a **legally enforceable debt or liability**.
2. Presented within **3 months** from date (or its validity period).
3. Payee gives a **written notice** demanding payment within **30 days** of receiving information of dishonour.
4. Drawer fails to pay within **15 days** of receipt of the notice.
5. Complaint filed before a Magistrate within **1 month** after the 15 days expire.

Punishment: imprisonment up to **2 years**, or fine up to **twice the cheque amount**, or both. Court may order **interim compensation up to 20%** of the cheque amount (Sec 143A). Offence is compoundable (Sec 147).

WORKED EXAMPLE Timeline under Sec 138

Cheque dated 1 June, presented 10 July, dishonoured 12 July; payee informed 13 July.

Notice must be sent by 12 August (30 days). Drawer receives notice 16 August → has till 31 August to pay. If not paid, cause of action arises 1 September; complaint by 30 September.

NOTE **Section 138 requires a legally enforceable debt – a cheque issued as a gift or donation does not attract Sec 138 (June 2024 question).**