

CHAPTER - 5

DOCTRINE

6. DOCTRINE OF ULTRA VIRES

The meaning of the term ultra vires is simply "beyond (their) powers". The legal phrase "ultra vires" is applicable only to acts done in excess of the legal powers of the comp.

Effect of Ultra Vires

- UV is wholly void and inoperative in law and is therefore not binding on the comp.
- The impact of the doctrine of UV is that a co. can neither be sued on an UV transaction, nor can it sue on it.
- Since the memorandum is a "public document", it is open to public inspection. Therefore, when one deals with a co. one is deemed to know about the powers of the comp. If in spite of this you enter into a transaction which is ultra vires of the comp, you cannot enforce it against the co.

An act which is ultravious, the co i.e MOA cannot be ratified even by the unanimous consent of all the shareholders.

An act which is UV the directors, but intoaries the co. can be ratified by the memb. of the co. through a resolution passed at a general meeting.

If an act is UV, the articles, it can be ratified by altering the articles by a special resolution at a general meeting.

Ashbury Railway Carriage and Iron Co. Ltd. vs Riche (1875)
The facts about the case are:

1. The main objects of a company were:
 - To make, sell or lend on hire, railway carriages & wagons.
 - To carry on the business of mechanical engineers & general contractors.
 - To purchase, lease, sell and work mines.
 - To purchase and sell as merchants or agents, coal, timber, metal etc.
2. The directors of the comp. entered into a contract with Riche, for financing the construction of a railway line in Belgium, and the comp. further ratified this act of the directors by passing a special resolution. The comp. however, cancels the contract as being ultra-vires.
3. Riche's contention was that the contract was well within the meaning of the word general contractors & hence within its powers.

Decision - It was held by the Court that the contract was null & void. It said that the term general contractors was associated with mechanical engineers. So, contention of comp. is valid in law.

(28)

DOCTRINE OF CONSTRUCTIVE NOTICE

Section 399 of the Co. Act, 2013 provides that any person can inspect by electronic means any document kept by the Registrar or get a copy of any document, including certificate of incorporation of any co., on payment of prescribed fees.

The MOA & AOA of a co. when registered with Registrar of Companies, become public documents, and they are available for inspection to any person, on the payment of a nominal fees. This doctrine operate in favour of co. & against the outsider.

By constructive notice is meant:

- (i) Whether a person reads the documents or not, he is presumed to have knowledge of the contents of the documents. He is not only presumed to have read the documents but also understood them in their proper meeting, and
- (ii) Every person dealing with the co. not only has the constructive notice of the memorandum & articles, but also of all the other related documents, such as Special Resolutions etc., which are required to be registered with the registrar.

Eg.

If written in AOA of a co. that the signatures of 3 BODs are necessary to appoint an employee, and only 2 of them have signed the agreement than it is assumed that the employee was never appointed.

3. DOCTRINE OF INDOOR MANAGEMENT / TURQUAND'S RULE

- The doctrine of indoor management is the exception to the doctrine of constructive notice.
- According to this doctrine, persons dealing with the co. need not inquire whether internal proceedings relating to the contract are followed correctly, once they are satisfied that the transaction is in accordance with the MoA & AOA.
- Persons dealing with the co. are entitled to assume that the acts of the directors or other officers of the co. are validly performed, if they are within the scope of their apparent authority. They are entitled to take it for granted that the co. had gone through all these proceeding in a regular manner.
- Thus, the doctrine of indoor management aims to protect outsiders against the co. & states that the people are entitled to presume that internal proceedings are as per documents submitted with the Registration of Cos.

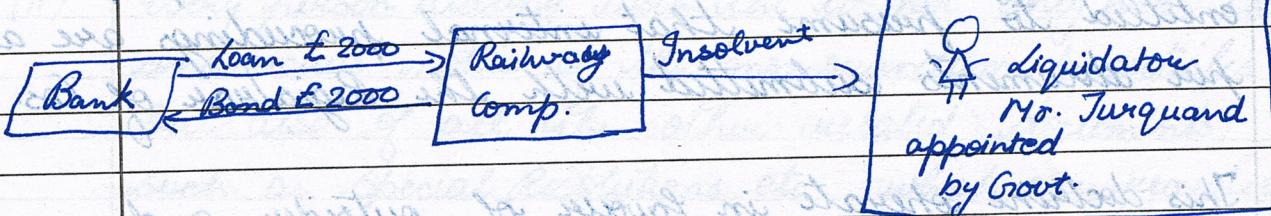
This doctrine operate in favour of outsider and against the comp.

Royal British Bank vs Turquand

Facts of the case are:

- Mr. Turquand was the official manager (liquidator) of the insolvent Railway Company.
- The comp. had given a secured bond for £ 2,000 to the Royal British Bank.
- The bond was under the comp's seal, signed by two directors & the secretary. When the comp. was sued, it alleged that under its AOA, directors only had power to borrow up to an amount authorized by a comp. resolution. A resolution had been passed but not specifying how much the director could borrow.

Decision: Held, it was decided that the bond was valid because there was no requirement to look into the comp's internal workings.



Q. Sound Syndicate Ltd., a public company, its AOA of 1956 empowers the managing agents to borrow both short and long term loans on behalf of the co. Mr. Liddle, the director of the comp. approached Easy Finance Ltd., a non banking finance comp. for a loan of 25,00,000 in name of the co. The lender agreed & provided the above said loan. Later on, Sound Syndicate Ltd refused to repay the money borrowed on the pretext that no resolution authorizing such loan have been actually passed by the co. & the lender should have enquired about the same prior providing such loan hence co not liable to pay such loan.

Analyse the above situation in terms of the provision of Doctrine of Indoor Management under the Co Act 2013 & examine whether the contention of Sound Syndicate Ltd is correct or not? (4 M)

Ans.

In the given question, Easy Finance Ltd. being external to the comp. need not enquire whether the necessary resolution was passed. Hence, the co is bound to pay the loan to Easy Finance Ltd.

Q. Mr X had purchased some goods from MIS ABC Ltd on credit. A credit period of one month was allowed to Mr X. Before the due date Mr X went to the co & wanted to repay the amt. due from him. He found only Mr Z there, who was the factory supervisor of the co. Mr Z told Mr X that the as accountant & the cashier were on leave, he is incharge of receiving money & he may pay the amt to him. Mr Z issued a money receipt under his signature. After 2 months MIS ABC Ltd issued a notice to Mr X for non-payment of the dues within the stipulated period. Mr X informed the co. that he had already cleared the dues & he is no more responsible for the same. He also contended that Mr Z is the employee of the co. to whom he had made the payment & being an outsider, he trusted the words of Mr Z as duty distribution is a job of the internal management of the co. Analyse the situation & decide whether Mr X is free from his liability (3M)

Ans.

In the given situation Mr X has made payment to Mr Z & he gave a receipt of the same to Mr X. Thus it will be rightful on part of Mr X to assume that Mr Z was also authorized to receive money on behalf of the co. Hence Mr X will be free from liability for payment of goods purchased from MIS ABC limited as he has paid amt. due to an employee of the co.

Expectation

Exceptions - The above mentioned doctrine of Indoor Management or Turquand Rule has limitations of its own. That is to say, it is inapplicable to following cases, namely:

Actual or constructive knowledge of irregularity Suspicion of irregularity / Negligence Forgery

Case Law Case Law Case Law
Howard vs Patent Ivory Manufacturing Co. *Anand Bihari Lal vs Dinsaw & Co.* *Ruben vs Guest Fingall Consolidated*

1. Actual or constructive knowledge of irregularity

The rule does not protect any person when the person dealing with the co. has notice, whether actual or constructive, of the irregularity.

Case Law - *Howard vs Patent Ivory Manufacturing co.*

Facts

- The act articles of a co stated that the directors could borrow money upto 1000 pounds without sanction of the members in GM.
- Hence, consent of shareholders was required to borrow in excess of 1000 Pounds.
- One of the director of the co. himself 3500 pounds to co.

Decision - It was held that as the director had the knowledge of the internal irregularity, hence the co. was liable to them only for 1000 pounds.

2. Suspicion of irregularity

The doctrine in no way rewards those who behave negligently. When the transaction is unusual or not in the ordinary course of business, it is the duty of the outsider to make necessary inquiry.

Case Law - Anand Bihari Lal vs. Dinsshaw & Co

Facts

- An accountant of the co entered into a contract of on behalf of a co. to sell the property of the co. to a third party.

Decision - It was held that the 3rd party could not assume that the accountant was authorized by the co to sell the property. Hence, the 3rd party could not enforce such a contract by the 3rd party, even though he had acted ^{innocent} ~~bonafide~~.

3. Forgery

The doctrine of indoor management applies only to irregularities but it cannot apply to forgery which must be regarded as nullity.

Case Law - Rubin vs Great Fingall Consolidated.

Facts

- A sh. certificate was issued under the common seal of the co.
- The CS had signed on the certificate.
- But, the signature of the 2 directors required on the certificate were forged by the CS.
- The holder of the certificate stated that he was not aware of the forgery & it was not possible for him to determine whether the signature were forged or genuine.

Decision - It was held that the certificate issued by way of forgery is void. Thus, the certificate was held to be invalid & 3rd party (holder) could not obtain the benefit of doctrine of indoor management.

Q.: Explain Doctrine of Indoor Management under the Co. Act 2013. Also state the circumstances where the outsider cannot claim relief on the ground of 'Indoor Management' (6M)

Ans -

LIFTING OR PIERCING THE CORPORATE VEIL

Meaning of corporate veil

Corporate veil refers to a legal concept whereby the co. is identified separately from the members of the co.

- The House of Lords in Salomon Vs Salomon & Co Ltd laid down that a co. is a person distinct & separate from its members, & therefore has an independent separate legal existence from its members who have constituted the co.

Effect

- The business is carried out by the co. & not by the members or directors.
- Only a company is responsible for acts and defaults.

Meaning of lifting or Piercing the Corporate veil

- It means ignoring the separate legal identity of a co. It means disregarding the corporate personality & looking behind the real persons who are in control of the co.
- The lifting is permissible only if it is permitted by law or there is clear evidence of abuse of the device of incorporation.

Lifting of Corporate veil under Judicial Decisions

1. Determining the Enemy Character of the Company -
A co. being an artificial person cannot be an enemy of friend. However, during the war, it may become necessary to lift the corporate veil and see the persons, behind it as to whether they are friends or enemy.

Case Law - Daimler Co. Ltd Vs Continental Tyre and Rubber Co. Ltd.

Prevention of fraud or Improper Conduct -

The corporate veil may be lifted if the company is found to defeat the law or defraud the creditors or avoid legal obligations.

Case Law - Gilford Motor Co. Ltd Vs Horne.

3. Check a Violation of welfare legislation -

When the structure of the co. is being used to defeat welfare legislation relating to employees, then court can disregard the corporate personality.

Case Law - Workmen employed In associates Rubber

Industry Vs Associated Rubber Industry.

4. Where comp. from mother cos. as their subsidiaries to act as other their agent -

Case Law - Merchandise Transport Ltd Vs British Transport Commission

5. To protect revenue / tax - Where corporate entity is used to evade or circumvent tax the corporate veil may be lifted.

Case Law - Sir Dinsaw Maneekjee Petit

- Q. There are cases where co. law disregards the principle of corporate personality or the principle that the co. is a legal entity distinct from its shareholders or members

Ans.

Case Law - Daimler Co. Ltd. Vs Continental Tyre and Rubber Co. Ltd.

Facts - (1) A co. was formed in England for selling tyres made by a German Comp. The German Company held virtually the entire share capital of England co. All the directors were German residents.

- (2) During the first World war, the co. commenced an action to recover a debt from another England co. Such another England co. refused to pay an amt. & filed a suit on linden co.

Decision - It was held that borrower co. was not liable to pay an amt. to linden co. on ground of enemy character of the linden co.

Case Law 2 - Gilford Motor Co. Ltd Vs Horne

Facts - (1) An employee entered into a contract with his employer that he will not solicit the customers of the employer after leaving his employment.

- (2) After leaving the employment, he incorporated a comp., in which apart from him, his wife & one other person were the only members.
- (3) The co. started soliciting the customers of the employer.

Decision - The court held that the only purpose of incorporating the co. was to avoid a legal obligation arising from a contract, the co. was restrained from soliciting the customers of the employer.

Case Law 3 - Workmen employed in associated rubber industry vs associated rubber industry.

Facts - (1) A co. was earning huge profits. As per the Bonus Act, the bonus is paid to the workers as a proportion of profits of the co.

- (2) The co. incorporated a subsidiary co. and transferred some valuable investments to it.
- (3) The subsidiary co. did not business, & had no assets except investments transferred to it.

Decision - The court lifted the corporate veil. It was held that the subsidiary was formed merely for the purpose of reducing the liability of bonus payable under the Bonus Act.

Case Law 4 - Merchandise Transport Limited Vs. British Transport Commission

Facts - Transport comp. wanted to obtain licences for its vehicles, but could not do so if applied in its own name. It, therefore, formed a subsidiary comp., and the application for licence was made in the name of the subsidiary. The vehicles were to be transferred to the subsidiary comp.

Decision - Court held that the parent and the subsidiary were one commercial unit and the application for licences was rejected.

Case Law 5 - (1) An assessee was receiving huge dividend & interest income on certain investments.

- (2) He formed four private limited companies & transferred the whole of the investments to these companies.
- (3) The interest received by these companies was within the exemption limit under Income Tax Act of that time.
- (4) The comp. did not have any business or assets except those investments.
- (5) The income received on investments these comps. was diverted to the assessee in the form of pretended loans, which were never paid back by him.

Decision - Court held that the only purpose of incorporating these comps. was to evade taxes, the income received by these comps. was treated as the income of assessee.

Bin Dinshaw Maneckji Petit (huge profit)

Inco. 4 subs. comp.	Transfer all profits in name of subs. co.	Such profit is re-treated as pretended loan	Such subs. co have no other business
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A, an assessee had large income in the form of dividend & interest. In order to reduce his tax liability, he formed 4 pvt. ltd co. & transferred his investments to them in exchange of their shares. The income earned by these cos. was taken back by him as pretended loan. Can it be regarded as separate from the pvt. ltd co. he formed? (3M)

Ans.

Corporate veil, lifting of CV, Bin Dinshaw Maneckjee's

Conclusion - As per above provisions & relevant case law No A & his pvt ltd co. is treated as one & same.

True or False

1. 'Patel & Co.' is a comp. in the eyes of Law - False
2. A co. has its own distinct entity - True
3. If the members composing a co. die or dissociate themselves from the co., such co. gets annihilated along with - False.
4. The creditors of the co. can sue its members for the debts of the co. - False
5. A co. being an artificial person cannot own property & cannot sue or be sued - False
6. A private co. need not have its own articles - False
7. A co. limited by guarantee must have sh. cap. - False
8. A co. that does not hold more than 50% of total sh. capital of another co., may still be a holding co. of that another one. - True
9. A Govt. co. is that co. of which all the shares are held by the Govt. - False
10. A licenced co. can be registered with limited liability without adding the word 'limited' to its name. - True
11. A 'one man co.' is a legal entity in the eyes of law. - True
12. Memorandum is the basic document facilitating the incorporation of a co. - True
13. It is not necessary for a co. to mention the actual address of its registered office in the MOA - True
14. The ^{incidence} domicile & nationality of a comp. are determined on the basis of its registered office - True
15. The acts ultra vires the directors are null & void & therefore cannot be ratified by the shareholders. - False

16. The transactions ultra vires the Memorandum can be ratified by the unanimous consent of all the shareholders. *(Note: All the above are false)* False
17. Articles are rules framed for governing the internal affairs of the co. *(Note: True)*
18. Articles are internal rules for the general administration of a comp. *(Note: True)*
19. Memorandum is subsidiary to articles *(Note: False)*
20. No form has been prescribed for the articles of comp. in the act. *(Note: False)*
21. Memorandum & articles bind the co. to its members, & also each member to the co. inter se. *(Note: True)*
22. Memorandum & articles are public documents open to public inspection. *(Note: True)*
23. An outsider dealing with a co. is presumed to have knowledge of the provisions of its memorandum & articles. *(Note: True)*
24. An outsider dealing with a co. has a right to assume that its internal management has no irregularity. *(Note: True)*

Long Questions

1. The principal business of XYZ Comp Ltd was the acquisition of vacant plots of land & to erect the houses. In the course of transacting the business, the Chairman of the co. acquired the knowledge of arranging finance for the development of land. The XYZ co. introduced a financer to another co. ABC Ltd & received an agreed fee of Rs 2 Lacks for arranging the finance. The MOA of the co. authorises the co. to carry on any

other trade or business which can in the opinion board of the directors, be advantageously carried on by the co. in connection with the co's general business. Referring to the provisions of the Co's act, examine the validity of the contract carried out by XYZ co Ltd with ABC Ltd.

Ans: Arranging finance or financier is an ultra vires act.

- since it falls outside the object clause of memorandum.
- since an object contained in the object clause is not valid if it authorises the co. to carry on any other trade or business which can be advantageously carried on by the co.

The contract entered into by the co. is ultra vires

- since the co. has no power to arrange finance or financier.
- since the board cannot take the defence that the memorandum authorises the co. to carry on any business which can be advantageously carried on in connection with comp's present business.

Q. The principal business of XYZ Co Ltd was the acquisition of vacant plots of land & to erect the houses. In the course of transacting the business, the Chairman of the co acquired the knowledge of arranging finance for the development of land. The XYZ co. introduced a financier to another co. ABC Ltd.

Ques 2. The object clause of MOA of LSR Private Ltd, Lucknow authorized to do trading in fruit & vegetables. The co. however, entered into a Partnership with Mr J. & traded in steel and incurred liabilities to Mr J. The co. subsequently refused to admit the liability to J on the ground that the deal was 'Ultra vires' the co. Examine the validity of the co's refusal to admit the liability to J. Give reasons in support of your answer.

Ans: The co. is not liable since the partnership agreement for trading in steel is an ultra vires contract, & an ultra vires contract between partners is void ab initio & is not binding on the co. or on the other party.

Since the power to enter into partnership is not an ancillary or incidental power.

Since such power can be legally exercised by the co. only if the object clause of MOA expressly authorizes the same in either written or verbal form.

3. The secretary of a co. issued a sh. certificate to A under the co's seal with his own signature & the signature of a director forged by him. A borrowed money from B on the strength of this certificate. B wanted to realize the security & requested the co. to register him as a holder of the shares. Explain whether 'B' will succeed in getting the sh. registered in his name?

Ans. A or B is not entitled to shares since in case of forgery, there is not a defect in consent, but absence of consent, and therefore the shares - certificate issued by way of forgery is invalid.

(Rubin v great fingsall Consolidated co.)

4. Under the AOA of Sunshine Ltd Co. directors had powers to borrow up to Rs 10,000 without the consent of the general meeting. The directors themselves lent Rs 35000 to the co. without such consent & took debentures of the co., decide under the provisions of the co. Act whether the co. is liable? If so, what is the extent of liability of the co. in this case?

Ans. The co. is not liable for Rs 35000/-

since the benefit of doctrine of indoor management can be availed of only by an outsider who has no knowledge of any irregularity in the internal management of the co.

The liability of the co. is

- since the directors, having knowledge of the fact that the limit of borrowings specified under the AOA would be exceeded, themselves lent Rs 35000 without the consent of the general meeting.

- since on the similar facts as in the given case, same decision was given in Howard v patent ivory Manufacturing Co.

5. Ques.

The AOA of XYZ Ltd provides the BODs has authority to issue bonds provided such issue is authorized by the shareholders by a necessary resolution in the GM of the co. The co. was in dire need of funds and therefore, it issued the bonds to Mr X without passing any such resolution in GM. Can Mr X recover the money from the co.? Decide referring to the relevant provisions of Co Act 2013?

Ans. The comp. is liable since the lender, Mr X had lent the money to the comp assuming that the co. was authorized to borrow money after obtaining authorisation from the members in GM.

• since, on the same facts, the Court held in Royal British Bank v. Tengnagard that the outsiders dealing with the co. were not required to inquire into the internal management of the co. the outsiders were entitled to assume that as far as internal proceedings of the company were concerned, everything had been done regularly (known as doctrine of indoor management)

True or False

1. The Registrar issued on 8th Jan, a Certificate of incorporation dated 5th Jan. An allotment of shares was made on 5th Jan. The allotment is void as it was made before the co. was incorporated. *False.*
- Reason - Effective date of incorporation is the date mentioned in the Certificate. Hence, allotment of shares made in the given case is valid.
2. All seven signatures on a MOA were forged by a single person & a Certificate of Incorporation was obtained. This is a valid certificate. *True.*
- Reason - Certificate of Incorporation is conclusive evidence of all that it contains. However, consequences for furnishing false particulars, registration are applicable.
3. A firm may be a member of a co. licensed sec. 8 but its membership shall cease on the dissolution of firm. *True.*
- Reason - Firm can be a member of sec 8 Co membership ceases upon dissolution of the firm.