DOCTRINE OF INDOOR MANAGEMENT

By
—**Dr. MUDDU VIJAI**, Advocate
High Court of Hyderabad for
the States of Telangana and Andhra Pradesh

Introduction

The doctrine of indoor management is an exception to the rule of constructive notice. According to the rule of constructive notice, a person dealing with the company is deemed to have knowledge of the memorandum and the articles of the company. If he enters into a transaction with the company which is *ultra vires*, he cannot treat the transaction as binding on the company. The doctrine of indoor management on the other hand argues that outsiders dealing with the company are entitled to assume that everything had been regularly done so far as its internal proceedings are concerned.

The rule of constructive notice is confined to the external position of the company, and therefore, it follows that there is no notice as to how the company's internal machinery is handled by its officials. If the contract is consistent with the public documents, the person contracting will not be prejudiced by irregularities that may beset the indoor working of the company.

Constructive Notice

Every outsider dealing with a company is deemed to have notice of the contents of the Memorandum and the Articles of Association. These documents, on registration with the Registrar, assume the character of public documents. This is known as 'constructive notice' of Memorandum and Articles.

The Memorandum and the Articles are open and accessible to all. It is the duty of every person dealing with a company to inspect these documents and see that it is within the powers of the company to inspect these documents and see that it is within the powers of the company to enter into the proposed contract. Likewise special resolutions, when registered with the Registrar, become public documents, so that an outsider is on notice of their contents in the same way as he is of the Articles and the Memorandum. Thus, anyone dealing with a company is presumed not only to have read the Memorandum and the Articles but to have understood them properly.

The doctrine of constructive notice of the Memorandum and Articles, however, is not a positive doctrine but a negative one. It is like doctrine of estoppels. It does not operate against the company. It operates only against an outsider dealing with the company. It prevents him from alleging that he did not know that the Memorandum and Articles rendered a particular act *ultra vires* the company.

Doctrine of Indoor Management

The doctrine of indoor management provides protection to the outsider against the company. As we know that a person who enters into the contract with the company is well expected to have the access to the contents of memorandum and articles of association. So far as the contents of articles and memorandum of association are concerned, they must be well known by the person, who wants to make the contact with the company. But at the same time we cannot presume to know that every internal proceeding has taken place properly, since that matter is dealt with by the company. Now every person dealing with the company

is entitled to assume that the company has carried out its own internal regulation and proceeding. It is known as doctrine of indoor management. According to this doctrine of indoor management, every person who wants to deal with the company can assume that all internal proceedings has been carried out smoothly and properly by the company. A person dealing with companies is not compelled to investigating thoroughly the internal machinery of a company to see if something is wrong. Definitely for such a person he or she may reasonably presume that for the company in question, it is expected and presumed that every internal proceeding has taken place in the company where such internal matters are concerned. So it is very important that we should presume that every person who wants to deal with the company must not be expected to have complete knowledge of the internal management, or where internal machinery of the company is concerned.

Doctrine of indoor management is also known as Turquand's Rule. [*Royal British Bank v. Turquand*, (1843-1860) All. ER 435]. This case came up before the Court of Exchequer Chamber through an appeal filed by the defendant, Turquand, who was the official manager of Cameron's Coalbrook, Steam, Coal and Swansea and London Rail Company. He was sued by the plaintiffs, The Royal British Bank, for the non-payment of a sum of 2000 pounds which the plaintiffs alleged that the company was bound to pay as they had acknowledged this debt through a bond bearing the common seal of the company and signed by two directors. The defendant pleaded that no such resolution had been adopted in authorizing the making of the bond and any such bond was given without the authority and the consent of the shareholders of the company. The Court of Exchequer Chamber did not accept this contention. It held that since the deed of settlement registered under the Joint Stock Companies Act, 1844, allowed the directors to borrow on bond, such bonds from time to time through a resolution passed at a general meeting of the company. The Court held that evidence showed that such a resolution had indeed been passed but the amount of money which the directors were authorized to borrow was never defined. The Court stated that dealings with companies were not dealings with ordinary partnerships and though the public should have known the contents of the documents that are published, they were not obligated to do more and any party reading the deed in instant matter would find that there was no prohibition from borrowing stated in the deed. Thus, any such party was entitled to assume that all internal procedural conditions not mentioned in the deed had been followed. Thus the Court ruled against the defendant directors and enunciated the rule that is now known as the Turquand rule or the Doctrine of Indoor Management.

In [*Ram Baran Singh v. Mufassil Bank Ltd.*, AIR 1925 All. 206], it was laid down that :

> "The Articles of Association of the company define the power of Directors as between themselves and the company, and unless there is anything in those Articles limiting the powers of the Board of Directors in carrying on the ordinary business of the Corporation, a third party who deals with the Directors or with the Managers acting under those powers, however, irregularly is protected if he acts in good faith in his dealing with them." (208).

In [*Debra Dun Mussorie Electric Tramway Co. Ltd. v. Jagmandar Das*, AIR 1932 All. 141], a Bench of this Court held that :

> "A company is liable for all the acts done by its directors even though unauthorized by it, provided such acts are within the apparent authority of the directors and not *ultra vires* of the company. Persons dealing *bona fide* with a managing director

> are entitled to assume that he has all such powers as he purports to exercise if they are powers which, according to the constitution of the company a Managing Director can have." (head-note).

In [*T.R. Pratt (Bombay) Ltd. v. E.D. Sassoon and Co.*, MANU/MH/0170/1935 = AIR 1936 Bom. 62], it was held that where the act of borrowing is *ultra vires* the directors, and not *ultra vires* the company, the company is liable to pay. Further it was held that : "If it is shown that a particular act was ostensibly authorised by the statute, the Memorandum and Articles of Association, persons dealing with the company are not concerned to see that the company has put itself into a position to exercise its power properly." (p.80). The reason of this rule was stated to be "that it would be disastrous if contracts made with companies could be impeached on account of matters known to the company but not to the other contracting party", (p.80).

In [*Biggerstaff v. Rowatt's Wharf Ltd.*, (1896) 2 Ch. D. 93(E)], it was held that :

> "Persons dealing *bona fide* with a Managing Director are entitled to assume that he has all such powers as he purports to exercise, if they are powers which according to the Constitution of the company a Managing Director can have." (head-note). Further, it was held in that case that if the director could have the power, or might have the power to do what he purported to do, then a creditor proceeding in a *bona fide* way could assume that he had the power to do what he actually did.
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> In Buckle on the Companies Act (12th Edition) the law relating to indoor management is stated at page 375 as follows : "Outsiders are bound to know what Lord *Hartherley* called the 'external position of the company'; but are not bound to know its 'indoor management'. If persons are held out as and act as directors, and the share-holders do not prevent them from so doing outsiders are entitled to assume that they are directors, and as between the, company and such outsiders, the acts of such directors, *de facto* will bound the company."

The Doctrine is however, Subject to the Following Exceptions :—

(a) Knowledge of irregularity :—A person who deals with the company and who has knowledge of the irregularity in its internal management in connection with the subject-matter of his dealing cannot claim the benefit of the rule in *Turquand's* case. In the case of [*Howard v. Patent Ivory Co.*], the directors cannot borrow more than 1000 pound without the consent of the company's annual general meeting. Directors borrowed 3500 pound without the consent of annual general meeting from another director who took debentures. Now as the plaintiff is director than he has the knowledge about the internal irregularity. Held, the debentures are good only for the 1000 pounds only because the plaintiff (director) has the knowledge of the internal irregularity.

(b) Negligence :—The doctrine of indoor management, in no way, rewards those who behave negligently. Thus, where an officer of a company does something which shall not ordinarily be within his authority, the person dealing with him must make proper enquiries and satisfy him as to the officer's authority. If he fails to make an enquiry, he is estopped from relying in the rule.

In the case of [*B. Anand Behari Lal v. Dinshaw & Co. (Bankers) Ltd.*, AIR 1942 Oudh. 417], an accountant of a company in favour of *Anand Behari*. On an action brought by him from breach of contract, the Court held the transfer to be void. It was observed that the power of transferring immoveable property of the company could not be considered within the apparent authority of an accountant.

(c) Forgery :—The rule in *Turquand's* case will not apply where a document on which the person seeks to rely on is a forgery or illegal or transactions which are *void ab initio*. In [*Ruben v. Great Fungall Consolidated Co*., (1906) AC 439]. Here the secretary of the company forged the signature of two of directors and issued the certificate without the authority. The issue of certificate requires the sign of two directors as given in the article. Held here the holder of certificate cannot take the advantage of the doctrine as it was forged transaction which is *void ab initio*. In the case of [*Kreditbank Cassel v. Schenkers Ltd*., (1927) 1 KB 826], a bill of exchange signed by the manager of a company with his own signature under the words stating that he signed on behalf of the company, was held to be forgery when the bill was drawn in favour of a payee to whom the manager was personally indebted. The bill in this case was held to be forged because it purported to be a different document from what it was in fact; it purported to be issued on behalf of the company in payment of its debt when in fact it was issued in payment of the manager's own debt.

(d) Act outside the apparent authority :—The rule in *Turquand* does not apply where a person acting on behalf of the company exceeds any actual or ostensible authority given to him. A person who enters into a transaction with a company official who has acted beyond official powers will not be protected by the rule in *Turquand* case. In [*Anand Lal v. Dinshaw & Co*., (1942)], accepted a transfer of company's property from its accountant. Since such transaction is apparently beyond the scope of the accountant's authority it was void.

(e) No knowledge of the contents of the articles and memorandum of association :—A person who has not actually read the memorandum and articles and who was not at the time he entered into the contract, aware of their content cannot seek to rely on the doctrine of indoor management. The doctrine of indoor management is based on the principle of estoppels and therefore cannot be invoked in favour of a person who has not consulted the company's memorandum and articles. In the case of [*Rama Corporation v. Proved Tin and General Investment Co*., (1952) 2 QB 147], the X who was director in the company entered into a contract with Rama Corporation while purporting to act on behalf of the company and he also took a cheque from them. The articles of the company did provide that the director may delegate their power but Rama Corporation did not have knowledge of this as they did not read the articles and memorandum of the company. Now later on it was found that company had never delegated their power to X. Held, plaintiff cannot take the remedy of the indoor management as they even don't that power could be delegated.

(f) The doctrine will not apply where the question is in regard of to the very existence of an agency. In the case of [*Varkey Souriar v. Leraleeya Banking Co. Ltd*., (1957) 27 Comp. Cas. 591 (Ker.)], the Kerala High Court held that the doctrine of Indoor management cannot apply where the question is not one as to scope of the power exercised by an apparent agent of a company but is in regard to the very existence of the agency.

(g). This doctrine is also not applicable where a pre-condition is required to be fulfilled before company itself can exercise a particular power. In other words, the acts done is not merely *ultra vires* the directors/ officers but *ultra vires* the company itself. [*Pacific Coast Coal Mines Ltd. v. Arbuthnot*, 1917 AC 353].

The next and most important embodiment to the doctrine of indoor management is the power of delegation in the article of association. This theory states that if there exists a power of delegation and a third party has knowledge of this power, then a person purporting to act in

consequence of this delegation will bind the company irrespective of whether such power was actually delegated or not. Such a scenario was exemplified by the case of [*Lakshmi Ratan Cotton Mills v. J.K. Jute Mills Co.*, AIR 1957 All. 311]. In this case, the directors of the company were authorized by the articles of association to borrow money from third parties and were empowered to delegate this power of borrowing to any one director or more. The company contended that no resolution was passed to actually delegate this power to the director who borrowed the money. This contention was not favoured by the Court which held that the mere existence of the delegation clause and the third party's knowledge of it was enough to bind the company. Therefore, two important criteria have to be satisfied before the Turquand Rule can apply. First, there must be ostensible authority vested in the person. This criterion will get satisfied if the person is in a position of ostensible authority, for example, a director. The other criterion is that such power of delegation was within the knowledge of the third party and if the third party did not have any idea about such power then that party cannot rely on this power. Thus in [*Rama Corporation v. Proved Tin and General Investment Co.* (supra)], the director of a company was empowered by the articles of association to delegate any of his powers but not the power to borrow or make calls. In any event, the third party did not know of the power to delegate at all and the Court was of the opinion that no reliance could be placed on the clauses whose existence was unknown to the third party. However, such a decision relates the doctrine of indoor management to the principle of estoppel and has been criticized.

How Indian Judiciary has interpreted this doctrine

In the case of *Lakshmi Ratan Cotton Mills Co. Ltd. v. J.K. Jute Mills Co. Ltd.*, the company of plaintiff sued defendant's company for the total amount of Rs.1,50,000/-. The defendant company raised the argument that no such resolution sanctioning the loan was passed by the board of director, thus it is not binding on the company.

The Court held that-"The director of the managing agency and also a delegate of the managing agency could be authorised to enter into this transaction. Under the above circumstances, even supposing that there was no actual resolution authorising him to enter into this transaction on behalf of the defendant company either by the Board of Directors or by the Board of Managing Agents, the claim of the plaintiff who was a creditor cannot be affected. A creditor dealing with a trading company is required by law to be conversant with the terms of its Memorandum and Articles of Association and no more. If it is found that the transaction of loan into which the creditor is entering is not barred by the charter of the Company or its Articles of Association, and could be entered into on behalf of the Company by the person negotiating it, then he is entitled to presume that all the formalities required in connection therewith have been complied with. If the transaction in question could be authorised by the passing of a resolution, such an act is a mere formality. A *bona fide* creditor, in the absence of any suspicious circumstances, is entitled to presume its existence. A transaction entered into by the borrowing under such circumstances cannot be defeated merely on the ground that no such resolution was in fact passed. The passing of such a resolution is a mere matter of indoor or internal management and its absence, under such circumstances, cannot be used to defeat the just claim of a *bona fide* creditor. A creditor being an outsider or a third party and an innocent stranger is entitled to proceed on the assumption of its existence; and is not expected to know what

happens within the doors that are closed to him. Where the act is not *ultra vires* the statute or the company such a creditor would be entitled to assume the apparent or ostensible authority of the agent to be a real" or genuine one. He could assume that such a person had the power to represent the company, and if he in fact advanced the money on such assumption, he would be protected by the doctrine of internal management.

In the case of [*Official Liquidator, Manasube & Co. (P) Ltd. v. Commissioner of Police*, (1968) 38 Comp. Cas. 884 (Mad.)].

It is expected from the person that he will read the article and memorandum when he enters into a contract with the company but it is highly unlikely that he will also check the legality, propriety and regularity of acts of directors.

In recent judgment Indian Courts had broadened the scope of the doctrine. The object is still same, to protect the third party who acted in god faith with the company and is unaware of the internal management of the company.

In the case of [*MRF Ltd. v. Manohar Parrikar*], the Supreme Court has first time analysed the doctrine of indoor management in some detail. The case is related to the public law but a reference was made to the doctrine of indoor management to draw an analogy.

In this case notification issued by State Government for granting rebate of 25 per cent in Tariff in respect of the power supply to the Low Tension and High Tension Industrial Consumers was rescinded by another Notification issued at instance of Ministry of Power – Legality of the notifications challenged on grounds that they were not issued in compliance with the requirements of Article 154 read with Article 166 of the Constitution of India and the Business Rules of the Government of State framed by the Governor. Decision taken at ministers level without submitting it to council of ministers or Chief Minister without obtaining concurrence of finance department, and notifications issued pursuant to ministers decision, so it was held that it is not sustainable in law. A decision can be treated as the decision of the Government only when decision satisfies requirements of with Rules of business framed under Article 116(3)/77(3). Decision having financial implications, if taken by a minister without seeking concurrence of finance department as provided by with Rules of business, cannot be treated as decision of State Government as a whole under Article 154. So notifications issued pursuant to ministers decision so taken, are *void ab initio* and all actions consequent thereto are *null* and *void*.

"Doctrine of indoor management is in direct contrast to doctrine of constructive notice which is essentially a presumption operating in favour of the company against the outsider. It prevents the outsider from alleging that he did not know the constitution of the company rendered a particular delegation of authority *ultra vires*. Doctrine of indoor management is an exception to rule of constructive notice. It imposes an important limitation on doctrine of constructive notice. According to this doctrine, persons dealing with company are entitled to presume that internal requirements prescribed in the memorandum and articles have been properly observed. Therefore doctrine of indoor management protects outsiders dealing with the company, whereas doctrine of constructive notice protects the insiders of a company or corporation against dealings with outsiders. However, suspicion of irregularity has been widely recognized as an exception to doctrine of indoor management. Protection of doctrine is not available where the circumstance surrounding are suspicious and therefore invite inquiry.

Applying the exception to the present scenario, there is sufficient doubt with regard to conduct of power minister in issuing notifications. Therefore there is a definite suspicion of irregularity which render doctrine of indoor management inapplicable to the present case.

Conclusion

It is analysed the rule laid down in the *Turquand* case and its evolution through English and Indian case law. The rule which later came to be known as the doctrine of indoor management was carved out so as to prevent the doctrine of constructive notice, used by companies to their advantage, from becoming an impediment to trade and commerce as otherwise third parties would be seriously affected if constructive notice was applicable in all cases. However, the doctrine of indoor management cannot also be applied over-extensively. In absence, a harmonious balance has to be maintained so as to promote business transactions between the company and third parties. Thus the doctrine of indoor management cannot give validity to a transaction where there is no authority; it can only apply as an exception to the doctrine of constructive notice as mentioned above.

A CRITICAL STUDY – IMPLEADMENT OF LEGAL REPRESENTATIVES ORDER 22(5) *VIS-À-VIS* SECTION 2(11) CPC

By

–POLLA SAMBASIVA RAO, Advocate
Narsipatnam

Whether legatees under a will can represent the estate of the deceased executor or DHR and can be impleaded.

There appears to be a considerable controversy with regard to the impleadment of legal representatives based on the will and the Law on the subject is not uniform among the decisions of the several High Courts covered by :

1. 1998 (2) ALD 296; 2. 1994 (4) An. WR 248; 3. AIR 1994 Raj. 31; 4. AIR 1981 Ori. 63; 5. AIR 1988 P&H 123.

Which laid down that the legal representatives cannot be impleaded based on a will which is contrary to the land mark and progressive judgment of the SC reported in 1992 (1) APLJ 47, SC laying down legal representatives can be impleaded based on a will or settlement deed which appears to have been ignorantly ignored at some levels which resulted for contribution of this article which is of day-to-day importance.

Be this as it may,

As a prefatory caveat, in order to answer this moot question of considerable importance there is a distinction between "legal representative" and "legal heirs" particularly in the light of the definition of the "legal representative" given under Section 2(11) CPC which is extracted as hereunder:

> "Legal Representative" means a person who in law represents the estate of a deceased person and includes any person who intermeddles with the estate the