LL.B IV SEMESTER

SUBJECT- COMPANY LAW

TOPIC – DOCTRINE OF INDOOR MANEGMENT

Meaning of Doctrine of Indoor Management

There are various principles in the corporate world that help determine the relationship which ensures the safety of various stakeholders in the company in the transactions that they undertake. The doctrine of indoor management is one such principle. The doctrine of indoor management was evolved 150 years ago. It is also known as Turquand's rule. The other principle that is commonly referred to in this context is the principle of constructive notice.

The principle of constructive notice protects the company from frivolous claims by outsiders'. The third party cannot claim to not having been notified of the Company's procedures or practices if they are a party to the MOA and the AOA. It is deemed to have been understood that a prudent person would have read the MOA and the AOA before agreeing to enter into an agreement with the company. The doctrine of constructive notice is limited to the external position of the company.

The role of doctrine of indoor management is opposed to of the role of doctrine of constructive notice.The doctrine of indoor management follows from the doctrine of 'constructive notice' laid down in various judicial decisions. The hardships caused to outsiders dealing with a company by the rule of'constructive notice' have been sought to be softened under the principle of 'indoor management'. It affords some protection to the outsiders against the company.

The doctrine of constructive notice protects company against outsiders whereas the doctrine of indoor management protects outsiders against the actions of company. This doctrine also is a possible safeguard against the possibility of abusing the doctrine of constructive notice. According to this doctrine, persons dealing with the company 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 memorandum and articles of association. Shareholders, for example, need not enquire whether the necessary meeting was convened and held properly or whether necessary resolution was passed properly. They are entitled to take it for granted that the company had gone through all these proceedings in a regular manner.

The doctrine helps protect external members from the company and states that the people are entitled to presume that internal proceedings are as per documents

submitted with the Registrar of Companies. Whereas the doctrine of constructive notice protects a company against outsiders, the doctrine of indoor management protects outsiders against the actions of a company. This doctrine also is a possible safeguard against the possibility of abusing the doctrine of constructive notice.
The person entering into a transaction with the company only needed to satisfy that his proposed transaction is not inconsistent with the articles and memorandum of the company. He is not bound to see the internal irregularities of the company and if there are any internal irregularities than company will be liable as the person has acted in the good faith and he did not know about the internal arrangement of the company.

The rule is based upon obvious reason of convenience in business relations. Firstly, the articles of association and memorandum are public documents and they are open to public for inspection. Hence an outsider "is presumed to know the constitution of a company, but what may or may not have taken place within the doors that are closed to him."

Origin of the Doctrine

This Doctrine of Indoor Management was first recognized in the case of **Royal British Bank v Turquand. (1856) 119 E.R 886**

The directors of the Company borrowed a certain sum from the plaintiff. The Article of the Company provided for the borrowing of money on bonds with a condition attached to it which stated that a resolution should be passed in the general meeting. But the shareholders claimed that such resolution was not passed in the general meeting and thus the company was not liable to pay the money. It was held that the Company would be liable to pay the amount. The Directors were entitled to borrow the amount only after a resolution was passed in the General Meeting, thus the plaintiff had the right to infer that the formalities were done and the resolution was passed. Turquand was thus entitled to sue the Company on the strength of the bond. Lord Hartherly in his judgment sated- "Outsiders are bound to know the external position of the company, but are not bound to know its indoor management."

The Doctrine of Indoor Management as identified in the Turquand Case was not accepted until it was approved by the House of Lords in the case of **Mahoney v East Holyford Mining Co(1875) LR 7 HL 869**.The Article of the Company stated that the cheque must be signed by 2 or 3 directors and the secretary. But the issue regarding this case was that the Director who signed the cheque was not properly appointed at the time of signing. The Court held that the Appointment of the Director came under the Internal Management of the Company thus even if the

director was not properly appointed, the third party was entitled to receive or cash the cheques as he is entitled to presume that the Directors were properly appointed.

Exceptions to Doctrine

(1) Where the outsider had knowledge of irregularity– The Application of the doctrine stands repealed in cases where the outsider dealing with the company is aware of the lack of authority of the person acting on behalf of the company.

In the case of **Howard v Patent Ivory Co (1888) 38 Ch D 156**., the Directors of the Company borrowed the sum of 3500 pounds from another director without the consent of the Annual General Meeting. The rule stated that no director was allowed to borrow more than 1000 pounds without the consent of the general meeting. Since the plaintiff here was the Director and was well aware of the rules and internal irregularities, the Company would not be liable.

(2) No knowledge of Memorandum and Articles– This doctrine shall not apply in cases where the plaintiff relies on the Company for not having knowledge of the Memorandum and Articles. **Rama Corporation v Proved Tin & General Investment Co. (1952) 1 All. ER 554** .brought this exception into the limelight. As per the facts of the case, Director X of the company entered into a contract with Rama Corporation. The Articles of the Company stated that the directors may delegate their power but Rama Corporation without reading the Article and Memorandum entered the contract. It was later discovered that the Company did not delegate power to Director X. The Court held that the plaintiff could not take the remedy of Indoor Management for not knowing the Article or Memorandum.

(3) Forgery- The Company cannot be held liable for forgery committed by officers. Thus the Doctrine is not applicable to forged transactions which are void ab initio. In the case of **Rouben v Great Fingal Consolidated(1906) AC 439** the secretary of the Company forged the signatures of two directors of the Company and issued a certificate without authority. It was thus held that the holder of certificate could not take the remedy of Indoor Management.

(4) Negligence- The doctrine is not applicable in the case where an officer of a company does an act beyond his authority. In the case of **B. Anand Behari v Dinshaw & Co (Bankers)Ltd. AIR 1942 Oudh 417**., an accountant of the Company transferred the Company in favour of Anand Behari. The Court held that the Doctrine of Indoor Management won't be applicable as the transfer would be void considering the fact that the transfer made by the accountant was beyond his authority.

(5) The doctrine would also remain inapplicable in cases where the question is with regards to the **existence of an agency** and not just regarding the power exercised by the agent.

The doctrine of Indoor Management in India

The Court in the case of **Lakshmi Ratan Cotton Mills Co. Ltd v J.K Jute Mills Co. Ltd AIR 1957 All 311.,** declared that in any transaction of loan where the creditor entering into a contract is not barred by any charter of the company or its articles and can enter into a contract on behalf of the Company, he/she is entitled to presume that all formalities required in connection have been completed.

In the case of **official Liquidator, Manasube & Co. (P.) Ltd. V. Commissioner of Police, [1968]38 Comp. case 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 good faith with the company and is unaware of the internal management of the company

In the case of **MRF Ltd. v. ManoharParrikar(2010) 11 SCC 374** the doctrine of indoor management does not apply on state of Goa because of the fact that there was an internal irregularity which should be taken care of and it is one of the exceptions of the doctrine. The doctrine of indoor management should not be used over extensively. A harmonious balance should try to be maintained to promote business transactions to third parties.

The doctrine of indoor management is available to the outsider who had acted in the good faith and entered into a transaction with the company, he can presume that there were no internal irregularities and all the procedural requirements are satisfied. But it compulsory that he should be aware of the memorandum and articles of the company, in order to take this remedy. The government authorities also come under the purview of this doctrine. As we have discussed in the case of MRF Ltd. v. Manohar Parrikar[23]there was a definite suspicion of irregularity which is also an exception of doctrine of indoor management

Conclusion

Doctrine of indoor management is evolved as a reaction of the doctrine of constructive notice. It puts a Bar on the doctrine of constructive notice and it protects the third party who acted in the act in the good faith. This doctrine protects outsiders dealing or contracting with a company, It was analyzed that the doctrine does not operate in arbitrary manner, there are some restriction imposed on it like forgery, third party having knowledge of irregularity, negligence, where third party don't read memorandum and articles and the doctrine will not apply where the question is regard of to the very existence of the company. Act done by governmental authorities in the course of their activities comes under the doctrine of indoor management