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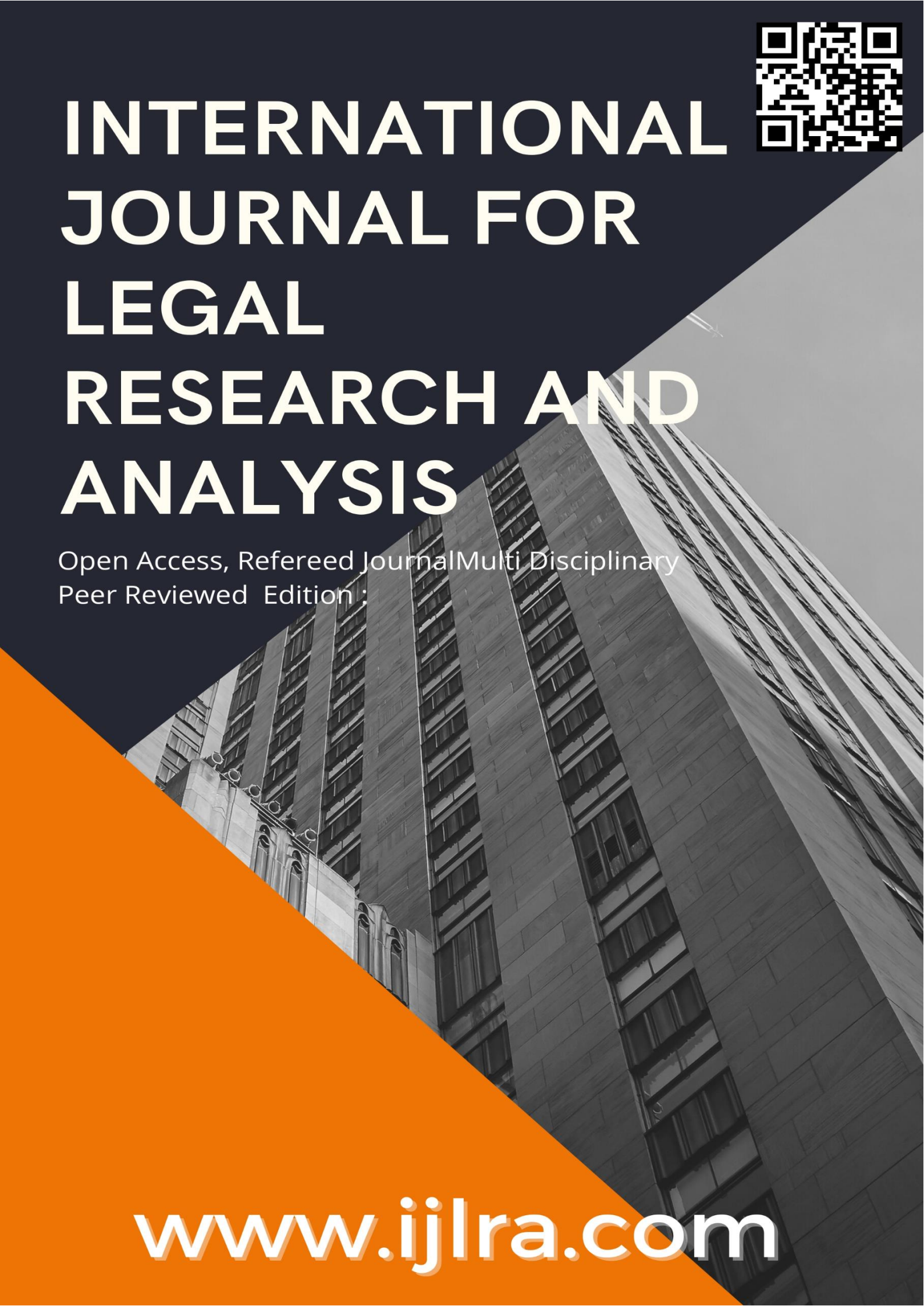

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 ISSN: 2582-6433

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ISSN: 2582-6433

BRIEF ANALYSIS OF TURQUAND RULE AND ITS EXCEPTIONS

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INDEX

 ISSN: 2582-6433

INTRODUCTION

As you are known, when an outsider deals with a corporate entity of a firm, they must check through incorporation documents such the company's memorandum of agreement and articles of association. They are not required to inquire about the company's internal management. He doesn't have to confirm beforehand that the entity has complied with all legal requirements, that the corporation's representative has the necessary capacity and has been given permission by the company's governing body, etc. When he signs a contract with the company, he assumes that the person he is dealing with has the right authority and is working in accordance with the applicable laws as well as the MOA and AOA of the corporation.

Common law serves as the foundation for the Turquand rule. It protects legitimate third parties who are ignorant of any corporate irregularities that could jeopardize the legality of a transaction or contract with the business. The "Indoor Management rule" is a frequent term used to describe the Turquand rule. When a business engages in transactions with other parties, it is its responsibility to make sure that all internal policies derived from its AOA and Memorandum of Association have been followed. The Turquand rule exempts third parties from having to find out if the business they plan to do business with has followed all of its internal policies. It protects legitimate third parties from being harmed by the company's inability to adhere to internal policies.

We will talk about a well-known case that established "The Turquand Rule". A person dealing with a corporation needed only look at the Memorandum of Association and the Articles of Association to know the extent of the authority and does not need to ask as to whether the internal procedures are regular. This was established in the well-known case of Royal British Bank v. Turquand.[1]

Prior to this judgment there are several rules for protecting the person dealing with the company and most of the rules were almost entirely common law rule.

1. Name of the Case Royal British Bank v. Turquand
2. Citation 6 E&B 327, All ER 435 5
3. Year of the Case 1 May 1856

[1] Available at: https://www.caclubindia.com/articles/analysis-of-turquand-rule-and-its-exceptions-47933.asp

 ISSN: 2582-6433

BACKGROUND

Submitted to the Registrar of Companies is the company's Memorandum of Association. Since those doing business with the company are allowed to review the document to see whether there are any restrictions on their authority or ability to conduct business, it is available for public viewing. It caused an issue by assuming that third parties would be aware of any restrictions imposed on the company's management. Consequently, it considers outsiders doing business with the Company to be aware of any irregularity that may subsequently be discovered within the Company regarding any decision.

Royal British Bank v. Turquand

FACTS

1. They appointed Turquand as the official manager to liquidate the insolvent 'Cameron's Coalbrook Steam, Coal, and Swansea and London Railway Company'. This company was incorporated under the Joint Stock Companies Act of 1844.

2. The company had issued a bond of £2000 to the Royal British Bank, which secured the company's drawings on its current account. The bond was under the seal of the company, signed by two directors and the secretary.

3. The plaintiffs, the Royal British Bank, for the non-payment of the same sued him.

4. The company claimed that, under its registered deed of settlement (the articles of association), the directors had only the power to borrow the company's resolution had allowed what.

5. The defendants also pleaded that it had adopted no such resolution allowing the making of the bond and that they give any such bond without the authority and consent of the shareholders of the company.

 ISSN: 2582-6433

ISSUE

Whether the company is liable for the loan?

JUDGMENT

1 Sir Jervis was of the opinion that the judgment of the Court of Queen's Bench should be upheld. He was inclined to believe that the question, which was mainly raised both in this case and in that Court, does not necessarily arise and does not need to be decided. His impression is that the resolution set out in the replication goes far enough to satisfy the requirements of the deed of settlement.

2. According to Sir Jervis, the deed allows directors to borrow on a bond the sum or sums of money which may be borrowed from time to time by a resolution passed at the General Meeting of the Company and the replication of the resolution, adopted at the General Meeting, authorizes the directors to borrow such sums on bonds for such periods and at such interest rates as they may deem expedient, in accordance with the act of settlement and the Act of Parliament; but the resolution does not otherwise define the amount to be borrowed.

3. Sir John Jervis CJ contended that it seems to me to be enough. If this is the case, the other question does not arise, we do not need to decide; for it seems to us that the plea, whether we consider it to be a confession and a refusal or a special Non-est factum, does not raise any objection to that advance as against the Company.

4. He further said that – we can now take for granted that dealings with these companies are not like dealings with other partnerships and that the parties dealing with them are bound to read the statute and the act of settlement. But they're not bound to do more than that. And the party here, reading the act of settlement, would find, not the prohibition of borrowing, but the permission to do so under certain conditions. In finding that the authority could be completed by a resolution, it would have the right to infer the fact of a resolution authorizing what appears to have been legitimately done in the face of the document.

 ISSN: 2582-6433

CONCEPTS HIGHLIGHTED

1. According to the Turquand rule, any outsider who enters into contracts with a company in good faith is entitled to assume that the internal requirements and procedures have been complied with. Consequently, the company will be bound by the contract even if the internal requirements and procedures have not been complied with.

2. One cannot claim under the doctrine of the indoor management if the outsider is aware that the internal requirements and procedures have not been complied with; or if the circumstances under which the contract was concluded on behalf of the company are suspicious.

However, it is sometimes possible for an outsider to determine whether an internal requirement or procedure has been complied with. If this can be ascertained from the public documents of the company, the doctrine of disclosure and the doctrine of the constructive notice shall apply and not the indoor management rule.

KEY TAKEAWAYS FROM ABOVE DECISION

1. The Turquand rule clarifies the underlying fundamental principle that, when an outsider enters into a contract with a company in good faith, the outsider can presume that no such irregularities exist and that, as a result, all procedural requirements have been complied with by the company appropriately.

2. When examined in the light of cases, Turquand rule it can be inferred that the rule does not function in an entirely unrestricted manner.

This Doctrine of Indoor Management is a long-standing idea that was created more than 150 years ago in the context of the "Doctrine of Constructive Notice" and has since come to be known as the "Turquand's Rule."[2]

As a concept, the Doctrine of Indoor Management clarifies the underlying fundamental principle that, when an outsider enters into a contract with a company in good faith, the outsider can presume that no such irregularities exist and that, as a result, all procedural requirements have been complied with by the company appropriately. The government authorities are

[2] Available at: https://www.lawyersclubindia.com/articles/an-analysis-of-the-turquand-rule-and-its-exceptions-15237.asp

 ISSN: 2582-6433

included within the scope of this doctrine even though it is necessary for outsiders to be informed about understanding of the structure of the specific company's Memorandum and Articles of Association in order to seek redress.

PLEASE NOTE THAT:

The common law, Turquand rule only serves as protection to third parties acting in good faith. This means that a third party who knew or even suspects that internal formalities have not been complied with but deliberately turns a blind eye will not be protected.

The statutory interpretation of the Turquand rule extends to people who ought to have reasonably known that the company had not complied with its internal formalities. A third party may be put on an inquiry judging from the nature of the transaction, which includes an unusual or suspicious transaction.

There must be absence of circumstances that put the third party on an inquiry. In addition, the Turquand rule does not protect a third party who relies on a forged document.

The Turquand rule needs to be applied carefully since it may be interpreted in terms of common law and statutory law.

DOCTRINE OF CONSTRUCTIVE NOTICE

Knowing the specific facts that a court assigns to a party is known as constructive notice. Constructive notice is based on the legal presumption that someone should have known something as if they truly do. A man of ordinary caution will be presumed to have known a specific fact about the transfer transaction if the circumstances suggest that he should have known it. This warning is operational as a legal provision. The court maintained that "constructive notice is itself evidence of notice" in the well-known Plumb v. Fluitt [1791] case. No one will be permitted by the court to refute it. Wigram V C determined the cases of constructive notice into 2 classes in the case of Jones V Smith [1841] namely:

1. Cases in which the party alleged has had actual notice regarding the fact that the property in dispute is somehow affected;

2. Cases in which the court has been persuaded from evidence on record before it that the party

 ISSN: 2582-6433

alleged has restrain himself from inquiring to avoid the notice.

WHAT ARE THE ESSENTIAL CONDITIONS FOR CONSTRUCTIVE NOTICE?

In respect of registered transaction, the followings are the essential conditions for constructive notice:

1. The instrument has to be registered in consonance with the Registration Act, 1908.
2. The instrument has to be duly entered or filed in books kept under section 51 of the Registration Act, 1908.
3. The particulars pertaining to the transaction to which the instrument relates have to be correctly entered in the indexes kept under section 55 of the Registration Act, 1908.

LEGAL PRESUMPTION OF CONSTRUCTIVE NOTICE

In the following circumstances the legal presumption of constructive notice arises

1. Willful abstention from an inquiry or search;
2. Gross negligence;
3. Document compulsorily registrable;
4. Actual possession;
5. Notice to an agent.

1. WILLFUL ABSTENTION FROM AN INQUIRY OR SEARCH

A person has notice if it was his responsibility to make an enquiry of if there was something to put him on an enquiry which if he pursued, he would have learnt the truth. The words 'will abstention from an inquiry or search' in section 3 means an abstention from inquiry or search as would show want of bonafides and a mere omission to make inquiries cannot be regarded as sufficient to constitute constructive notice within the meaning of the section. Illustration: A sells property to B. A got the property by partition and presumption right was reserved in the partition deed. It is B's duty to check the partition deed before purchasing the property, if he abstains himself from enquiring about the partition deed to avoid competition then it is a wilful abstention.

2. GROSS NEGLIGENCE

Gross negligence does not mean mere carelessness, it is a degree of negligence so gross in

 ISSN: 2582-6433

nature that a court of law may treat it as a proof of fraud. If there exists mental indifference to obvious risks, then it is a gross carelessness or negligence. What would be gross negligence in one case would not be so in another. It all depends on the man's knowledge and the means of information which lay to his hand. The main difference between wilful abstention and gross negligence is that in latter the intention is not wrong or fraudulent.

Illustration: X purchases a property within the municipality. X did not check whether any municipal taxes pertaining to the property were in arrears. As X failed to check before purchasing it amount to gross negligence.

3. REGISTRATION AS NOTICE

Registration is considered as constructive notice when the document is compulsorily registrable. The amending act of 1929 made it clear that registration of an instrument relating to immovable property amounts to notice of the instrument from the date of registration.

Registration is notice only in the following circumstances:

i) When the instrument is required by law to be registered;

ii) Registration is notice to a subsequent transferee. Prior transferee is not affected by notice of subsequent transactions from the registration of the same;

iii) The instrument must have been registered in the manner prescribed by the Registration Act, 1908.

4. POSSESSION AS NOTICE

If someone possesses an immovable property, then the purchaser must know that someone is exercising right to possession and enjoyment on that property. In other words, the person dealing with any immovable property shall be deemed to have notice of the title of any person who, temporarily is in actual possession thereof. The possession must be actual. Illustration: A sells his property to B and then A requested B to let him live in the property as long as A finds a new place to live. Registration was not done. A sells the same property to C. As B's possession is not actual so it is not a constructive notice to C.

5. NOTICE TO AGENT

The general principle is that a person has notice of fact when information of the fact is given to or obtained by his agent. The knowledge of the agent is regarded the knowledge of the principal. This general principle has certain limitations.

 ISSN: 2582-6433

Notice to agent is notice to principal in the following circumstances:

a. The agent must have actual knowledge of a fact.
b. The agent must have obtained the knowledge during agency.
c. The agent must have appointed for particular transaction or business.
d. The knowledge of fact must be material to that particular transaction or business.
e. The agent must obtain the knowledge in a good faith as a reasonable prudent man.

EXCEPTIONS TO THE PRINCIPLE

i) If the agent fraudulently conceals a knowledge of fact with wrongful intention, then his knowledge will not amount to principal's knowledge.

ii) If there is a third party who is involved with agent in the fraud and the third party knows that agent conceals the fact with a wrongful intention then agent's knowledge will not amount to principal's knowledge.

 ISSN: 2582-6433

THE CONSTRUCTIVE NOTICE DOCTRINE IN THE COMPANIES ACT OF 2013

The Doctrine of Constructive Notice is the legal concept of presumption of knowledge of that certain subject or information. A business is a separate legal entity that can be formed by a group of persons to profitably carry out economic operations. The company's formation and operation are governed by a set of laws, rules, and regulations. The objective of establishing such regulations is to protect both the company and its management, as well as any outsiders who have a contractual relationship with the company. A set of rules and principles have been established to safeguard the company from outsiders and the other way around.

Companies make money by utilizing the resources of the country. As a result, companies play a critical role in economic growth, necessitating the establishment of laws governing them. These rules function as a disincentive to unethical and unfair commercial practices.

THE CONSTRUCTIVE NOTICE DOCTRINE

The concept of Constructive Notice is one of the most important ideas we meet when studying Company Law. The theory of Constructive Notice means that the AOA is well-known by an outsider who wishes to hold any contact with the firm shortly since the AOA is a public document and is available to everyone u/s 399 of the Companies Act, 2013.

From the time the business is registered, the AOA and MOA are considered "public papers." They are open to the general public for viewing. As a result, it is believed that everyone who interacts with the company is familiar with its policies and procedures. The Doctrine of Constructive Notice is the name given to this assumption.[3]

The rule of constructive notice applies not only to MOAs and AOAs but also to all other documents that must be filed with the Registrar of Companies, such as Section 117 special decisions. The theory of constructive notice, on the other hand, does not apply to papers filed with the registrar of companies only to preserve records.

[3] Available at: https://www.fasken.com/en/knowledge/2022/08/10-the-turquand-rule-and-litigation-in-courts#:~:text=A%20further%20exception%20to%20the,or%20transaction%20that%20is%20void

 ISSN: 2582-6433

The notion, according to Palmer, only applies to papers that influence the company's rights.

Constructive responsibility is a concept that attempts to simplify business rules. It protects businesses from outsiders when they interact with them. Nonetheless, this regulation was seen to cause more harm than benefit, lowering its credibility. When the rule in dispute is internal, the courts established the idea of indoor management to limit the application of this provision.

This English term was originally only used in cases of fraud, but it rapidly expanded to include cases of extreme carelessness.

EFFECTS OF THE DOCTRINE OF CONSTRUCTIVE NOTICE

According to the Constructive Notice thesis, it is the outsider, he's responsible for knowing the papers that govern the company. He should be well-versed in all legal papers before signing any deal with the firm. It is also the responsibility of the third party to comprehend the real meaning of the provision and conditions included therein. According to the idea, corporate bodies are preferred.

The Madras High Court disputed the scope of constructive responsibility in the case of KotlaVenkataswamy vs. Rammurthy, AIR 1934 Mad 579. The question, in this case, was whether the mortgage bonds were issued lawfully in line with the company's AOA, therefore rendering the business liable.

All deeds, checks, certificates, and other papers must be signed on behalf of the Company by the Managing Director, the Secretary, and the Working Director before they are recognized valid, according to Article 15 of the Company's AOA.

The plaintiff accepted a mortgage deed signed by only the secretary and an executive director in this case. According to the court, the plaintiff cannot bring a claim under this deed. The Court went on to say that if the plaintiff had read the articles, they would have seen that a deed to carry out the job required by the firm's three authorized officials was badly signed, and they would not have accepted such a deed.

Even though she may have acted in good faith and that her funds were used for the company's advantage, the bond is void.

 ISSN: 2582-6433

Nonetheless, the court later developed a principle in Royal British Bank v. Turquand (1856) 6 E&B 327, holding that, while the third party should have notice of all the contents of the MOA & AOA, they are not required to scrutinize internal matters and see whether the corporation followed all internal procedures.

THE DOCTRINE OF INDOOR MANAGEMENT IS AN EXCEPTION TO THE DOCTRINE OF CONSTRUCTIVE NOTICE

The theory of constructive notice is an exception to the principle of indoor management, and it's important to note that it doesn't allow outsiders to have access to or notice of the company's internal actions. As a result, if an act is allowed by an MOA or AOA, an outsider might assume that all formalities are followed in carrying out the act, which is known as the Turquand Rule or the Doctrine of Indoor Management.

This is based on The Royal British Bank vs. Turquand (1856), 6 E&B 327, a landmark case. The notion of indoor management asserts, in layman's terms, that the company's indoor concerns are its responsibility. As a result, those who engage with a company through its directors or other persons must understand this indoor management idea. They might assume that the members of the firm are acting or carrying out their tasks within the scope of their stated authorization. As a result, if an act authorized by the Articles is carried out in a certain way, outsiders working with the company may conclude that the director or other authorities acted on their behalf.

 ISSN: 2582-6433

CONCLUSION

The rule's main point is that people doing business with limited liability companies are not required to inquire about their indoor management and won't be impacted by irregularities they were unaware of. It is a requirement of the rule that a third party cannot enforce a transaction if the company could not have engaged into it lawfully under the conditions. The rule only provided protection for "outsiders," or those doing business with the company "externally."

It should be remembered that, while dealing with a company one should at least check the Charter /MOA & AOA of the company and other information related to concern available on various forums. You should check the position and authority of person dealing with you on behalf of company, you have to check resolution/authorisation letter/Board Resolution and the authority to which extent the person has power to deal with you on behalf of the company. Please note that ignorance is not a remedy, it will affect you badly, when you know there is something fishy or you have knowledge the internal management of the company or that the person dealing with you do not have proper authority, then you will not claim benefits of above rule.[4]

[4] Sealy, L. S. (1990). Agency Principles and the Rule in Turquand's Case. The Cambridge Law Journal, 49(3), 406–408. doi:10.1017/S000819730012224X