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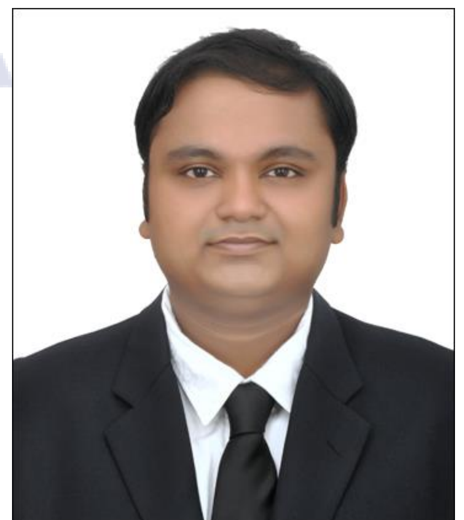

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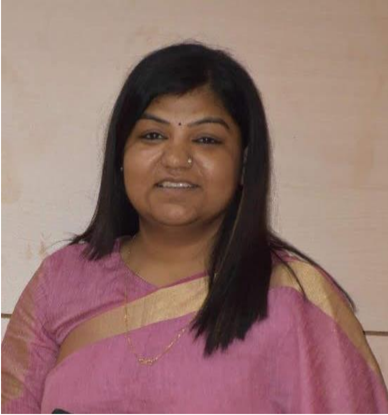

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THE DICHOTOMY BETWEEN DOCTRINE OF INDOOR MANAGEMENT AND DOCTRINE OF CONSTRUCTIVE NOTICE

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1. Introduction

The doctrine of indoor management stands in direct contrast to the doctrine or rule of constructive notice, which is essentially a presumption operating in favour of the company against the outsider. The doctrine of Constructive Notice prevents the outsider from alleging that he did not know that the constitution of the company rendered a particular act or a particular delegation of authority ultra vires.[1]

It is noteworthy that the doctrine of indoor management is an exception to the doctrine of constructive notice. The doctrine of constructive notice is subject to a significant restriction imposed by the doctrine of indoor management. This philosophy states that parties doing business with the company may assume that internal guidelines outlined in the memorandum and articles have been appropriately followed.[2] As a result, the idea of constructive notice defends insiders of a company or corporation from transactions with outsiders, whereas the doctrine of indoor management protects outsiders doing business or entering into contracts with a company.[3]

The philosophy of indoor management does, however, have an exception for suspicion of irregularity. Where the circumstances surrounding the transaction seem questionable and hence invite investigation, the doctrine's protection is not applicable. In the English case of *Houghton & Co. v. Nothard, Lowe & Wills Ltd.*[4], it was determined that an ordinary director acting without authority in fact is not capable of binding a company by a contract with a third party, merely on the grounds that the third party assumed that the director had been given authority

[1] MRF Ltd. v. Manohar Parrikar, (2010) 11 SCC 374

[2] Jasdev Singh & Ors. V. Unit Trust of India, 2011 SCC OnLine Del 2026

[3] 24th Edition, Dr. G.K Kapoor & Dr. Sanjay Dhamija, Company Law and Practice, 180 (Taxmann's , August 2019)

[4] Houghton & Co. v. Nothard, Lowe & Wills Ltd., (1927) 1 KB 246 (CA)

by the Board to make the contract.

2. Origin And Evolution Of Doctrine Of Indoor Management

2.1.Origin of Constructive Notice

The constructive notice doctrine required that when a person enters into a contract with the company, he is deemed to be aware of the company's memorandum of association (MoA) and the articles of association (AoA) as filed by the company to the Registrar of Companies (RoC) since the certificate of incorporation is received. Also such person is deemed to have the constructive notice of the other documents which the company is required to file with the RoC, provided they are open for public inspection and had been gazetted where necessary[5] of which the company has a positive duty to make it available in the public domain. As a result the person who is dealing with the company could not later complain if a transaction entered into with the company turns out to be invalid because it is in conflict with the requirements of the documents which he was expected to look into before entering in the contract.

The House of Lords propounded the doctrine of constructive notice in the case of *Ernest v. Nicholls*[6], when it was decided for the first time that anyone engaging with the corporation is presumed to be aware with the information included in all of its public publications. In addition, it was decided by the House of Lords in the case of *Mahony v. East HolyFord Mining Co.*[7] that the partnership's rules would apply in the absence of the notion of constructive liability.

However, the British courts also explicitly recognised that the law of constructive notice had significant negative effects on business, particularly investors. Even if doing so results in injustice for the parties involved, the courts are required to apply them. The clause may occasionally be ambiguous and subject to a company policy. When the doctrine of constructive notice is applied in this situation, people will be treated unfairly. Thus, the idea of indoor management, also known as Turquand's Rule, was formed by the courts to alleviate such a

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[5] Royal Bank v. Turquand, (1856) 6 E&B 327
[6] Ernest v. Nicholls (1857) 6 H.L.C. 401
[7] Mahony v. East HolyFord Mining Co., (1875) LR 7 HL 869

predicament. It has been determined to be an exception to the constructive liability rule, and it is covered in more detail in the paragraph that follows.

2.2.Origin of Doctrine of Indoor Management

Since this doctrine was developed in the case of *Royal Bank v. Turquand*[8], it is also known as Turquand's Rule. In the instant case, the deed of settlement, which in this instance served as the equivalent of a company's memorandum and articles, gave the Board of Directors the authority to borrow money in accordance with a resolution passed by the general meeting of shareholders. On the authority of two of its Directors who verified the firm's common seal, the company borrowed money from a bank. No authority was provided in the general meeting to do so. The corporation refused to return the loan, claiming that the bank was aware of the lack of power because it had constructive notice of the articles. It was decided that an outsider did not need to check to see if such a resolution had been passed. Because the resolution's passage constituted an internal affair, the corporation was obligated to the bank.[9]

In the case of *Mahony v. East Holyford Mining Co.*[10], the House of Lords further attempted to explain the Turquand Rule. The case is a superb illustration of the court defining exceptions to the rule. In this instance, payments were made by the business's bank based on a formal copy of a board resolution allowing the payment of checks signed by any two of the three named "directors" and countersigned by the named "secretary." The secretary signed the document on its own. Later it was discovered that neither the directors nor the secretary had ever received an official appointment. The memorandum's subscribers were supposed to nominate the directors, and the board was supposed to decide how the checks were signed. Both requirements were stated in the articles. The House of Lords ruled that because the bank had already received formal notice of the board's decision in the usual manner, it was not required to pursue the matter further. [11]

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[8] *Id.* at 5
[9] Raunak Bajaj, The Turquand Rule and its implications on the Indian Corporate Law, (2013) PL September 67
[10] *Id.* at 7
[11] Kunvar Bharat Singh, Doctrine of Indoor Management and exceptions to this rule, Legal Service India (June 21, 2022, 09:12 P.M.) https://www.legalserviceindia.com/article/l203-Indoor-Management.html

3. Position Under The Companies Act, 2013

3.1. Position of Doctrine of Constructive Notice

The legal basis for the doctrine of constructive notice is provided by Section 399 of the Companies Act, 2013. According to this provision, the Companies Act permits a third party to view and review the company's records that are kept by the registrar of the company. The ability to see the company's documents is also provided in this part. The company's MOA and AOA are public records, and an outsider may only enter into a contract after reviewing these documents. This clause establishes the theory of constructive notice, according to which a person is assumed to be aware of the information in papers that are open to the public.[12] The outsider person must have information of the company before entering into a deal with it, and he must make sure that his objective will be served. Making public records available to the general public constitutes notification to the general public. The documents that are on public record at the Registrar of Companies are subject to this doctrine of constructive notice.

In the case of *Oakbank Oil Co. vs. Crum*[13], the court observed that everybody who is involved in a contract with the company is presumed to recognise and understand the company's MOA and AOA. As a result, the person is believed to be aware of it. The doctrine of constructive notice is the name given to this notion.

3.2. Position of Doctrine of Indoor Management

The Companies Act of 2013 does not contain any specific language addressing the indoor management doctrine. However, the Indian courts have acknowledged this theory in numerous cases and it is now accepted in India.

The Doctrine of Indoor Management was approved in the case of *Varkey Souriar v. Keraleeya Banking Co. Ltd.*[14] The court observed that it is undoubtedly true that when a company is governed by a set of memorandum and articles that have been registered with a public office, those who do business with it are required to read those documents and make sure that the proposed transaction does not conflict with them, but they are not required to take any further

[12] Pearl Narang, Memorandum of Association : Know everything about it, Companies Act 2013, iPleaders blog (June 2022, 06:22 P.M.) https://blog.ipleaders.in/memorandum-of-association-2/
[13] Oakbank Oil Co. vs. Crum, 1882 8 AC 65
[14] Varkey Souriar v. Keraleeya Banking Co. Ltd. Thiruvalla, 1956 SCC OnLine Ker 32

action.[15] They are not required to look at the consistency of the internal processes, or what Lord Hatherley referred to as "indoor management."[16] A person dealing with him may therefore infer that it falls under the normal responsibilities of a managing director if there is one and authority in the articles for the directors to delegate their powers to him.[17]

In the case of *Lakshmi Ratan Cotton Mills Co. Ltd, v. J. K. Jute Mitts Co. Ltd.*[18], the court, with regard to Turquand's case and other Indian cases, observed that the creditor is entitled to assume that all formalities necessary in connection with the loan transaction have been followed if it is determined that the loan transaction he is entering is not prohibited by the company's charter or articles of association and could have been entered into on the company's behalf by the person negotiating it. Such an act is merely a formality if the transaction in question might be approved by the passage of a resolution. In the absence of any suspicious circumstances, a bona fide creditor is allowed to assume its existence. It is not sufficient to argue that a transaction entered into by the borrowing firm in such circumstances was invalid since no such resolution was actually enacted. The adoption of such a decision is merely an issue of internal management, and in such cases, its absence cannot be used to disprove a bona fide creditor's rightful claim.

4. Exceptions Of Doctrine Of Indoor Management

It is notable that the doctrine of indoor management is subject to certain exceptions. The doctrine of indoor management is not applicable in the following circumstances:-

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i. ***Where the outsider had knowledge of irregularity*** — Any person who is aware, explicitly or implicitly, that the person operating on behalf of the corporation lacks the necessary authorization is not protected by the regulation. Therefore, a person who enters into a transaction while fully aware that the directors lack the right to do so is ineligible for protection under the indoor management rule. The articles of a corporation allowed the directors in *Howard v. Patent Ivory Co.*[19] to borrow up to £1,000 only. With the company's approval at the annual general meeting, they might, however, exceed the limit of 1,000 pounds. They borrowed 3,500 pounds from one of

[15] Ram Baran Singh v. Muffassil Bank Ltd., AIR 1925 All 206 (2) (B)
[16] Royal British Bank v. Turquand, (1856) 6 El & Bl 327 (A)
[17] Dehra Dun Mussorie Electric Tramway Co. Ltd. v. Jagmandar Das, AIR 1932 All 141 (C)
[18] Lakshmi Ratan Cotton Mills Co. Ltd, v. J. K. Jute Mitts Co. Ltd., AIR 1957 All 311
[19] Howard v. Patent Ivory Co., (1888) 38 Ch D 156.

the directors who took debentures without first obtaining this consent. The payment of the amount was refused by the company. It was held that since the director had notice or was deemed to have the notice of the internal irregularity, the debentures were good to the extent of one thousand pounds only.

ii. ***No knowledge of memorandum and articles*** —A person who did not consult the memorandum and articles and thus did not rely on them cannot invoke the rule of indoor management in his favour. In *Rama Corporation* v. *Proved Tin & General Investment Co.*[20], T worked as a director for the company. In the name of the company, he entered into a contract with the Rama Corporation and received a check from it. The articles of incorporation did state that the directors could delegate their authority to one of them. However, Rama Corporation employees had never read the articles. It was later discovered that the company's directors did not delegate their powers to T. The Plaintiff relied on the indoor management rule. They couldn't, because they didn't even know power could be delegated.

iii. ***Forgery*** — The rule of indoor management does not apply to transactions involving forgery or that are otherwise void or illegal from the start. In the case of forgery, there is no free consent; rather, there is no consent at all. The person whose signatures were forged is unaware of the transaction, and the question of whether his consent was free or not does not arise. As a result, the person's title is not defective; rather, there is no title at all. As a result, no matter how clever the forgery, the personates gain no rights at all. Thus, when the secretary of a company forged the signatures of two of the directors required by the articles on a share certificate and issued the certificate without authority, the applicants were denied membership in the company. The certificate was declared null and void, and the holder was barred from using the doctrine of indoor management.[21]

In the context of a business, forgery can take several forms. It may entail, in addition to forging of authorised officials' signatures, the execution of a document for the personal discharge of an official's liability rather than the company's liability. When a bill of exchange was prepared in favour of a payee to whom the management was personally indebted, a bill of

[20] Rama Corporation v. Proved Tin & General Investment Co., (1952) 1All. ER 554
[21] Rouben v. Great Fingal Consolidated (1906) AC 439

exchange signed by the business's manager with his own signature under wording claiming that he signed on behalf of the company was held to be forgery.[22] In the instant case, it was held that the bill was forged since it was issued to settle the manager's personal debt even though it purported to be issued on behalf of the firm and was actually issued to pay the company's obligation.

iv. ***Negligence*** — The 'doctrine of indoor management' in no way rewards careless behaviour. Thus, if an officer of a company does something that is not ordinarily within his powers, the person dealing with him must conduct appropriate inquiries and satisfy himself as to the officer's authority. If he fails to inquire, he is barred from relying on the Rule. In the case of *Underwood* v. *Benkof Liverpool*[23], A company's sole director and principal shareholder deposited checks drawn in the company's favour into his own account. The bank, it was held, should have inquired about the director's authority. The bank was under investigation and thus could not rely on the ostensible authority of the director.

In the case of *Anand Behari Lal* v. *Dinshaw & Co. (Bankers) Ltd.*[24], an accountant for a company transferred some of the company's property to Anand Behari. The transfer was declared void by the Court in response to an action brought by him for breach of contract. It was discovered that the power to transfer the company's immovable property could not be considered within the apparent authority of an accountant.

v. Again, when the question is related to the very existence of an agency, the doctrine of indoor management does not apply. In *Varkey Souriar* v. *Keraleeya Banking Co. Ltd.*[25], the Kerala High Court held that The 'doctrine of indoor management' cannot apply when the issue is not one of the scope of power exercised by an apparent agent of a company, but of the agency's very existence.

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[22] Kreditbank Cassel v. Schenkers Ltd. (1927) 1 KB 826
[23] Underwood v. Benkof Liverpool, (1924) 1 KB 775
[24] Anand Behari Lal v. Dinshaw & Co. (Bankers) Ltd., AIR 1942 Oudh 417
[25] Varkey Souriar v. Keraleeya Banking Co. Ltd., (1957) 27 Com Cases 591 (Ker.)

vi. This Doctrine is also inapplicable where a pre-condition must be met before the company can exercise a particular power. In other words, the act is not only against the directors/officers, but also against the company.[26]

It is notable that Section 6 of the Companies Act, 2013 gives the provisions of the Act overriding force and effect, notwithstanding anything to the contrary contained in a company's memorandum or articles, or in any agreement executed by it, or for that matter in any resolution of the company in general meeting or of its board of directors. A provision in the memorandum, articles, agreement, or resolution that is contrary to the provisions of the Act will be considered void.

5. Conflict Between Doctrine Of Constructive Notice And Doctrine Of Indoor Management

The doctrine of constructive notice assumes that everyone is aware of the contents of the Memorandum of Association, Articles of Association, and any other document such as special resolutions because they are filed with the Registrar and are available for public inspection, whereas the doctrine of indoor management protects third parties who enter into a contract with the company from any irregularities in the company's internal procedures. Third parties cannot discover internal irregularities in a firm, hence the company is liable for any losses incurred as a result of these irregularities.[27]

Prima Facie, it appears that there is a tussle between the doctrine of constructive notice and doctrine of indoor management as both contradict each other. In this regard, it is notable that the doctrine of indoor management is an exception to the doctrine of constructive notice.[28]

The rule of constructive notice expects every outsider not only to know the company's documents but also to understand the exact nature of those documents, which is practically impossible and thus is a little unfavourable to outsiders dealing with the company because an outsider can have multiple transactions with multiple companies in a single day.[29] In actuality, the company is known by the people who represent it and deal with outsiders, not by the

[26] Pacific Coast Coal Mines v. Arbuthnot, (1917) AC 607.
[27] Dey v. Pullinger Engg Co., (1921) 1 KB 77.
[28] MRF Ltd. v. Manohar Parrikar, (2010) 11 SCC 374
[29] Morris v. Kanssen, (1946) 1 ALL ER 586,592.

documentation. Those who engage into contracts with the firm frequently do so based on the goodwill and reputation of the people representing the company rather than the company's paperwork.[30]

As a result, in order to protect the interests of outsiders, the courts developed the doctrine of indoor management as an alternative to the doctrine of constructive notice. The indoor management theory is required for shielding outsiders and compelling the corporation to perform their half of the commitment in genuine transactions. This, too, must be executed subject to specific exclusions, which have been established by the courts. This is why the British and Indian courts have changed their approach to dealing with problems involving the company's outsider.

While the idea of constructive notice protects a firm from outsiders, the doctrine of indoor management protects outsiders from a company's acts. This notion may also be used to protect against the risk of abusing the law of constructive notice. The theory of indoor management is founded on public convenience and justice policy. The reason for the requirement for such doctrine is that the internal procedure that occurs within the organisation is not public knowledge.[31] As a result, while any outsider is presumed to be aware of papers that are publicly accessible, he is not presumed to be aware of internal procedures that he cannot reasonably be aware of since they are not publicly accessible.

Outsiders who acted in good faith and engaged into a transaction with the company can assume that there were no internal problems and that all procedural criteria were met under the philosophy of indoor management. However, in order to take this remedy, he must be aware of the company's memorandum and articles.

It is important to note that the theory of indoor management should not be applied excessively because it may harm firms that are the lifeblood of a country's economy. Thus, the theories of constructive notice and indoor management are inextricably linked, and an effort must be made to achieve a harmonious balance between both doctrines in order to encourage economic interactions between a company and a third party.[32] On the one hand, the idea of constructive notice protects the firm from outsiders; on the other hand, the principle of indoor management shields outsiders when dealing with the company's operations. When an outsider fails to

[30] *Id.* at 2

[31] Mahoney v East Holyford Mining Co., (1875) LR 7 HL 86

[32] *Id.* at 17

enquire about the company, the doctrine of constructive notice comes into play. The philosophy of indoor management, on the other hand, can be claimed by any outsider engaging with the company but cannot be invoked by the company.

6. Conclusion

The doctrine of indoor management is an exception to the doctrine of constructive notice. The doctrine of constructive notice is subject to a significant restriction imposed by the doctrine of indoor management. The doctrine of indoor management states that parties doing business with the company may assume that internal guidelines outlined in the memorandum and articles have been appropriately followed. As a result, the idea of constructive notice defends insiders of a company or corporation from transactions with outsiders, whereas the doctrine of indoor management protects outsiders doing business or entering into contracts with a company. In order to protect the interests of outsiders, the courts developed the doctrine of indoor management as an alternative to the doctrine of constructive notice. The indoor management theory is required for shielding outsiders and compelling the corporation to perform their half of the commitment in genuine transactions subject to certain exceptional circumstances where the doctrine of indoor management is not applicable.

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