



FACULTY OF JURIDICAL SCIENCES

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NAME OF FACULTY: Ms. Anjali Dixit
Assistant Professor

FACULTY OF JURIDICAL SCIENCES



LECTURE-17

THE DOCTRINE OF INDOOR MANAGEMENT

(Continued)

Provisions Under The Indian Companies Act, 1956

The provision under the Indian Act which directly imbibes the Turquand rule is section 290, which reads as under:

Section 290:- Validity of acts of directors:-Acts done by a person as a director shall be valid, notwithstanding that it may afterwards be

discovered that his appointment was invalid by reason of any defect or disqualification or had terminated by virtue of any provision contained in this Act or in the articles:

Provided that nothing in this section shall be deemed to give validity to acts done by a director after his appointment has been shown to the company to be invalid or to have terminated:

Another Provision which directly follows the above stated rule is section 81 of the Indian Companies Act, 1956 which bears the heading 'further issue of shares' . Bona fide allottees of shares are protected by the Doctrine of Indoor Management under s81. Illustrating upon the point the Punjab & Haryana High Court has avowed in the case of **Diwan Singh v Minerva Mills** [1959] 29 Comp Cas 263 (P&H) that

"The allottees of the shares were contracting in

good faith with the Company and they were entitled to assume that the acts of the Directors in making allotments of the shares to them are within the scope of their powers conferred upon them by the shareholders of the Company. They were not bound to enquire whether the acts of the Directors which as in this case related to internal management had been properly and regularly performed. Even when the Directors exceed their powers or infringe the restrictions imposed upon them, the company may be bound for the outsider dealing with the company is only required to see that the transactions are consistent with the article. Strangers are justified in assuming that all matters of Indoor management have been done regularly” .

Application of the Rule by the Indian Courts

The Turquand's rule has been approved and followed by Varadaraja Iyengar J., in Varkey

Souriar v. Keraleeya Banking Co. Ltd [1957] 27 Comp Cas 591, 594 ; AIR 1957 Ker 97, In the following way: " Coming to the alternative ground, it is no doubt true that where a company is regulated by a memorandum and articles registered in some public office, persons dealing with the company are bound to read the registered documents and to see that the proposed dealing is not inconsistent therewith but they are not bound to do more. They need not enquire into the regularity of the internal proceedings what -Lord Hatherley called 'indoor management'.

So if there is a managing director and authority in the articles for the directors to delegate their powers to him, a person dealing with him may assume that it is within the ordinary duties of a managing director. All he has to see is that the managing director might have power to do what

he purports to do. But the rule cannot apply where the question, as here, is not one as to the scope of the power exercised by an apparent agent of the company, but is in regard to the very existence of the agency."

In **Lakshmi Ratan Cotton Mills Co. Ltd, v. J. K. Jute Mitts Co. Ltd**, AIR 1957 All 311 the plaintiff company sued the defendant company on a loan for Rs. 1,50,000. Among other things the defendant company raised the plea that the transaction was not binding as no resolution sanctioning the loan was passed by the board of directors. The court, after referring to **Turquand's case** and other Indian cases, held :

"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 company 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 case of **Official Liquidator, Manasube & Co. (P.) Ltd. V. Commissioner of police** [1968]38 Comp. cas 884 (Mad) the learned judge observed that the lenders to a company should acquaint themselves with memorandum and articles but they cannot be expected to embark upon an investigation as to legality, propriety and regularity of acts of directors.

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

The wheels of commerce would not go round smoothly if persons dealing with the company were compelled to investigate thoroughly "the internal machinery of a company to see if something is not wrong." People in business would be very shy in dealing with such companies.

The rule is of great practical utility. It has been applied in a great variety of cases involving rights

and liabilities. It has been used to cover acts done on behalf of a company by de facto directors who have never been appointed, or whose appointment is defective, or who, having been regularly appointed, have exercised an authority which could have been delegated to them under the company' s articles, but never has been so delegated, or who have exercised an authority without proper quorum.

Thus, where the directors of company having the power to allot shares only with the consent, something which he could do only with the approval of the board; where the managing agents having the power to borrow with the approval of directors borrowed without any such approval, the company was held bound.

MCQs

1. Provision which directly follows the above stated rule is section 82 of the Indian Companies Act, 1956 which bears the heading 'further issue of shares' .

- i. True
- ii. False
- iii. Can not say
- iv. None of the above

2. The wheels of commerce would go round smoothly if persons dealing with the company were compelled to investigate thoroughly "the internal machinery of a company to see if something is not wrong.

- i. True
- ii. False
- iii. Can not say
- iv. None of the above

3. A transaction entered into by the borrowing company under such circumstances cannot be defeated merely on the ground that no such resolution was in fact passed.

- i. True
- ii. False
- iii. Can not say
- iv. None of the above

4. Acts done by a person as a director shall be valid, notwithstanding that it may afterwards be discovered that his appointment was invalid by reason of any defect or disqualification or had terminated by virtue of any provision contained in this Act or in the articles

- i. True
- ii. False
- iii. Can not say
- iv. None of the above

5. A bona fide creditor, in the absence of any suspicious circumstances, is entitled to presume its existence. A transaction entered into by the borrowing company under such circumstances cannot be defeated merely on the ground that no such resolution was in fact passed.

- i. True
- ii. False
- iii. Can not say

iv. None of the above

