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DOCTRINE OF INDOOR MANAGEMENT: HOLISTIC ANALYSIS FROM LEGAL AND BUSINESS PRISM

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Abstract

The Constitution of the company, that is "Memorandum of Association along with Articles of Association" are of quintessential importance not only for the 'Incorporation of a Company', but also forming the base and foundational documents for future transactions of the company. There is a "presumptive value which works in favour of the company" that whenever an action is being performed by the competent authorities and management of the company, be it Board of Directors or Managing Director or any competent authority on behalf of the company, there is a value attached to it. In an industrial setup, the stakeholders in the supply chain, be it the raw material suppliers, stockists, traders, distributors, manufacturers, wholesalers, dealers, retailers would perceive such a decision taken by the company as that, which conforms not only to the provisions of the public documents viz. the "Memorandum of Association" (MoA) and "Articles of Association" (AoA), but the authority is working as per the set norms and rules as have been delegated to it by internal management of the company. The set of statutory provisions and catena of judicial pronouncements have evolved the doctrinal approach and the lead to the concept of "Doctrine of Ultra Vires" along with two vital doctrines, that is "Doctrine of Constructive Notice" and "Doctrine of Indoor Management". It is pertinent to note that "Doctrine of Constructive Notice" protects the company from the stakeholders, that is 'outsiders' in the realm of functioning of the company. While at the same time, the "Doctrine of Indoor

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Management" protects the aforesaid 'outsiders' from the irregularities of the company, when seen in the prism of functioning of the management of the company and in their day to day dealing with the stakeholders with whom it enters into 'contractual obligations' or 'obligations and duties' which are imperative in the functioning of the company. The present article is an attempt to explore and to understand the nitty-gritties of the functioning of the company, in a practical sense.

Keywords: *Doctrine of Indoor Management; Doctrine of Constructive Notice; Principles of Estoppel; Turquand Rule.*

Introduction

The article delves into the varied facets of "Doctrine of Indoor Management" and its exceptions and how it acts as a guiding light to delineate what is within the realm and scope of 'powers and privileges of the authorities being delegated to perform duties of the company' and how are they responsible, thereby protecting 'outsiders' against the functioning and operations of the company. The doctrine helps to spell out the viable roles and responsibilities which an authority on behalf of the company is expected and is supposed to perform, ensuring that the affairs of the day to day functioning of the company are in line and consistent with the documents known to the outside world. Many a times, the decisions are taken in haste and without any consideration to the public documents, rather not in consonance with aforesaid MoA and AoA, then the company becomes duty bound to be held responsible for such a lapse. Reliance is placed on the documents such as "the Constitution of the Company" when dealing with external agencies such as traders, customers, wholesaler and myriads of stakeholders who are linked to the functioning and day to day smooth running of the company. It forms the bedrock of any transactions done by behalf of the company as the document are being relied upon by a wide cross-section of value-added stakeholders in the fabric of the Corporate and its interaction with external agencies and entities. Company Law[4] is a law based on set of Contracts, underpinning the vital utility of 'Compliances' for ensuring. As mentioned, that the aforesaid Company Law is 'Compliance based law' and aggregation of contract between various stakeholders, set out some clear guidelines, which has to be adhered to. In response to the adherence and set of compliances the 'State' provides the protection to the company. Likewise, if there is any deviance from set compliance procedures, rules and regulations, then it is subject to penalties including fines. The leading case of Saloman[5] made it clear that the corporate identity is different from that of the members of the company. In catena of cases the conceptual understanding of "Doctrine of Indoor Management" finds relevance. In some of the latest cases of ***M/s. Renaissance Build Co. Pvt Ltd. and Ors. vs. M/s. S.E. Investments Ltd. & Ors.***[6]; while, in other cases, ***D. Cube***

[4] "Companies Act, 2013 (18 of 2013) as amended by The Companies (Amendment) Act, 2020 (29 of 2020) and The Tribunals Reforms Act, 2021 (33 of 2021)" which seen in tandem with Schedules as amended in 2021

[5] Salomon v A Salomon & Co Ltd [1896] UKHL 1

[6] M/s. Renaissance Build Co. Pvt Ltd. and Ors. vs. M/s. S.E. Investments Ltd. & Ors. FAO(OS) (COMM) 253/2018 & CM APPL.Nos.46198- 46201/2018

Constructions (Pvt.) Ltd. v V.M. Ravindra[7] and ***MRF Limited v. Manohar Parrikar and Others***[8], the doctrine finds a conspicuous presence and is of relevance.

'Entity Shielding' Principle

The 'Entity Shielding' principle which has evolved has led to various problems where the management of the company have utilised it for either defrauding or even getting undisclosed profitability, which has been the grounds of criticism. It is vital to note that company law[9] is a compliance driven law which involves various statutory authorities in its ambit of functioning including the established rules and procedures followed by Securities Exchange Board of India (SEBI), varied SEBI Regulations including for listing in a recognised stock exchange, Reserve Bank of India, Securities Contract Act, SEBI Issue of capital and Disclosure Regulations (ICDR) among others. The basic essence of the guidelines and regulations provide the safeguard of capital or various instruments by the investors so that there is accountability and transparency in the process. The corporate veil and its lifting have been held to be necessary vide statutory and judicial pronouncements over the years. The corporate entities work in myriads of models of business operations which necessitates that its functioning, operation and its control mechanism have been clearly laid down in a transparent manner before the members of the company. In the landmark case which established the 'Doctrine of Indoor Management' was the ***Royal British Bank***[10] case, where even though the Articles of Association of the company allowed for borrowing on bond on the conditionality of passing the resolution via a General Meeting of the company, the management of the company disregarded the condition and went ahead with borrowing a sum from the plaintiff bank. It was held to be in contravention of the established aforesaid doctrine and the company was liable for the loan amount borrowed bearing the seal of the company. Lord Hatherly went on to remark that, "Outsiders are bound to know the external position of the company, but not bound to know its indoor management…". Corporate entities are functioning a mesh or rather a network of business environment where the companies are intertwined to function to achieve their set goals and purpose of profitability, sustainability or

[7] D. Cube Constructions (Pvt.) Ltd. v V.M. Ravindra, Revision Petition Num. 1288 of 2015 (against the order dated 19th February 2015 in Appeal Num 2/2013 of the State Commission Tamil Nadu)
[8] MRF Limited v. Manohar Parrikar and Others, (2010) 11 SCC 374
[9] Companies Act, 2013
[10] Royal British Bank v Turquand (1856) 6 E&B 327

even for fulfilling the obligation on the broader parameters of social need requirement and Corporate Governance.

Networked Corporate Entities

Today the corporate entities are faced by a myriad of challenges. Sustainability of the companies in the knowledge, information and digital era of today's is dependent on a plenitude of factors. Tackling cyber space issues is one of them. Cyberspace is a conceptual term or understanding of widespread interconnected web of digital technology. The connects system across the globe forming a web of resources, either in the form of hardware or software. The technological advancements have necessitated a relook at social, cultural, political, economical, technological and philosophical landscape of any nation, society and even the activities of individuals. The increasing number of cases pertaining to cyber hacking, cyber offences, cyber stalking, cyber fraud, cyber economic and financial malpractices and misrepresentation has warranted all to relook at legal and business framework of any country. Cyberspace offences have to be ascertained in the scales of nature and gravity of offences. Going with a supposition that a company has been functioning with a contractual obligation where significant amount in the form of 'Capex'[11] and 'Opex'[12] is being contracted with third party vendor. It is quite obvious or rather a presumption is that work that the "outsourced vendor or partner" assumes that doctrine[13] is of utmost practical importance and is at play. In this context, the outsourced vendor is not bothered or rather presumes that the internal management has complied with the norms and regulations as spelt out in the MoA and AoA.

Judicial Precedents

In the context of the deliberation as aforementioned, it is pertinent to note that the leading scholars and jurists have been quite equivocal on the fact that what the protection to the third party has to be accorded when he is contracting with the company in good faith and it has to be given credence. At the same time, the expectation is that the outsider is aware of the constitution

[11] Capex denotes "Capital Expenditure" in functioning of the business entity.
[12] Open denotes "Operational Expenditure" in its operation of its day to day functioning.
[13] Doctrine of Indoor Management

of the companies and the know-how of what is happening inside the 'doors' of the company is not the lookout for the outside stakeholders when dealing with the company officials and management. As held in ***Pacific Coast Coal Mines Ltd***.[14] Case, "the outsider is presumed to know the constitution of the company, but not what may or may not have taken place within the doors that are closed for him…". An authority in Corporate Law, Gower[15] asserts, "The lot of creditors of a limited liability company is not a particular happy one; it would be unhappier still if the company could escape liability by denying the authority of the officers to act on its behalf…" **Atkins LJ** brings forth the similar assertion in the landmark judgment in ***Kreditbank Cassel***[16] case, "If you are dealing with a director in a matter in which normally a director would have power to act for the company, you are not obliged to enquire whether or not the formalities required by the Articles have been complied with before he exercises that power…"

Rule of Estoppel

When the "Doctrine of Indoor Management" is looked closely and analysed from vital viewpoint of 'Rule of Estoppel' it is vital to note that the company later cannot deny or rather its is estopped from alleging that it has not delegated powers and privileges to its internal management, thereby authorising the authority concerned in exercising the power so authorised on behalf of the company. However, it is pertinent that such a logical argument can't be averred if there is no knowledge of the "constitution of the company" via its MoA and AoA by a plaintiff if he pleads ignorance of lack of knowledge; thereby, the rule of 'estoppel' cannot be applied by him against the company. In a leading case involving Rama Corporation[17], Slade J emphasises, "the rule of indoor management is based on principle of estoppel. If plaintiff did not have knowledge of the articles of the company and did not know of the existence of the power to delegate, he could not make the company liable. The plaintiff could have relied upon the power of delegation only if he knew that it existed and had acted on the belief that it must have been exercised…"

Exceptions to Doctrine of Indoor Management

[14] Pacific Coast Coal Mines Ltd. V Arbuthnot (1917) AC 607
[15] Davies PL, Worthington S and B Gower LC, "Limited Liability and Lifting the Veil", Principles of Modern Company Law, 9th Ed., Sweet and Maxwell (2012)
[16] Kreditbank Cassel v Schenkers Ltd. (1927) 1 KB 826
[17] Rama Corporation v Proved Tin & General Investment Co. (1952) 2 QB 147

"Knowledge of irregularity, negligence with the suspicion of irregularity, forgery and representation through Articles, which is acting beyond the scope of apparent authority" are potential exceptions to the aforesaid doctrine. In such aforementioned scenarios, "a person having prior knowledge of the irregularity cannot claim the benefit of the doctrine". In ***Devi Ditta Mal***[18], it was held that a transfer of share in concurrence with two directors, where one of the director was aware of disqualification considering the fact that the director was never appointed as per compliances, such a impugned transfer in such instance was held to be "ineffective". In ***T.R. Pratt Ltd.***[19], money was lent out on a mortgage of its assets by a Company to another. It was held that such a mortgage was not in compliance with procedure enumerated in the Article and hence, lending was deemed to be an irregularity. In such an instance, it was held that the mortgage was not binding. Similarly, in a case of share certificate forged by secretary of a company was held that conferment of rights to shareholder was fraught with irregularity in ***Ruben* v *Great Fingall Consolidated***[20] as reported on 1906. It is pertinent to note that where an act or omission is void *ab initio,* such an reliance on documents which turns out to be forgery cannot be corrected and deemed to be fit case where doctrine of indoor management cannot be squarely applied. Similar case came up before the Hon'ble Madras High Court in Official Liquidator[21] as plaintiff where the directors' credential was forged and it was held that, "the company cannot escape liability under the document. 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 the acts of the directors…" A.L. Underwood Ltd. case[22] established that, "the sole director of a company depositing cheques drawn in favour of the company, in his personal account in the bank; the bank was held liable for the irregularity of crediting the personal account of the director with the amount of cheques belonging to the company, because the irregularity was so obvious that the bank had a duty to enquire as to whether the company had a separate banking account or not…"

Conclusion

[18] Devi Ditta Mal v Standard Bank of India (1927) 101 IC 568
[19] T.R. Pratt Ltd v E.D. Sasson & Co. Ltd. AIR 1936 Bom.62
[20] Ruben v Great Fingall Consolidated (1906) AC 439
[21] Official Liquidator v Commissioner of Police (1969) 1 Comp LJ 5 Mad
[22] A.L. Underwood Ltd. v Bank of Liverpool (1924) 1 KB 775

The "Doctrine of Indoor Management" has to be seen conjointly and not seen in silos or in discreet manner from that of the "Doctrine of Constructive Notice". While the objective of these doctrine is to protect the outsider against irregularity not in tandem with the documents viz. the constitution of the company when seen in light of Indoor Management; at the same time, the later doctrine has to be seen in the broader context of protecting the company from outsiders, as such both the aforesaid doctrines co-exist together. It has to be provided a harmonious construction where the essence is to protect not only the company but also the outsider from the whims and fancies of the management of the companies, when they take decisions not in consonance with the constitution of the company. As held in catena of judgments and evolved through judicial precedents, the doctrines help provide a light to understand and to analyse what is the efficacious and apt for the management of the company. Company Law as has been seen and quintessentially understood to be a set of compliances and nexus of contracts to be adhered to and inbuilt into the fabric of the companies' functioning. Non-compliance of established and statutory and as per judicial precedents rather in its mode of functioning dents credibility of the entities with its fallout in the reputation, goodwill, profitability and long-term sustainability of the company. It is quintessential that such a compliance-based mode of functioning is the very essence where companies are driving the socio-economic growth of the country and lending its contribution to the Gross Domestic Product (GDP) of the country. The macro-economic factors when seen along with the micro-economic and industry competitiveness, it has to be seen in entirety and not on a piece meal basis that the growth of the companies, based on compliances to States, Citizens and especially, members of the company provide the credibility for its sustenance. Such a credibility is essential not only for sustaining in the business landscape with meeting Corporate Governance norms as is expected of the companies but also for long term sustainability in the mind space of the members and global citizens of the interconnected networked companies in this world.