CASE LAW UPDATES

# Company Law Important Cases (Part 2): Doctrine of Indoor Management

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## Introduction

Every outsider dealing with a company faces a basic question: how much do I really need to check before I sign on the dotted line? The **Doctrine of Constructive Notice** once answered this harshly. It assumed that anyone dealing with a company had already read its Memorandum and Articles of Association, regardless of whether they actually had.

*This assumption created real problems. A trader or banker could never peek inside a company's boardroom to confirm whether internal formalities had been followed.* ***Consequently, courts developed a fairer counterbalance – the Doctrine of Indoor Management.***

This doctrine allows outsiders to assume that a company has followed its own internal procedures correctly. Over time, four landmark judgments shaped its scope and limits. This piece walks through each of them, one by one.

## Royal British Bank v. Turquand (1856) 6 E&B 327

### Facts of the Case

Directors of a company borrowed money from the Royal British Bank through a bond. The company's Articles required shareholder approval through a resolution before any such borrowing. However, no resolution had actually been passed when the directors executed the transaction.

### Issue

Whether a company can escape liability on a transaction entered into by its directors on the ground that an internal procedural requirement under its AOA – such as a shareholders' resolution – had not, in fact, been complied with, where the outsider dealing with the company had no means of ascertaining this non-compliance.

### Judgment

The court sided with the bank. Judges reasoned that outsiders had no realistic way of confirming whether internal formalities had been completed, since such matters remained hidden within the company's private records. Anyone dealing with a company in good faith may presume that its internal rules have been properly followed. They need not investigate matters of internal management.

*This ruling created what lawyers still call the* ***"Turquand Rule."*** *Every later case on indoor management builds on this foundation, making it the starting point for the entire doctrine.*

## Mahony v. East Holyford Mining Co. (1875) LR 7 HL 869

### Facts of the Case

A company's Articles required cheques to carry signatures from two of the named directors, along with a countersignature from the secretary. In reality, the company never validly appointed these directors or the secretary. Despite this gap, cheques were signed and honoured through the bank in the usual manner.

### Issue

Whether a company can repudiate payments made under cheques signed by persons purporting to act as its directors and secretary, on the ground that such persons had never been validly appointed to their respective offices, where nothing on the face of the transaction indicated any irregularity to the outsider dealing with the company.

### Judgment

The House of Lords ruled against the company. Since nothing appeared irregular on the surface, the bank could reasonably trust the outward appearance of proper appointments. Outsiders need not verify whether a company validly appointed its officers. They may rely on the apparent authority such officers seem to hold.

***This case extended Turquand's logic beyond resolutions*** *and into the territory of officer appointments. It confirmed that the burden of ensuring internal compliance always falls on the company itself.*

## Anand Bihari Lal v. Dinshaw & Co. (1946)48BOMLR293

### Facts of the Case

An accountant working for a company transferred company property to another party. The transferee accepted this deal, believing the accountant held enough authority to carry out such a transaction on the company's behalf.

### Issue

Whether a transferee can invoke the doctrine of indoor management to protect a transaction involving the transfer of company property carried out by an accountant, where such a transaction falls manifestly outside the ordinary scope of an accountant's authority.

### Judgment

The court rejected the transferee's claim. Judges noted that transferring company property has never fallen within an accountant's typical duties, so no reasonable outsider should have assumed such authority existed. The doctrine of indoor management does not protect transactions that an officer would not ordinarily have the power to carry out, given the nature of their position.

*This judgment introduced a crucial limitation. Protection under the doctrine applies only when a transaction falls within the officer's usual scope of authority – not to acts that appear obviously irregular which therefore* ***established the "Suspicion of irregularity" rule.***

## Lakshmi Ratan Cotton Mills Co. Ltd. v. J.K. Jute Mills Co. Ltd. AIR1957ALL311

### Facts of the Case

A director, who also served as the company's managing agent, borrowed funds on the company's behalf. The Articles did permit directors to borrow money. However, a specific procedural step had not been strictly completed at the time of the transaction: the resolution was not passed by the board of directors sanctioning this transaction.

### Issue

Whether a lender can recover a loan advanced to a director-cum-managing agent, whose authority to borrow existed under the company's AOA, notwithstanding that the board's resolution formally sanctioning that specific transaction had not been passed.

**Judgment**

The court ruled in the lender's favour. Since the Articles allowed directors to borrow money, and the director's position carried apparent authority for such transactions, the company could not escape liability by citing an internal procedural lapse. When the power to act genuinely exists under a company's Articles, and a person holding an appropriate position exercises it, internal irregularities cannot defeat an outsider's rightful claim.

*This case confirmed that Indian courts firmly embraced the Turquand principle. It remains one of the clearest Indian applications of indoor management protection.*

## Exceptions to the Doctrine of Indoor Management

The doctrine of indoor management protects outsiders, but this protection isn't unlimited. Courts have carved out clear exceptions where an outsider cannot claim its benefit. Four judicial decisions illustrate these limits well.

### Knowledge of Irregularity – Howard v. Patent Ivory Manufacturing Co. (1888) 38 Ch D 156

Directors borrowed money exceeding their authorised limit under the company's Articles. One of these directors also happened to be the lender in this very transaction. Since he personally knew about the irregularity, the court refused to let him invoke the doctrine for his own benefit. Anyone aware of an internal defect simply forfeits this protection.

### Suspicion of Irregularity – Underwood v. Bank of Liverpool (1924 1 K.B. 775)

A company director deposited cheques, drawn in the company's favour, straight into his personal account. The bank processed these deposits without asking a single question. Judges found the circumstances suspicious enough to demand further inquiry, so the bank couldn't hide behind indoor management while ignoring obvious red flags.

## Forgery – Ruben v. Great Fingall Consolidated 1906 AC 439

A company secretary forged two directors' signatures onto a share certificate, making it look entirely genuine. Forgery, the court held, falls completely outside the doctrine's reach, since forged documents carry no legal validity from the outset. Good faith, however strong, cannot resurrect something that never legally existed.

## Negligence on the Outsider's Part – Rama Corporation v. Proved Tin and General Investments Ltd. (1952) 1 All ER 554

A company representative signed a contract without holding the actual authority his role required. The claimant, meanwhile, never bothered checking the company's Articles before trusting him. Consequently, the court denied protection, ruling that outsiders who skip basic due diligence cannot later hide behind this doctrine.

*Taken together, these four exceptions round out the doctrine nicely. Genuine outsiders acting in good faith deserve protection – but those who ignore red flags, act carelessly, or deal with forged documents don't.* ***Grasping both the rule and its exceptions is exactly what is critical for your CLAT PG preparation.***