
DECODING THE ENIGMA OF DUOMATIC PRINCIPLE AND ITS APPLICATION IN INDIA

Aditi Yadav, B.B.A LLB (Hons.), O.P. Jindal Global Law School

ABSTRACT

This research paper will explore the practical difficulties that businesses frequently face in trying to comply with the intricate web of shareholder compliance obligations set forth under the Indian Companies Act, 2013. It specifically explores the applicability of the "**Duomatic principle**," a legal doctrine derived from English Company law. The Duomatic principle provides companies a novel way to speed up decision-making, especially when unanimous consent from all shareholders is obtainable. When the same people serve as shareholders and directors of smaller businesses, this idea can be very helpful. The paper will aim to provide insights into how Indian Corporates might use the Duomatic principle to streamline decision-making procedures while keeping compliant with the Companies Act, 2013 and its already existing shareholder meeting regulations. It examines the judicial interpretations and implications of this principle, assessing its impact on corporate governance and statutory compliance in India. It further draws a parallel between the Principle of Substantial Compliance and the Duomatic Principle, drawing inference on the loopholes and issues that might prevail.

Introduction

The Duomatic principle, which has its origins in common law, gives shareholders of a company the authority to informally grant approval through unanimous consent. The principle effectively enables shareholders to circumvent the procedural need of approving a resolution. It establishes that if all shareholders of a corporation provide unanimous permission, such assent will obligate the firm to take action within its legal authority. It is emphasised that fraud should always be considered an exception to this rule and should only be used in situations where there have been bona fide transactions.

The Duomatic principle finds its roots from common law and has had much deliberation by the English Courts in the UK. On the other hand, this principle has not had a wide application in the Indian context and is still on its path to being implemented and formalised. However, in a recent judgement of the Supreme Court, significant clarification was given on the doctrine within the Indian corporate landscape via the case of *Mahima Datla v. Dr. Renuka Datla (2022)*¹.

Duomatic Principle provides higher flexibility, which is mostly applied in situations that are urgent or time-sensitive and in which shareholder resolution procedures cannot be complied with.

When an issue falls within the purview of the Duomatic Principle, the following conditions must be met in order for the principle to be applicable:

- Shareholders' consent on the pertinent matter ought to be unanimous.
- The principle will not apply if the shareholders do not offer their assent with complete knowledge of the relevant matter.
- The transaction must be bonafide; for example, it cannot lead to fraud or be used as a means of circumventing an insolvency law moratorium.

Brief History of The Duomatic Principle in the United Kingdom

The Duomatic principle, which originated in the United Kingdom, has garnered considerable

¹ *Mahima Datla v. Dr. Renuka Datla* [2022] SCC OnLine SC 580.

attention and has been subject to several interpretations. The principle in question lacks statutory recognition, hence its evolution is exclusively reliant upon judicial decisions and interpretation.

This principle is partially retained in *Section 281(4) of the Companies Act, 2006*² which stipulates that resolutions by members can only be passed in compliance with this provision. Subclause 4 upholds the fundamental principle of unanimous consent in common law. The Duomatic Principle enables shareholders of a corporation to grant informal consent to the company's operations without convening a formal general meeting, provided that such consent is unanimous.

The principle in question was first addressed in the landmark case of *Salomon v. A Salomon & Co Ltd. (1897)*³. The legal matter pertained to a lawsuit filed against Mr. Salomon in relation to the transaction involving the transfer of his business to Salomon & Co. Ltd. According to the House of Lords, the fulfilment of the "obligation of disclosure" would be deemed satisfactory if all prospective shareholders were adequately informed about the transaction's specifics. Additionally, if every shareholder of the firm provided their consent, the corporation would be legally obliged by such a unanimous agreement.

The principle was subsequently reaffirmed in the case of *Re: Duomatic Limited*⁴, when the determination of pay for the directors of a specific company occurred in the absence of a formal meeting. According to the ruling, if it can be established that all shareholders who possess the right to participate and vote in a company's general meeting give their approval to a certain item that the general meeting has the power to implement, this consent holds the same legal weight as a resolution passed in a general meeting.

Hence, according to the principle, it is permissible to forgo the formal procedure of approving a resolution in situations where all shareholders have unanimously agreed to a specific action or omission. The aforementioned approach can be extended to many scenarios beyond the approval of shareholder resolutions, as exemplified in the case of *Cane v. Jones*⁵, where it was

² The UK Companies Act 2006, s 281(4)

³ *Salomon v. A Salomon & Co Ltd.* [1897] A.C 22.

⁴ *Re: Duomatic Limited* [1969] 2 Ch 365.

⁵ *Cane v. Jones* [1980] 1 WLR 1451

utilised to validate modifications to the Articles of Association, without the need for a formal meeting.

In order to apply the principle, it is imperative that there exists genuine consideration among the shareholders concerning the issue as established in the case of *Rolfe v. Rolfe*⁶, with a distinct establishment of unanimous agreement from the shareholders regarding said matter. The application of the concept requires the consent or objection of the shareholder on the subject matter to be clear. Establishing that mere presence cannot substantiate the application of this principle as seen in *Schofield v. Schofield*⁷.

Situations wherein the applicability of the Duomatic principle will be disallowed

It is vital to possess an understanding of the limitations associated with the Duomatic Principle. The application of the Duomatic Principle is contingent upon the validity of a formal member's resolution. In cases where the resolution would have been deemed invalid, such as instances involving *fraudulent actions*, the implementation of the Duomatic Principle would also be considered invalid. Furthermore, this principle should not be employed during *insolvency proceedings*, as it may result in financial loss for the company's creditors or exacerbate the company's insolvency. The application of the Duomatic Principle in conducting company transactions was reaffirmed in the case of *Henry v Finch (2015)*⁸. The Court determined that some transactions lacked validity and opined that the absence of a formal resolution by the members would render such a resolution illegal. Consequently, the Duomatic principle lacked validity and should not have been deemed dependable by the shareholders.

The Growing Evolution of The Duomatic Principle in India

The Apex Court, in the judgement *Mahima Datla v. Dr. Renuka Datla (2022)*,⁹ has analysed the utilisation of the 'Duomatic' principle within the realm of Indian legal jurisdiction. The essential *facts of the suit* are as follows:

The directors of M/s Biological E. Ltd. were Dr. Renuka Dalta, Dr. Vijay Kumar Dalta

⁶ *Rolfe v. Rolfe* [2010] EWHC 244.

⁷ *Schofield v. Schofield* [2011] EWCA 154.

⁸ *Henry v Finch* [2015] EWHC 2430 (Ch).

⁹ *Mahima Datla v. Dr. Renuka Datla* [2022] SCC OnLine SC 580.

(deceased), and G.V. Rao. On April 6, 2013, G.V. Rao submitted his resignation by means of a formal letter, only to subsequently retract it on April 9, 2013. The board convened a meeting on April 9th, 2013 to evaluate the letter of withdrawal of the resignation. Dr. Renuka Dalta did not raise any objections over the presence of Dr. G.V. Rao at the board meeting. Dr. Renuka participated in the board meetings held on August 22, 2013 and September 25 of the same year. In none of the meetings did she express her dissent for the reappointment of Mr. G.V. Rao as a director.

Subsequently, Dr. Renuka lodged a formal complaint with the Company Law Board, alleging the illegality of the board meetings. She further asserted that an endeavour was undertaken to augment the number of members within the company, thereby ensuring that her shareholding would not meet the threshold required for initiating a petition under Sections 397 and 398 of the Companies Act, 1995.

The case was dismissed by the Board, but, the appeal filed by Dr. Renuka on behalf of the Company was granted by the High Court of Judicature in Hyderabad.

During the Supreme Court Appeal, a key question arose regarding the applicability of the Duomatic Principle in the current case. Specifically, the issue at hand was whether the resignation of Dr. G.V. Rao had become invalid due to his continued directorship in the firm, which was seemingly accepted by Dr. Renuka through her acquiescence.

Observations of the Court:

The principle in question was found to have originated from the ruling in the case of ***Re: Duomatic Ltd***, as determined by the Court. Herein the court stated that The Duomatic Principle can succinctly be defined as the notion that any action that may be taken by the members of a corporation through a formal resolution in a general meeting can also be undertaken informally, provided unanimous consent is obtained from all members involved.

In the case of ***Salmon v. Salmon Co. Ltd. [1897]***¹⁰, Lord Devey's decision was cited by the Court, which found that a business is legally obligated to abide by the unanimous consent of its members in matters within its legal authority.

¹⁰ *Salomon v. A Salomon & Co Ltd.* [1897] A.C 22.

The aforementioned principle derived from Salmon's Case has shown to be useful in several areas of corporation law, including the Duomatic Principle and the Doctrine of Indoor Management as well as the Lifting of the Corporate Veil. The origin of this Principle may be traced back to common law and it remains applicable within the Indian setting as well.

In relation to the findings in the legal case of *Bowthorpe Holdings Ltd. v. Hills*¹¹, the Court additionally observed that, within the aforementioned context, it acknowledges that the utilisation of the Duomatic concept is restricted to situations where bonafide transactions are implicated.

The Court additionally asserted that the Principle posits that stringent compliances might be waived if it can be shown, based on the circumstances, that all members have given their consent. In the present situation, there exists a substantial body of evidence indicating that respondent No. 1 had indeed reinstated Mr. G.V. Rao as a member of the Board. The behavior exhibited by respondent No. 1 strongly suggests that the resignation submitted on 06.04.2013 was unequivocally rejected.

The Court noted that G.V. Rao's directorship in the Company remained intact due to Dr. Renuka's consent, as he retracted his resignation prior to its acceptance. Additionally, it is asserted that the High Court's failure to consider the applicability of the Duomatic Principle is an evident error.

The Duomatic principle can also be applied in cases where a special resolution is necessary, given that all shareholders are in agreement and meet the required majority for approving such a resolution. The case of *Brilliant Bio Pharma Limited v. Brilliant Industries Limited*¹² highlighted a situation wherein the firm sought to decrease its share capital. One of the mandated prerequisites for the diminution of share capital is that said decrease must be duly permitted in accordance with the Articles of Association of the company. In the current scenario, the firm was authorized to take such action as per the provisions outlined in the Articles of Association, specifically by the enactment of a special resolution. Nevertheless, the decrease was implemented even though no specific resolution was voted for it. This was

¹¹ *Bowthorpe Holdings Ltd. v. Hills* [2002] EWHC 2331 (Ch)

¹² *Brilliant Bio Pharma Limited v. Brilliant Industries Limited* [2013] 180 CompCas 168 (AP).

because all the members were informed and the necessary majority, as required by Section 189 (2) of the Companies Act, 1956, had given their approval for the reduction.

Analysis on the issues faced with regard to Duomatic principle and its limitations:

The court established specific conditions for the use of the Duomatic Principle while clarifying its scope. The court is obligated to examine the merits and justifications for the use of the Duomatic principle while determining its appropriateness. In the event that the neglect of formalities was solely motivated by the desire to benefit shareholders, it is possible for the courts to use the principle. However, in the event that such actions were undertaken to serve the interests of other entities/ third parties, the courts would exhibit reluctance in applying the aforementioned concept. The relaxation of procedures is permissible solely in instances where the welfare of the shareholders is being duly considered.

One other significant constraint, which has been deliberated about by English courts, pertains to the application of the principle exclusively in cases where a corporation maintains solvency. If the company is insolvent or approaching insolvency, such informality would be prohibited, as demonstrated in the case of *Sosti v. Doffman*¹³. The underlying concept is that if a corporation experiences a decline in its financial stability, the interests of emerging creditors must take precedence over the interests of shareholders *West Mercia Safetywear Ltd. v. Dodd*¹⁴.

In the case of *Advansys (India) Private Limited and Others v. Ponds Investment Limited*¹⁵ and Another, which was decided on 9 May 2014, the Bombay High Court declined to apply the Duomatic principle. This decision was based on the absence of an agenda during the meeting where the course of action was allegedly determined, as well as the lack of any shareholder discussion or deliberation on the matter. Hence, any decision made without the knowledge or against the wishes of shareholders is deemed unacceptable.

Lastly, the constraint on the applicability of the Duomatic principle pertains to its inability to serve as a justification for any illegal actions under Company law. This was established by the Chancery Division in the case of *Finch (UK) plc v. Finch (2015)*¹⁶, wherein the directors

¹³ *Sosti v. Doffman* [2010] EWHC 3175 (Ch).

¹⁴ *West Mercia Safetywear Ltd. v. Dodd* [1998] BCLC 250.

¹⁵ *Advansys (India) Private Limited and Others v. Ponds Investment Limited* [2014] SCC 580

¹⁶ *Finch (UK) plc v. Finch* [2015] EWHC 2430.

wholly neglected their obligations as prescribed by Company law. The court reached the determination that the use of this principle does not serve to legitimize unlawful acts. In the Indian jurisdiction, the Supreme Court, in the case of Mahima Datla, reiterated that fraud is a distinct exception to the application of the principle, and can solely be invoked in transactions that are conducted in good faith.

Correspondence between Substantial Compliance and the Duomatic Principle

Notably, the Telangana High Court and the Delhi High Court made reference to the Duomatic principle in relation to the concept of 'substantial compliance' in the cases of ***Brilliant Bio Pharma Limited v. Brilliant Industries Limited***¹⁷ and ***Mazda Theatres Pvt. Ltd. v. New Bank of India Ltd. (1975)***¹⁸, respectively. The Telangana High Court made a specific observation¹⁹:

The essence of the Duomatic Principle is in the notion that if it can be proven through factual evidence that the essence or objective of a statutory requirement has been indirectly achieved or fulfilled, strict adherence to said requirement may be waived.

Nevertheless, the Court's comparison of the concept of substantial compliance with the Duomatic principle raises concerns regarding the possibility for uncertain and risky implementation of the principle.

It is noteworthy to acknowledge that the doctrine of substantial compliance has been recognised as a legal defence available to a party who deviated from strict adherence to rules or regulations, yet successfully achieved the intended objectives of such restrictions. The Supreme Court, in the case of ***Commissioner of Central Excise, New Delhi v. M/s Hari Chand Shri Gopal, (2010)***²⁰, made a distinction between mandatory and directory rules in relation to the 'doctrine of substantial compliance'. The court observed that rules categorised as "directory" or "non-essential" for the smooth functioning of business can be adhered to in a substantial manner, even if not strictly. Nevertheless, while considering the Duomatic principle, the question that emerges pertains to whether the court is obligated to evaluate procedural

¹⁷ *Brilliant Bio Pharma Limited v. Brilliant Industries Limited* [2013] 180 CompCas 168 (AP).

¹⁸ *Mazda Theatres Pvt. Ltd. v. New Bank of India Ltd.* [1975] ILR 1 Del 1.

¹⁹ Aggarwal S and Baghmar A, 'Duomatic Principle: Neither Mere Substantial Compliance nor a Normative Right' (*IndiaCorpLaw*, 7 June 2022) <<https://indiacorplaw.in/2022/06/duomatic-principle-neither-mere-substantial-compliance-nor-a-normative-right.html>> accessed 1 November 2023

²⁰ *Commissioner of Central Excise, New Delhi v. M/s Hari Chand Shri Gopal* [2010] 3 SC 260.

formalities in light of whether consent requirements are required or not, and if they may be easily waived or not.²¹

In the given setting, this equivalence offers the possibility of two hypotheses for the implementation of the Duomatic principle. According to certain scholars like J. C. Hardman, it has been proposed that:

The default state of rules should be that they are applicable, but they may be waived by the individuals whom they are intended to safeguard. However, it is imperative that any safeguards intended for other parties be either obligatory regulations or solely capable of being waived by these third parties.

Additionally the Duomatic concept should be established as a norm, wherein decisions that solely pertain to the interests of shareholders can be made without the requirement of formal general meetings. This practise has been preferred due to its ability to mitigate agency costs associated with decision-making. Nevertheless, this hypotheses elicits substantial critiques.

Initially, it might be argued that implementing a presumption strategy would potentially compromise the fundamental objective of meetings, that is of carrying forward deliberations and discourse among the shareholder and members of the organisation. This provides shareholders with the opportunity to contemplate the perspectives of fellow stockholders. Furthermore, the utilisation of the Duomatic principle assumes that the pertinent stakeholders, such as shareholders, form a homogenous group whose interests consistently coincide. However, this is typically not the prevailing situation owing to the prevalence of the **agency problems**, as a minority shareholder may own divergent interests in comparison to a dominant shareholder. Third, it should be noted that while the company may be able to achieve a surface-level or significant level of compliance with procedural requirements, it would place a significant burden on the courts to subsequently evaluate each individual case, taking into account its unique circumstances, in order to determine if such compliance was absolutely essential.

²¹ Aggarwal S and Baghmar A, 'Duomatic Principle: Neither Mere Substantial Compliance nor a Normative Right' (*IndiaCorpLaw*, 7 June 2022) <<https://indiacorplaw.in/2022/06/duomatic-principle-neither-mere-substantial-compliance-nor-a-normative-right.html>> accessed 1 November 2023

The Brilliant Bio case is an established instance of a case where the High Court permitted capital reduction without using the Duomatic Principle to estop shareholders from retracting their decision. On the other hand, the Duomatic Principle was utilised to support the substitution of a general meeting, proving that all necessary conditions were met for "substantive compliance." Applying this concept, businesses have a significant opportunity to legally take advantage of the Duomatic Principle as a means of getting around formalities.

The Duomatic Principle Paradox and its loopholes:

In stark contrast to the aforementioned, the court in the case of *In Re Barry Artist Ltd.*²², which involved a comparable factual scenario to that of Brilliant Bio, expressed disapproval of such an approach. However, due to the company providing a valid justification for seeking confirmation of the reduction prior to the expiration of the term, the court permitted the reduction with the restriction that no similar order would be granted in future instances. This particular scenario serves as an illustration of the second hypothesis, which pertains to the use of the Duomatic principle. It posits that the normative application of the Duomatic principle should be contingent upon the existence of valid justifications for selecting an informal process. An instance from India that supports this proposition can be found in the case of *Dr. Jayanta Kumar v. Astha Nursing Home Private Limited*²³. In this case, the Calcutta High Court ruled that while the Duomatic principle may be invoked to waive a statutory requirement, it is essential for the parties to establish that the decision was made in the best interests of the company. This necessitates not only unanimous shareholder consent but also a demonstration of the decision's benefit to the company.

Nevertheless, the concept of a valid justification lacks clarity to a certain degree and may also elicit specific critiques. For instance, take the remarks made in the cases of Duomatic and *In Re George Newman & Co.*²⁴. In both instances, a legal challenge was initiated against specific remunerations disbursed to the Directors and the Chairman of the respective firms at the period when they were on the brink of bankruptcy. In the Duomatic case, the Court, in establishing the concept, chose to disregard the absence of formal decision-making to support these payments in light of the company's deteriorating financial situation. In the Newman case,

²² *Re Barry Artist Ltd.* [1985] 1 WLR 1305.

²³ *Dr. Jayanta Kumar v. Astha Nursing Home Private Limited* (2016) 5 CHN 515

²⁴ *In Re George Newman & Co.* [1895] 1 Ch. 674.

however, the Court noted that the assertion that a general meeting would have approved the payment without considering the company's position this assertion was purely speculative.

Assuming a comparable scenario, it is posited that a significant amount of remuneration is granted to the director of a financially troubled firm, without convening a public meeting, for a justifiable cause such as medical expenses that have been authorized under the company's articles of association. In this present scenario, it is unquestionably imperative to arrive at a resolution that aligns with the company's financial standing, while also considering the valid justifications for remunerating the director. The inquiry at hand pertains to the extent to which the courts can tolerate the power of shareholders to evade formal decision-making in the absence of a compulsory regulation. This illustrates that while there may be a directory protocol for conducting a general meeting, the presence of valid reason must be taken into account, and adherence to the rules cannot always be waived off. The present analysis suggests that the evaluation of the Duomatic principle has not yet been incorporated into Indian legislation, hence creating a potential for misuse by corporate decision-makers. This is due to the absence of any specific restrictions on firms to adopt a normative approach towards the application of the Duomatic principle.

Conclusion:

Undoubtedly, the Duomatic principle possesses practical value when employed to prevent company members from straying from their prior determinations. Mahima Datla serves as a notable exemplar in this context. Nevertheless, the prior utilisation of the Duomatic concept in India renders it vulnerable to the potential diminishment of the Duomatic principle to a state of mere substantial compliance by company members. The reasoning behind the same is firstly that the utilisation of the Duomatic principle by third parties has the potential to prevent members from reversing their prior decisions. Secondly, while examining the potential application of the Duomatic principle in relation to substantial compliance, it becomes apparent that there is room for firms to incorporate this principle into their normative practices which raises significant issues. Lastly, it is important to note that the criterion employed for the doctrine of substantial compliance, specifically distinguishing between mandatory and directory rules, remains applicable in the context of the Duomatic principle. In order to ensure a justifiable application of the Duomatic principle, it is imperative that even a directory formal procedure should not be disregarded without sufficient justification, such as for the benefit of

the company. In light of this perspective, it is evident that there exists a valid necessity to provide clear guidelines for the implementation of the Duomatic concept. However, the Mahima Datla judgement is a favourable declaration by the Supreme Court, indicating that the Duomatic concept will likely be more frequently applied in the foreseeable future.

Furthermore, it is necessary to provide further elucidation in legal discourse regarding the alignment and the dilemma presented by the substantial compliance doctrine in relation to the Duomatic principle. The utilisation of the Duomatic principle shall not serve as a justification for disregarding statutory restrictions or engaging in activities that circumvent significant compliance. The complex relationship among shareholder interests, decision-making efficiency, and the Duomatic principle requires a careful and sophisticated strategy that takes into account both the practical needs of the corporation and its legal obligations.

In summary, the Duomatic principle has brought a novel viewpoint to the legal framework of corporate law in India. The adoption of this technique within the Indian jurisdiction underscores the need of adopting a balanced strategy that enables effective decision-making while yet upholding adherence to regulatory compliance. The continuous development of the Duomatic principle and its integration into the Indian corporate governance system is demonstrated through the dynamic legislative interpretations and judicial examination.

The Duomatic principle is a sophisticated and powerful legal tool that presents considerable potential for streamlining decision-making processes. However, it is crucial to exercise caution and adhere to legal and ethical parameters in order to ensure its effective and responsible application within the corporate framework of India.