



## The Doctrine of Ultra Vires: Its Relevance Today

Meetu Agarwal\*

---

### ABSTRACT

*In the scenario, at hand, whether the act is an individual act or a group act, censuring is a necessity. A very important principle known as the 'Doctrine of Ultra Vires' helps in defining where a company has gone wrong or taken an action that is outside the scope of the authority of the company. The objective of the Doctrine of Ultra Vires is to ensure that the shareholders and the creditors that provide funding and the assets of the company will not be used for any purpose other than those specified in the Memorandum. This paper delves into the concept of 'Doctrine of Ultra Vires' and its relevance today. The paper discusses the meaning, evolution of the concept, the effects, its relevance in the present times and other aspects of the doctrine.*

**Keywords:** *Doctrine of Ultra Vires; Company; Beyond the powers; Memorandum.*

---

### 1.0 Introduction

1.1 The involvement Ultra vires is a Latin phrase meaning literally “beyond the powers”, although its standard legal translation and substitute is “beyond power”. If an act requires legal authority and it is done with such authority, it is characterized in law as intra vires (literally “within the powers”; standard legal translation and substitute, “within power”)<sup>1</sup>. If it is done without such authority, it is ultra vires. Acts that are intra vires may equivalently be termed “valid” and those that are ultra vires “invalid”. An act of the company must not be beyond the objects clause, otherwise it will be ultra vires and, therefore, void and cannot be ratified even if all the members wish to ratify it. This is called the doctrine of ultra vires, which has been firmly established in the case of *Ashtray Railway Carriage and Iron Company Ltd v. Riche*.

---

\*Joint Commissioner of Income Tax, Department of Revenue, Jaipur, Rajasthan, India (E-mail: meetuag.24@gmail.com)

Thus, the expression ultra vires means an act beyond the powers. An ultra vires act is void and cannot be ratified even if all the directors wish to ratify it. Sometimes the expression ultra vires is used to describe the situation when the directors of a company have exceeded the powers delegated to them.<sup>2</sup>

1.2 This rule is applicable to all powers, express or implied, created by a contract or statute. However, whereas an incorporated firm has no liability beyond its corporate powers, neither the firm nor a third party may use ultra vires as an excuse or defence to invalidate a contract. Stockholders (shareholders) may sue the directors of a firm for recovery of losses resulting from their ultra vires acts, and each director may be personally liable. Latin word for, “beyond the powers” is ultra vires. Its opposite is intra vires (within the powers).<sup>3</sup>

1.3 The expression ultra vires is used to indicate an act of the company which is beyond the powers conferred on the company by the objects clause of its memorandum. The promoters must make a decision regarding the type of company i.e. a public company or a private company or an unlimited company, etc. and accordingly prepare the documents for incorporation of the company. In this connection the Memorandum and Article of Association (MOA & AOA) are crucial documents to be prepared.

Contents of Memorandum: The MOA of every company must contain the following clauses:-

- **Name Clause:** The name of the company is mentioned in the name clause. A public limited company must end with the word ‘Limited’ and a private limited company must end with the words ‘Private Limited’. A company cannot use a name which is prohibited under the Names and Emblems (Prevention of Misuse Act), 1950 or use a name suggestive of connection to government or State patronage.<sup>4</sup>
- **Domicile Clause (Declaration of place of Registered Office of the company):** The state in which the registered office of company is to be situated is mentioned in this clause. If it is not possible to state the exact location of the registered office, the company must state it provide the exact address either on the day on which commences to carry on its business or within 30 days from the date of incorporation of the company, whichever is earlier.
- **Object Clause:** This clause specifies the activities which a company can carry on and which activities it cannot carry on. The company cannot carry on any activity which is not authorized by its MOA.
- **Liability Clause:** A declaration that the liability of the members is limited in case of the company limited by the shares or guarantee must be given. The effect of this

clause is that in a company limited by shares, no member can be called upon to pay more than the uncalled amount on his shares. If his shares are already fully paid up, he has no liability towards the company.<sup>5</sup>

- **Capital Clause:** The amount of share capital with which the company is to be registered divided into shares must be specified giving details of the number of shares and types of shares. A company cannot issue share capital greater than the maximum amount of share capital mentioned in this clause without altering the memorandum.
- **Association/ Subscription Clause:** Declaration by the persons for subscribing to the memorandum that they desire to form into a company and agree to take the shares place against their respective name must be given by the promoters.

## **2.0 Doctrine of Ultra-Vires**

2.1 Any transaction which is outside the scope of the powers specified in the objects clause of the MOA and is not reasonable incidentally or necessary to the attainment of objects is ultra-vires the company and therefore void. No rights and liabilities on the part of the company arise out of such transactions and it is a nullity even if every member agrees to it.

Consequences of an ultra-vires transaction:-

- The company cannot sue any person for enforcement of any of its rights.
- No person can sue the company for enforcement of its rights.
- The directors of the company may be held personally liable to outsiders for an ultra vires

However, the doctrine of ultra-vires does not apply in the following cases:-

- If an act is ultra-vires of powers the directors but intra-vires of company, the company is liable.
- If an act is ultra-vires the articles of the company but it is intra-vires of the memorandum, the articles can be altered to rectify the error.
- If an act is within the powers of the company but is irregularly done, consent of the shareholders will validate it.
- Where there is ultra-vires borrowing by the company or it obtains deliver of the property under an ultra-vires contract, then the third party has no claim against the company on the basis of the loan but he has right to follow his money or property if it exist as it is and obtain an injunction from the Court restraining the company from

parting with it provided that he intervenes before is money spent on or the identity of the property is lost.

- The lender of the money to a company under the ultra-vires contract has a right to make director personally liable.<sup>6</sup>

2.2 An ultra vires act is void and cannot be ratified even if all the directors wish to ratify it. Sometimes the expression ultra vires is used to describe the situation when the directors of a company have exceeded the powers delegated to them. Where a company exceeds its power as conferred on it by the objects clause of its memorandum, it is not bound by it because it lacks legal capacity to incur responsibility for the action, but when the directors of a company have exceeded the powers delegated to them. This use must be avoided for it is apt to cause confusion between two entirely distinct legal principles. Consequently, here we restrict the meaning of ultra vires objects clause of the company's memorandum.

2.3 Basic principles included the following:

- An ultra vires transaction cannot be ratified by all the shareholders, even if they wish it to be ratified.
- The Doctrine of Estoppel usually precluded reliance on the defense of ultra vires where the transaction was fully performed by one party
- A fortiori, a transaction which was fully performed by both parties could not be attacked.
- If the contract was fully executory, the defense of ultra vires might be raised by either party.
- If an agent of the corporation committed a tort within the scope of his or her employment, the corporation could not defend on the ground the act was ultra vires.
- If the contract was partially performed, and the performance was held to be insufficient to bring the Doctrine of Estoppels into play, a suit for quasi contract for recovery of benefits conferred was available.

2.4 In corporate law, ultra vires describes acts attempted by a corporation that are beyond the scope of powers granted by the corporation's objects clause, articles of incorporation or in a clause in its bylaws, in the laws authorizing a corporation's formation, or similar founding documents. Acts attempted by a corporation that are beyond the scope of its charter are void or voidable.<sup>7</sup>

2.5 Several modern developments relating to corporate formation have limited the probability that ultra vires acts will occur. Except in the case of non-profit corporations (including municipal corporations), this legal doctrine is obsolescent; within recent years, almost all business corporations are chartered to allow them to

transact any lawful business. The Model Business Corporation Act of the United States that: “The validity of corporate action may not be challenged on the ground that the corporation lacks or lacked power to act.” The doctrine still has some life among non-profit corporations or state-created corporate bodies established for a specific public purpose, like universities or charities.<sup>8</sup>

#### 2.6 Is It Ultra Vires Or Illegal?

The ultra vires act or transaction is different from an illegal act or transaction, although both are void. An act of a company which is beyond its objects clause is ultra vires and, therefore, void, even if it is legal. Similarly an illegal act will be void even if it falls within the objects clause. Unfortunately the doctrine of ultra vires has often been used in connection with illegal and forbidden act. This use should also be prevented.<sup>9</sup>

### **3.0 Historical Background of Doctrine of Ultra Vires:**

3.1 Doctrine of ultra vires has been developed to protect the investors and creditors of the company. The doctrine of ultra vires could not be established firmly until 1875 when the Directors, &C., of the Ashbury Railway Carriage and Iron Company(Limited) vs. Hector Riche, (1874-75) L. R. 7 H. L. 653<sup>10</sup> was decided by the House of Lords. A company called “The Ashbury Railway Carriage and Iron Company,” was incorporated under the Companies Act, 1862. Its objects, as stated in the Memorandum of Association, was “to make, and sell, or lend on hire, railway carriages and wagons, and all kinds of railway plant, fittings, machinery, and rolling-stock; to carry on the business of mechanical engineers and general contractors ; to purchase, lease, work, and sell mines, minerals, land, and buildings; to purchase and sell, as merchants, timber, coal, metals, or other materials, and to buy and sell any such materials on commission or as agents.”<sup>11</sup> The directors agreed to purchase a concession for making a railway in a foreign country, and afterwards (on account of difficulties existing by the law of that country), agreed to assign the concession to a SociétéAnonyme formed in that country, which sociétéwas to supply the materials for the construction of the railway, and to receive periodical payments from the English company.

The objects of this company, as stated in the Memorandum of Association, were to supply and sell the materials required to construct railways, but not to undertake their construction. The contract here was to construct a railway. That was contrary to the Memorandum of Association; what was done by the directors in entering into that contract was therefore in-direct contravention of the provisions of the Company Act, 1862

3.2 The decision in this case confirmed the application of this doctrine to the companies by registration under Companies Act. The House of Lords has held that an ultra vires act or contract is void in its inception and it is void because the company had not the capacity to make it and since the company lacks the capacity to make such contract, how it can have capacity to ratify it. If the shareholders are permitted to ratify an ultra vires act or contract, it will be nothing but permitting them to do the very thing which, by the Act of Parliament, they are prohibited from doing.

3.3 The House of Lords has expressed the view that a company incorporated under the Companies Act has power to do only those things which are authorized by its objects clause of its memorandum and anything not so authorized (expressly or impliedly) is ultra vires the company and cannot be ratified or made effective even by the unanimous agreement of the members. It was held that this contract, being of a nature not included in the Memorandum of Association, was ultra vires not only of the directors but of the whole company, so that even the subsequent assent of the whole body of shareholders would have no power to ratify it. The shareholders might have passed a resolution sanctioning the release, or altering the terms in the articles of association upon which releases might be granted. If they had sanctioned what had been done without the formality of a resolution, that would have been perfectly sufficient. Thus, the contract entered into by the company was not a voidable contract merely, but being in violation of the prohibition contained in the Companies Act, was absolutely void. It is exactly in the same condition as if no contract at all had been made, and therefore a ratification of it is not possible. If there had been an actual ratification, it could not have given life to a contract which had no existence in itself; but at the utmost it would have amounted to a sanction by the shareholders to the act of the directors, which, if given before the contract was entered into, would not have made it valid, as it does not relate to an object within the scope of the Memorandum of Association.<sup>12</sup>

Later on, in the case of Attorney General vs. Great Eastern Railway Co.<sup>13</sup>, this doctrine was made clearer. In this case the House of Lords affirmed the principle laid down in *Ashbury Railway Carriage and Iron Company Ltd vs. Riche*<sup>14</sup> but held that the doctrine of ultra vires "Ought to be reasonable, and not unreasonable understood and applied and whatever may fairly be regarded as incidental to, or consequential upon, those things which the legislature has authorized, ought not to be held, by judicial construction, to be ultra vires."<sup>15</sup>

3.4 The doctrine of ultra vires was recognised in Indian the case of *Jahangir R. Modi vs. Shamji Ladha*<sup>16</sup> and has been well established and explained by the Supreme Court in the case of *A. Lakshmanaswami Mudaliar vs. Life Insurance Corporation Of India*<sup>17</sup>. Even in India it has been held that the company has power to carry out the

objects as set out in the objects clause of its memorandum, and also everything, which is reasonably necessary to carry out those objects.<sup>18</sup> For example, a company which has been authorized by its memorandum to purchase land had implied authority to let it and if necessary, to sell it.<sup>19</sup> However it has been made clear by the Supreme Court that the company has, no doubt, the power to carry out the objects stated in the objects clause of its memorandum and also what is conclusive to or incidental to those objects, but it has no power to travel beyond the objects or to do any act which has not a reasonable proximate connection with the object or object which would only bring an indirect or remote benefit to the company.

#### **4.0 Research Methodology**

In this research both primary and secondary sources of information gathering are used. Exploratory and descriptive methods were employed for research purpose.

#### **5.0 Research Hypotheses**

The ultra vires doctrine, which prevents a company from undertaking any object which they are not specifically granted, is still a force in Indian business law.

#### **6.0 Research Plan**

The research endeavors to discuss the intricacies involved in doctrine of ultra vires. The areas that have been discussed are viz. origin and establishment of the doctrine, whether investors and creditors are protected by this doctrine. It also deals with as to how this doctrine is ascertained. The research also includes effect of ultra vires transactions, liability of the directors and exceptions to this doctrine with the help of decided case laws. The paper also focuses on the comparison between English Law and Indian Law regarding the Doctrine of ultra vires and its relevance today.

#### **7.0 Discussion**

##### **7.1 Doctrine of ultra vires- evasion**

7.1 Very soon after the Ashbury's case, the shortcomings or disadvantages of this rule became apparent. The doctrine created hardships both for the management and outsiders dealing with the company. An outsider dealing with the company is, in law, presumed to have knowledge of the provisions of the memorandum and articles of the company. A contract made by an outsider with the company in respect of anything which

is not covered under the objects clause in its memorandum is ultra vires and therefore void. At every step the management is required to see whether the acts which are sought to be done are covered in the objects clause of its memorandum. It restricts the frequency of the business activities.

7.2 No doubt, if the act sought to be done by the management is not covered by the object clause in the memorandum of the company, the object clause may be altered so as to cover it, but for such alteration a long procedure is to be followed and consequently the alteration will take much time.

7.3 Thus, the rule causes much nuisance by preventing from changing its activities in a direction upon which all members have agreed. The Cohen Committee has recommended the abolition of this doctrine for it serves no positive purpose and is a cause of unnecessary prolixity and vexation. In the opinion of this committee it is an illusionary protection for the shareholders and a pitfall for the third parties dealing with the company. The Jenkins Committee has also expressed its dissatisfaction with this doctrine. In England an Act called the European Communities Act, 1972 has been passed and it has modified the doctrine ultra vires to a large extent. Soon after Ashbury's case the shortcomings of the doctrine were realized and the reaction against it stated. Both the courts and business community began to make attempts to reduce the rigours of the doctrine.

7.4 The courts have developed the following principles to reduce the rigours of the doctrine of ultra vires:

- Powers implied by statute: According to this principle a company has a capacity to do an act or to exercise a power, which has been conferred on it by the Companies Act, or any other statute, even if such act is not covered by the objects clause in the memorandum of the company.
- The principle of implied and incidental powers: This principle has been established in the Attorney General's case. According to this principle a company, in addition to the powers conferred on it by the object clause of its memorandum, has power to do all those acts, which are:
  - Necessary for, or
  - Incidental to, or
  - Incidental to or consequential upon, the exercise of those powers. For example, a company formed for the object of carrying on the business of buying and selling coal has capacity to purchase or hire trucks, carts and labours etc. because they are necessary for the business of buying and selling coal.

7.5 The doctrine of ultra vires played an important role in the development of corporate powers. Though largely obsolete in modern private corporation law, the



doctrine remains in full force for government entities. An ultra vires act is one beyond the purposes or powers of a corporation. The earliest legal view was that such acts were void. Under this approach a corporation was formed only for limited purposes and could do only what it was authorized to do in its corporate charter.

7.6 This early view proved unworkable and unfair. It permitted a corporation to accept the benefits of a contract and then refuse to perform its obligations on the ground that the contract was ultra vires. Therefore, the courts adopted the view that such acts were voidable rather than void and that the facts should dictate whether a corporate act should have effect.

7.7 Over time a body of principles developed that prevented the application of the ultra vires doctrine. These principles included the ability of shareholders to ratify an ultra vires transaction; the application of the Doctrine of Estoppel, which prevented the defence of ultra vires when the transaction was fully performed by one party; and the prohibition against asserting ultra vires when both parties had fully performed the contract. The law also held that if an agent of a corporation committed a tort within the scope of the agent's employment, the corporation could not defend on the ground that the act was ultra vires.

7.8 Despite these principles the ultra vires doctrine was applied inconsistently and erratically. Accordingly, modern corporation law has sought to remove the possibility that ultra vires acts may occur. Most importantly, multiple purpose clauses and general clauses that permit corporations to engage in any lawful business are now included in the articles of incorporation.

7.9 Protection of Creditors and Investors: Doctrine of ultra vires has been developed to protect the investors and creditors of the company. This doctrine prevents a company to employ the money of the investors for a purpose other than those stated in the objects clause of its memorandum. Thus, it enables the investors to know the objects in which their money is to be employed. This doctrine protects the creditors of the company by ensuring them that the funds of the company to which they must look for payment are not dissipated in unauthorized activities. This doctrine prevents the wrongful application of the company's assets likely to result in the insolvency of the company and thereby protects creditors. Besides the Doctrine of Ultra Vires prevents directors from departing the object for which the company has been formed and, thus, puts a check over the activities of the directors.

7.10 Ascertainment of the Ultra Vires: To ascertain whether a particular act is ultra vires or not, the main purpose must first be ascertained, then special powers for effecting that purpose must be looked for, if the act is neither within the main purpose nor the special powers expressly given by the statute, the inquiry should be made

whether the act is incidental to or consequential upon. An act is not ultra vires if it is found:

- Within the main purpose, or
- Within the special powers expressly given by the statute to effectuate the main purpose, or
- Neither within the main purpose nor the special powers expressly given by the statute but incidental to or consequential upon the main purpose and a thing reasonably done for effectuating the main purpose.

In *Attorney General vs. Mersey Railway Co.*, (1907) 1 Ch. 81, the court held that a company incorporated for carrying on a hotel can purchase furniture, hire servants and maintain omnibus to attend at the railway station to take or receive the intending guests to the hotel because these are reasonably necessary to effectuate the purpose for which the company has been incorporated and consequently these are within the powers of the company, although these are not expressly mentioned in the object clause of the memorandum of the company, or the statute creating it.<sup>20</sup>

7.11 Evasion by Businessmen and Principle Developed By the Courts to Prevent Such Evasion. The businessmen have also made number of attempts to evade the ultra vires rule. Their tendency has been to make the object clause too wide. This tendency makes the objects clause incapable to indicate properly the main object clause saying that if the main objects of the company are followed by wide powers expressed in general words the latter (i.e. the power expressed in general words) will be construed as covering their exercise only for the purpose of the main object. In other words, where not only main objects but also general powers are stated in the object clause of the memorandum, the general powers will be construed ancillary to the main object.

7.12 In *Re, German Date Coffee Co.*, (1882) 20 Ch. D. 169, the court held that the that the main object for which the company was formed was to acquire the German patent and the other objects stated in the object clause of its memorandum were merely ancillary to that object and since the main object had failed, it was just and equitable that the company should be wound up.

7.13 Independent Objects Clause: The main object rule of construction has been avoided by inserting a statement in the object clause to that effect that “all the objects are independent and in no way ancillary or subordinate to one another.” this is known as ‘independent object clause’. Thus, where a clause stating that all objects specified in the object clause are independent and not ancillary or subordinate to one another is inserted, the failure of anyone of them cannot be a ground for ordering the winding up of the

company, that is to say that a company cannot be wound up merely because one of the two main objects has failed.<sup>21</sup>

Although the tendency of inserting an independent object clause has been criticized by the House of Lords in the following cases but the device was held to be valid and sufficient to exclude the ‘main objects rule’ of construction.

7.14 In *Cotman v. Brogham*, (1918) A. C. 514, there was a clause in the object clause that each of the objects was to be considered independent and on this ground the court held that the underwriting was not ultra vires.

7.15 In *Re, Introductions Ltd.*,<sup>22</sup> the court took a positive step to prevent such tendency. The court held that an “independent object clause” could not convert a power into an object. There is a difference between a power and an object. Only the objects are required to be stated in the object clause of the memorandum and not powers but if the powers are also stated in the object clause, they must be exercised to effectuate the objects stated therein.

7.16 In *Bell Houses Ltd., v. City Wall Properties Ltd.* (1966) 2 WLR 1323, the court held that if there is such a clause and the directors decide to carry on a business which can be carried on advantageously in connection with or ancillary to the main business will be intra vires and not ultra vires even if it has no relationship with the main business of the company. The acceptance of such a clause may be taken to mean the death of ultra vires doctrine because a clause of this kind does not state any objects but leave the objects to be determined by the bona fide opinion of the Board of Directors.

## **8.0 The Doctrine of Ultra Vires Effects**

### **8.1 Ultra vires transactions**

8.1 A contract beyond the objects clause of the company’s memorandum is an ultra vires contract and cannot be enforced by or against the company as was decided in the cases of *In Re, Jon Beaufore (London) Ltd .*, (1953) Ch. 131, *In S. Sivashanmugham And Others v. Butterfly Marketing PrivateLtd.*, (2001) 105 Comp. Cas Mad 763,

8.2 In England, S. 9(1) of the European Communities Act, 1972 has lessened the effect of the judgment given by the court in this case. In England a third person dealing with the company in good faith is protected and he can enforce the ultra vires contract against the company if:

- The third person has acted in good faith and
- The ultra vires contract has been decided on by the directors of the company.

8.3 In other words, third person can enforce the ultra vires contract against the company if he had no knowledge of the fact that it was ultra vires and the contract was decided on by the directors of the company. The third party is presumed to have acted in good faith unless the contrary is proved by the company. However, the provisions operate in favour of a person dealing with the company in but the third party can plead ultra vires.

8.4 In India, there is no specific legislation like European Communities Act, 1972 and therefore, there is no specific statutory provision under which an innocent third party making contract with the company may be protected. However, it is to be noted that even in India the courts have evolved certain principles to reduce the rigors of the Doctrine of UltraVires.

8.5 The following principles may be deduced form the judicial decisions:

- If the ultra vires contract is fully executed on both sides, the contract is effective and the courts will not interfere to deprive either party of what has been acquired under it.
- If the contract is executory on both sides, as a rule, neither party can maintain an action for its non-performance. Such a contract cannot be enforced by either party to the contract.
- If contract is executory on one side (i.e. one party has not performed the contract) and the other party has fully performed the contract, the courts differ as to whether an action will be on the contract against the party who has received benefits.

However, the majority of courts appear to be in favour of requiring the party who has taken the benefit either to perform his part of the contract or to return the benefit.<sup>23</sup>

## **8.2 Ultravires borrowings**

8.6 A borrowing beyond the power of the company (i.e. beyond the object clause of the memorandum of the company) is called ultra vires borrowing.

In England, S. 9(11) of the European Communities Act, 1972 provides, even such a borrowing can be enforced by a third party against the company if he has acted in good faith and the borrowing has been decide on by the directors of the company.

In India, there is no specific legislation like the European Communities Act, 1972. Consequently the ultra vires borrowing is void and cannot be ratified by the company and the lender is not entitled to sue the company for return of the loan.

8.7 However, the courts have developed certain principles in the interest of justice to protect such lenders. Thus, even in a case of ultra vires borrowing, the lender may be allowed by the courts the following reliefs:

- Injunction --- if the money lent to the company has not been spent the lender can get the injunction to prevent the company from parting with it.
- Tracing--- the lender can recover his money so long as it is found in the hands of the company in its original form. Where his money is applied in purchasing certain property, he can claim the property so long as it remains in the actual possession of the company. Where the lender's money and that of the company have become mixed up and the two cannot be separated from each other, the lender can claim *pari-passu* distribution of the assets of the company with the shareholder in the event of the winding up of the company, i.e. the mixed fund should be appointed between the shareholders and the creditors in proportion to the amount paid by them respectively.<sup>24</sup>
- Subrogation: if the borrowed money is applied in paying off lawful debts of the company, the lender can claim a right for subrogation and consequently, he will stand in the shoes of the creditor who has been paid off with his money and can sue the company to the extent the money advanced by him has been so applied but this subrogation does not give the lender the same priority that the original creditor may have or had over the other creditors of the company.

## **9.0 Ultra Vires Torts or Crimes**

As regards the extent to which the ultra vires rules are applied to torts and crimes, the law is not well settled. The following views may be mentioned:

- Company is allowed to do only those acts which are stated in the objects clause of its memorandum and, therefore, an act beyond the objects clause is not considered as an act of the company. Since the objects clause can never include the commission of wrongs, a company can never be liable in torts or crimes. In other words, a wrong committed by the servants or the agents of the company ostensibly on its behalf cannot be binding on the company because their acts are beyond the powers of the company.

However, this is not the present law at this point and in practice companies are made liable in torts and convicted for crimes.

- The second view is that the Doctrine of Ultra Vires applies only to contract and property and never applies to tortious or criminal liability.

- The third view is that a company may be held liable in torts or crimes provided that they are committed in the course of an activity, which is warranted by the objects clause of its memorandum. In other words, an act of the company's servants or agents beyond the object clause is not an act of the company and therefore, the company cannot be held liable for the wrongs committed by its servants or agents in respect of an activity which is not covered by the object clause of its memorandum. But the correct rule is that a company may be held liable for torts or crimes committed in pursuance of its stated objects but should not be liable for acts entirely outside its objects. Thus a company may be held liable for any tort or crime if:

The tort or crime has been committed by the officers or agents or the Directors or the servants of the company within the course of their employment, and

The tort or crime has been committed in respect of or in pursuance of any activity, which falls within the scope of the objects clause of its memorandum. It is to be noted that whether or not the company is liable for ultra vires torts or crimes, the officers or servants committing the act will, no doubt, be personally liable therefore.<sup>25</sup>

Property Acquired Under Ultra vires Transactions: Where the funds of a company are applied in purchasing some property, the company's right over that property will be protected even though the expenditure on such purchasing has been ultra vires.<sup>26</sup>

## **10.0 Doctrine of Ultra Vires Exceptions**

10.1 There are, however, certain exceptions to this doctrine, which are as follows:

- An act, which is intra vires the company but outside the authority of the Directors may be ratified by the shareholders in proper form.<sup>27</sup>
- An act which is intra vires to the company but done in an irregular manner, may be validated by the consent of the shareholders. The law, however, does not require that the consent of all the shareholders should be obtained at the same place and in the same meeting.
- If the company has acquired any property through an investment, which is ultra vires, the company's right over such a property shall still be secured.
- While applying Doctrine of Ultra Vires, the effects which are incidental or consequential to the act shall not be invalid unless they are expressly prohibited by the Company's Act.

- There are certain acts under the company law, which though not expressly stated in the memorandum, are deemed impliedly within the authority of the company and therefore they are not deemed ultra vires. For example, a business company can raise its capital by borrowing.
- If an act of the company is ultra vires, the company can alter its articles in order to validate the act.

10.2 A brief analysis of the doctrine of ultra vires with regard to its consequences would reveal that only those activities of the company shall be valid i.e., intra vires, which are:

- Essential for the fulfilment of the objects stated in the main object clause of the memorandum;
- Incidental or consequential or reasonably within its permissible limits of business; and
- Which the company is authorised to do by the Company's Act, in course of its business.

10.3 All other activities of the company except the above shall be ultra vires and therefore invalid. If an act of the company is ultra vires the company can alter its articles in order to validate the act.

### **11.0 Important Case Laws**

- *Eley v The Positive Government Security Life Assurance Company, Limited*, (1875-76) L. R. 1 Ex. D. 88
- *The Directors, &C., of the Ashbury Railway Carriage and Iron Company (Limited) v Hector Riche*, (1874-75) L. R. 7 H. L. 653.
- *Shuttleworth v Cox Brothers and Company (Maidenhead), Limited, and Others*, [1927] 2 K. B. 9
- *In Re New British Iron Company*, [1898] 1 Ch. 324
- *Rayfield v Hands and Others*, [1957 R. No. 603.]
- *Guinness v Land Corporation of Ireland*, (1883) L. R. 22 Ch. D. 349

### **12.0 Important Case Laws**

12.1 According to American laws, the concept of ultra vires can still arise in the following kinds of activities in some states:

- Charitable or political contributions

- Guaranty of indebtedness of another
- Loans to officers or directors
- Pensions, bonuses, stock option plans, job severance payments, and other fringe benefits
- The power to acquire shares of other corporations
- The power to enter into a partnership

12.2 In the United Kingdom, the Companies Act 2006 sections 31 and 39 greatly reduced the applicability of ultra vires in corporate law, although it can still apply in relation to charities and a shareholder may apply for an injunction, in advance only, to prevent an act which is claimed to be ultra vires.

### **13.0 Current Scenario**

#### **A. England**

13.1 In England the Doctrine of Ultra Vires has been restricted by the European Communities Act, 1972. According to Section 9(1) of the Act in favour of a person dealing with a company any transaction decided by its directors shall be deemed to be within the capacity of the company to enter into validity and the other party is not required to inquire about the capacity of the company and thus such transaction may be enforced by the other party acting in good faith against the company and the company cannot plead that the transaction was ultra vires, but it cannot be enforced by the company against the other party for the other party can still plead that the act was ultra vires. It is to be noted that in England, the Act merely restricts the application of the Doctrine of Ultra Vires but does not abolish it. The company can still plead that the act was ultra vires, against the third party if it is proved that the third party has not acted in good faith. It can be pleaded by the company against the third party if the transaction or act has not been approved by the Directors. Along with it, as has been already stated, the third party can still plead against the company that it has acted ultra vires, i.e. the ultra vires transaction cannot be enforced by the company against the third party.

13.2 Thus, the Doctrine of Ultra Vires in England applies with certain restrictions and modifications and certain provisions have been inserted in the European Communities Act, 1972 in order to protect innocent third party from the hardship created by this doctrine for them.

#### **B. India**

13.3 In India there is no legislation like the European Communities Act. Consequently, the principles laid down in Ashbury Railway Carriage and Iron Company



Ltd vs. Riche and Attorney General vs. Great Eastern Railway Co. are still applied without restrictions and modifications. Thus, in India the ultra vires act is still regarded, as void and it cannot be validated by ratification even if all the shareholders consent to such ratification. Thus, in India the ultra vires act or transaction neither can be enforced by the company against the third party nor by the third party against the company and thus, both the third party and the company can plead against each other that the transaction or act was ultra vires. However, the provisions similar to those inserted in the European Communities Act, 1972, should also be inserted in the Indian Companies Act, 1956, to protect the innocent third party.<sup>28</sup>

#### **14.0 Critique of the Doctrine of Ultra Vires**

14.1 There are several questions, which may be of interest and involve certain contentious points in the subject regarding the position of two most important players in this regard i.e. the creditors and the shareholders.

##### **Creditor Interests**

14.2 The existence of the doctrine does not entitle a creditor dealing with a company to assume that it will only act intra vires and, if he neglects to enquire or, having enquired, draws the wrong conclusion, he may risk loss from which other creditors may fortuitously benefit. The doctrine was more in the nature of a trap than a protection for the creditor. Indeed, the doctrine had adverse effects even for a diligent creditor or third party dealing with a company, as he may spend considerable time and effort to ensure that a proposed transaction is intra vires.<sup>29</sup>

14.3 In theory, no doubt the Doctrine of Ultra Vires may provide protection by limiting the business and so preventing unauthorized operations, which may damage the solvency of a company and its ability to repay. In practice this is not a consideration, which weighs with creditors at all. The prolixity of Memorandum of Association, and the power of a company to alter its objects, and the ability of a company to operate through subsidiaries, make it impractical to rely on the objects to impose any limitation on the businesses which the company may carry on<sup>30</sup>. Such limitations may be, however, and in many cases are, imposed by creditors by including the necessary restrictions in their contracts with the company.

14.4 In practicality, a creditor lending funds on a long-term basis will normally impose conditions to ensure that the loan is applied for a particular purpose, and will check the object clause of the company. A creditor advancing short-term funds, or advances repayable on demand, is less likely to scrutinize the object clause of the company and be more ready to assume that, if it is a trading company, the borrowing is

within its powers. Normally, the creditor lending funds on any significant scale will ascertain whether or not there are in the article any restrictions on the Directors' borrowing powers, but these normally expressly provide that any breach of the borrowing limit will not invalidate the borrowing.

14.5 One important and pertinent question in this regard is that, what is the standing of a creditor regarding challenging of the alteration by the company. The view in this regard is that a creditor per se has no right and all his rights are merely contractual in nature which is a notion further solidified by the fact that if the ultra vires doctrine is abolished then the contractual capacity of the company will be more like that of a natural person and further the intervention of a creditor regarding the company entering into and ultra vires transaction is not practical since it is very difficult for a creditor to know of the transactions being entered into by the company. Thus, as such the creditor has no practical means of knowing that what the company is doing and since his relationship with the company is more in the nature of a contract, there seems no justification to the researcher to allow the creditor to object to the alteration of the object clause of the company.<sup>31</sup>

14.6 In view of some commentators even if such a right is created that will be totally ineffectual for the reasons mentioned above by the researcher. Further, the company cannot bind itself not to exercise its right conferred by the statute without shareholders' approval.

Shareholders' interests

14.7 No doubt shareholders' interests are well protected in theory, by the law as well. However in practicality, MOA is excessively prolix, being designed to include every conceivable business. This defeats the object of having an object clause and confers no protection on members. It also fails to guide investors as to what is the real business of a company.

14.8 Consequent to industrial growth and wide dispersal of shareholding vis-a-vis the vastness of India, those who deal with the company are not only confined to the place over which the Registrar of the Companies has jurisdiction. They may have a right to receive the required information by post; but such exercise will involve time and it may frustrate conclusions of dealing with a company.<sup>32</sup>

14.9 More or less, the English law and Indian law are same as far as procedure for attraction is concerned i.e. both legal systems require the special meeting of the members to pass the resolution conferring the attraction but the English law is regarding the grounds on which the attraction can be asked, is much more liberal in nature than Indian law since, the English law has done away with the specific grounds mentioned. The company can now alter the object clause for any purpose, provided it is lawful.

Further, in Indian law the grounds pre-specified and are the only grounds or purposes for which an alteration can be made. In fact, after the 1996 amendment, the Indian law is inching closer to the English law.

### **15.0 Its Relevance Today**

15.1 As India's economy grows and modernizes the state has worked to bring their business, trade, and intellectual property law into line with international standards, but a large fragmented system plagued by corruption and attachment to tradition can sometimes cause problems. One area where this is clearly the case is in trademark where a traditional reading of ultra vires and naming requirements is at odds with trademark principles.

15.2 The ultra vires doctrine, which prevents a company from undertaking any object which they are not specifically granted, is still a force in Indian business law. While England and United States have moved away from the doctrine by allowing corporations to state their objectives broadly when incorporating, India still requires a specific purpose to be outlined when registering a company. Additionally, when registering a company in India an entrepreneur must select a name which relates in some way to the business. Name approval is time consuming, it can take weeks to get approval, and it also takes away an entrepreneur's ability to control his or her marks. An individual who wants to do business in India must submit their choice of name and two alternates for the government to choose from. If they are not seen as having enough to do with the company they will be rejected. (The Indian government recently prevented an online gaming company from calling itself "Kratos" after the Greek god of strength, because the business had nothing to do with Greek mythology.)<sup>33</sup>

15.3 The name registration procedure incentivizes marks that are the opposite of what a traditional trademark scheme prefers. In order for a trademark to be valid it must be distinctive. Trademark law has traditionally given the greatest protection to "arbitrary" or "fanciful" marks, marks which have a meaning unrelated to the goods or services they are attached to ("bubbly publishers") or that did not exist prior to the company's use ("Kodak"). A generic mark can be canceled because it doesn't distinguish itself as a brand from other similar goods and the protection granted to descriptive rights is severely curtailed.

15.4 What Indian business law has left for its companies is suggestive marks, which indicate the nature, quality, or a characteristic of the products or services. This doesn't close off trademark protection but it does prevent owners from receiving the

broad protection; arbitrary marks are granted, potentially injuring Indian firms in global trade.

15.5 Seeing this problem, India's Ministry of Corporate Affairs (MoCA) has drafted a proposed rule to remove the naming requirement when applying to form a company. However, the draft rule was published in March of this year and no progress has been made on implementing it. Additionally, some in the business community wonder about the efficacy of such a policy change considering the nature of India's federalism, where ministries sometimes lack direct control over local offices and local officers are often tied to tradition.<sup>34</sup>

15.6 The Doctrine of Ultra Vires played an important role in the development of corporate powers. Though largely obsolete in modern private corporation law, the doctrine remains in full force for government entities. An ultra vires act is one beyond the purposes or powers of a corporation. The earliest legal view was that such acts were void. Under this approach a corporation was formed only for limited purposes and could do only what it was authorized to do in its corporate charter.<sup>35</sup>

15.7 This early view proved unworkable and unfair. It permitted a corporation to accept the benefits of a contract and then refuse to perform its obligations on the ground that the contract was ultra vires. The doctrine also impaired the security of title to property in fully executed transactions in which a corporation participated. Therefore, the courts adopted the view that such acts were voidable rather than void and that the facts should dictate whether a corporate act should have effect.<sup>36</sup>

15.8 Over time a body of principles developed that prevented the application of the ultra vires doctrine. These principles included the ability of shareholders to ratify an ultra vires transaction; the application of the Doctrine of Estoppel, which prevented the defence of ultra vires when the transaction was fully performed by one party; and the prohibition against asserting ultra vires when both parties had fully performed the contract. The law also held that if an agent of a corporation committed a tort within the scope of the agent's employment, the corporation could not defend on the ground that the act was ultra vires.

15.9 Despite these principles the ultra vires doctrine was applied inconsistently and erratically. Accordingly, modern corporation law has sought to remove the possibility that ultra vires acts may occur. Most importantly, multiple purpose clauses and general clauses that permit corporations to engage in any lawful business are now included in the articles of incorporation. In addition, purpose clauses can now be easily amended if the corporation seeks to do business in new areas. For example, under traditional ultra vires doctrine, a corporation that had as its purpose the manufacturing of shoes could not, under its charter, manufacture motorcycles. Under modern corporate

law, the purpose clause would either be so general as to allow the corporation to go into the motorcycle business, or the corporation would amend its purposes clause to reflect the new venture.

15.10 State laws in almost every jurisdiction have also sharply reduced the importance of the ultra vires doctrine. For example, Section 3.04(a) of the Revised Model Business Corporation Act, drafted in 1984, states that “The validity of corporate action may not be challenged on the ground that the corporation lacks or lacked power to act.” There are three exceptions to this prohibition: it may be asserted by the corporation or its shareholders against the present or former officers or directors of the corporation for exceeding their authority, by the attorney general of the state in a proceeding to dissolve the corporation or to enjoin it from the transaction of unauthorized business, or by shareholders against the corporation to enjoin the commission of an ultra vires act or the ultra vires transfer of real or personal property.

15.11 Government entities created by a state are public corporations governed by municipal charters and other statutorily imposed grants of power. These grants of authority are analogous to a private corporation's articles of incorporation. Historically, the ultra vires concept has been used to construe the powers of a government entity narrowly. Failure to observe the statutory limits has been characterized as ultra vires.

15.12 In the case of a private business entity, the act of an employee who is not authorized to act on the entity's behalf may, nevertheless, bind the entity contractually if such an employee would normally be expected to have that authority. With a government entity, however, to prevent a contract from being voided as ultra vires, it is normally necessary to prove that the employee actually had authority to act. Where a government employee exceeds his authority, the government entity may seek to rescind the contract based on an ultra vires claim.

## **16.0 Findings and Observations**

- An ultra vires act is void and cannot be ratified even if all the directors wish to ratify it.
- The provisions similar to those inserted in the European Communities Act, 1972 should also be inserted in the Indian Companies Act, 1956 to protect the innocent third party.
- The tendency of inserting “independent object clause” to exclude the main object rule of construction is dangerous also because it makes the distinction between the object and power obscure.

- This doctrine prevents the wrongful application of the company's assets likely to result in the insolvency of the company and thereby protects creditors.
- The Doctrine of Ultra Vires also prevents directors from departing the object for which the company has been formed and, thus, puts a check over the activities of the directors. It enables the directors to know within what lines of business they are authorized to act.
- In India, there is no specific legislation like European Communities Act, 1972 and therefore, there is no specific statutory provision under which an innocent third party making contract with the company may be protected. Thus, in India, if the doctrine of ultra vires is strictly applied, where the contract entered into by a third party with a company is found ultra vires the company, will be held void and cannot be ratified by the company and neither the company can enforce the contract against the third party nor the third party can enforce it against the company.

### Endnotes

1. Davies, P. L., *Gower's Company Law*, Sweet and Maxwell. Pg.202.
2. Robert W. Hamilton (1996). *The Law of Corporation* 4th Edition. West Group
3. [http://en.wikipedia.org/wiki/Ultra\\_vires](http://en.wikipedia.org/wiki/Ultra_vires)
4. <https://docs.google.com/viewer?a=v&q=cache:E0ytIpw5nikJ>
5. *Law and Economics*, (1966). JBL 301 at pp. 302-03.
6. Paras Divan (rev.), PriyaNathSen, *GENERAL PRINCIPLES OF HINDU JURISPRUDENCE*, 2nd ed. 2004, p. 23.
7. [http://en.wikipedia.org/wiki/Ultra\\_vires](http://en.wikipedia.org/wiki/Ultra_vires)
8. *The Ultra Vires Doctrine in a Constitutional Setting: Still the Central Principle of Administrative Law* [1999] *Cambridge Law Journal* Vol. 58 129.
9. <http://www.slideshare.net/IndrajithKr/doctrine-of-ultra-vires>.
10. *The Directors of the Ashbury Railway Carriage and Iron Company (Limited) v. Hector Riche* (1874-75) L. R. 7 H. L. 653, ultra Vires.
11. Sealy, L. S., "Cases and Materials on Company Law".
12. Vaidya, Nidhi and Raghuvanshi, Raghendra Singh, (2010, February 25). *Applicability of Doctrine of Ultra Vires on Companies*. Available at SSRN: <http://ssrn.com/abstract=1558971>
13. (1880) 5 A. C. 473.
14. *Supra* at note 4.
15. *Order appealed from affirmed; and appeal dismissed, with costs*. *Lords' Journals*, 27th May, 1880.(1879-80) L. R. 5 App. Cas. 473.
16. (1868) 4 Bom. HCR 185.
17. (1963) 1 SCJ 521. (1963) 1 SCJ 521.

18. Gujarat Mining & Manufacturing Company v. Motilal H. S. Weaving Company, AIR 1930 Bom. 84.
19. Ibid.
20. In Re, Patent File Co., (1970) L. R. Ch. 83.
21. In Re, Kitson & Co. Ltd., [1946] ALL E. R. 435.
22. [1969] 1 ALL E. R. 887.
23. Sen, S. C., "The New Frontiers of Company Law, pp. 109 & 110; See also " Dutta on the Company Law," p. 538.
24. Sinclair v. Brougham, (1914) A. C. 398.
25. R. v. Ovel, (1969) 1 Q. B. 17.
26. Ad. Salt v. Bank of Mysore, (1930) MLJ 59.
27. Rajendra Nath Dutta v. Shailendra Nath Mukherjee, (1982) 52 Comp. Cas. 293 (Cal.).
28. Lord Wedderburn, Death of Ultra Vires (1966) 29 MLR 673 at 675
29. Ultra Vires, LAW SOCIETY'S GAZETTE 1772 (83(22): 11th June, 1986).
30. Id.
31. Snodgrass, Frank R. 1995. Dealing with Governmental Entities. New York: Practising Law Institute.
32. Kesavan, A. C. & Vasudevan, V. (1990). Ambiguities, Absurdities and Archaism in the Companies Act: Doctrine of Ultra Vires. 1 Comp LJ 33.
33. [http://online.wsj.com/article/SB10001424052970204479504576639233537716542.html?mod=WSJ\\_hp\\_us\\_mostpop\\_read#articleTabs%3Darticle](http://online.wsj.com/article/SB10001424052970204479504576639233537716542.html?mod=WSJ_hp_us_mostpop_read#articleTabs%3Darticle)
34. [http://www.mca.gov.in/Ministry/pdf/Companies\\_rules\\_15Mar2011.pdf](http://www.mca.gov.in/Ministry/pdf/Companies_rules_15Mar2011.pdf)
35. Greenfield, Kent. 2001. "Ultra Vires Lives? A Stakeholder Analysis of Corporate Illegality." Virginia Law Review 87 (November).
36. <http://www.companyformationindia.com/guidelines-name-approval.html>