CHAPTER-6
EVASION, REFORMATION, ABOLITION /
EXCEPTIONS OF THE DOCTRINE

1. EVASION

Before we go to the evasion of the doctrine of *ultra vires*, we may remind ourselves that it was not until the latter part of the 19th century that it was clearly established that the strict type of *ultra vires* applied to companies. As we know that until 1844, the most type of company were governed by the “deed of settlement” and companies had no corporate personality; that was enjoyed by Chartered Companies (to which the strict doctrine of *ultra vires* did not apply). After the Joint Stock Companies Act 1856, deed of settlement companies became superseded by registered incorporated companies with limited liability and memorandum of association which had to specify their objects. Only then courts forced to decide whether or not doctrine of *ultra vires* applied or not.\(^697\)

If we talk about the efficacy of the doctrine of *ultra vires* in company law, we find it in the form of a tool for restricting the parameters of commerce of a company to the objects set forth in the memorandum and as an effective safeguard protecting the interest of shareholders and creditors of the company. The researcher has attempted to answer this question in the light of legal scenario prevailing over corporate law. Through the twentieth century, company law has been developing alternative rules to protect shareholders and creditors against dissipation by the directors of the funds made available to the company. For instances:-

1. Rules regarding the funds which could be used to pay dividends or other distributions have been progressively tightened
2. Provisions of insolvency legislation attacking preferences or transactions at an under value also sought to prevent unwarranted disposals of corporate funds.
3. Accounting and reporting obligations imposed on directors by the company legislation became more onerous thus giving those dealing, or considering

\(^{697}\) Gower and Davies on Principles of Modern Company Law by Sweet & Maxwell 7th Ed. Page 132
sealing, with the company to monitor the stewardship of its affairs by consulting its published financial information

4. Publish accounts and reports of the company were more helpful source than its objects clause.

5. The provisions of insolvency legislation relating to wrongful trading, preferences and transactions at and undervalue provided adequate protection to creditors against dissipation of assets without the added protection of the doctrine of *ultra vires*, shareholders were also protected against gratuitous dispositions, reporting requirements.698

However, with regard to the question whether the doctrine of *ultra vires* serves any effective purpose in the present scenario, the British Parliament, after examining the report of Professor Dan Prentice from various aspects concluded that the doctrine of *ultra vires* no longer serves any useful purpose, the report further went on to elucidate the grounds on which it had recommended the abolition of the doctrine.699

Thus, it is submitted that the doctrine of *ultra vires* has had to surrender its virtue to later developments. But it still retains its vice, namely, that it can be a pitfall, as before, for the outsider who deals with the company because there can even now be some such activity which the company cannot perform under its objects clause. If the company pursues that very activity, the persons who deal with the company in connection with that activity cannot recover anything from the company which may be due to them in regard to that dealing, e. g. for the goods supplied or services rendered to the company.700

Soon after the famous and historical case of *Ashbury Railway Carriage Company’s case*701 the shortcomings of the doctrine became apparent. It created hardship both for the management and the outsiders dealing with the company. An outsider in law is presumed to have the knowledge of the provisions of the memorandum of association and articles of association which are public documents and any contract made outside the object clause with the company is *ultra vires* and therefore void. Beside, it started to cause much hardship to the management. At every

699 Ibid
700 Jon Beauforte (London) Ltd., Re, (1953) 1 All ER 634
701 (1875) LR 7 HL 653
step, the management is required to see whether the acts done are covered by the object clause in the memorandum of association, and if not, the alteration to be made in the objects are in accordance with the lengthy procedure followed under the act. It thus, restricts the frequency of the business activities.

Prof. Gower has rightly said “The doctrine causes much nuisance by preventing the company from changing its activities in a direction upon which all members have agreed”.703 “Ballentine has also described it as a mischievous doctrine”.704

The Cohen committee which was appointed after the Second World War to consider and report the major amendments which were desirable in the then existing English Companies Act 1929, and in particular to review the requirements prescribed in regard to the formation and affairs of companies and the safeguard afforded for investor and for the public interest. The Committee recommended the abolition of the doctrine for it served no positive purpose and was a cause of unnecessary prolixity and vexation. In the opinion of this committee, the doctrine was an illusory protection for the shareholders and a pitfall for third party dealing with the company. The Committee made many more suggestions and proposals. Most of them have been accepted and got recognition in the shape of the companies Act 1948, and the work of the committee was widely acclaimed as bringing a new era in the company law. But the suggestion of this committee for abolition of the doctrine of ultra vires was not accepted by the English Parliament.705

It is pertinent to mention here that as per the provisions contained in section 5 of the English companies act 1948, a company by special resolution can alter the “object clause” and unless such an alteration is challenged in a court of law within 21 days of the passing the resolution, by or on behalf of the members holding not less than 15% of the issued capital, the alteration automatically becomes operative.706

The Jenkin committee also submitted its report in the year 1962 and expressed dissatisfaction with the doctrine and suggested the abolition of the rule of constructive

702 Dhingra L.C.in his Article on Doctrine of Ultra Vires in Company Law; An Overview published in Company law journal 1992 Page 23 to 26
703 Prof. Gower L.C.B The Principles of Modern Company Law 4th Ed. (1979) page 83
704 Ballentine on Corporation (1947) page 115
705 Cohen Committee Report 1945 on Company Law Amendments Para 12
This led to a legislative relaxation unilaterally of the clauses of memorandum. The Committee pointed out that doctrine of *ultra vires* hardly leads to unjust result. The committee gave its suggestion that that *ultra vires* doctrine should not be repealed but protection should be given to the third parties dealing with the company in good faith. The Committee lastly recommended slight amendment in section 5 of the English Act 1948, which deals with the alteration of the objects, including the abolition of the list of purposes for which alterations are authorized and allowing the alteration to extend to the inclusion of any new object which could lawfully have been included originally.

**A. EVASION BY BUSINESS AND PRINCIPLE DEVELOPED BY COURTS TO PREVENT SUCH EVASION**

The business have also made number of attempts to evade the *ultra vires* rule. Their tendency has been to make the object clause too wide. All sorts of objects, which a company may wish to adopt, are stated in the objects clause saying that if the main objects of the company are followed by wide powers expressed in general words, the later (i.e. the power expressed in general words) will be construed as covering their exercise only for the purpose of main objects. In other words, where not only main objects but also general powers are stated in the objects clause of the memorandum, the general power will be construed ancillary to the main objects. If the main objects fail, the company may be wound up on the petition of the shareholder thereof.

In *Re German Date Coffee Co.*

708, the main objects rule of construction was applied. There was a company and was formed to acquire and use a German patent for making coffee from dates. It was to acquire other patents and inventions by purchase or otherwise for improvements and extensions of German patent. On learning that the German patent could not be obtained, the majority of shareholders allowed the company to continue, but two shareholders presented a petition for winding up of the company on the ground that the main object of the company was to acquire the

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707 Jenkin committee Report 1962 Para 35- 42
708 (1882) 20 Ch. D 169
German patent and since it had become impossible to acquire, the company should be wound up.

**Issue involved:**

Whether the doctrine of *ultra vires* can be applied?

**Decision:**

The court held that the main object for which the company was formed was to acquire German Patent and the other objects stated in the objects 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.  

**B. OBJECT CLAUSE A DEVICE OF EVASION**

The main objects rule of construction has been avoided by inserting a statement in the objects clause to the effect that “all the objects are independent and in no way ancillary or subordinate to one another”. This is known as “Independent Objects Clause”. Thus where a clause stating that all objects specified in the objects clause are independent and not ancillary and subordinate to one another is inserted, the failure of any one of them can not be 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.  

Although the tendency of inserting an independent objects clause has been criticized by the House of Lords in the following case but the device was held to be valid and sufficient to exclude the ‘main objects Rule’ of construction. In *Cotman V Brogham*, a Rubber company underwrote shares in an oil company. The objects clause in the memorandum of the company contained many objects and one of them was to subscribe for shares of other companies. There was a clause in the objects 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*.

Similarly in *Re Introduction Ltd.* the court took a conservative opinion while interpreting the objects clause so that doctrine of *ultra vires* has some important

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709 www.slideshare.net visited on 3rd Oct 2011
710 Ibid
711 (1918) A.C. 514
applications. This is particularly important in relation to the doctrine of powers. The court will not permit a power to be changed in to an object and this has limited the ability of the company directors to circumvent the objects clause. In this case the court held that an “independent objects clause” could not convert a power in to an object. There is difference between a power and an object. Only the objects are required to be stated in the objects clause of the memorandum and not powers, but if the powers are also stated in the objects clause, they must be exercised to effectuate the objects stated therein.

The subsequent Companies Acts provided alteration in the objects clause to a limited extent by following an elaborate procedure and also the intervention of the courts. But still clear evasion of the restriction imposed was observed in an important case of *Bell House Ltd. V City Wall Properties Ltd.* \(^{713}\)

- The development and the evasion of the doctrine has been approved the decision of the Court of Appeal in *Bell House Ltd V City Wall Properties Ltd.* \(^{714}\). In this case a company’s objects clause authorized to carry on such trade or business which in the opinion of board of directors could be carried out advantageously with the existing business of the company. The facts of the case were as under-

- The plaintiff company’s principal business was the acquisition of vacant sites and the erection thereon housing estates. But the object clause of the company included power “to carry on any other trade or business whatsoever which can in the opinion of board of directors, be advantageously carried on by the company, in connection with or as ancillary to any of the above business or the general business of the company”. In the course of transacting the business, the company acquired knowledge of source of finance for property development and introduced the financier to the defendant company. Company claimed the agreed fee of 20,000 pound for its services. Defendant contested that claim on the ground that the contract was *ultra vires* the plaintiff company and therefore void.

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713 (1966) 2 All E. R. 674
714 Ibid
**ISSUE INVOLVED**

Whether the contract is *ultra vires* the company?

**DECISION**

Although the object clause stated above comes close to saying that the company could carry on any business it chooses, but the court held that the clause was effective to empower the company to undertake any business which the directors bona-fide thought, could be advantageously carried on as an adjunct to its other business. The court held that since the directors honestly believed that the transaction could be advantageously carried on as ancillary to the company’s main objects, it was not *ultra vires*. The defendant company was held liable to pay the required amount.\(^715\)

The court held that since the directors honestly believed that the transaction could be advantageously carried on as ancillary to the company’s main objects, it was not *ultra vires*. The decision has been welcomed as a progressive development in the direction of the doctrine. Commenting on this case, P.V.B. says “it would tend to reduce the prolixity of modern memoranda of association, and to cure the injustice to third parties who enter in to contract, with companies which are afterwards discovered to be *ultra vires*, both these objectives were favored by JANKIN COMMITTEE”.\(^716\)

It is submitted that this approach is not very sound. The formula in the *Bell House Case* allows the directors to carry on any business which according to them can be carried on with the main business. The directors have been given too much discretionary powers and it is not necessary that their good faith will keep in view the wishes of the shareholders\(^717\). But the doctrine of *ultra vires* has great powers of resilience and it seems that those who hailed the Bell House case as the death of the doctrine may have been premature.\(^718\)

Ultimately, in England, the parliament took a very bold step forward due to extreme pressure of the business community and conferred on the companies, the unlimited freedom to mend their “objects clause” as and when a specific majority desired to do so. This freedom is however is subject to judicial scrutiny. But the

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715 Bell Houses Ltd. v City Wall Properties Ltd. 1966 2 WLR 1323
716 Cochin Law Review (1979) page 308-309
717 The Bell House case has been followed by British Columbia Court of Appeal in H & H Logging CO. Ltd. v Random Services Corporation Ltd. (1967) 63 DLR (20) 6
718 Astiyah, P.S. Annual Survey of Commonwealth Law , 532 (1968)
provision contained in section 5 of the English companies Act 1948, a company by special resolution can alter the “object clause” and unless such an alteration is challenged in the court of law within 21 days by or on behalf of the members holding not less than fifteen percent of the issued capital, the alteration automatically becomes operative. The petitioners members ought not to be those earlier voted in favor of such alteration. The net effect thus would be that so long as 85 percent of the shareholders have voted for the amendment, or so long as none challenges it, in court of law within 21 days of the passing of a resolution for alteration, the companies in the United Kingdom will have complete freedom to change their objects by themselves. It is only because of these statutory developments that the doctrine of ultra vires has not virtually become a dead horse in English law. But the Indian conditions are different. Here the horse is not only much alive, but has also been made more formidable, capable of giving not only more violent kicks, but probably even nasty kicks at times.719

The provisions of section 5 of the English Companies Act 1948 have not been incorporated in the Indian Companies Act 1956, nor is it expected that the similar provisions would be incorporated in the foreseeable future. However, the Indian Judiciary have accepted the view that the business should have the wisdom to decide whether a new business, not originally provided for in the “objects clause” ought to be taken up or not by the company.

In the case of New Asarwa Mfg. Co. Ltd720, the company formed to manufacture textiles and to deal in cotton was allowed to amend its objects clause so as to enable it to carry on an entirely new business of running a theatre for showing films. The facts are as under:-

FACTS- The petitioner company, New Asarwa Manufacturing Company was a registered company. The company was more or less a one-object company and its object clause provided the objects of the company as “To purchase the factory known as… and to expand the business of weaving cloth etc”, and activities of allied nature. The company at its extraordinary general meeting passed a special resolution for

719 Rule of Ultra Vires in Company Law; Has it outlived its purpose- Published in (1985) 27;2 JILI 286
720 (1975) 45 Comp Case 151
alteration of its objects. The main object of the future business of the company was intended as “to acquire and take over from Echem Investment Private Limited as a going concern the business of cinema exhibition carried on by the said Echem Investment Pvt. Ltd in the name and style of Shital Theatres at Gomtipur road, Ahemdabad”. The company also intended to carry on incidentally the business of spinning and weaving and all other incidental activities in relation thereto, and it has been mentioned under the heading “other objects” of the company. The company therefore approached the court for sanction to the alteration under section 17 of the companies Act 1956 and the issue involved before the court was whether such kind of alteration should be confirmed.

The court rejected the objection raised by the Registrar of companies, that the business which the company was intending to carry on was entirely a new business, which could not be incidental or ancillary or even akin or alike to the then existing business of the company. The court held that “it is an established legal position that in deciding as to whether sanction to the alteration of a memorandum should be granted or not, the court should not reject an application ex-facie merely because the new business is wholly different from or bears no relation to the existing business of the company. All that should be essential and borne in mind is that it should be capable of being conveniently and advantageously combined with the existing business”.

The court held that the new business intended by the company having regard to the changed circumstances, namely, that the original undertaking of the company had been sold away for a sum of Rs. 40 Lac, whereby the company had received such a big amount, could conveniently with its business of some manufacturing activities as well as its business of dealing in cotton, be put to profitable use by investing the same in some lucrative line. No circumstances had been pointed out by the Registrar, nor brought on record by any other affected party that it would not be convenient or advantageous for the company to engage itself in the main business of exhibition of films with the existing business of the company.

Held, that it is no doubt true that the court may refuse to confirm an alteration unconnected with the existing objects or where the change has altered the basis of the company, but it could not be said that the proposed alteration would change the basis
of the company or destroy the then existing business of the company. The alteration of the objects was confirmed.\textsuperscript{721}

As regards the other aspects relating to third party and the company, it is no longer possible that an innocent person would be caught napping as it previously happened, for example, in the case of poor dealers in \textit{Re Jon Beauforte (London) Ltd.}\textsuperscript{722}

The company, Jon Beauforte Ltd., was authorized by its memorandum of association to carry on business of costumers, gown, robe, dress and mantle makers, tailors and other activities of allied nature. But later the directors of the company decided to carry on the business of manufacturing veneered panels, which was admittedly \textit{ultra vires} the objects of the company. For this purpose the company erected a factory.

A firm of builders who constructed the factory had brought an action claiming 2078 pounds. Another firm supplied veneer to the company and had a claim of 1011 pounds. A firm sought to prove for a simple contract debt of 107 pounds in respect of fuel supplied to the factory. The claimants did not have acknowledged that the veneered business was \textit{ultra vires}, however, the court held that the company was not liable to the claims of the aforesaid claimants because the money was taken from them for the business of veneered panels which was admittedly \textit{ultra vires} the objects of the company, the court has held that the memorandum is a constructive notice to the public and therefore if an act is \textit{ultra vires}, it will be void and will not be binding on the company and outsider dealing with the company cannot take a plea that he had no knowledge to the contents of the memorandum. The builders of the factory had obtained a consent judgment in the nature of compromise, but it was obviously arrived at on the footing that the contract was \textit{ultra vires}.

Deciding the question of consent judgment, the court held that “in the case of \textit{ultra vires} contract, no judgment founded on it is inviolable unless it embodies a decision of a court on the issue of \textit{ultra vires} or a compromise of that issue”. The court further observed that “if the act is beyond the power of the company to do or ratify, no judgment obtained by the consent of the company treating it as authorized...

\textsuperscript{721} Ibid

\textsuperscript{722} (1953) Ch. 131
can remove its invalidity, for the virtue of such judgment rests merely on the agreements of the parties and the incapacity to do act involves the incapacity to consent that it be treated valid”. Thus it is quiet clear that a company can not do what is beyond its legal power by simply going in to court and consenting to a decree which orders that the thing shall be done. A company cannot do what is beyond its large powers by simply going in to the court and consenting to a decree which orders that the thing shall be done.

All the three applications were dismissed.

The reason being very clear, that one who deals with the company is supposed to know its objects. In India there is an even earlier authority on this point.723

In England the doctrine of *ultra vires* has been restricted by the European Communities Act 1972. In United Kingdom the third party dealing with the company in good faith is protected and can enforce the *ultra vires* contract against the company if he has no knowledge of the fact that it was *ultra vires* and the contract was decided on by the directors of the company.724 In other words, the third party can enforce the *ultra vires* contract against the company, if he has 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 will be presumed to have acted in good faith unless the contrary is proved by the company. However the provisions operate only in favor of the person dealing with the company in good faith. Consequently the company can not enforce the *ultra vires* contract against the third party and the third party can plead *ultra vires*. In brief, in England, if a third party makes a contract with the company which is though lawful, is *ultra vires* the company, the third party can enforce the contract against the company, provided the third party has acted in good faith and the contract has been decided by the directors; but the contract can not be enforced by the company against the third party.

In India, there is no legislation like the European Communities Act 1972 which had been made applicable to U.K. and therefore, there is no 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 a

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723 Port Canning & Land Investment Co. Re, (1871) 7 Beng LR 583
724 Section 9(1) of The European Communities Act 1972
contract entered into by a third party with a company is found *ultra vires* the company, it will be void and cannot be ratified by the company. Neither the company can enforce it against the third parties nor the third parties can enforce against the company. The courts in India have evolved certain principles to reduce the rigors of the doctrine of *ultra vires*. The principles, in brief, as deduced from the judicial decisions may be stated as under.\(^\text{725}\)

1. 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.

2. If the contract is executor in both sides, as a rule either party can maintain an action for its non-performance. Such contract can not be enforced by either party to the contract.

3. If the contract is executor on one side (i.e. one party has not performed the contract) and the other party has fully performed the contract, the court differs as to whether an action will be on the contract against the third party who has received the benefits. However, the majority of the courts fully in favor of performance of the contracts, the courts differ as to whether an action will be on the contract against the third party who has received the benefits. However, the majority of the courts appear to be in favor of requiring the party who has taken the benefit either to perform his part of the contract or to return the benefit.

As regard the other aspects of the doctrine of *ultra vires* and the position of the company directors, it may be mentioned that the directors are primarily responsible to ensure and see that the funds of the company are used only for legitimate business of the company. Consequently if the funds of the company are used for a purpose, foreign to its objects clause as mentioned in the memorandum of association, the directors will be personally liable to restore the company, the funds used for this purpose. Property, legally and by formal transfer or conveyance transferred to a

corporation is in law duly vested in such corporation, even though the corporation was not empowered to acquire such property.726

The directors of a company are treated as the agents of the company, and therefore, it is their duty not to go beyond the authority conferred on them in the memorandum. When the directors represent to the third party and assert that the contract entered into by them on behalf of the company is within the powers of the company, while in reality, the company has no such power under its memorandum, the directors are personally liable to third party for the loss on account of breach of warranty of authority. To make the directors personally liable for the loss of the third party, because of the breach of warranty of authority, the following condition must exist:-

(a) There must be representation of the authority of the directors and such representation must be of fact and not of law.

(b) By such representation, the directors must have induced the third party to make a contract with the company in respect of matters beyond the memorandum of association or the powers of a company

(c) The third party must have acted on such inducement, and consequently suffered loss.

But when an act or transactions is ultra vires the directors (i.e. beyond their powers, but within the power of the company) the shareholders can ratify it, by a resolution in the general meeting or even by acquiescence provided they have knowledge of the facts relating to the transaction to be ratified or the means of knowledge is available to them. Similarly when an act is within the power of the company, any irregularities can be cured by the consent of all the shareholders. If an act or transaction is ultra vires the Article of Association, the company can ratify it by altering the articles by a special resolution at the general meeting. Again if the act is done on irregular basis it can be validated by the consent of all the share holders, provided it is within the powers of the company.727

726 Ibid
727 Supra Note 702. page 26
C. NEW TECHNIQUE OF EVASION

The already attenuated doctrine of *ultra vires* has been given another death blow by the decision of court of appeal in *Bell houses Ltd. V City Wall Properties Ltd* as discussed above.

The decision of Bombay high Court in *Wamanlall C. Parekh V Scindia Steam Navigation Co.* passed a vague and subjective clause like this in a company’s objects. The clause enabled the directors “to invest money of the company in such a manner as the directors think fit”. They bought gold and silver. Holding the transaction as valid Kania, J (afterward Chief Justice of Supreme Court) said “On a plain reading of this clause it is clear that it does not restrict the power of the company to utilize its money for any limited purpose”.

In India an attempt has been made to tackle the problem of prolixity of objects at both the legislative and administrative levels. The legislative measure was adopted in the year 1965 through the companies (Amendment) Act of that year. Section 13 as amended requires the objects clause to be divided into two sub-clauses.

The first sub-clause is required to state the main, incidental and ancillary objects of the company.

In the second sub-clause may be included any other objects that are not mentioned in the first sub-clause.

The purpose of this section does not become clear unless it is taken in connection with the amendment of section 149. This section deals with the certificate for the commencement of business which is necessary to enable every public company to commence its business activities. As the section stood before this amendment, a company had to obtain this certificate only once in its life. But now a new certificate would be necessary every time, a company picks up a new business from its stated objects. A company which was in existence at the commencement date of the amendment Act of 1965 would have to obtain a certificate “wherever it

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728 By Singh Avtar (Lecturer in Law, Lucknow University) “IN DEFENCE OF ULTRA VIRES” published in Supreme Court Cases (1971) Journal Section, Page 31 to 34.
729 (1966) 2 WLR 1323
730 AIR 1944 Bom. 131
731 Ibid at page 137
commences any new business which is not germane to the business which it is carrying on at the commencement of the Act\textsuperscript{732}

In case of a company incorporated after the enforcement date of the amendment, a certificate would be necessary whenever the company wants to commence any business stated in the second sub-clause of its objects\textsuperscript{733}

In either case the relevant and the most important requirement for the issue of a certificate is that the business in respect of which the certificate is desired must have been approved by special resolution passed by the company in its general meeting. Where however, the company can not manage a special resolution, it may pass an ordinary resolution and then obtain the approval of the central government to commence any new business\textsuperscript{734}

Thus no new business can be commenced without consulting at least a majority of the company’s shareholders. This in essence is the adoption of partnership principle, with only this difference that while under the Partnership Act\textsuperscript{735}, unless there is an agreement to the contrary, a new business can be adopted only with the consent of all the partners, the companies Act requires the consent of only a special majority of shareholders. But even so it is likely to afford the same degree of protection as is afforded by the partnership principle and will make up for the illusory protection now provided by the *ultra vires* doctrine. It will also discourage a company from spreading its net wider and wider until it embraces diverse kinds of business. The purpose of the amendment becomes apparent from the following statement of Mr. D.L. Majumdar\textsuperscript{736}

“Ill advised diversification by board of companies may result in building up *hotch-potch* of business in to an industrial holding company. Since the surplus funds of a company, which can be thus utilized by its board are derived from withholding from shareholders, the profits earned from its principal lines of business, it is only fair and just that before these surpluses are ploughed back for purposes which were not in shareholders minds when they bought or subscribed for their shares. The shareholders

\textsuperscript{732} Section 149 (2A), Explanation
\textsuperscript{733} Section 149 (2A) (a) regarding penalty for breach
\textsuperscript{734} Section 149 (2B)
\textsuperscript{735} Section 13 of Indian Partnership Act 1932
\textsuperscript{736} The Chairman of Company Law Administration and Principal Brain (behind Amendment)
wishes are ascertained. In other words, the board of the company should not proceed with plans for diversification of its business, involving a substantial dilution of the existing equity without obtaining, in the first instance, the consent of the shareholders to the intended use of these funds.\textsuperscript{737}

\textbf{D. SUBSEQUENT EROSION OF THE ULTRA VIRES DOCTRINE\textsuperscript{738}}

No sooner had the \textit{ultra vires} doctrine been propounded by the \textit{Ashbury carriage company's case}\textsuperscript{739} that the reaction against it started. Both the business community and the courts became aware of the disadvantages of the \textit{ultra vires} doctrine, and attempts started at reducing the rigors of the absolute doctrines. On the part of the court there has always been noticeably a conscious move towards validating transactions if possible by various legal interpretations. On the part of the company management and those dealing with the companies there were various types of attempts at the evasion of this rule.\textsuperscript{740}

Attempts at avoidance of the company managers broadly took the following shapes:-

(1) Wide powers were introduced in the objects clause of the memorandum of association and all sorts of powers to do all sorts of business were introduced. In such cases, the memorandum hardly gave any proper indication as to what was really the main business of the company

(2) In the memorandum sometimes as “all power” purpose clause was incorporated giving the company the power to do any type of business that the management may wish to do

(3) In some memorandum a clause was introduced that all the objects stated in the memorandum in the objects clause were to be considered as main objects of the company.

The courts therefore strove to curb this abuse in two ways-

\begin{itemize}
    \item \textsuperscript{737} Mazumdar D.L. Towards a philosophy of the Modern Corporation (1967) Asia pages 119-20
    \item \textsuperscript{739} (1875) LR 7 HL 653
    \item \textsuperscript{740} Supra Note 706 at page 106
\end{itemize}
First, they applied the Ejusdem Generis rule to the construction of the objects clause saying that when the main objects specified in the first few paragraphs were followed by general words.

The later should be construed as covering their exercise only for the purposes of the main objects. This however was avoided by the practice of inserting in the objects clause a clause to the effect that all the specified objects are deemed to be independent and in no way ancillary or subordinate to one another. Although this was challenged in *Cotman V Brougham*\(^\text{741}\) and was severely criticized in the judgment, nonetheless it was considered to be valid and legal.

The net result was that if the management was careful to have a wide objects clause in the memorandum of association, there was no effective protection for the shareholders to prevent application of assets of the company in objects other than those that were originally in the minds of investors.\(^\text{742}\)

2. **REFORMATION OF THE DOCTRINE**

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 a limited purpose and could do only what it was authorized to do in its corporate charter.

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.

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

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\(^\text{741}\) (1918) Ac 514
\(^\text{742}\) Supra note 740, page 107
the defense 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*.\(^\text{743}\)

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 purposes clauses and
general clauses that permit corporations to engage in any lawful business are now
included in the articles of incorporation. In addition, purposes 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 purposes 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.\(^\text{744}\)

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*.

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.

\(^\text{743}\) Website at Infra Note 745
\(^\text{744}\) Ibid

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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*.

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/her authority, the government entity may seek to rescind the contract based on an *ultra vires* claim.745

Thus introducing a further distinction between partnership and companies, it meant that anyone having dealings with a company was deemed to have knowledge of contents of its objects clause. In *Re Jon Beauforte (London) Ltd*746 (where the insolvent company’s stated objectives were to manufacture dresses but it had for some time instead been making veneered panels) a combination of actual knowledge of business being carried on by the company and of constructive notice of its stated objects resulted in all but one of its creditors claims being *ultra vires*. Even the claim of the supplier of heating fuel, who argued that this would have been needed whatever the company’s business, was met by the answer that he had actual knowledge of the present nature of the business, since the fuel had been ordered on the company’s notepaper which described it was “veneered panel manufacturers” and the constructive knowledge that this was *ultra vires*. The result, therefore of this constructive notice rule was that where the businesses being carried on by the company were known to the third party and, whether he actually knew it or not, were *ultra vires*, he would be to sue the company.747

Whereas the *ultra vires* doctrine is limited to provisions in the company’s object clause (and perhaps to other provisions restricting the scope of its business contained in the memorandum), there is no reason why restrictions on agents

746(1953) Ch. 131
747 Supra note 697 page 135
authority should not be found in the article, and indeed it is usual to put them there, if a company wishes to deploy such restrictions.

Thus, the article may say that contracts over a certain value must be approved by the shareholders in general meeting and can not be entered into by the board alone, or the article may give a particular director authority to act on behalf of the company in relation to certain type of contract but not others. Thus, any reform measure relating to the authority of agents must embrace the articles as well as the memorandum. Further, such restriction may be found in decisions of the shareholders in the general meeting or in agreements among the shareholders concluded outside the article and so the question arises whether restrictions located in such places should be treated differently from restrictions in articles. On one hand, the argument for relieving third parties from investigating the existence of such provisions seems even stronger than in relation to the articles, since such resolutions and agreements are not public documents. On the other hand, since such resolutions and agreements are not register-able, the doctrine of constructive notice, arising out of registration, does not apply to them. As we will see that the 1989 reforms introduced in the English law embrace resolutions and agreements, as well as provisions in the articles and memorandum. They are treated as part of company’s constitution.748


That the strict ultra vires doctrine in relation to companies should be abolished had long been recognized. But we made very heavy weather of doing so. It was not until our entry in to European Community that we belatedly did anything effective and than only to the minimum extent thought necessary to comply with our obligations under the First Company Law Directive. Section 9(1) of the European Communities Act 1972, later re-enacted as section 35 of the English companies act 1985, attempted to dispose of all the problems posed in two short subsections.

The first of which provided that, in favor of a person dealing with a company in good faith, any transaction decided on by the directors should be deemed to be within the capacity of the company and

748 Supra note 697 page 143
The second of which relieved the other party of any obligation to inquire about those matters.\textsuperscript{749}

Although this was a considerable step forward, it was widely criticized as failing fully to implement the Directive and as leaving much to be desired on policy grounds. It covered only “transactions decided by the directors” and protected only a third party dealing with the company in good faith and it did nothing to protect the company against invocation of \textit{ultra vires} by the other party. It is pertinent to mention here that in many cases and in case of public companies in most cases, transactions will not in fact be decided on by the board of directors. Art. 9(1) of the E.E.C. Act 1972 (corresponding to section 35 of 1985 English Act, refers to “acts done by organs” and “organs” was certainly intended to cover more than the board of directors). Moreover, Art. 9(2) further provides that “ The limits on power of the organs of the company, arising under the statutes (memorandum and articles) or from a decision of the competent organs, may never be relied on as against third parties, even if they have been disclosed”.

The few reported cases\textsuperscript{750}, on the section show that the courts did their best to construe it sensibly and consonantly with the Directive, but it was recognized that more needed to be done. Hence, anticipating further company legislation in 1989, the department of Trade and Industry commissioned Professor Dan Prentice to undertake a review of the position and to make recommendations. His report, delivered in 1986 was circulated as a Consultative Document\textsuperscript{751} and what the department described as a “refined” (i.e. a more complicated but less far reaching) version of his recommendations was enacted in the Companies Act 1989.\textsuperscript{752}

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\item \textsuperscript{749} Supra note 697 Pages 135-136
\item \textsuperscript{750} International Sales & Agencies Ltd. V Marcus (1982) 3 All ER 551
\item \textsuperscript{751} Reform of the Ultra vires Rule By Prof. Dan Prentice
\item \textsuperscript{752} Supra note 697 Page 136
\end{itemize}
\end{footnotesize}
B. REFORMS OF THE YEAR 1989

Professor Dan Prentice had recommended that the companies should be afforded the capacity to do any act whatsoever and should have the option of not stating their objects in their memoranda. Unfortunately this straightforward solution was not adopted, notwithstanding the precedent for it in some other common law countries. Some of those countries, however, were not subject to two complications which arose here.

First, our companies, as we have seen are not necessarily business corporations and on the contrary most of those limited by guarantee are formed to enable the advantages of corporate personality and limited liability to be obtained by those undertaking activities which are not carrying on of business with a view of profit. Such companies are entitled to dispense with “Ltd” as the suffix to their names and many of them are recognized, both by Charity Commission and by the Inland Revenue, as charities. In all these cases the Department of Trade and Industry and in the case of charities, the Charity Commission and the Inland Revenue will need to be satisfied that they have stated objects and keep within them. But that need not have prevented the adoption of professor Prentice’s recommended solution which would have permitted companies to register objects if they wanted or needed to and which was expressly not intended to derogate in any way from the relevant authority’s power to intervene.753

The second complication (from which non-EC countries are free) was that the second Company Law Directive requires that, in the case of public companies, the statute or instruments of incorporation shall state the objects of the company. But total abolition of limitations on capacity was in no way dependent on abolition of object clauses and, if the Directive precluded the latter, it certainly did not preclude the former. Whatever the reason may have been, what the 1989 Act did was rather different:

After inserting the new section 35, 35A, 35B, 711A and 322A by English Act of 1989, and section 719 of 1985 Act read with section 187 of the Insolvency Act 1986, to comply with EC Directives and section 64 and 65 of the charity Act 1993, to synchronize with domestic laws, the scope of ultra vires doctrine and its corollary of

753 Ibid Page 137
constructive notice evolved by the courts in U.K. is very much narrowed down, as
may be seen from section 35 and 35A of the 1989 Act extracted below:

Section 35(1) the validity of any act done by a company shall not be called in
to question on the ground of lack of capacity by reason of anything in company’s
memorandum.

(2) A number of the company may bring proceedings to restrain the doing of
an act which but for subsection (1) would be beyond the company’s capacity, but no
such proceeding shall lie in respect of an act done in fulfillment of legal obligation
arising from a previous act of company.

(3) It remains the duty of the directors to observe any limitation on their
powers following from the company’s memorandum and action by the directors
which, but for subsection (1) would be beyond the company’s capacity may only be
ratified by the company by special resolution.

A resolution ratifying such action shall not affect any liability incurred by the
directors or any other person; relief from any such liability must be agreed to
separately, by special resolution.

Section 35A (1) In favor of a person dealing with the company in good faith, the
power of the board of directors to bind the company, or authorize others to do so,
shall be deemed to be free of any limitations under the company’s constitution.

(2) For this purpose:-

a. A person deals with the company if he is a party to any transaction or other act
to which the company is a party.

b. A person shall not be regarded as acting in bad faith by reason only of his
knowing that an act is beyond the powers of directors under the company’s
constitution and

c. A person shall be deemed to have acted in good faith unless the contrary is
proved.

(3) “Any limitation under the company’s constitution” includes not only a limitation
in the memorandum and articles (or the equivalent) but also one deriving from an
agreement or resolution of the members or a class of members even if it does not formally alter the memorandum or articles.\textsuperscript{754}

It will therefore be seen that the protection afforded to a third party who has dealt with an employee is considerably less than that afforded to one who has dealt with the board of directors, or with someone actually authorized by the board. The statutory reforms have improved his position by the modifications of \textit{ultra vires} and constructive notice but section 35A helps him only to the extent that he may safely assume that the board had power to delegate to that employee. That will not protect him unless the board has actually done so or is stopped from denying that it has or has ratified what he did. If it has not, he will be unprotected unless the employee has acted within his apparent authority; and he will loose that protection not only if he has not acted in good faith but also if he negligently failed to make proper inquiries or if he actually knew or ought to have known that the officer had exceeded his authority\textsuperscript{755}.

\section*{I. CASES OUT SIDE SECTION 35A}

The objective of the foregoing statutory changes was to draw the sting of the \textit{ultra vires} and constructive notice doctrine, thus improving the position of those who dealt with the company externally, while making as few alterations as possible to the position as between the company and its members, directors and other agents. This limited objective appears to have been achieved reasonably and satisfactorily. But the reforms did not attempt to provide a complete code defining when a third party can safely assume that those dealing with him on behalf of a company have power to bind the company.\textsuperscript{756}

Normally, as a result of new sections, if a transaction with a third party acting in good faith is effected on behalf of a company by the board of directors or by a person who, in fact, the board has authorized, the transaction will bind the company. But except where the company is very small or the transaction is very large, the third party will probably not have had dealings through the board. His dealings will be in practice more often with someone who is an executive of the company or even a

\begin{thebibliography}{99}
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\bibitem{754} Ibid
\bibitem{755} Supra Note 697, page 164
\bibitem{756} Ibid page 156
\end{thebibliography}
comparatively lowly employee of whom the members of the board of directors may never have heard. Nor will the third party be likely to know whether in fact that executive or employee has actually been authorized by the board. Is he than entitled to assume that the board has, in fact authorized that person to bind the company? And that the board has imposed no limitations on the exercise of that person’s authority? And what is his position if in fact there is no legally constituted board of Directors? The new sections 35A and 35B give no answers\textsuperscript{757}. For them we have to turn to the basic common law principle of agency as refined in relation to companies by the rule in \textit{Royal British Bank v Turquand}\textsuperscript{758}

\textbf{II. KNOWLEDGE TO AGENT/THIRD PARTY}

As we have already seen the \textit{Turquand} rule does note benefit a third party who knows or that the agent does not have the authority or even a third party who has been put on enquiry as to whether the agent is duly authorized. In both respects the common law rule is less generous than sec 35A even actual knowledge of lack of authority does not necessarily take the third party out of category of one who has acted in good faith. Even worse, until section 711A of company’s act 1985 or its equivalent, is brought in to force, the doctrine of constructive notice arising out of registration of the company’s constitution at company’s House will apply to common law rule. Suppose the company’s constitution provides that no agent of company has authority to contact on behalf of the company for a value of more than x pound. Only the general meeting can enter in to contracts above that figure. If a third party, who has not in fact read the articles and does not otherwise know of the restrictions, contracts with the company through board or someone authorized by it, he or she will be protected by sec 35A. In any other case, however, except where the third party dealt with shareholders in general meeting, the third party, at present will be defeated by the doctrine of constructive notice. Only if the constructive knowledge revealed that the person with whom the third party dealt might have had the requisite authority,

\textsuperscript{757} Ibid
\textsuperscript{758} (1856) 6 E&B 327 Exch.Ch
will *Turquand* help him or her as where as in *Turquand* itself, the general meeting could have authorized the agent to contact above the relevant level.\footnote{Supra note 697, page 161}

Once sec 711A or its equivalent is implemented, the third party will be free of the doctrine of constructive notice arising out of public filing, but the doctrine of constructive notice arising out of failure to make enquiries is preserved by sec 711A (2) and, as we have seen, is embraced in the common law formulation of the *Turquand* rule. Section 35B provides as under

That a party to a transaction with the company is not bound to enquire, whether it is permitted by the company’s memorandum or as to any limitations on the powers of the board to bind the company or to authorize others to do so. Thus the form of constructive notice arising out of failure to enquire is specifically excluded in the area covered by sec 35B. However this is only limited value to third party, since the form of constructive notice which arises out of public registration appears not to be covered by sec 35B.

Therefore sec 35B removes the duty to enquire in respect of those who deal with the board of directors or those authorized by the board of directors but do not help other third parties. However, the Company Law Review has recommended that this second form of constructive notice should be removed as well and across board. If this were done, then constructive notice would cease to trouble third parties under the *Turquand* rule.\footnote{Ibid page 162}

At this point, only a third party who actually knew of a limitation on the agent’s authority would be at risk under the *Turquand* rule. By contrast to third party falling within sec 35A, who has the chance to argue that even actual knowledge would defeat the third party relying on *Turquand* rule. However, even here, the Company Law Review proposes to improve the lot of third party. It proposes to enact that “In determining any question whether a person has ostensible authority to exercise any of company’s powers in a given case, no reference may be made to the company’s constitution” This is a clause of utmost importance. As we have seen that the *Turquand* rule only comes in to operation only once the ostensible authority of non-board agent has been established. This provision will ease the third party’s path
in this respect, because he or she will be able to ignore any provision in company’s constitution, even if it is actually known, which limits the ostensible authority, the agent would have. It is a provision which further implement the policy as observed and concludes that the constitution is not an appropriate mechanism for communicating to third parties limits on the authority of the agents which is further explained below.761

III. AUTHORITY OF AGENT AT COMMON LAW

There are many ways by which a principal can limit the authority of an agent, but where the principal is a company, an obvious method of limitation is the inclusion of a provision in the company’s memorandum or articles of association. In principle, there is no reason why a provision in company’s constitution should not be effective to limit the agent’s actual authority and in appropriate cases, the provision might effectively limit the agent’s ostensible authority as well. The courts in the 19th century would have regarded the restrictive impact of provisions in the constitution upon both the actual and more important, the ostensible authority of the company’s agent as entirely unproblematic. Indeed by developing the doctrine of constructive notice the courts substantially enhanced the restrictive impact of provisions upon agent’s ostensible authority. In recent decades, however, the legislature has become skeptical about the utility of allowing constitutional provisions to restrict agents’ ostensible authority, to the detriment of third parties. The view has been taken that commerce will be promoted by believing third parties of the need to check the company’s constitutional documents before engaging with company’s representatives This is not to say that the company is not free to limit the authority of its agents as it wishes, but constitution is no longer seen as an obviously appropriate way to communicate such limitations to third parties. Other and most direct methods must be employed.762

Before we examine these developments in more details, we need to see more clearly how constitutional provisions operate to limit agent’s authority. An obvious source of such limitations is the objects clause which we have been examining in connection with the ultra vires doctrine. At common law, the objects clause operated

761 Ibid
762 Supra Note 697 Page 142
so as not only to restrict the capacity of the company but also, and not surprisingly, the authority of agents to act on its behalf. What the company did not have capacity to do its agents did not have authority to do. Consequently, to deal with *ultra vires* consequences of the objects clause would be inadequate law reform because, the third parties transaction would no longer be at risk of being regarded as void on grounds of want of corporate capacity, it might not bind the company on the grounds that it was beyond the authority of the company’s organ or agent which acted on its behalf. Nevertheless, the Cohen Committee failed to appreciate this when in 1945 it simply recommended that companies should have all the powers of a natural person, but it did not deal with the question of authority. However the reforms of 1972 and 1989 did deal with both aspects of objects clause.\(^{763}\)

First without amending section 2 of the 1985 Act, which requires the objects of the company to be stated in its memorandum, it inserted a new section 3A providing the following:

(a) That a statement that the company’s object is to carry on business as a “general commercial company” means that its object is to carry on any trade or business whatsoever and

(b) That the company has “power to do all such things as are incidental or conducive to carrying on of any trade or business by it”, and

Secondly, it substituted a new section 4 providing simply that a company may, by special resolution, alter its memorandum with respect to the statement of the company’s objects but that if an application is made under section 5, the alteration is not to have effect except in so far as it is confirmed by the court.\(^{764}\)

The object of section 3A is to encourage the use of simple general statements of objects. So far as objects in the sense of type of business are concerned, it may perhaps succeed in that aim in the case of some companies limited by shares and it is a boon to the marketers of shelf companies. It is doubtful, however, whether it has led to the hoped-for disappearance of the present long list of what are really powers but which are stated to be independent objects.

\(^{763}\) Ibid

\(^{764}\) Ibid
The importance of the new section 4 is in what it omits, namely the former provision that alteration of the objects is to be for one or more of seven specified reasons only. That had long been a pretty ineffective restraint since it could be ignored unless there was a likely-hood that there would be an application under section 5. That section remain unchanged and entitles holders of 15 percent of company’s issued shares capital or any class of it or, if the company is not limited by shares, 15 percent of the members (provided in either case that they have not consented to, or voted for, the resolution) to apply to the court within 21 days of the passing of the resolution which then does not take effect except to the extent that it is confirmed by the court. Now the court has discretion in all cases and, in the light of the statutory acceptance, by new section 3A, of generalized objects clauses and the fact that the change will have been approved by the requisite three-fourths majority of those voting, the court is unlikely to refuse confirmation save in exceptional circumstances. Under section 6 (also unchanged) the validity of the alteration cannot be challenged on any ground unless proceedings are taken, under the section or otherwise, within 21 days of passing the resolution.  

C. REFORM OF 1989 AND THE CHARITABLE COMPANIES
The 1989 Act also made special provision regarding charitable companies. These provisions are now contained in the Charity Act 1993. Section 64 deals with alterations by a charitable company of its objects clause. The broad effect seems to be where a charity is a company, no alteration which has the effect of the body ceasing to be a charity will affect the application of any of its existing property unless it brought it for full consideration in money or money’s worth. In other words, although the company is not prevented from changing its objects (as long as the prior written consent of the charity commission) in such a way that they cease to be exclusively for charity, its existing property obtained by donations continues to be held for charitable purpose only.  

In effect, the company will be in an analogous position to an individual trustee of a charitable trust; parts of its property will be held for charitable purposes only and

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765 Ibid page 139
766 Liverpool Hospital V attorney General (1981) Ch. 193
part of it not. And presumably, it will have to segregate the former. The result seems to be that if the charity Commission consents to a change of objects which results in the company being empowered to undertake both charitable and non-charitable activities, any future donations which it receives will not be regarded as charitable donations vis-a-vis either the donors or the company unless donors specifically direct that the gifts are to be held by the company for its charitable objects. In practice, donations to it are likely to dry up since the company will no longer be recognized by either the commission or the Revenue as a charity.\textsuperscript{767}

Section 65 of the Charity act 1993 provides that sections 35 and 35A of the companies Act do not apply to acts of company which is charity except in favor of person who either:

(1) Gives full consideration in money or money’s worth and does not know that the act is not permitted by the company’s memorandum or is beyond the power of the charity or

(2) Does not know that the company is a charity.

Under sub section (2), however, subsection (1) does not affect the title of any person who subsequently acquires an interest in the property transferred by the company so long as he gave full consideration and did not have actual notice of the circumstances affecting the validity of the transfer. It is clear that “know”, in sub section (1) connotes actual (not constructive) knowledge and sub section (3) provides that in any proceedings the burden of proving knowledge lies on the party alleging it. That burden, especially in relation to whether he knew that the company was a charity, but has a name which does not include the word “charity” or “charitable”, to state on all business documents in English in legible characters that it is a charity. Proof that party concerned has received such documents should go a good part of the way to discharging that burden.\textsuperscript{768}

Finally, section 65(4) provides that in the case of a company which is charity, ratification of an act under section 35(3) or to which section 322A applies shall be ineffective without the prior written consent of the Charity Commission. The Charity

\textsuperscript{767} Supra note 697 page 153- 154
\textsuperscript{768} Ibid
Act does not extend to Scotland. Hence section 112 of the 1989 Act makes comparable provisions applying to Scotland only.769

D. REFORM PROPOSED BY COMPANY LAW REVIEW

The company Law Review has proposed to complete the reform process which began in the year 1972, and to do so very much along the lines suggested by Professor Prentice. The crucial step would be to provide that a registered company has unlimited capacity. This would remove the conceptual foundation for the *ultra vires* doctrine. There would simply be no basis for arguing, as between the company and a third party, that the transaction was outside the company’s capacity because of anything contained in its constitution. However companies would be free to insert restrictions on the scope of their business in their constitutions and in the case of public companies would be obliged to do so to meet the requirements of the second Directive. However, private companies would no longer be obliged to do so and the statutory “general objects clause” would be repealed. When a company did choose to insert restrictions in its constitution, the policy of the 1989 reforms would be followed and the restrictions would have internal effect. Thus the CLR proposed that the effect of both sections 35(2) and 35(3) of the present Act should be retained in the new Act, although with modification that ratification would be by ordinary resolution. Finally, the special machinery for altering the objects clause (if included) would be replaced by the general rules for altering the companies constitution, which are supposed to be equivalent to those presently laid down for altering a company’s articles, that is, special resolution of the shareholders. The vestigial role for the court would finally disappear.

If these reforms were carried out, we could finally cease to talk of *ultra vires* in the strict sense. However, we should still have to consider what impact provisions in the company’s constitution (memorandum and articles of association) may have upon the authority of the company’s organs and agents to contract on its behalf.770

769 Ibid
770 Ibid Pages 141-142
3. STATUS OF CONSTRUCTIVE NOTICE IN THE LIGHT OF FAMOUS DECIDED CASES

The doctrine of constructive notice provides that the memorandum and articles of association when registered with the registrar of the companies become public documents. These documents are open and can be inspected by any one before dealing with the company including entering into any contract with the company for the purpose of ascertaining the power of the company and to what extent these powers have been delegated to the directors of the company. So every person dealing with the company is treated and presumed to have actual and constructive knowledge of the contents of these documents. Therefore it is the duty of every person who contemplates dealing with the company to inspect these documents and make sure that his contract is in conformity with these documents and note ultra vires, the object clause as held in Ashbury Railway Carriage and Iron Co. v/s Riche and Re Jon Beauforte (London) Ltd. Every person dealing with the company is presumed to have read the memorandum and articles of association and understood them in their true sense and perspective. Therefore whenever a person enters into any contract with the company which is not permitted by the memorandum than it is ultra vires the company and the company will not be liable for the same. Similarly if the articles stipulate that the deed on behalf of the company should be signed by three specified directors/officers of the company and if it is signed only by one or two of them, than the deed will not be valid and the transaction will be ultra vires.

Ashbury’s company decision stood the test of time in many subsequent cases. The rationale behind the doctrine was that although a company in the eye of law is a person, it is an artificial person so devoid of intelligence and conscience and, consequently, law has not conferred on the companies a general capacity to enter into contract. A company has capacity to transact business only on those areas which are

771 Section 610 of companies, Act 1956
772 (1875) LR 7HL 653
773 (1953) 1 All E.R 634
permitted by the “objects clause” of its memorandum of association. Moreover, if the activities of the company diversify in to the areas not authorized by the memorandum of association, the interest of the shareholders and creditors may be injured since the funds may be spent for objects other than those about which the corporators and creditors had knowledge and for which they funded. The doctrine therefore is based on the concept that power, whenever conferred, cannot and should not be unlimited and all acts must be kept within the ambit of defined powers. 774

The rule in *Turquand’s case* 775 as enunciated by the courts has mitigated the effect of the constructive notice doctrine.

The facts of the case were as under-

That the directors of the company, who were the defendants in this case, borrowed a sum of money from the plaintiff bank on a bond, bearing seal of the company. The company’s deed of settlement provided that the directors might borrow on bond such sums as should from time to time by a general resolution of the company authorized to be borrowed. In fact no such resolution was ever passed by the company. In an action by the plaintiff bank against the defendant company put forward the plea that there had been no such resolution, authorizing the making of the bond and that the same was given and made without authority or consent of the shareholders of the company.

**ISSUE INVOLVED**

1. Whether the bank was before giving the loan, bound to ensure that necessary resolution in terms of “deed of settlement” has been passed?

2. Whether the company was liable for the loan?

**DECISION**

The dealings with these companies are not the dealings with other partnerships. The parties dealing with them are bound to read the statute and the “deed of settlement”. But they are not bound to do more. The part here on reading the deed of settlement would find not a prohibition from borrowing but a permission to do so on certain condition. Finding that authority might be made complete by a resolution, he would have a right to infer the fact of

775 (1856) 6 E&B 327 Exch. Ch
resolution authorizing that which on face of the document appeared to be legitimately done. In fact bank had the right to infer that necessary resolution must have been passed.

The bank was held to be not bound to ensure that the necessary resolution in terms of deed of settlement of the company had been passed, and the company was held liable for the loan taken by its directors on bond bearing seal of the company. 776

It is currently very much needed in that role, because despite the statutory provisions introduced in the 1989 Act abolishing constructive notice arising out of public filing, the provision has not been brought in to force. Even if that section, or some equivalent, is eventually brought in to force, the Turquand rule will not cease to be relevant, though its significance will be reduced, because it operates to protect those who have actual knowledge of company’s constitution as well as those who have constructive knowledge. 777

In another matter of Mohoney v East Holyford mining Co 778 the doctrine was approved and applied by House of Lords in an even more difficult case. Here a bank had honored the company’s cheque, signed by two of three named directors, after having received from the company’s secretary a copy of a board resolution giving cheque signing powers to three directors, to which their signatures had been appended. Unfortunately, neither secretary nor directors had been properly appointed, but the bank successfully resisted an action for the repayment of the money. Provided nothing appeared which was contrary to the articles, the bank was entitled to assume that the directors had been properly appointed. This protection to third parties is partially re-affirmed by section 285 779 which states that “the acts of a director or manager” are valid notwithstanding any defect that may afterwards be discovered in his appointment or qualification. However the statutory protection is only partial because the House of Lords has held in Morris v Kanseen 780 that the section applies only when there has been a defective appointment and not where there has been “no

776 Ibid
777 Supra note 697 page 157
778 (1875)L.R. 7 H.L.869
779 English Companies Act 1985
780 (1946) AC 439
appointment at all”. Thus in the case of no appointment at all the *Turquand* principle as applied in *mohoney’s* may still be needed. It will also be needed if the courts hold, as it is hoped they will not, that sec 35A applies only to properly appointed directors

However in the light of sec 35A which is also known reformation of 1989 which reads as under:

(1) In favor of a person dealing with a company in good faith, the power of the board of directors to bind the company, or authorize others to do so, shall be deemed to be free of any limitations under the company’s constitution.

The normal scope in future for the deployment of the *Turquand* principle will be where the third party has not dealt with the company through the board or a person authorized by the board. The first thing is to note is that the principle does not, by itself, normally operate so as to confer ostensible authority on a company’s agent. Ostensible authority has to be established separately from the *Turquand* rule. On the assumption of such authority, *Turquand* gives the third party an answer, in a limited range of cases, to the company’s defense that the third party should not be permitted to rely on the agent’s ostensible authority because that third party knew, actually or constructively, that the company’s constitution stood in the way of the confinement upon the agent of the authority he or she appeared to have. That answer is available if all the company’s constitution shows is that the agent might or might not have the ostensible authority to act, i.e. knowledge defeats the third party only where the constitution clearly deprives the agent of that ostensible authority. If ostensible authority were not a pre requisite of the *Turquand* rule, in a company whose article permitted the board to confer upon any person the power to sell the company’s assets on its behalf, the rule might have the absurd consequences that a third party could assume that any person had such authority, even if in fact unconnected with the company.781

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781 Supra Note 697 page 158
Thus it would be absurd if he could safely assume, say that authorization to sell the company’s premises had been conferred on the office boy, the lift attendant or someone who had no apparent connection with the company. Despite the apparent width of the *Turquand* rule as expressed in the dicta in *Turquand* and *Mohoney*\(^{782}\) quoted above (and despite the fact that the rule will eventually be freed from the limitations on it under the constructive notice doctrine), the later case on *Turquand* rule make it clear that these assumptions can be made only on the basis of a holding out by the company, often taking the form of an appointment to a particular employment. A very similar result would be reached by applying normal principle of agency.\(^{783}\)

4. ABOLITION OF THE DOCTRINE

The standard justification for the *ultra vires* doctrine is that it protects members and creditors. It enables investors and those lending or extending credit to the company to assess the risk of so doing by reference to the company’s published business objectives, and renders void any transaction that falls outside them.

It is now accepted that this justification is no longer valid and such beneficial effects of the doctrine may be outweighed by its disadvantages. Thus whilst *ultra vires* may still play a limited role in controlling non-commercial transactions, the almost universal practice of equipping companies with a set of objects which authorize every conceivable activity that it is of no value in limiting the risk undertaken by investors and creditors. The doctrine merely serves, though infrequently, to allow a company unmeritously to escape its obligations by draft defects in its own objects clause.\(^{784}\)

After having made attempts to simplify the objects clause which probably remained in vain, the second step is taken to make an attempt to remove the consequences of exceeding any limitations on a company’s capacity without actually admitting that it had full capacity. This has been done in the 1989 Act by substituting

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\(^{782}\) (1875) L.R 7 H.L. 869
\(^{783}\) Supra Note 697 page 157
\(^{784}\) ibid
for the original section 35 of the 1985 Act new section 35. Hence subsection (1) of new section 35 reads as follows:

(1) The validity of an act done by a company shall not be called in to question on the ground of lack of capacity by reason of anything in the company’s memorandum. It is to be further noted that this is not restricted to the objects clause of the memorandum; it applies, for example, to a separate clause saying that the company shall not undertake certain types of business and to any provision in the memorandum imposing limitations on the company’s powers and thereby on its “capacity”.785

This is obviously an improvement on the former section 35(1). It omits the former words “in favor of a person dealing with a company in good faith” and “good faith” but makes it clear that neither the company nor the third party can any longer invoke strict ultra vires. However, whilst the legislator’s objective was to relieve third parties from the impact of the ultra vires doctrine, it wished to retain the effect, within the company’s internal affairs, of the restrictions contained in the memorandum on the scope of the company’s business. Section 35, consequently, goes on to make two major qualifications to the principle stated in section 35(1). However subsection (2) provides the followings:-

“A number of companies may bring proceedings to restrain the doing of an act which but for subsection (1) would be beyond the company’s capacity; but no such proceeding shall lie in respect of an act done in fulfillment of a legal obligation arising from a previous act of the company”.786

This preserves the right of the individual shareholder to restrain the commission by the company of ultra vires acts, but clearly this right of the member has to be subordinated to that of third party to enforce his or her transaction with the company, if the policy behind section 35(1) is to be fully implemented. This is achieved by the provision to subsection (2) that a member cannot bring proceedings to restrain an act of the company which, but for sub section(1) would be beyond its

785 Supra note 697 Page 139.
786 Ibid.
capacity, if that act is to be done in fulfillment of a legal obligation arising from a previous act of the company.\textsuperscript{787}

Hence if, say, that the company has entered in to a contract which is beyond its powers but which as a result of sub section (1), cannot be questioned, the company cannot be restrained from performing its obligations under that contract. If, however that contract was one under which, say, the company bought an option to purchase, a member could take proceedings to restrain it from exercising the option since it would not be under a legal obligation to do so. Thus overall, the policy of protecting third parties legal right is given priority, to that of holding the company to its constitution.\textsuperscript{788}

The second qualification made by subsection (3), which provide as under:-

“\textit{It remains the duty of the directors to observe any limitation on their powers flowing from the company’s memorandum and action by the directors which, but for subsection (1), would be beyond the company’s capacity may only be ratified by the company by special resolution. A resolution ratifying such action shall not affect any liability incurred by the directors or any other person; relief from any such liability must be agreed to separately by special resolution}”\textsuperscript{789}

This provision in fact deals with two things-

First, it makes it clear that the directors are still under a duty to abide by the provisions in the company’s memorandum, restricting the scope of its business, even if third party need no longer concerned with such restrictions. That duty is owed to the company and so the company( for example, by resolution in general meeting) might decide to sue the directors to recover for the company the loss suffered by it as a result of the director’s failure to abide by the terms of the memorandum. The section also makes it clear that the shareholders can instead ratify the directors actions (by special resolution, requiring a three quarter majority), so as to relieve the directors of any liability to the company. This is more demanding test for ratification than is required for actions in excess of authority, where an ordinary resolution will do.

\textsuperscript{787} Supra note 697 Page 140.\textsuperscript{788} Ibid\textsuperscript{789} Ibid
Second, the section empowers the shareholders to pass a second type of ratification resolution, one which makes the transaction binding on the company. At common law as we have seen, an *ultra vires* act could not be ratified by even the unanimous consent of the shareholders. The shareholders might want to ratify, for example, where one of their number threatened to bring injunctive proceedings under section 35 (2), but the majority of shareholders were in fact in favor of the directors transaction. Thus the section distinguishes between two types of ratification resolutions (though both require super-majorities), the one to relieve the directors of the liability to the company and the other to make the transaction binding on the company. The shareholders could adopt either, neither or both of these resolutions.\(^{790}\)

However, subsection (1) only in respect of the liabilities incurred by the directors and “other person” (words presumably inserted to catch officers of the company who participated in the directors act). It enables them to escape liability in respect of their action, which formerly could not be ratified even by the unanimous consent of the members, provided it is ratified by a special resolution in accordance with the subsection. The subsection does not detract from the protection afforded to the other party to the transaction against the company. Under subsection (1) the company’s act cannot be called in to question on the grounds of lack of capacity. So far as other party is concerned, ratification by special resolution is of relevance only if it took place before any legal obligation to him was incurred (in which event it would preclude a member from bringing an action under sub section (2)).\(^ {791}\)

**A. EXCEPTION TO THE DOCTRINE**

**I. UNDER ENGLISH LAW**

**a. BY EURPOEAN COMMUNITY ACT 1972**

At one point of time up to the last quarter of 20\(^{th}\) century, there were no exception to this doctrine, but due to the fast growth and progress in the corporate sectors it became essential for the people to change their view towards this doctrine. This change can further be attributed to the concept of welfare state concept and also to the socialistic pattern of society. As a result of this, exceptions to the doctrine were

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\(^{790}\) Supra note 697 Pages 140-141

\(^{791}\) Ibid
introduced. To bring the law in conformity with the European community requirements, the Great Britain applied the European Community Act 1972 as we have referred above also, which makes provision in favor of the person dealing with the company in good faith and carrying out lawful transaction, than such transaction will be deemed to be within the company’s capacity and this will mitigate the harshness of the doctrine of *ultra vires* as was faced in the matter of *Jon Beauforte London Ltd.*

To bring the law in conformity with the European Community requirements, the Great Britain has passed the law and section 9 of the Act has modified the doctrine of *ultra vires* in favor of the person dealing with the company in good faith in any transaction. However if the company can show actual knowledge on the part of third party dealing with it, that the transaction was out side the scope of the objects clause, then there will be no good faith. However, there is no obligation for that part, to investigate the company’s capacity by inspecting the memorandum.

### b. UNDER ENGLISH COMPANIES ACT 1948

Further section 448 of the English Companies Act 1948 which is equivalent to the section 633 of the Indian companies Act 1956 which is a protective section for the directors, by this a relief can be given, even when the director has done an act *ultra vires* the company, if he has acted honestly, reasonably and fairly. It is not enough to prove that a director acted honestly, but it must also be proved that he ought to be excused, for example where the company’s money was applied for the purpose which was *ultra vires* but the director was acting on the advice of counsel and as per the opinion given by the counsel the act was *intra vires*.

### c. UNDER DIFFERENT RULINGS OF COURTS

However, further points also support the exception to the doctrine

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792 Sec 9 (1) of the Act
793 (1953) 1 All ER 634
794 European Communities Act 1972
795 National Trustee Company of Australia V General Finance company (1905) AC 373
796 Re Claridge Patent Ashphate Co. (1921) 1 Ch 543
1. If an act is *ultra vires* the powers of the directors only e.g. their borrowing powers, the ratification can be done by the shareholders.\(^\text{797}\)

2. If any thing contained in the articles is *ultra vires* the articles then the error may be ratified.

3. If an act is within the powers of the company but is irregularly done than the consent of all the shareholders will validate that act.

4. The company’s right over property will be protected even though the property has been acquired by *ultra vires* means and money.\(^\text{798}\)

5. Though the act is *ultra vires*, rights arising independently there from, will not be affected.\(^\text{799}\).

6. A company, borrowing money from the company under a contract which is *ultra vires* can be sued by the company.

7. Where there is *ultra vires* borrowing by the company or it obtains delivery of property from a third party under an *ultra vires* contract, that 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 exists in species and obtain an injunction restraining the company from parting with the same, provided the intervention is made before the money is spent or the identity of the property is lost out.\(^\text{800}\)

8. If any director of a company makes payment of any amount of money which is *ultra vires* the company, he can be compelled by the company to refund the same, but the defaulting director in his turn may claim indemnity from the person who receive it knowing the same to be *ultra vires*.

**d. UNDER COHEN COMMITTEE REPORT 1945\(^\text{801}\)**

Basically in England more general discussions took place about the doctrine of *ultra vires* at the end of Second World War. Therefore the aforesaid committee, named The Cohen committee was appointed with the instruction ‘to review the requirement prescribed, in regard to the formation and affairs of the companies and

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797 Grant V U.K. Switch Back Rly Co. (1888) 40 Ch. D 135  
798 Turner V Bank of Bombay (1901) ILR 25 Bom 52  
799 Garrad V James (1925) Ch. 616  
800 Sinclair V Brougham (1914) AC 616  
801 Of 1945
about various safeguards which could be afforded for the investors and for public interests. The report was presented in the year 1945.

The committee made various dynamic suggestions and proposals, some of them- particularly on disclosure were far reaching in the light of public interest, for the consideration of the Parliament. Most of them have been accepted and got recognition in the shape of Companies Act 1948 and its work was widely acclaimed as bringing a new era in the company law. After a review of the pattern, that took place in framing the objects clause due to inserting tendency of draftsmen probably all objects, there-in, and judicial response to their attempts by various decisions in last 65 years, the committee made striking proposals of abolishing this doctrine.

It is also suggested that the company should have as regards the third persons same power as an individual and memorandum in future should operate solely as a contract between a company and its shareholders. Hence by these suggestions, though not accepted by the British Parliament, in framing of the companies Act 1948, the committee had tried to save the third party dealing with the company, as well as the shareholders. Because if the company possess the same powers as an individual, then, the company will be held liable to the third person for its ultra vires acts. On the other hand if memorandum operates as a contract then the company will also be answerable to the share-holders who invest their money in it.

Doctrine of ultra vires - Had memoranda of association closely followed the forms in the First Schedule to the Act, this protection might have been real, but, partly with a view to obviating the necessity of applying to the Court for confirmation of an alteration of objects, a practice has grown up of drafting memoranda of association very widely and at great length so as to enable the company to engage in any form of activity in which it might conceivably at some later date wish to engage and so as to confer on it all ancillary powers which it might conceivably require in connection with such activities. In consequence, the doctrine of ultra vires is an illusory protection for the shareholders and yet may be a pitfall for third parties dealing with the company.

For example, if a company which has not taken powers to carry on a taxi-cab service nevertheless does, then the third persons who have sold the taxi-cabs to the

802 Excerpt from the Cohen Committee Report 1945
company or who have been employed to drive them may have no legal right to recover payment from the company. We consider that, as now applied to companies the *ultra vires* doctrine serves no positive purpose but is, on the other hand, a cause of unnecessary prolixity and vexation. We think that every company, whether incorporated before or after the passing of a new Companies Act, should, notwithstanding anything omitted from its memorandum of association, have as regards third parties the same powers as an individual. Existing provisions in memoranda as regards the powers of companies and any like provisions introduced into memoranda in future should operate solely as a contract between a company and its shareholders as to the powers exercisable by the directors. In our view it would then be a sufficient safeguard if such provisions were alterable by special resolution without the necessity of obtaining the sanction of the Court, subject in cases where debentures have been issued before the coming into force of a new Act, to the consent of the debenture-holders by extraordinary resolution passed at a meeting held under the provisions contained in the trust deed or (in the absence of such provisions) convened by the Court.803

**Recommendation**

We recommend that section 5 be repealed and a new section be inserted in the Act to give effect to our suggestions in paragraph 12 of the report.

The view on the doctrine of *ultra vires* pertaining to the contract were “A contract made by the directors upon a matter not within the ambit of company’s objects is *ultra vires* the company and therefore, beyond the powers of the directors. This principle is intended to protect both those who deal with the company and its shareholders.

e. **UNDER THE JENKIN COMMITTEE REPORT 1962**

On 10th December 1959, the president of the Board of Trade appointed a committee, under the chairmanship of Lord Jenkin to review and report on the provisions and working of the companies Act 1948, and to further suggest in the light of the modern conditions and practices, what should be the duties of directors and the

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803 Ibid
right of the shareholders and also to recommend whether any changes in law were desirable.

The committee gave its report in the year 1962 in the name of Jenkin committee report which is as under:-

The committee pointed out that the doctrine of *ultra vires* hardly led to unjust results. The committee suggested that *ultra vires* rule should not be repealed but protection should be afforded to the third parties dealing with the company in good faith and the doctrine rarely led to unjust results. They concluded:-

“it seems to us that the best course will be to attempt no general repeal of the existing law of this doctrine, in relation to companies registered under the companies act, but to provide protection to third parties contracting with the companies as follows:

(i) Against the unfair operation of the *ultra vires* rules and
(ii) By abrogating the rule already mitigated by the decision in *Royal British Bank V Turquand*\(^{804}\), that third party parties are fixed with constructive notice of the contents of a company’s memorandum and articles of associations.

In the light of this conclusion the committee addressed itself to the *ultra vires* doctrine and further recommended as follows:-

**DOCTRINE OF ULTRA VIRES**- The companies objects and powers in various paragraphs:-

(i) A contract entered into between a company and another party (including a shareholder contracting otherwise than in his capacity as a shareholders) dealing with the company in good faith should not be held invalid as against the other party on the ground that it was *ultra vires* (beyond the powers of the company) but, if he wishes to enforce the contract, he must perform his part.

(ii) In entering into any such contract, the other party should be entitled to assume, without investigation that the company is in fact possessed of the necessary power, and should not, by reason of his omission so to investigate, be deemed not to have acted in good faith. Nor should be deprived of or lose his right to enforce the contract on the ground that at the time of entering in to, it had

\(^{804}\) (1856) 6 E & B 327
constructive notice of any limitation on the powers of the company or the directors or other person to act on the company’s behalf, imposed by its memorandum or articles of associations.

(iii) The other party should not be deprived of his right to enforce the contract on the ground that he had actual knowledge of the contents of the memorandum and articles. He should still be able to enforce the contract if he honestly and reasonably failed to appreciate that they had the effect of precluding the company (or its directors or other person on its behalf) from entering into such contracts.

There should be no change in the position of a company in relation to ultra vires contracts. Thus a shareholder would still be able to sue for an injunction to prevent the company from carrying out ultra vires activities.

(iv) The companies act should be amended to provide that every company should have certain specified powers, except to the extent that they are excluded, expressly or by implication, by its memorandum, such powers being those which any company would normally need to pursue its objects.

(v) In this paragraph the committee recommended slight amendment to the section 5 of the 1948 Act (which deals with the alteration of the objects), including the abolition of the list of purposes for which alterations are authorized and allowing the alteration to extend to the inclusion of any new object which could lawfully have been included originally.805

5. REPORTS OF INDIAN COMMITTEES/COMMISSION LEADING TO ENACTMENT OF COMPANIES ACT 1956/AMENDMENT EFFECTING THE DOCTRINE OF ULTRA VIRES

I. UNDER BHABHA COMMITTEE REPORT 1952

The government of India appointed a committee, under the chairmanship of Mr. Bhabha, which is known as Bhabha committee, in the year 1950, with the object of recommending the overhauling of the company’s legislation in the country. The committee submitted its report in the year 1952, on the basis of which a bill was prepared and laid down before the Indian parliament in the year 1953 and the bill after

805 Excerpt from Jenkin Committee Report 1962
the consideration of the joint select committee of the parliament, with few modifications was passed by the parliament in the year 1953, and as a result of which the companies act 1956 took the shape of company’s new legislation by repealing the act of 1913. This act of 1956 was brought in to force with effect from 1st day of April 1956.

On the doctrine of *ultra vires* this committee expressed the similar view as expressed by the Cohen committee that the doctrine is merely illusory protection for the shareholders and pit fall for the third parties dealing with the company hence this committee report is also falling within the purview of exceptions to the doctrine of *ultra vires*.

About the lengthy objects clauses of memoranda, the committee considered the question of imposing certain restrictions on the wide powers taken by companies in their memoranda to carry on every conceivable business and though the committee fully appreciated the necessity of restrictions it was unable to evolve a practical method to distinguish the two type of businesses and to recommend the basis of an effective legal provision. The committee however preferred to rely on the responsible judgment of the management and the periodical vigilance of the shareholders would ordinarily come into the picture when the company seeks to amend its objects clause and rarely in cases of utilizing wide powers taken in the memorandum to participate in some other activities.\(^{806}\)

**II. VIVIAN BOSE COMMISSION**

This commission of enquiry was appointed to investigate into the affairs of the Dalmia-Jain Airways Ltd. under the chairmanship of Justice Vivian Bose, The commission was directed to report separately on the following issues:-

1. The action which in the opinion of the commission should be taken to act as a preventive in future cases and
2. The measures which in the opinion of the commission are necessary in order to ensure that in future the due and proper administration of the funds and assets of the companies and firms in the interest of the investing public.

\(^{806}\) Excerpt from Report of company law committee 19 of 1952
The commission made a thorough inquiry for about six years in the case of the company, Dalmia Jain Airways Ltd. and suggested amendments aimed at preventing some of the evils of the kind, which came to light as a result of the inquiry. The report of the commission of inquiry disclosed that, this company, the Dalmia Jain Airways Ltd. was floated ostensibly for the purpose of carrying on air transport business. But even from its very inception the promoters had never intended that the huge sum of over 319 Lac raised by public subscription towards the share capital should be utilized for such business. They had only intended to form a private company for carrying on a totally unrelated adventure, namely, purchasing surplus motor vehicles and spare parts and machineries left by the U.K. and the American forces at the conclusion of the last war, and after reconditioning the vehicles selling them at a profit. The attempt was to run a skeleton air transport as a make believe show. The memorandum of association of the company included an omnibus clause that gave power to the company to deal in vehicles of all kinds and which even specified cycles, carriages and perambulators. The prominence given to the ostensible object made the public believe that the company would really conduct the business of air transport. The memorandum being comprehensive within its scope and the dealing in motor vehicles and spare parts, the persons in control, without reference to the shareholders and even to the controller of capital issues who had authorized the issue of share capital, were able to divert the funds so obtained into the surplus motor vehicles and spare parts business. Though its funds were freely utilized for acquiring the surplus motor vehicles and spare parts, the public company did not get the benefit and profits from the deal. The profits went to the private company, which entered in to contract for the purchase and the public company suffered a huge loss in the result. The commission submitted various recommendations on the objects clause of the memorandum of association.\textsuperscript{807}

It is a matter of common knowledge that it is customary to make the objects and purposes of a company’s memorandum as wide as possible in order to obviate applications to the court when some new venture is contemplated. No objection can normally be taken to make the objects as wide in scope as possible, but at the same time, this practice holds out ample opportunities for participating in activities which

\textsuperscript{807} Section 13 of the companies Act 1956
are neither the main activities nor are ancillary there-to, but are very remote in character and removed from the principal and ancillary objects for which a company has been incorporated.808

The reason for floating of this company in that form was that, at that particular time, Air line business was very much in the public eyes and there was a big demand for shares in such companies. It is significant that though the ostensible main business was given prominence in the memorandum of association, the activities which the company intended to pursue were totally different, namely business of all types of surplus motor vehicles and spare parts etc.

The commission remarked that in recent time, there have been instances, where companies have gone in for diversification and diversified their activities into lines other than the principal objects or objects ancillary thereto. We are not necessarily condemning diversification as such and feel that this tendency may largely be due to the system of inter-corporate taxation of dividends. In country where inter corporate taxation does not exist, the tendency for a group is to form desperate subsidiary companies under the main holding company, but this would prove to be for too expensive from the tax point of view, in this country owing to dividends being taxed at each stage of its corporate travel.

Nevertheless, we think that the shareholders should have some say in the matter, and it is, therefore. Recommended that:-

(1) The act should be suitably amended to provide that every company shall clearly state its purposes and objects under two separate categories as under:-

(a) The principal and ancillary objects which the company intends at the time of its incorporation to pursue and

(b) All other objects which are separate from the principal and ancillary ones mentioned in item (a) above.

(2) A provision should be made in the act to the effect that a company shall not engage itself in any activities coming within the scope of clause (b), unless such activities are sanctioned by a special resolution of the company in general meeting.809

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808 Report of the Commission of Enquiry on the Administration of Dalmia-Jain Companies
809 Ibid
III. DAPHTARY SASHTRI COMMITTEE REPORT 1957

This committee was appointed in May 1957 under the chairmanship of Shri A. V. Vishwanath Shastri, Advocate of supreme Court, along with another member of the committee Shri C. K. Daphtari, the then Attorney General of India and the committee submitted its report in November 1957 about the doctrine of *ultra vires* and the object clause.

Referring the facts of the “Dalmia-Jain Airways Ltd.” and considering the recommendation of Vivian Bose commission regarding the classification of the objects clause, the committee further mentioned that:

The committee after reviewing the Vivian Bose Commission report stated that the real objects often get buried beneath the mass of words, when objects clause packed with objects and powers without discrimination and shareholders could not acknowledge in what enterprise their money is going to be spent. Though the committee accepted the division of the objects into (i) principal and ancillary and (ii) others, for the recommendation as suggested by Vivian Bose commission but pointed out that the remedy does not lie merely in making provisions for separating the principal objects from the other objects for even then it is possible to include under the head “Principal objects” a variety of objects not necessary having any connection.

The committee weighed to the sanction of the shareholders and expressed that the first directors should be required to obtain by a resolution, the approval of the shareholders in general meeting in first instance; and thereafter, if it proposed to engage in new activities, by a special resolution, and every such resolution should be incorporated in all copies of the memorandum of the company.810

The memorandum states that what shall be the powers of the company and the objects to the attainment of which the power could be exercised. The objects specified in the memorandum (as per section 13(1) (c) of the act) gives a measure of protection to the subscribers to the share capital and the person dealing with the company and are intended to indicate plainly and unambiguously the purpose, for which the funds of the company can be used or filled of business, within which the company’s

810 Excerpt from Daphtary- Shastri committee 1957
activities have to be confined. It is well settled that an act which is beyond the powers of a company as specified in the memorandum of association is *ultra vires*.

Further, a change in the memorandum involves the observance of certain formalities including an application to the court for approval in cases falling within section 17 of the companies Act 1956. It has therefore, become normal to specify objects having a wide scope and variety and in an anxiety to avoid acts of directors being declared *ultra vires* a multitude of objects which are specified without any distinction being made between the objects and the powers. The principle of real objects often gets buried beneath a mass of words and a multitude of other objects and powers brought indiscriminately in to the memorandum, disapproval has been expressed of this tendency but no attempt has so far been made to correct it, as seen in *Cotman V Brougham*.

The government of India has accepted the recommendation of this committee in the shape of the companies (amendment) act 1965. It amends the sub-clause (c) of section 13(1) and provides and makes provision for clear definition of the (i) main and incidental or ancillary objects of the company and (ii) other objects in the memorandum of association.

After having studied the reports of all committees and commission in relation to the doctrine of *ultra vires* that these committees and commission are not very serious for the existence of the doctrine of *ultra vires*, however they have found to be anxious about the safeguard of the followings:-

1. The interest of the shareholder be protected either by the doctrine of *ultra vires* or by any other provisions.

2. The interest of the third persons/parties dealing with the companies be protected, and it should not prove pit fall for as commented by committees.

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811 (1918) AC 514