DOCTRINE OF ULTRA VIRES UNDER COMPANIES ACT 1956

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ABSTRACT

“Research” means to find out and examine again. Legal research means research in that branch of law which deals with the principles of law and legal institutions. The significance of legal research is based on justice, equity and good conscience. There are two kinds of Legal Research. A. Doctrinal or the Traditional Research. B. Non-Doctrinal or Empirical Research. This topic is covered under first category of research

The historical background of the doctrine is divided into two parts which is before and after 1855, since the concept of limited liability was made applicable in this year. The doctrine is basically applies to the companies and the so called corporations but it can be applied to other areas also, such as in the matter of legislations too, in the form of substantive ultra vires and procedural ultra vires. It has been further remarked that the doctrine should be made applicable to LLP’s (limited liability partnerships) also, which are having all characteristics of corporations. The applicability of the doctrine to England and Sri Lanka dates back to 19th century and accordingly to other country too. However in India, it dates back to 1866 when applied by Bombay High Court.

Company becomes a legal person soon after its incorporation. There are two kinds of corporations i.e. corporation aggregate and corporation sole. There are various theories about the corporate personality. Memorandum of association and articles are two main documents of the company. Doctrine of constructive notice is a presumed notice by which it is assumed that those dealing with the company have read and understood the documents filed with the Registrar. Alteration of the objects clause is having direct impact on the doctrine which can be affected by passing special resolution as per the provisions of companies Act and filing the same with the Registrar. The doctrine has its primary, secondary and modern meaning. The doctrine differs from illegal acts and want of jurisdiction too. Corporations too have social responsibilities towards society at large.
The directors of the company will have to face litigations and be personally liable in case of *ultra vires* transactions/actions, examples of *ultra vires* and *intra vires* transactions are given at appropriate place. Business people have tried to evade the effect of the doctrine by different ways. In England certain reforms have been affected on the recommendations of the committees, by European Communities Act 1972, in favor of the third party dealing with the company in good faith, which has been further enacted in the English Companies Act 1985 and 1989 also. Lastly the Act of 2006 has greatly reduced the applicability of the doctrine in United Kingdom although it can still apply to charity. But in India the doctrine is very much static and strong.

In India, based on the recommendations of certain reports of Committees and commissions, few legislative developments, which include enactment and amendments having effect on the doctrine, have been made. In addition to England and our country, the status of the doctrine of *ultra vires* in other countries has been discussed. Based on the conclusions few suggestions including amendments in the Companies act 1956 have been recommended.
SUMMARY

DOCTRINE OF ULTRA VIRES UNDER COMPANIES ACT 1956

The doctrine of “ultra vires” is a Latin term which means beyond powers. This term is usually used to mean and refer to the acts of the corporations or the companies that are taken outside the power or authority granted to them by law or under the charter of the corporation. The memorandum of association is the charter of the companies, which contain objects clause within it, which serves two fold purpose as explained by Lord Parker in famous case of Cotman V Broughm (1918) AC 514 at page 520 that it puts on notice of (a) the members as to the purposes of the company on which the money subscribed by them would be laid out to protect themselves and (b) the other outsiders intending to deal with the company on the extent of the company’s powers to protect themselves, as a corollary to the doctrine of constructive notice. The corporations or their officers cannot pursue any objects beyond those objects which are mentioned in the objects clause. If the corporate capital is spent beyond the objects clause contained in the memorandum of association than the doctrine of ultra vires will operate against it.

This doctrine was not given much attention up to the period of 1855. The reason behind this was that before 1855 companies used to be in the form of enlarged partnerships and these were governed by the rule of partnership. As per the partnership rule no change in the business of partnership could be made without the consent of all the partners. These rules of partnership were considered sufficient to protect the investors. On account of the limited liability of the members, the creditors also felt themselves protected and did not require any other device for their protection.

However in the year 1855 some important developments took place. One of them was the introduction of the principles of limited liability. After the introduction of the principle of limited liability, it was possible to make the liability of the members limited. Hence so long as the liability of the members was unlimited up to 1855, the creditors of the company considered themselves protected, but after the
development of the principle of limited liability, they found themselves in unsecured and miserable state of affairs.

This necessitated a device which could protect the creditors and this further molded the minds of the pioneers towards the doctrine of ultra vires.

Nature of the doctrine is the judge made law, and the rulings of various courts of different countries have made a great contribution in the survival and development of the doctrine.

The doctrine has other meanings such as primary and secondary meanings, improper meaning and modern meaning. There is difference between ultra vires and illegality and want of jurisdiction as well.

The earliest case of Sutton’s Hospital of the year 1612 is generally taken to have established that the doctrine had no application to Chartered corporations despite the fact that they did have a legal personality distinct from that of their members.

The doctrine of ultra vires was applied in England and Sri-Lanka in the year 1840 in Colman V Eastern County railway Company.

The doctrine of ultra vires was invoked for the first time in case of Joint Stock Company in the year 1860 in Simpson V West Minister Palace Hotel. In this case the memorandum of the company stated:-

“The objects for which the company is established are the purchase of the leasehold lands, the erection, furnishing and maintenance of Hotel and carrying on the usual business of Hotel and tavern there-in, and doing of all such things as are incidental or otherwise conducive to the attainment of these objects”. While the Hotel was being built, the directors agreed to let off for a few years, a large portion of building. The House of Lords held that the letting was not ultra vires, as it was temporary and preliminary and conducive to the attainment of these objects.

This doctrine was firstly invoked in the case of companies, in celebrated case of Ashbury Railway carriage & Iron Co. V Riche as early as in the year 1875. The company was basically formed for the following objects:-

“To make and sell or lend on hire, railway carriages and wagons, and all kinds of railway plants, fittings, machinery and rolling stock; and to carry on the business of mechanical engineers and general contractors, to purchase, lease, work and sell mines, minerals; land and buildings; to purchase and sell as merchants, timber, coal, metals or other materials and to buy and sell any such
materials on commission or as agents; to acquire, purchase, hire, construct or erect works and buildings for the purpose of the company, contingent, incidental or conducive to all or any of such objects.”

The company had entered into a contract with the plaintiff for financing of the construction of a railway line in Belgium. The House of Lords held the contract was *ultra vires* the company, and altogether void. Further it was incapable of ratification by the unanimous consent of all the shareholders.

Soon after the above celebrated case of *Ashbury*, where the doctrine of *ultra vires* was strictly made applicable, the similar principle was followed in *Attorney General V great Eastern Railway* in the year 1880, where the important wordings of Lord Halsbury L.C. “those two cases constitute the law upon the subject of doctrine of *ultra vires*”

Accordingly in *London County Council V Attorney General* in 1902, the council having statutory power to work tramways was restrained from running omnibus in connection with tramways. The court found that the omnibus business was in no way incidental to the business of working tramways.

In another famous English case of *Beauforte (Jon) London, Ltd. Re*, which was decided in the year 1953, the three number suppliers of materials to their factory manufacturing veneered panels could not recover their payments, since the objects contained in the memoranda of the company was to carry on the business of costumer, gown, robe, dresses and tailoring activities of allied nature and not of veneered panels for which they supplied material. Hence all the three applications of suppliers were dismissed.

The doctrine of *ultra vires* has been given a premature death in England in the case of *Bell House Ltd. V City Wall Properties Ltd.* in the year 1966 where the objects clause of the company authorized the board of directors to carry on such trade or business which in their opinion could be carried out advantageously with the existing business of the company. Although their main object of business was the acquisition of vacant sites and erection there-on housing estates. In the course of transaction of their business, the company acquired the knowledge of source of finance for property development and introduced the financer to the defendant company. The Company claimed the agreed fee of 20,000 pounds for its services. Defendant contested the claim on the ground that the contract was *ultra vires* the plaintiff company and therefore void.
The Court of Appeal 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 to pay the required amount.

Where as in Aviling *Barford Ltd. V Perion Ltd*, decided by Chancery Division in the year 1989, in which it was held that the directors who spent money on unauthorized objects were personally liable to restore it.

The application of the doctrine of *ultra vires* was made applicable to the than existing Municipal Corporations in the year 1855 and to non-sovereign legislature in 1861, but few authorities are having difference of their opinions on this issue.

For example Lord Atkinson and Lord Halsbury make it applicable to all registered unions,

Where as Lord Mac Naughton and Lord Haldane remarked that factum of incorporation for the purpose of application of doctrine is not material.

According to H.A. Street the voluntary associations, co-operatives societies, industrial provident fund societies, friendly societies which also include building societies and clubs make their own by-laws and rules and regulations and any act done against those by-laws will be treated as *ultra vires*. In the case of friendly societies which may be formed for any purpose, hence such societies have no power to enlarge their objects. However they may convert themselves in to companies and enlarge their objects and after incorporation be governed by respective companies acts.

In India the Bombay High Court for the first time applied the doctrine of *ultra vires* in *Jahangir R. Modi V Shamji Ladha* in 1866. The facts of the case were that the plaintiff was the registered share-holder of 601 shares in a company of which the defendants were the directors. The object of the association, neither included dealing in shares, nor the purchase of company’s own shares; yet the defendant directors did deal in share and they incurred losses on behalf of company, and did purchase 1422 shares of the company. Therefore, the plaintiff contended that the defendant should account for such unauthorized dealings and should pay all losses thereby incurred to the company.

Similar to the celebrated English case of *Ashbury*, in India, the Supreme Court of India in *A. Lakshmanaswami Mudaliar V L.I.C. in 1963* held that an *ultra vires*
contract remains *ultra vires* even if all the shareholders agree to it. A company cannot be allowed to work beyond the scope of its objects.

The commercial corporations are bound by their memorandum of association that being the charter of the company, and it was remarked by Lord Cairn in *Ashbury’s case* that memorandum of association is the charter of the corporation, which must be adhered to by the companies and their members.

This doctrine has been constantly invoked in the cases of railways, Water, Gas and other public undertakings. These companies are bestowed by the legislature with very large and arbitrary powers derogating from private rights and are consequently most necessary that they should not be allowed to exceed or abuse such powers.

The doctrine of *ultra vires* should be equally applied to Limited Liability partnerships to protect the interest of partners, creditors and other people dealing with LLPs, since LLPs have the following characteristics namely:-

1. LLP is an artificial person. 2. LLP is a separate legal entity. 3. Liability of partners is limited in LLPs. 4. LLP is governed by LLP agreement. 5. LLPs are not liable for unauthorized acts of other partners.

Company is a juristic person and incorporation is conferred upon the legal personality only for the purpose of the particular objects stated in the objects clause of its memorandum of association. For the purpose of formation of the company, the promoters have to comply with certain requirement of preparing certain documents, out of which articles and memorandum of association are important ones. Because the objects for which the company is formed are contained in the memorandum of association, and any other foreign object which is not mentioned there-in makes the transaction *ultra vires* and hence void.

There are two types of corporations which are corporation aggregate and corporation sole. Any company usually formed by the promoters is an example of corporation aggregate and the Crown in England is the example of corporation sole. There are various theories of corporate personality. Some times corporate veil is lifted by the courts by ignoring the company as a separate entity and looking beyond the corporate veil to ascertain few things unknown to outside world.

The doctrine of constructive notice which was evolved by the courts in U.K. for the protection of the companies against third parties dealing with the company, in that they presumed to have knowledge of company’s document filed with the registrar, which are open to public for inspection and with the right to have certified
copies of relevant extract from them. Section 610 of our Companies Act 1956 contains this provision, irrespective of the fact, whether the third parties have the knowledge or not.

If any ultra vires transaction takes place in a company than the directors will be held personally liable and injunction can be sought against those and they can be made liable for breach of warranty and authority. In the same way ultra vires borrowings will have its own results, however ultra vires property becomes the property of the company since company’s capital is involved in it. As we have studied, all ultra vires contracts are void and of no effect.

As regard ultra vires torts are concerned, the law is not well settled and there are different opinions about tortuous liability. The doctrine of sufficient close connection and doctrine of identification are the later developments in English Law.

The business people have made attempts to evade the doctrine by one way or the other way by drafting such an objects clause which contains everything under the sun.

There have been reforms in England by section 9(1) of the European Communities Act 1972, by which third party protection is provided to those dealing in good faith with the company. This provision corresponds to the similar provision enacted in section 35 of 1985 Act which refers to “Acts done by organs” and organs was certainly intended to cover more than the board of directors. Thereafter anticipating further legislation in 1989, the department of Trade and Industry commissioned Professor Dan Prentice to undertake a review of the position and to make necessary recommendations. His report was delivered in the year 1986 and was circulated as a Consultative Document known as reform of ultra vires rule. His recommendations were incorporated into the Act of 1989, but his recommendations that the companies should be afforded the capacity to do any act what so ever, and should have the option of not stating their objects in memoranda were not straightway accepted, although few common law countries have adopted the same. The above provision of section 35 of 1985 Act is further re-enacted as section 35 of 1989 Act.

By way of law reform, in an attempt at ending the sway of the doctrine, attention may be drawn toward sections 3A, 4 and 5 inserted into 1989 Act of United Kingdom. It is provided that for a general commercial company, for perspective companies to be formed, for which it is sufficient to make just one statement as its object in its memorandum adopting the very language of section 3A to the effect that
the company’s object is to carry on business as a general commercial company, that is to carry on any trade or business, with power to do all such things as are incidental or conducive to the carrying on of any trade or business (section 3A). Other companies have the freedom to alter the objects by special resolution, subject to confirmation of, if it is taken before the court by members holding not less than 15% in nominal value of company’s issued share capital within 21 days of passing of special resolution. The court has the power to confirm the alteration in whole or in part as also to order purchase of the dissenting member’s shares or order any alteration to the memorandum and articles (section 4 and 5). Hence in reformation of the doctrine the Legislature has played its role by enacting these laws in U.K.

About abolition of the doctrine, the first report of Cohen Committee which was submitted in the year 1945, recommended its abolition being the illusory protection for the share-holders and a pitfall for third party dealing with the company. The committee considered that the doctrine of *ultra vires* serves no positive purpose but is, on the other hand, a cause of unnecessary prolixity and vexation. Similar views were expressed by Bhabha Committee which was appointed by Government of India with the object of recommending the overhauling of the company’s legislation in our country. The committee submitted its report in 1952 on the basis of which the old companies Act 1913 was repealed and the new Act of 1956 was brought in to force with effect from 1st April 1956. About the doctrine of *ultra vires* this committee expressed the similar view as that of Cohen Committee, that the doctrine is merely illusory protection for shareholders and pitfall for the third parties dealing with the company.

The Jenkin Committee Report 1962 which was constituted to report on the working of the Companies Act 1948, and to further suggest in the light of the modern conditions and practices, as to what should be the duties of directors and the right of the shareholders and also to recommend whether any change in law were desirable. About the doctrine of *ultra vires* the Committee recommended that the doctrine should not be repealed since it rarely leads to unjust results and paid much emphasis on the protection of third parties dealing in good faith with the company.

In India the Vivian Bose Commission was appointed to investigate into the affairs of the Dalmia-Jain Airways Ltd. under the Chairmanship of Justice Vivian Bose. The commission made thorough inquiry for about six years in this case and
suggested amendments aimed at preventing some of the evils of this kind, which came
to light during the course of inquiry.

There-after Daphtary Sashtri Committee was appointed in May 1957 which
submitted its report in November 1957 about the doctrine of *ultra vires* and the
objects clause. Referring to the facts of the Dalmia-Jain Airways Ltd. and considering
the recommendations of the Vivian Bose Commission regarding the classification of
the objects clause, the Committee accepted the division of the objects in to (i)
Principal and ancillary and (ii) others.

The Government of India accepted the recommendation of this committee in
the shape of Companies Amendment Act 1965 and amended section 13 and 149
accordingly.

After the above amendment, the companies Amendment Act 1996 has made
the alterations of the objects clause easy by passing a special resolution and its filing
with the Registrar. The requirement of seeking confirmation of company law board
has been dispensed with, hence the alteration of the objects clause has become an
internal matter and no out side confirmation is necessary. However the same
alteration can be challenged by even a single share-holder if the alteration is not
within permissible range of section 17 of the companies Act 1956.

The company law board earlier had the discretion to refuse the confirmation of
the alterations made in the objects clause or to confirm wholly or in part or subject to
such condition as may be deemed fit as provided under section 17(5) of the companies
act. In one particular case which was before the Allahabad High Court, an alteration
was confirmed only in part and that too subject to condition that a separate profit and
loss account in respect of new business should be maintained for the duration of five
years.

However under English Law the confirmation of the court in alterations of the
objects clause is not necessary, except when an application had been made/ lodged
against the alteration within 21 days of the passing of the special resolution, by the
holders of not less than 15% nominal value of the company’s issued share capital or
any class there-of. The debenture holders of 15% could also proceed under section 5
of the English companies Act which saved a good deal of time and expenses.

As regard the above provisions of English law is not made applicable and
adopted in our country. A Learned Judge said- “It may be that the Indian Parliament
in its wisdom might have thought that the shareholders in India have neither the sense
of responsibility, nor the maturity of business experience of English share-holders to be left free to judge by themselves the ultimate desirability of altering so important a feature of the company as the objects clause of the memorandum.