

CRITICAL ANALYSIS OF THE DOCTRINE OF ULTRA VIRES

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INTRODUCTION

In today's day and age, practically every human act needs to be censured. Whether the act is an individual act or a group act, censuring is a necessity. The reason why censuring has become such an important part of society is because of the lack of control people show in exercising self-restraint and abundance of temptation in every direction. Censuring only individual or group acts is insufficient. Even when the Company- treated as an artificial person after incorporation- has committed a mistake, censuring has to be done. Obviously, a company is an artificial person with no physical manifestation. Sending a 'company' to jail is not a possibility. Therefore, those people who run the company and are responsible for the daily functioning of the company are the ones going to be held guilty.

A very important principle helps in defining where a company has gone wrong or an action is outside the scope of the authority of the company. This principle is known as the 'Doctrine of Ultra Vires'. This doctrine has been recognized all over the world for its important applications. From India to USA, every company follows the doctrine of ultra vires. Simply speaking, it is a doctrine that helps in determining if in a particular situation, the company has acted outside the scope of its authority as mentioned in the object clause of the memorandum of associations²³.

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² Section 2 (1) (c) of the United Kingdom Companies Act, 1985 states, "*The memorandum of every company must state- with respect to (a) the name of the company; memorandum. (b) whether the registered office of the company is to be situated in England and Wales, or in Scotland ; (c) the objects of the company*". the company must have the object clause which states the object of the company

³ Schedule I of the Companies Act, 2013, states Memorandum of association of company limited by shares has six clauses, which are described below:-

1) Name Clause: – Under this clause name of company is stated, as approved by MCA.

2) Registered Office Clause: – The memorandum must mention the state in which registered office of the company is situated. Complete address of the company need not required to mention here.

3) The Object Clause: – This is the most important clause. Company is free to choose any object which is not illegal. This clause is divided in two parts that is a) Main Object and b)The objects which are necessary for furtherance of the object specified in clause 3(a)

4) Liability Clause: – Liability clause states that the liability of the member is limited to the extent of amount unpaid on shares.

5) Capital clause: – Limited company having share capital must state the amount of its share capital and division thereof into shares of fixed denominations in its capital clause.

This paper will delve into the concept of the ‘doctrine of ultra vires’ and its applicability. The paper will discuss the process of evolution of the concept and the various angles and aspects of the doctrine. In this paper, we will not just look at the journey the doctrine has taken in India, but we will also study about the applications of the doctrine in countries like United States of America and the United Kingdom.

Through this paper, the readers should have a clear understanding of the concept of ‘ultra vires’ and its uses. Also, the author will attempt to make certain suggestions that can be implemented in law to better the applications of this doctrine and render it more effective.

BASIC CONCEPT OF THE DOCTRINE OF ULTRA VIRES

‘Ultra vires’ comes from the Latin word meaning ‘beyond the powers of’. Any action or transaction beyond the scope of the company or the authority endowed upon a care taker of the company will fall under the doctrine of ultra vires and will be censured accordingly.

The concept of ultra vires has basically been in existence since the beginning of man itself. Even though it had never been codified formally, this concept is the basis of reasoning for any man to determine whether an action is legitimate or illegitimate. This concept has been elaborated upon by judges in various judgements given over a period of time.

The concept of doctrine of ultra vires was acknowledged formally in 1612 in the United Kingdom for the first time. In the case, Sutton’s Hospital of the year, it was stated that the doctrine will not be applied for any action or transaction of a chartered corporation⁴, despite the fact that such corporations are corporate personalities with a separate and distinct identity.

In 1612, the country made use of documents called the ‘royal charters’ to incorporate companies and give them an identity separate and distinct from its owner in the eyes of law. Such royal chartered companies would have the same rights as a natural human being such as the right to sue and the right to be sued without having any physical manifestation- an artificial

6) Subscription Clause: – The memorandum has to be signed by each subscriber in presence of at least one witness. Each subscriber must written number of shares he shall take. At least one share should be taken by each subscriber.

⁴ Doctrine of Ultra Vires Under the Companies Act, 1956, available at- http://shodhganga.inflibnet.ac.in:8080/jspui/bitstream/10603/9793/17/17_summary.pdf (Last accessed on 26/08/2016)

human being⁵. Thus, in the case of Sutton's Hospital of the year, despite the fact that the company had a separate existence in the eyes of law, the doctrine of ultra vires did not apply. This case listed out an important exception to the doctrine of ultra vires and its scope.

NEED FOR THE DOCTRINE OF ULTRA VIRES

Even though United Kingdom acknowledged the existences of the doctrine of ultra vires in 1612, the first time it was adopted as an important concept of law was in the year 1855. In India, the concept was adopted officially in 1866 by way of a Bombay High Court judgement.

Prior to 1855 and 1866, respectively, there was no need for the doctrine of ultra vires because the most common types of businesses were sole proprietorships and partnerships. In both these types of companies, the owner(s) of the business had unlimited liability because of which the creditors were always protected. Since there was no distinction between owners of the business and business itself, the creditors were always assured of getting their money back- even if it meant that the owners would have to attach their private and personal property to the business in order to pay off the business loans. The creditors had the option of juicing the owners/partners of the business down to their last penny to recover loans.

In 1855, the Limited Liability Act introduced the Parliament of UK introduced the concept of limited liability partnerships (LLP's). This concept basically means that partners will have a limited extent of liability in their business beyond which they will be absolved of any responsibility to clear the credit of the company. This concept distinguished the company from the partners. Partners were no longer going to be held unconditionally liable for the loans of the company. They would be liable only to the extent of the capital invested in the business or the pre decided profit sharing ratio, as the case maybe.

After the Limited Liability Act, 1855, the creditors were suddenly worried about their ability to recover loans given to LLP's, To give respite to creditors and ensure that the partners did not take undue advantage of the limited liability concept, the doctrine of ultra vires found an integral place in law. Any transaction beyond the capacity of the company will, thus, be wholly void.

⁵ The Privy Council Official Website- available at <https://privycouncil.independent.gov.uk/royal-charters/chartered-bodies/> (Last accessed on 27/08/2016)

SCOPE OF THE DOCTRINE OF ULTRA VIRES

The doctrine of ultra vires is applicable to all those companies that have been incorporated and have a separate existence in the eyes of law. All those companies that have not been registered, such as partnerships and sole proprietorships will not come under the scope of the doctrine of ultra vires. Only incorporated companies with an independent existence in the eyes of law will be considered under this doctrine.

Every illegal transaction or abuse of power by a director/ employee will not fall under the ambit of the doctrine of ultra vires⁶. Only those transactions that are beyond the scope of what a company can do will be censured under the doctrine. What a company can do or the purpose of the company is always mentioned in the object clause of the Memorandum of Associations of the Company. Thus, if the company is exceeding the authority it has given itself in the object clause of the Memorandum of Association, it will be censured under this doctrine.

EXCEPTION TO THE DOCTRINE OF ULTRA VIRES

There are a few exceptions to the Doctrine of Ultra Vires. They are listed out as follows-

- An act which is within the scope of the object clause of the company but outside the authority of directors can be ratified by the share-holders
- The share-holders have the authority to validate an intra vires act performed in irregular manner in the company.
- If the company acquires any property through an ultra vires investment, even then the company right over that property shall be secured⁷.
- An incidental or consequential effect of an act shall not be considered as ultra vires, unless it is expressly prohibited by the statute⁸.

⁶ Rolled Steel Product (Holdings) Ltd v. British Steel Corp (1986) 1 Ch 306

⁷ APPLICATIONS OF THE DOCTRINE OF ULTRA VIRES IN DEVELOPED COUNTRIES AND DEVELOPING COUNTRIES, Muhammad Waqas, International Journal of Current Research in Social Science & Humanities

⁸ *Ibid*

EVOLUTION OF THE CONCEPT OF DOCTRINE OF ULTRA VIRES AND CURRENT SCENARIO IN ENGLAND AND INDIA

England- Evolution of the Concept of Doctrine of Ultra Vires

As previously mentioned, the first time England acknowledged the doctrine of ultra vires was in 1612. However, after the introduction of the Limited Liability Partnership Act, the real importance of the Doctrine of Ultra Vires came to light.

In England, the Doctrine was used for the first time in joint stock companies in 1860 in the case of **Simpson V. West Minister Palace Hotel**⁹. Essentially, the company's memorandum stated that the purchase land and construct hotel on those lands. They would be responsible for the upkeep and maintenance of the hotel. The land would not be used for any other purpose apart from that of a hotel. The company would also have the authority to use the land in a manner that would help in the upkeep of the hotel and would further the cause of maintaining a hotel e.g. – constructing a swimming pool would be a legitimate use of the land because it furthers the cause of maintaining and running a hotel¹⁰.

In this case, the plaintiff had sold his building to the defendants for the hotel to be used as a hotel. The building could not function as a hotel in its current state and needed to be re-modelled in part. During the course of the construction of the hotel, a large part of the building was demolished and re-modelled to create a structure that was more conducive to being a hotel. The plaintiff filed a case against the defendants on the grounds that they had acted outside the scope of the object clause in the Memorandum of Association by demolishing large parts of the building. Thus, they needed to be punished and a compensation was sought. However, the Courts held that the defendants had not acted outside the scope of the object clause of the Memorandum of Associations.

⁹ Doctrine of Ultra Vires Under the Companies Act, 1956, available on the link- http://shodhganga.inflibnet.ac.in:8080/jspui/bitstream/10603/9793/17/17_summary.pdf (Last accessed on 26/08/2016)

¹⁰ The original object clause in the Memorandum of Associations are as follows: “*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*”. Doctrine of Ultra Vires Under the Companies Act, 1956, available on the link- http://shodhganga.inflibnet.ac.in:8080/jspui/bitstream/10603/9793/17/17_summary.pdf (Last accessed on 26/08/2016)

In 1875, in the case **Ashbury Railway carriage & Iron Co. V Riche**¹¹, the company in question- Ashbury Railway Carriage & Iron Co. - entered into an agreement to construct a railway line in Belgium with a man named Mr. Riche. However, the object clause of the Memorandum of Association of the Company did not include in its scope the construction of railway lines. Owing to this fact, the company repudiated the contract. Mr. Riche filed a suit for damages against the company on the grounds of cancellation of the contract. Also, he strengthened his argument by stating that the company had ratified the agreement with the majority of the stakeholders in the company. Hence, it was binding.

The Court held that the object clause of the memorandum¹² is, essentially, the purpose of the company i.e. it states what a company is supposed to do. It is the most important document of a company and cannot be over ridden by ratification of the stake holders. Thus, the contract will be considered wholly void because of an invalid consideration. Mr. Riche was not awarded any compensation due to the lack of a void contract. This case was extremely important in the development of the concept of doctrine of ultra vires.

Over time, the importance and scope of the doctrine of ultra vires has reduced dramatically in England. The reason for this was the straight jacketed approach utilized by Courts previously. Sometimes, it may happen that an action/ transaction is not explicitly mentioned in the object clause, but is necessary and legitimate for the betterment of the business. In such cases, the doctrine of ultra vires was becoming more of a hindrance than a protection to shareholders and creditors.

In 1880, in the case, **Attorney General V. Great Eastern Railway Co.**¹³ the courts stated for the first time that if a particular activity is for the benefit of the business, then despite the fact

¹¹ (1875) LR 7 HL 653, Doctrine of Ultra Vires Under the Companies Act, 1956, available on the link- http://shodhganga.inflibnet.ac.in:8080/jspui/bitstream/10603/9793/17/17_summary.pdf (Last accessed on 25/08/2016)

¹² The object clause of Ashbury Railway Carriage & Iron Co. “*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*”. Doctrine of Ultra Vires Under the Companies Act, 1956, available on the link- http://shodhganga.inflibnet.ac.in:8080/jspui/bitstream/10603/9793/17/17_summary.pdf (Last accessed on 26/08/2016)

¹³ (1880) 5 App Cas 473 HL

that it is not mentioned in the object clause, it will not be deemed ultra vires. This was the first time that the Courts had taken a decision reducing the importance of the doctrine.

In 1966, in the case **Bell House Ltd. V City Wall Properties Ltd**¹⁴, the Courts held that if the directors of the company are convinced that a particular activity should be performed for the furtherance of the main business or some ancillary purpose, then such an activity will be considered intra vires and not ultra vires. Normally, before this case, the directors did not have any discretionary powers to decide whether a particular activity was within the scope of the object clause or not. However, after this case, the Court recognized this discretionary power given to directors. It, essentially, meant the death of the doctrine of ultra vires. After 1966, the Courts have the final say in whether a particular activity is intra vires or ultra vires.

England- Current Scenario of the Applicability of the Doctrine of Ultra Vires

The straight jacketed method of following the object clause of the memorandum has, to a very large extent, been done away with. S. 110 of the Companies Act, 1989¹⁵ further reiterated the importance of having an expansive object clause and judging each action on its merit whether it is benefitting the business or not.

¹⁴ (1966) 36 Comm Cases, 779, Doctrine of Ultra Vires Under the Companies Act, 1956, available on the link- http://shodhganga.inflibnet.ac.in:8080/jspui/bitstream/10603/9793/17/17_summary.pdf (Last accessed on 26/08/2016)

¹⁵ 110 Statement of company's objects. In Chapter I of Part I of the M1Companies Act 1985 (company formation), after section 3 (forms of memorandum) insert—
“3A Statement of company's objects: general commercial company. Where the company's memorandum states that the object of the company is to carry on business as a general commercial company—
(a) the object of the company is to carry on any trade or business whatsoever, and
(b) the company has power to do all such things as are incidental or conducive to the carrying on of any trade or business by it.”
(2)In the same Chapter, for section 4 (resolution to alter objects) substitute—
“4 Resolution to alter objects.
(1)A company may by special resolution alter its memorandum with respect to the statement of the company's objects.
(2)If an application is made under the following section, an alteration does not have effect except in so far as it is confirmed by the court.”

Even S. 31¹⁶ and S.39¹⁷ of the Companies Act, 2006 has greatly reduced the significance of the doctrine of ultra vires in the country. S. 31 clearly stated that any objective that is not explicitly excluded from the object clause of the memorandum will not be deemed ultra vires. Also, the object clause can be ratified by the consensus of the shareholders to remove or add particular objectives to the object clause. Such an amendment will hold only after registration by the registrar. However after registration, the amendments to the object clause or non-questionable. This was an important change from the stance taken by the Court in the Ashbury case, where the Court had stated that no such an amendment made to the object clause of the memorandum will hold true despite shareholder consensus. Similarly, S. 39 also reiterated that the final decision on whether certain activities are within or outside the scope of the business will be determined by Courts on the basis of the merit of the case.

As recently as in 2013, the case *White and another v South Derbyshire District Council*¹⁸, the English Courts held that an ultra vires act does not become ultra vires immediately, the Courts will first examine the credibility and legitimacy of the act and accordingly decide whether it needs to be censured or can continue to remain in force.

It can be safely said that even though the doctrine of ultra vires has not been eradicated from England completely- its applicability has been curbed. Till date, the doctrine can be invoked in Courts of Law, but the final decision lies with the judge. Over a period of time, legislation encouraging expansive object clauses and encouraging judges to consider each case on merit have also contributed to the reduced emphasis on the doctrine of ultra vires. It is, however, a

¹⁶ Statement of company's objects

- (1) Unless a company's articles specifically restrict the objects of the company, its objects are unrestricted.
- (2) Where a company amends its articles so as to add, remove or alter a statement of the company's objects— (a) it must give notice to the registrar, (b) on receipt of the notice, the registrar shall register it, and (c) the amendment is not effective until entry of that notice on the register.
- (3) Any such amendment does not affect any rights or obligations of the company or render defective any legal proceedings by or against it.
- (4) In the case of a company that is a charity, the provisions of this section have effect subject to— (a) in England and Wales, section 64 of the Charities Act 1993 (c. 10); (b) in Northern Ireland, Article 9 of the Charities (Northern Ireland) Order 1987 (S.I. 1987/2048 (N.I. 19)).
- (5) In the case of a company that is entered in the Scottish Charity Register, the provisions of this section have effect subject to the provisions of the Charities and Trustee Investment (Scotland) Act 2005 (asp 10).

¹⁷ A company's capacity

- (1) The validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's constitution.
- (2) This section has effect subject to section 42 (companies that are charities)

¹⁸ [2013] P.T.S.R. 536 90 (UK Case)

brilliant concept that was the need of the hour back in 1855 when it was introduced. The fact that it has stood the test of time and is still in operation, is, in itself, a great deal.

India- Evolution of the Concept of Doctrine of Ultra Vires

In India, prior to the introduction of LPP's, the need for the doctrine of ultra vires was not very grave. Post the introduction of LPP's, doctrine of ultra vires gained notoriety in the legal fraternity. The first time the concept of ultra vires was accepted in India was through the case **Jahangir R. Modi V Shamji Ladha**¹⁹ in 1866.

The facts of this case were as follows: In this case, the plaintiff has purchased 601 shares in a particular company. The directors- also the defendants in this case- purchased 1422 shares of the company. The object clause of the memorandum of the company did not allow the directors to purchase and sell shares. However, the directors went ahead and purchased shares anyways. The plaintiff filed a suit against the directors in the Court and asked for compensation for the losses incurred due to such purchase. The Court exercised the Doctrine of Ultra Vires in this case. It was held that the defendants had acted outside of the scope of the object clause of the memorandum. Since the memorandum was the most important document of any company, an action/transaction overriding the document will be completely void. Thus, the defendants were held guilty as per the doctrine of ultra vires.

This case paved the way for the doctrine in India. With LLP's just having been introduced, there were several cases of partners/owners/directors of companies misusing their limited liability position with respect to the company. Since this case, the scope of the doctrine of ultra vires has increased manifold and is of great importance as of now.

Another important case that has helped in shaping the doctrine of ultra vires in India is **A. Lakshmanaswami Mudaliar V L.I.C.**²⁰. In this case, the company's memorandum stated that the directors should donate a part of the company's profit to charitable organisations that help the general public or undertake useful objects. In accordance with this, the directors donated Rs. 2 lacs to a charitable organisation. At that point in time, LIC had taken over the said

¹⁹ (1866-1867) 4 Bom. HCR (1855), Doctrine of Ultra Vires Under the Companies Act, 1956, available on the link- http://shodhganga.inflibnet.ac.in:8080/jspui/bitstream/10603/9793/17/17_summary.pdf (Last accessed on 26/08/2016)

²⁰ AIR (1963) SC 1185

business and questioned the charitable donation stating that it was out of the scope of the object clause of the memorandum. The object clause did not mean for the company to donate to any charitable organisation. It should donate to a cause is related to the business in some manner or furthers the business objectives of the company. The charitable organisation that was donated to did not fall under either categories. Therefore, the Courts deemed the charity as an ultra vires act and not an intra vires act. Donating to research facilities that focus on certain business processes followed by the company or to non-profits making men and woman employable in companies would be considered intra vires and valid.

Further, in *National Provincial Bank v. Introductions Ltd*²¹ it was stated that if a bank or any other lending institution lends money to a company for a purpose that is out of the scope of the object clause of the memorandum of association of the company, then such a loan cannot be recovered with the help of any remedy that would normally be used for the recovery of such loans. This is because any action that is outside the scope of the object clause falls under the doctrine of ultra vires and is wholly void.

India- Current Scenario of the Applicability of the Doctrine of Ultra Vires

In a developing country like India, the economy is still growing. New companies need to be formed to increase the GDP of the country. In a country like ours, having the doctrine of ultra vires is very important. The doctrine of ultra vires basically restricts the company from acting outside the scope of its object clause as mentioned in the Memorandum of Association. This gives new companies an opportunity to be formed. Thus, the doctrine is important in India. Also, with new businesses being formed frequently, banks and lending institutions need to give out loans to such new companies. The doctrine of ultra vires protects the lenders by giving them a guarantee of money back should the companies act outside the scope of their object clause. The doctrine of ultra vires plays a very important role in India till date.

In 2009, in the case, *Radhabari Tea Company Private Limited vs. Mridul Kumar Bhattacharjee and Other*²², the Court decided that any action taken by the board of directors of a company or

²¹ (1969) 1 All ER 887

²² 2009 Indlaw GUW 44

the company itself beyond the scope of powers conferred on the company and/or its directors by the object clause of the memorandum of association of the company, is ultra vires.

In the new Companies Act, 2013, S. 245 (1) (a)²³ states that any company that acts outside the scope of the object clause of the memorandum of association will be censured under the Doctrine of Ultra Vires.

Thus, it is amply clear the doctrine of ultra vires is still playing a very important and dominant role in the country. It will continue to retain its importance in times to come. It is a safeguard for investors and shareholder. Its prominence is not going to diminish any time soon.

ANALYSIS OF THE APPLICATION OF THE DOCTRINE OF ULTRA VIRES IN INDIA AND USA

The Model Business Corporation Act, 2002 majorly reduced the applicability of the doctrine of ultra vires in USA. Its application could be found in certain not for profit organizations and state run corporation. Apart from that, the doctrine of ultra vires is applied in-

1. Charitable contributions and political contributions
2. Guaranty of indebtedness of another person
3. Loans to officers or directors of the company
4. Pensions, bonuses, stock option plans, job severance payments, and other fringe benefits given to employs
5. The power to acquire shares of other corporations
6. The power to enter into a partnerships

The reason why the applicability of the doctrine of ultra vires has been restricted so prominently in USA is because of the economy. USA is a land of multinationals and big corporations. A large part of the country's GDP comes from such multinationals and big corporations. The

²³ 245. (1) Such number of member or members, depositor or depositors or any class of them, as the case may be, as are indicated in sub-section (2) may, if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors, file an application before the Tribunal on behalf of the members or depositors for seeking all or any of the following orders, namely:—
(a) to restrain the company from committing an act which is ultra vires the articles or memorandum of the company;

doctrine of ultra vires forces companies to stick to the object clause of the company's memorandum with very little scope to do something different- even if the action/transaction will help the business eventually. Restricting business practices merely because they are not included in the object clause of the company's memorandum seems redundant in the USA scenario. The government wants people to take such corporations to expand and try new ways of raking in profits as this will eventually help in the country's growth. Thus, the doctrine of ultra vires is fundamentally against the principles of the country's economy.

On the other hand, in India, the doctrine of ultra vires has been codified in the most recent Companies Act, 2013. This act of codification just emphasizes the need for the doctrine to control unscrupulous business practices undertaken by directors and employees of a company alike. India is still developing. If corporations are allowed to have expansive object clauses, then new businesses will find it difficult to incorporate themselves for the lack of new ideas in the market. No businessman is going to want to start a business that has already been undertaken by another. Thus, the doctrine of ultra vires gives a fair playing field to all and allows for the country's economic growth at the same time. Also, the protection given to creditors and shareholders is an important added benefit of the doctrine.

CONCLUSION

From the above report, we can see that the doctrine of ultra vires, which may seem insignificant, plays a very big role in the companies. Almost, all actions/transactions of a company come under the scrutiny of the doctrine of ultra vires. Even though the doctrine of ultra vires had not been officially codified since the very beginning, its importance cannot be discounted.

This paper has clearly explained the process of evolution of the concept of doctrine of ultravires in England and India. Also, an analysis of the application of the doctrine in USA and India has been given to further understand the various aspects of the doctrine of ultra vires and the extent to which it has been followed in various countries.

Additionally, the author would like to commend the drafters of the Indian Companies Act, 2013 for codifying the doctrine of ultra vires and further elucidating the significance of the doctrine.

This paper has made it clear that this doctrine is an integral safeguard to be followed in all companies and its application is not going to be done away with any time soon.