ULTRA VIRES : A DOCTRINAL ANALYSIS OF ITS ROLE COMPANY LAW.

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Introduction

The word ultra vires is a Latin word which means "beyond the scope" or "in excess of legal power or authority." An act is considered to be an act of ultra vires when the statutory authority of exercising the power and performance of those acts goes beyond the powers conferred upon the body by any legitimate authority. According to the doctrine of ultra vires only those acts will be considered to be intra vires which have been exercised within the power conferred by the statute. In corporate world there are a number of instances which shows the arbitrary use of power by the company's directors or authorities exercising power in an arbitrary manner, thus in order to protect the corporations, share -holders, creditors and any such other associated persons with the company's affair and in order to protect their rights and interest the role of ultra vires is applied. The object clause in the MOA of the company gives very important protection to share -holders by ensuring that the funds raised for are undertaking one not going to be risked in another and if such case appears the rule of ultra vires is applied.[1] Under the object clause of MOA the actions of a company are controlled and states that for what exact reasons or object of the company has been floated. An act is deemed ultra vires when it exceeds the legal authority granted to a corporate body by statute or its governing documents. For e.g. The object clause in the MOA safeguards shareholder interests by restricting company funds to specified activities. The activities even are for the profit motive, laudable, beneficial members, employees, society are considered to be ultra vires until or unless it falls within the object for which the company has been established. The powers of the company are restrained by the objects specified for its establishment. Any act which is beyond MOA, statutory authority falling beyond the object of its establishment is are ab initio, null and void.

In order to protect the wrongful use of assets, goodwill and other associated attributes of the company which would result in the insolvency of the company or which would result into negative repercussions on its members, the doctrine of ultra vires is applied. Further the doctrine of ultra vires provides prevention to the directors of the company to do not deviate from the objects of the company for which it has been established, and puts a close scrutiny over such beyond the scope exercise of powers in the arbitrary manner.

[1] Wamanlal Chhotalal Parekh vs. The Scindia Steam Navigation Co. AIR 1944 BOB 131 at 135.

Origin and development of doctrine of Ultra vires;

In relation to the statutory companies, the doctrine of ultra vires was initially introduced. However it does not got the impactful attention till 1855, and the fundamental reasons being that the concept was not much useful and the awareness for necessity of protection of investors and creditors were not in light.

Further, during the period of 1855 to 90s the companies were mostly in the form of partnership and thus were regulated by the rules of partnerships. The other reasons was that the members had unlimited liability, thus the creditors and investors does not felt urgent requirement of such doctrine as they were under protection. The third reason being that the philosophical support by the jurists was not exhibited to the doctrine during the initial phase. The assumptions that an incorporated company is enshrined with all the powers that a natural person has, given a big support to the non- authorized or beyond the power transactions until or unless it has taken away in an expressed manner. Later on, important concepts was discovered i.e. the concept of limited liability which confined the liabilities of the members limited with the extent of the amount of shares subscribed by them. Now, the scenario has been changed as the liability of members were restrained to their respective subscribed shares, thus the investors and creditors found themselves at a miserable stage. Thus, the need of a device to protect the interest and rights of the creditors and investors became a necessity which moulded the minds of pioneers towards the doctrine of ultra vires.

MOA and AOA became two important documents containing the objects and management of the company. All these developments in the corporate world created an atmosphere which became favourable for the development of doctrine of ultra vires. Creditors rely on the doctrine to ensure that companies only engage in legally authorized transactions. All such acts prejudice of trade, commerce, payments, transfers and other matters which were performed by the corporate body was condemned as illegal by the Bubbles Act[2] until any leave by either an Act or Parliament or any charter from the authority was inflicted. The other provisions coherently shows that the attributes of the doctrine sowed. The act made those exercises illegal which were actually out of the grant of the charter, thus applying the doctrine in an indirect manner.

Several legislative amendments between 1900 and 1946 attempted to refine corporate governance, but none provided a comprehensive ultra vires framework. Meanwhile during 1850s till 1900s, the doctrine was discussed in number of cases by the House of Lords. In a case J. Mr. Perke held " where a corporation is created by the act of parliament for particular purpose with special powers, their deed though under their corporate seal does not bind them if appears by express provisions of statute creating the corporation or by necessary or reasonable inference from its enactment that deed is ultra vires i.e. that the legislature meant that

[2] Holdsworth, A history of English Law195.

such a deed shall not be made.[3] The doctrine of ultra vires originated in common law but gained prominence in company law with Ashbury Railway Carriage and Iron Co. Ltd v. Riche (1875).. The act which was later on passed in 1956 had a deep association with the English Companies Act of 1948. The substantial principal and concepts were similar to that of the Act of 1948.

The rule of ultra vires and main object rule;

In the MOA all those essential powers were vested by the promoters so that the contracts are protected from being declared as void ab initio, thus falling under the act of ultra vires. Therefore, the object clause of under MOA was not only confined to the objects and business that the company will conduct initially but it also contained all the purposes which the company may conduct in the future. To circumvent ultra vires restrictions, promoters drafted broad object clauses, sometimes spanning unrelated activities (e.g., from timber trading to operating beauty salons)."

It was under this background that the main rule of interpretation was adopted by the courts in order to prevent the company from having power to do anything by the virtue of the lengthy object clause conferring a wide range of powers on companies. With the advent of Ashbury's case, to which the rule owes its origin, it was held "general contractors must be read with in connection to the company's object clause.

General words construed literally may mean anything but they must be taken in connection with what are shown by the context to be the dominant or main objectives. It will not do under general words to turn a company for manufacturing one thing into a company for importing something else, however the general words are. The rule was further reiterated in the case of Stephen vs. Mysore Mining Co. ltd.[4] In which it was held "Not with standing a declaration, contained in the objects clause of a memorandum of association, that the objects specified in each paragraph of this clause shall be in no wise limited or restricted by reference to or inference from the term of any other paragraph or the name of the Company," wide powers given in general words will be contend as ancillary only to a specified object mentioned in the initial paragraph.[5]

Thus the rule of construction of the objects clause is to seek for the initial paragraphs which appear to embody the main object of the company is provided under the principle of main objects where the objects of a company are expressed in the series of paragraphs.

[3] The South Yorkshire Railway and River Dun Company V. The Great Northern Railway and River Dun Company V. the Great Northern Railway Company, (1853) 3 De Gex Ma 8. Gord 576; 43 E.R. 226; 156 E.R. 23.
[4] (1902) Ch 745.
[5] North England 200 V. Chesters (1959)2 All ER 116

The need of the doctrine of ultra vires;

The very essential need of the doctrine of ultra vires is to provide protection to the share-holders, creditors, investors and other associated members to the company that the fund and assets of the company are used only for the purpose conferred in the MOA and not for any other purpose other than that. It is for the creditors to make them aware of the fact that their transaction required by the companies falling under the act of intra vires and not ultra vires. If the transaction is found to be beyond the scope of the powers of the company, then the rule of ultra vires is applied and thereby a safeguard is provided to them in respect of their interest.

In detail the need as well as advantages of the doctrine are:

a) **Protection to the investors;**

It is the contribution of the shareholders and the trust of them which is conferred upon the company which leads to generation of the capital for the company. Thus a rule assuring the investors that there investment will not be employed in any unauthorised manner which they did not have in mind at the time of investing their money in the company. According to Gower, "the doctrine of ultra vires as enables the investor in the company to know the objects".

b) **Protection to the creditors;**

The doctrine also provides protection to the creditors as they trust the affairs of the company for the repayment only out of its assets and the business concern. It is the condition that the company capital cannot be spent on any project or business outside the object clause of the company.

c) **Protection to the public;**

The statement of objects serves to public interest by confirming the corporate activities within a definite field. It prevents diversification of a company's activities indirection not closely associated with the affairs for which the company may have been initially established. The object clause in the MOA ensures corporate activities remain within a legally defined scope, preventing misuse of investor funds and safeguarding public interest.

There are several other reasons which have been suggested justification of the rule of ultra vires. According to Palmer, the reasons for the development of the rule are :

(i) As a matter of constitutional law, parliament has the sovereign power in the country, does not grant more power to delegate bodies that it has authorized.

(ii) As a practical consideration it was thought that the rule would project investors in the company and creditors of it against the unauthorised use of funds.[6]

(iii) An investor in a gold mining company should not unexpectedly find their investment diverted to an unrelated business, such as a restaurant.

Consequences of ultra vires transaction;

No legal relationship or affect in sues from the acts which is beyond the objects mentioned in moa and is ultra vires. Such acts is declared as void and thus cannot be rectified even if all the members agreed upon such act. These acts falling under the doctrine leads to affects such as:

a) Injunction;

Whenever an act falling beyond the scope of the powers of moa of the company, or is about to take in, search active ultra vires and any member of the company can get an injunction to restrain it from proceedings of it.[7]

b) Personal liability of the directors;

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It is provided that the directors of the company are bound under the statutory duty to make sure that capital generated is used only for an authorised purpose. Any transaction which is unauthorised is entered by the director and is ultra vires then the director in default is guilty of grave dereliction of duty and if the company suffers a loss he is personally liable to the company.[8]

c) Breach of warrant of authority;

[6] LCB Gower.
[7] (1880) 5 AC 473.
[8] Jehnagir R. Modi vs. Shamji Lodha, HCR 185.

If the directors engages an agent and the agent goes beyond his authority he will be personally liable to the third party for breach of warranty of authority. It is the duty of an agent to act within the scope of his authority. Not always true. The Turquand Rule limits liability in cases where external parties rely on corporate authority.[9]

d) Ultra vires contrac;t

Any contract outside a company's stated MOA objectives is void ab initio, meaning it has no legal effect from inception. Such an act is absolutely void and cannot be ratified even if all the shareholders agree to it. Neither the company nor the other contracting party can enforce such contracts.[10]

Conclusion;

The doctrine finds its origin and has been developed through various historical backgrounds. The doctrine is applied on the affairs of the companies which are beyond its MOA. The MOA is the charter of the companies, which contains the main object clause within it. The companies or their officers cannot pursue any act beyond those objects which are mentioned in the object class under the MOA. The doctrine got attention after 1855, as before 1855 companies used to be in the form of enlarged partnerships and the same were governed by the rule of partnership. Ultra vires transactions result in legal consequences such as injunctions, director liability, and void contracts, serving as remedies for affected stakeholders. The main objective of the doctrine is that it provides safeguard to the investors, creditors and all other associated members to the company in order to make them sure that their interest is protected by the virtue that all the affairs of the company is authorised and is not beyond its authority to exercise such powers.

[9] Royal British Bank v. Turquand, 1856

[10] Birbeck Building Society (1912) 2 Ch 183.