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DOCTRINE OF ULTRA-VIRES - THE EXTENT OF  
ITS DESIRABILITY IN THE INDIAN COMPANY LAW

By

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I

A company is an artificial person. It owes its existence to the constitutional document known as memorandum. Every company must necessarily have a memorandum. The company comes into existence to carry on the objects mentioned in the memorandum. Usually the memorandum of a company is prepared by the promoters of the company. It is they, who decide the objects of the company. The memorandum of a company lays down positively what the company can do, and implies negatively what the company cannot do.

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1. Per Cairns L.C. in Ashbury Carriage Co. v. Riche (1875) L.R. 7 H.L. 653 at p. 667: " If that is the purpose for which the corporation is established-it is a mode of incorporation which contained in it both that which is affirmative and that which is negative. It states affirmatively the ambit and extent of vitality and power which by law are given to the corporation, and it states, if it is necessary so to state, negatively that nothing shall be done beyond that ambit and that no attempt shall be made to use the corporate life for any other purpose than that which is so specified." Cotman v. Broughan (1918) A.C. 514.

So a company cannot effectively do anything beyond what is mentioned in the objects clause. This cannot be done even if all the shareholders agree. Any act of the company which goes beyond what is mentioned in the memorandum is ultra vires the company and so it is not binding on the company. This is what is known as the doctrine of ultra vires. Introduction of the railways brought forth so many limited companies and the doctrine of ultra vires is the direct offshoot of it. This came into existence to serve two separate and distinct ends:

- i) persons who invest money in the companies must know the nature and scope of business with which the companies deal;
- ii) and to protect the creditors of the company by ensuring that the company's money is not wasted or lost in unauthorised activities.<sup>1</sup>

The law relating to the doctrine of ultra vires is usually explained in the light of two leading cases. In Ashbury Railway Co. v. Riche<sup>2</sup> the objects clause of the company was as follows: 1. to make, and sell, or lend on hire, railway carriages and wagons; 2. to carry on the business of mechanical engineers and general contractors; 3. to purchase, to lease, work and sell mines, minerals, land and buildings. The company with such an objects clause entered into agreement with the plaintiff to construct a railway in Belgium. There was some evidence that the shareholders have ratified the

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1. L.C.B.Gower, Modern Company Law, at p.78 (1957); In Cotman v. Brougham, it was pointed out that the statement of the company's objects in the memorandum of association is to serve a double purpose. In the first place, it gives protection to subscribers, who learn from it the purposes to which their money can be applied. In the second place, it gives protection to persons who deal with the company, and who can infer from it the extent of the company's powers.
  2. (1875) L.R. 7 H.L.653.

the contract entered into by the company. The issue before the House of Lords was whether such a contract is valid. Lord Cairns held that such a contract is ultra vires the company and it is not binding on the company, even if all the shareholders agree. The learned Lord observed, "This contract was entirely...beyond the objects in the memorandum of association. If so, it was thereby placed beyond the powers of the company to make the contract. If so...it is not a question whether the contract ever was ratified or was not ratified. If it was a contract void at its beginning, it was void because the company could not make the contract. If.. ever shareholder of the company had said, 'That is a contract which we desire to make,' That is a contract which we desire to make.' the case would not have stood in any different position from that in which it stands now. The shareholders would thereby, by unanimous consent, have been attempting to do the very thing which, by the Act of Parliament, they were prohibited from doing."<sup>1</sup>

The principle laid down in the above case was qualified in Att.Gen. v. Great Eastern Rly.<sup>2</sup> in which it was held that the company can do what is fairly and reasonably incidental of the objects clause. These two cases read together form the law on the doctrine of ultra vires in England.<sup>3</sup>

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1. Per Lord Cairns in Ashbury Railway Carriage Co. v. Riche (1875) L.R. 7H.L.653 at p.672.
  2. (1880) 5 App.Cas.473.
  3. Palmer, Company Law, at p.80 (1959); Charlesworth, Company Law, at p.30 (1965); London County Council v. Att.Gen. (1902) A.C. 165.

Doctrine of ultra vires - its application in the modern company law:-

Whatever might be the salutary intentions of the doctrine of ultra vires, it hindered the modern industrial growth. A company which has come into existence with a particular object cannot switch on to another object if it fails to thrive on the objects mentioned in the memorandum. This, as observed earlier, cannot be done even if all the shareholders agree to a change. The only way left for them is to wind up the company and then start a new company with a fresh objects clause. This is certainly a difficult task, involving considerable expenditure. Even in day to day matters directors of the company are threatened with the striking down of their transactions as ultra vires. It is difficult to know before hand as to what the court will construe as incidental to the objects clause. Usually no businessman would like to leave such matters to the entire discretion of the courts. In their anxiety to avoid the hardships of the doctrine of ultra vires, the framers of the memorandum are filling the objects clause with all conceivable objects so that it might be helpful in future. But this in turn causes the following undesirable things:

- i) The intention of the Legislature that the objects clause should be simple and unambiguous is utterly defeated;
- ii) a person investing in a modern company may not with certainty know whether he is investing in Gold Mines or in fried-fish shop;
- iii) the latitude with which the directors exercise their powers because of the lengthy objects clause may threaten the security of the creditors of the company.

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1. L.C.Gower, Modern Company Law, at p.82(1957):  
"It ensured that an investor in a gold mining company did not find himself holding shares in a fried-fish shop, and it gave those who allowed credit to a limited company some assurance that its assets would not be dissipated in unauthorised enterprises."

### III

#### Doctrine of ultra vires and the provisions of the Indian Companies Act:-

The definition of memorandum is not very happy in the Indian Companies Act.<sup>1</sup> There is no hint in the whole of the companies Act as to the exact nature of the role of the memorandum to play in the affairs of the company.<sup>2</sup> Courts usually look to the English and Indian decisions on the issue. Section 13 of the Act lays down the requirements of memorandum. Section 16 lays down that the contents of memorandum cannot be altered except in accordance with the provisions of the Act. Under section, a company may by a special resolution change the place of its registered office from one state to another or the objects clause to the extent allowed by the section. The alteration suggested by such a special resolution cannot have effect unless and until it is confirmed by the court.

#### b) Decisions of the courts in India and the doctrine of ultra vires:-

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Most of the reported cases under section 17 of the Indian Companies Act are on the alteration

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1. Section 2 (28) of the Act:-Memorandum means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous companies law or of this Act.
  2. S.M.Shah, Lectures on Company Law, at p.20 (1966).
  3. The discussion in this article is limited to the decisions of the courts in India, reported in comp.Cas. from 1957 to 1970.



In Modi Spinning and Weaving Mills Co. Ltd.<sup>1</sup> the existing business of the company was the manufacturing of the artificial silk cloth. The company by a special resolution sought to alter the objects clause so as to authorise the company to manufacture industrial and power alcohol, other spirits and alcoholic liquors. Confirming the resolution, court observed that whether the additional business undertaken is inconsistent or destructive of the existing business or not is a matter which can best be decided by the shareholders.

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In Ambala Electric Supply Company Ltd., the company under its objects clause was authorised to generate, accumulate and supply electricity. Because of the Bakra Nangal Hydro. Electric Grid its motors and power house ceased to be of any utility. The company after passing a resolution started the cold storage plant. The company applied to the court for the confirmation of the resolution. S.B.Capoor of the Punjab High Court observing that the words "some business" in section 17(1) clause (d) may mean a business which is entirely a new departure which is already carried on, confirmed the alteration.

In Motilal Padampat Sugar Mills Co.(Private) Ltd.,<sup>3</sup> the main objects of the company were to manufacture sugar and oil. It sought to introduce steel makers, steel fabricators, etc. The court confirmed the alteration.

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In Dalmia Cement (Bharat) Ltd., veeraswami J. of the Madras High Court permitted the company which was carrying on business in cement to alter its memorandum, so as to authorise the company to do export business in all varieties of goods and commodities. He held that such an alteration was well within the ambit of section 17(1) (a) and (d).

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1. (1963) 33 Comp.Cas.901
  2. (1963) 33 Comp.Cas.585
  3. (1964) 34 Comp.Cas.86
  4. (1964) 34 Comp.Cas.729

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In Re New Asiatic Insurance Company Ltd., H.R. Khanna J. of the Punjab High Court allowed the alteration of the objects clause though the new business had no relation to the business which the company was originally carrying on.

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In Straw Products Ltd. v. Registrar of Companies, a company whose main business was the manufacture of paper was allowed to alter its memorandum so as to authorise it to manufacture machinery.

The old view that memorandum is an unalterable document does not hold the ground now. Section 17 of the Companies Act permits the alteration of the memorandum to enable the company to carry on a business which is entirely new. All that is necessary is that the business which it wants to introduce must be one which can be conveniently or advantageously combined with the existing business, under the existing circumstances of the company. The question whether a particular business can be advantageously or conveniently be combined with the existing business was held to be a matter which can better be decided by the shareholders of the company. The court while confirming certainly exercises its discretion. But it was held that this discretion is one which is not controlled by the judicial decisions but by the facts of each case.<sup>3</sup> There are only two reported cases wherein the courts have refused to confirm the alteration.

i) In Punjab Distiller Industries v. Registrar of Companies<sup>4</sup> the objects of the company were, to purchase, acquire, and to carry on the business carried by the existing distillery company together with the whole real and personal assets of the company and to carry

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1. (1967) 37 Comp.Cas.331
  2. (1969) 39 Comp.Cas.974.
  3. Per Vimadlal J. of the Bombay High Court in Re Indo-Pharmaceutical Works Pvt. Ltd. (1968) Comp. Cas.313 at p.313.
  4. (1963) 33 Comp.Cas.811.



on the business of distillers, rectifiers, brewers etc. The Company passed a special resolution to alter the memorandum adding a new object viz., to acquire or take over on hire picture houses, cinemas, theatres and similar houses for exhibiting pictures and films. The court refused to confirm the alteration. It observed, "There is no suggestion whatsoever that the new business which is sought to be carried on has anything to do even remotely with its existing business and it cannot be said that the new business will be conducive and economical or efficient in doing the existing business. Even combining the two businesses is absent. There is no suggestion to show that the existing business of the company when combined with the new business will advance the purpose of section 17 (1) (d)."<sup>1</sup> Though there is plenty of authority that an altogether new business can be introduced under section 17, the court seems to have been strongly influenced by the fact that the existing business (distillers) has not only nothing to do with the running of picture houses but also by the fact that the existing business cannot be conveniently or advantageously combined.

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b) In Re Bharat Mining Corporation Ltd. the company was formed mainly for the purposes of carrying on mining operations. It sought the sanction of the court to alter the objects of the company to enter into contracts with government for construction of buildings, to do all kinds of fabrication works of steel etc. The court held that the business which the company wants to introduce cannot be conveniently or advantageously be combined with the existing business. It also observed that it sounds most illogical and misleading that a company with the name of Bharat Mining Corporation Ltd. to carry on the business as it sought to alter.

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1. Punjab Distilling Industries v. Registrar of Companies, (1963) Comp.Cas.811 at p.812-813.
  2. (1967) 37 Comp. Cas.430

The above discussion of the case law in India leads to the following conclusions:-

i) It is not very difficult for the companies under the present Act to change their objects clause. With the consent of the shareholders the companies can easily switch on to another object which might be an altogether different one from the one carrying on. This shakes partially the basis of the doctrine of ultra vires. If the company wants to enter into an ultra vires transaction, all that it has to do is, pass a special resolution and get it confirmed by the court. It is true that the doctrine of ultra vires still hold the ground so far as the transactions for which no such resolutions are passed and also to those transactions which are prior to the passing of the resolutions.

ii) When a company with the name of Modi Spinning and Weaving Mills Co. Ltd. is permitted to alter its objects clause so as to authorise it to carry on the manufacturing of liquors etc., how far it is desirable to allow it under the old name? As suggested by somebody this is not only illogical but also misleads the public.

#### Iv.

#### Consequences of the doct ultra vires act:-

Whenever the directors of the company do any act which the company itself under the existing memorandum cannot do any of the following problems may crop up for consideration:

1. Whether the act can be ratified by passing a special resolution to that effect?
2. What rights the company shall have against the directors who are responsible for the ultra vires act?
3. Whether the directors who were held liable to the company may be permitted to proceed against the third parties?
4. What rights the out-siders shall have against the company and against the directors in the ultra vires transactions?
5. Whether the property passed under an ultra vires transaction can be recovered?
6. What is the liability of the company for the torts committed.

It might be thought that when the Legislature was provided for the much extended powers of alteration, that it might be taken to be permitting the ratification of the ultra vires act by a subsequent resolution. But J.C.Shah J. of the Supreme Court of India delivering the judgment in *A. Lakshmanaswami Mudaliar v. Life Insurance Corpor.*<sup>1</sup>, observed, "Where a company does an act which is beyond the objects mentioned in the memorandum and therefore ultra vires, no legal relationship or effect ensues therefrom. Such an act is absolutely void and cannot be ratified even if all the shareholders agree." When the company is permitted to alter its objects clause, there is<sup>2</sup> no reason why it should not resort to this method. Otherwise it naturally results in the directors going beyond their powers and then pressing the shareholders for their consent. In cases where anything is to be done beyond the powers of the memorandum, it is desirable that the shareholders be consulted first.

In *A. Lakshmanaswami Mudaliar v. Life Insurance Corpor.*,<sup>3</sup> directors of the company have been personally held liable to compensate the company<sup>4</sup> on an ultra vires transaction. In an English case it was held

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1. (1963) 33 Comp.Cas.420 at p.430.
  2. L.C.B.Gower, *Modern Company Law*, at p.86 (1957)
  3. (1963) 33 Comp.Cas.420
  4. *Cullerne v. London Etc., Society*, 25 Q.B.D.485, Per Lindley J. at p.490: "If a director, acting ultra vires, that is, not only beyond his own power but also beyond any power the company can confer on him, parts with money of the company, I fail to see on what principle the fact that he acted bona fide and with the approval of the majority of the shareholders can avail him as a defence to an action by the company to compel him to replace the money."

that the directors are liable to the company even if they had acted in good faith. Of course it is true that when good faith is not a defence to an out-sider, it should not be allowed as a defence to a director of a company. It may however be commented that no qualifications are laid down in the Act (except perhaps the purchasing of the qualifying shares as laid down in the Table A of the Companies Act) to be appointed as a director and as such they should not be held liable when they have acted in good faith. However there is nothing to prevent the judges in India to reduce the liability either wholly or partially under section 633<sup>2</sup> of the Act in those circumstances.

Under an ultra vires transaction the directors cannot be usually held liable to the outsiders because the out-sider is also expected to know the contents of the memorandum. But under English law director has been held liable on the ground of breach of implied warantee<sup>3</sup>

With the registration of memorandum and articles of association, they rise to the position of public documents. Anybody who has dealings with the company is held to have the knowledge of these documents. Law presumes that the third party who has dealings with the company has not only the knowledge of the contents of the memorandum but also that they have been understood in the proper sense. If any transaction between a third party and the company turns out to be ultra vires, it is no defence for the third party to say that he in fact did not know that the company lacked the authority to enter into such a transaction. It certainly works out a great injustice, because it expects a layman like a supplier of bricks, coal, building contractor etc.

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1. Table A, 66:-The qualification of the director shall be the holding of at least one share in the company.
  2. Sec.633:Power of court to grant relief in certain cases:(1)If in any proceeding for negligence, default, breach of duty, misfeasance or breach of trust against any officer of a company.... but that he had acted honestly and reasonably and that having regard to the circumstances of the case, including those connected with his appointment, he ought fairly to be excused, the court may relieve him, either wholly or partly from his liability on such terms as it may think fit.  
provided.....  
(2).....  
(3).....
  3. Weeks v. Pronert, 8 C.F.427

to know the contents of memorandum, before they enter into transaction. There does not appear to be a reported case on this point in India. But in Re Jon Beauforte London Ltd., the company under its objects clause was authorised to carry on business as costumiers and gown makers, started business of making veneered panels. This was beyond the powers of the company. Persons who supplied coke, building material did not know that it was for an ultra vires transaction. It was held that the claims of none of them should be allowed as the transaction was ultra vires. It was also argued that these things could have as well been supplied to an intra vires transaction. But the court held that it matters little as they in fact supplied to veneered panel manufacturers. Cohen's Committee<sup>2</sup> and also Jenkin's<sup>3</sup> report rightly recommended the abolition of the doctrine of ultra vires when the third parties are involved.

Under an ultra vires transaction property might have passed from one to the other or services might have been rendered by one party in pursuance of the contract. If a transaction cannot create rights and obligations, can it deprive the parties of their rights to the property parted under the transaction? There seems to be no reported case law on the point. Property so passed if it can be identified, the party might be allowed to follow it. This must be done even if money

1. (1953) Ch.131.

2. Omd.6659(1945), para 12

3. Omd.1749(1962) paras 35-42: "A contract between a company and another party contracting in good faith should not be invalid as against the other party on the ground that it was ultra vires the company.

In entering into such a contract the other party should be entitled to assume without investigation that the company is possessed of the necessary power; and should not by reason of his omission to investigate be deemed not to have acted in good faith, or be deprived of his right to enforce the contract on the ground that he had constructive notice of any limitation on the powers of the company, or on the powers of any director or other person to act on the company's behalf imposed by its memorandum or articles."

has passed from one to the other. Difficulty may arise in cases where in pursuance of an ultra vires contract one party has fully or party partly performed his part, machinery has been set up, or building has been constructed. In such cases all that the court can do is to allow the party to take away his property if possible. In all these cases it is better to accept the principle suggested by the learned author, Gower, He observed, "The whole of this branch of the law is likely to remain a jungle until the courts openly recognise that they will intervene to restore the status quo only to the extent that this may be necessary to prevent unjust enrichment of the one party or the other."<sup>1</sup>

How far the liability of the company for the torts committed by its servants during the course of employment be extended to the ultra vires transactions is a matter of great academic interest. There are at least three theories on this point:

- i) the company is not liable because it is an ultra vires transaction;
- ii) the ultra vires doctrine has no application except to contract and property;
- iii) the company can be liable in tort only when they are committed in the intra vires activities.<sup>2</sup>

But it is submitted that the doctrine of ultra vires should not be a defence against an innocent third person who has been injured by the servants of the company though they were at the relevant time engaged in ultra vires transactions, provided that ultra vires transaction has been carried on in pursuance of a resolution passed by the competent body. (Board of Directors in case of companies, Municipal councillors in case of Municipalities etc.)

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1. L.C.B.Gower, Modern Company Law, at p.91 (1957)
  2. Ibid. at. 91-92 (1957)

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Points for discussion at the Seminar:

1. Desirability of excluding definitions like memorandum, articles of association from the Act with a view to simplify Act.
2. What is the view of the Seminar on the effect of section 17 of the Act on the doctrine of ultra vires?
3. How far it is desirable to allow the companies which have their objects clause altered to carry on business on with the old name?
4. Implementation of the Jenkin's report so as to abolish the doctrine of ultra vires as regards the third parties.
5. Liability of the company for the torts committed by its servants while they were engaged in the ultra vires transactions.
6. Acceptance of a principle to maintain status quo in cases where the property has passed under an ultra vires contract or transaction.

