

## THE DOCTRINE OF ULTRA VIRES: RECENT DEVELOPMENTS

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In this article the writer intends to consider recent developments concerning the doctrine of *ultra vires*.<sup>1</sup>

Reference will be made to common law developments and developments under the *Companies Code* 1981<sup>2</sup> brought about by virtue of the *Companies and Securities Legislation (Miscellaneous Amendments) Act* 1985.<sup>3</sup>

### A. Judicial Re-Appraisal of the Parameters of the Common Law Doctrine of Ultra Vires

For many years, the concept of *ultra vires* has been used by company lawyers in two senses. Firstly, it has been used in a 'narrow sense' to describe a transaction which is outside the scope of the objects expressed in the memorandum of association of a company or which can be implied as reasonably incidental to the furtherance of the objects thereby authorized.<sup>4</sup> Secondly, it has been used in a 'wider sense' to describe a transaction which, although it falls within the scope of the objects of a company, express or implied, is entered into in furtherance of some purpose which is not a purpose authorized by the company's memorandum of association.<sup>5</sup> It has been suggested that the reason why a transaction which is *ultra vires* in the 'wider sense' is equated with one which is *ultra vires* in the 'narrow sense' is that neither transaction is capable of being made binding on the company by assent of all the members.<sup>6</sup> On the other hand, it has been suggested that there is a crucial difference between the two types of transaction since a transaction which is *ultra vires* in the 'narrow sense' is altogether void and cannot confer rights on third parties, whereas a transaction which is *ultra vires* in the 'wider sense' may confer rights on a third party who can show that he dealt with the company in good faith and for valuable consideration, and did not have notice of the fact that the transaction was entered into in furtherance of a purpose which was an unauthorised purpose.<sup>7</sup>

Recently, the English Court of Appeal, in *Rolled Steel Products Ltd v. British Steel Corporation*,<sup>8</sup> has expressed the view that confusion has crept into the common law because of the use of the phrase '*ultra vires*' in its different senses and that the phrase in the context of company law should be rigidly confined to describing transactions which are beyond the corporate capacity of the company and not transactions which are merely in abuse of powers of the company.<sup>9</sup>

The question whether a transaction is outside the capacity of a company depends solely upon whether, on the true construction of its memorandum of association, the transaction is objectively capable of falling within the objects of the company or of being performed as reasonably incidental thereto. A transaction will not be rendered *ultra vires* the company merely because the directors in entering into the particular transaction do so for purposes other than those set out in the memorandum. The state of mind or knowledge of the persons

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1. This article is designed to update the law as set out in the article '*Ultra Vires in 1984*' (1985) Q.I.T. L.J. 31.

2. Hereafter referred to as the *Companies Code*.

3. Hereafter referred to as the 1985 Amending Legislation.

4. See *Rolled Steel Products (Holdings) Ltd v. British Steel Corporation* [1982] Ch. 478 at 497, per Vinelott J.

5. *Ibid.*

6. *Ibid.* at 499.

7. *Ibid.*

8. [1985] 3 All E.R. 52. See also *Re Horsley & Weight Ltd* [1982] 3 W.L.R. 431.

9. *Ibid.* at 87 per Slade L.J.; and at 91-2, per Browne-Wilkinson L.J.

managing the company affairs or of the persons dealing with it is irrelevant in considering the question of corporate capacity.<sup>10</sup>

Accordingly, the English Court of Appeal takes the view that if a transaction is capable of falling within the objects and therefore the capacity of the company, it is not *ultra vires* the company and is not therefore absolutely void. Further, if a company enters into a transaction which is *intra vires* but in abuse of its powers, such transaction may be ratified or set aside at the instance of the shareholders. Where a third party has actual or constructive notice that a transaction, which although *intra vires* the company, has been entered into in abuse of the powers of the company, the third party cannot enforce such transaction against the company and will be accountable as constructive trustee for any money or property of the company received.<sup>11</sup>

In the course of making these pronouncements the Court analyzed the decisions of *Re David Payne & Co. Ltd*<sup>12</sup> and *Re Introductions Ltd*<sup>13</sup> and found that they lent no support to the proposition that a transaction is beyond the corporate capacity of a company simply because it is effected for an improper purpose not authorized by its memorandum of association.<sup>14</sup>

### **B. The Abolition of the Doctrine of Ultra Vires under the Companies Code**

Before considering the 1985 Amending Legislation it is instructive to consider the amendments introduced in this area by virtue of the *Companies and Securities Legislation (Miscellaneous Amendments) Act 1983*.<sup>15</sup>

#### **1. The 1983 Amending Legislation:**

##### **(a) Outline of Sections 37, 67 and 68:**

Under the 1983 Amending Legislation there were substantial amendments to ss. 37, 67 and 68 of the *Companies Code* which were to operate on and from 1 January 1984. The provision in s.37 which required a company to state its objects in its memorandum of association was repealed and replaced by s.37(1A) which provides that it is now optional for companies to state objects. Sections 67 (powers) and 68 (*ultra vires* transactions) were replaced by new provisions.

Section 67(1) provided that, subject to the Code, every company was to have the rights, powers and privileges of a natural person and in addition certain specific powers peculiar only to companies e.g. power to issue and allot its shares or to grant a floating charge on its property. Pursuant to s.67(2) a company was able to restrict or prohibit the exercise by it of any of those statutory powers by provision in its memorandum or articles. Section 67(4) provided that nothing in the section was to affect the operation of any restrictions or prohibitions on the exercise by a company of any of its powers contained in its memorandum or articles before 1 January 1984.

Section 68(1) prohibited a company from exercising any power that it was prohibited or restricted from exercising by its memorandum or articles or from doing anything otherwise than in pursuance of any objects which may have been stated in its memorandum. Furthermore, s.68(2) prohibited an officer of the company from being knowingly concerned in a contravention of the prohibition in s.68(1). However, by virtue of s.68(3) neither a company nor an officer committed an offence against the section notwithstanding any breach of the prohibition set out in the relevant subsection. Again, s.68(4) and (5) provided that no act of a company or officer was invalid notwithstanding any breach of the

10. *Ibid.* at 85 per Slade L.J.; and at 93 per Browne-Wilkinson L.J.

11. *Ibid.* at 85-6 per Slade L.J.; and at 93 per Browne-Wilkinson L.J.

12. [1904] 2 Ch 608 (C.A.)

13. [1970] Ch 199 (C.A.)

14. *Supra* n. 8 at 82-5 per Slade L.J.; and at 93 per Browne-Wilkinson L.J. .

15. Hereafter referred to as the 1983 Amending Legislation.

prohibition set out in the relevant sub-section. Nonetheless, s.68(6) provided that the doing of an act by a company or an officer that was or would be prohibited under the relevant subsection might be asserted only in certain proceedings: (c) a prosecution of a person for an offence under the code; (d) an application under s.227A to have a person disqualified from acting as a director or manager of a company; (e) an application for an order with respect to conduct amounting to oppression, unfair prejudice or unfair discrimination pursuant to s.320; (f) an application for an injunction under s.574; (g) proceedings by the company, or by a member of the company against present or former officers of the company for breach of duty; (h) an application by the Commission or a member of the company for winding up of the company.

**(b) Purpose and Effect of Sections 67-68:**

The stated purpose of the 1983 amendments was to abolish the doctrine of *ultra vires* so as to ensure that persons dealing in good faith with a company would be protected against any assertion that the company lacked the necessary capacity.<sup>16</sup> However, commentators have suggested that the 1983 amendments made the position worse in that they would have resulted in a wider application of the *ultra vires* doctrine than the previous legislation.<sup>17</sup> The amendments were seen to be defective in a number of respects. Firstly, although s.67 invested a company with 'rights', 'powers' and 'privileges' no reference was made to 'capacity' of the company.<sup>18</sup> Secondly, the terminology of s.68(1) was capable of being interpreted as prohibiting the doing of *ultra vires* acts<sup>19</sup> and s.68(1)(c), in particular, was capable of being interpreted as importing into the code the doctrine of *ultra vires* in its wider sense. Thirdly, since s.67(1) was to be read subject to the rest of the Code, including s.68(1), the s.67(1) powers were seen to be limited in the case of a company with stated objects because such powers could only be exercised in pursuance of the stated objects. This was particularly important in the case of companies incorporated prior to 1 January, 1984 because these companies were required to have stated objects.<sup>20</sup> Fourthly, s.67(4) created an implied prohibition on the s.67(1) powers in the case of a company which expressly included some powers in its memorandum because it was arguable that powers not so included were not required.<sup>21</sup> This was again important in the case of companies incorporated prior to 1 January, 1984. Fifthly, although the Schedule 2 powers were repealed by the 1983 Amending Legislation it was arguable that, in the case of companies incorporated prior to 1 January 1984, these powers were retained to the exclusion of the wider s.67(1) powers under s.29(1)(c) of the *Companies and Securities (Interpretation and Miscellaneous Provisions) Act* 1980 which provides that a repeal of legislation does not affect any right, privilege, obligation or liability acquired under such legislation unless the contrary intention appears.<sup>22</sup> Sixthly, when s.68(1) was read with s.68(6)(f), which allowed an application for an injunction under s.574, the doctrine of *ultra vires* achieved a much wider ambit than under the previous Uniform Companies Legislation.<sup>23</sup> Section 574(1) gives the Court a discretion to grant an injunction restraining a person from engaging in conduct that constituted, constitutes or would constitute a contravention of the Code on the application of any person whose interests have been, are, or would be affected by the conduct. The reference to

16. See the Explanatory Memorandum to the 1983 Amending Legislation, para. 188.

17. J. Wilkin, 'Ultra Vires . . . is alive and well and living in Australia', (1984) 58 L.I.J. 256; H.K. Sikkema, 'Ultra Vires — Like Phoenix Arisen from its Ashes . . . A Bird's Eye View of the New Legislation' (1985) *Company and Securities Law Journal* 16; R. Baxt, *Introduction to Company Law*, (1982) at 36.

18. Sikkema, *supra* n.17 at 16-17.

19. *Ibid.* at 19.

20. Wilkin, *supra* n.17 at 257.

21. *Ibid.*; Sikkema, *supra* n.17 at 17.

22. Wilkin, *Ibid.*; Sikkema, *supra* n.17 at 18.

23. Wilkin, *supra* n.17 at 258; Sikkema, *supra* n.17 at 19.

'persons interested' has been liberally interpreted by the Courts to mean the interests of any person which go beyond the mere interests of a member of the public.<sup>24</sup> As a result it was arguable that a wide class of persons, including members and creditors, would have been enabled to restrain not only the entry into any ultra vires contract with a third party but also acts of performance under any such executed contract.<sup>25</sup>

As a result of these defects it was arguable that the 1983 amendments did not protect persons dealing in good faith with a company from any assertion that the company lacked the necessary capacity.

## 2. The 1985 Amending Legislation

### (a) Outline of Sections 66A — 68:

By virtue of the 1985 Amending Legislation there were further substantial amendments to Sections 67 and 68 of the Companies Code. Further, new provisions were added in the form of Sections 66A-C.

In part, ss 66A and 66B have the following effects: (a) the amendments are deemed to have come into effect on 1 January 1984; (b) the amendments are to apply to all companies whenever incorporated; and (c) the amendments are to apply in respect of restrictions or prohibitions contained in the rules of companies<sup>26</sup> regardless of when those prohibitions or restrictions were included.

Section 66C states that ss 67 and 68 have the dual purpose of: (a) abolishing the doctrine of ultra vires and (b) without affecting the validity of the dealings of a company with outsiders, ensuring that provisions of the rules of a company relating to objects or powers of the company are given effect to by the company's officers and members. Thus, s.66C makes it clear that a company's capacity to enter into arrangements with outsiders is not affected by limitations imposed by a company's internal rules. The function of s.66C is apparent when one considers s.5A(1) of the *Companies and Securities (Interpretation and Miscellaneous Provisions) Code 1980* which provides that in the interpretation of a provision of relevant Companies legislation,<sup>27</sup> a construction that would promote the purpose or object underlying the relevant Act (whether the purpose or object is expressly stated in the relevant Act or not) shall be preferred to a construction that would not promote that purpose or object.

Section 67(1) has been amended so that a company has the legal capacity of a natural person in contradistinction to the rights, powers and privileges of a natural person. The specified powers in s.67(1)(a)-(g) have not been altered. This concept of unlimited capacity of a company is fortified by the repeal of s.67(2)-(4) and the introduction of new provisions. Section 67(2) and (3) now provide inter alia that subs. (1) has effect in relation to a company notwithstanding: (i) any express or implied restriction on or prohibition of the exercise by a company of any of its powers set out in the rules of the company; (ii) the memorandum of a company contains a provision stating the objects of a company; (iii) a company contravenes s.68(1) where it acts contrary to an express restriction on or prohibition of the exercise of its powers or does an act otherwise than in pursuance of its objects; (iv) an act of the company may not be in the best interests of the company. As a result of these amendments it is clear that the defects which limited the capacity of a company under the previous provisions,<sup>28</sup> such as the s.67(1) powers being read subject to s.68(1) and

24. *Broken Hill Proprietary Co. Ltd v. Bell Resources Ltd* (1984) 2 A.C.L.C. 157.

25. Note, however, the Courts power under s.574(8) to award damages to any other person in addition to or as an alternative to granting the injunction.

26. A reference to 'rules of the company' is a reference to the memorandum and articles of the company. Section 66B(c).

27. This includes the *Companies [Qld] Code 1981*: See Section 3(3) of that Code.

28. This is particularly in relation to companies incorporated prior to 1 January 1984. Ante, at 4-5.

the existence of implied prohibitions upon other powers, have been cured. Further, it is clear that although the legislature has primarily directed its attention in s.66C and s.67(1) and (2) to the doctrine of *ultra vires* in the 'narrow sense'<sup>29</sup> it has also sought in s.67(3), where the reference is to 'an act not being in the best interests of the company', to specifically exclude the effect upon the capacity of a company of any wider concept of *ultra vires* as expounded, for instance, by Vinelott J. in *Rolled Steel Products (Holdings) Ltd v. British Steel Corp. and ors.*<sup>30</sup>

Section 68 has also undergone amendment. Section 68(1A), a new provision, specifies that the rules of a company may contain an express restriction on, or an express prohibition of, the exercise by the company of any of its powers. Section 68(1) has been amended so that it no longer prohibits a company from the doing of *ultra vires* acts but rather states that if a company exercises a power that it is expressly prohibited or restricted from exercising by its memorandum or articles or does an act otherwise than in pursuance of any objects contained in its memorandum then this results in a contravention of the sub-section by the company. The stated dual purpose of these amendments 'is to enable a company to impose restrictions on itself while still retaining the legal capacity conferred by s.67(1)' and to do 'away with the notion of implied restrictions and therefore clear up any uncertainties which may have been created by the introduction of C.A. s.67(4) in the 1983 amendments.' Whilst this dual purpose may have been achieved, the amendments may produce an undesirable result in practice when it is considered that the concept of implied prohibitions is not just rendered ineffective so as to maintain the unlimited legal capacity of the company but is also rendered innocuous for the purpose of considering whether there has been any breach of the company's internal rules. Thus, where companies incorporated prior to 1 January 1984 have stated some powers with the intention that other powers would thereby be excluded, members may be left without a remedy for a breach of the internal rules of the company when a power other than a stated power is exercised. On the other hand, it may be that the effect of these amendments is also to invest a member with an additional right of action where a company breaches its internal rules by doing an act otherwise than in pursuance of its objects and thereby contravenes s.68(1)(b). It is clear that in relation to the application of s.68(1)(b) the previous case law upon the construction of objects clauses and upon ancillary powers will still apply. Thus, where a company's memorandum states objects and contains a provision that each clause shall be construed independently of the other clauses, then each object must be treated as a substantive object unless either (i) the subject matter of the clause is by its nature incapable of constituting a substantive object or (ii) the wording of the memorandum shows expressly or by implication that the clause was intended merely to constitute an ancillary power only.<sup>31</sup> Where an object is merely an ancillary power, then the effect of the case law and s.68(1)(b) is that such power must be exercised in furtherance of the substantive objects of the company. However, the language of s.68(1)(b) is such that a contravention of it may occur either where the acts of a company are objectively incapable of being performed as reasonably incidental to its objects or where the acts, whilst objectively being capable of being performed as reasonably incidental to its objects, are also performed by the management for an unauthorized purpose. In this latter instance, the state of mind or knowledge of the persons managing the company's affairs becomes relevant. In both situations the acts of the company would now involve an abuse of power by management rather than an excess of power. As a result, if a company intends to exercise a

29. See Explanatory Memorandum to the 1985 Amending Legislation: para's 186, 187.

30. *Supra* n.8; see Explanatory Memorandum to the 1985 Amending Legislation: para. 199.

31. *Introductions Ltd v. National Provincial Bank Ltd* *supra* n.13 at 210 per Harman L.J.; *Re Horsley and Weight Ltd* *supra* n.1 at 437 per Buckley L.J.; *Rolled Steel Products Ltd v. British Steel Corporation* *supra* n.8 at 81, per Slade L.J. (C.A.).



power, such as a power to give a guarantee to persons having dealings with it, and the exercise of such power could be seen to be reasonably incidental to the company's business, but would be for an unauthorized purpose of reducing the liability of one of the directors under a personal guarantee<sup>32</sup> then a member may be entitled to restrain such exercise under s.68(6)(f). If s.68(1)(b) does not cover acts performed by the management for an unauthorized purpose, then a member would have to show that he is entitled to sue as an individual shareholder under an exception to the Rule in *Foss v. Harbottle*,<sup>33</sup> for example, under s.320 of the Code, a member would have to show oppression, unfair prejudice or unfair discrimination in the conduct of the company's affairs.

Next, it is to be noted that in harmony with s.68(1), s.68(2)-(6) are stated more neutrally in that they make reference to a contravention of the section rather than any reference to a prohibition of *ultra vires* acts. However, the more substantive amendments are to be found in that part of s.68(6) which details the proceedings in which a contravention of the section may be asserted or relied upon. Thus, s.68(6)(f) now only allows an application for an injunction under s.574, by any person whose interests would be affected, to restrain the company from entering into an agreement rather than to restrain the performance of acts by the company under an executed contract. Further, s.68(6)(g) has been amended so as to exclude from the proceedings mentioned therein an application for an injunction. Note, however that under s.68(7), any person whose interests would be affected may be entitled to be awarded damages by the Court where he is prevented from restraining the performance of acts by the company under an executed contract by virtue of s.68(6).

These amendments further support the earlier amendments which abolish the doctrine of *ultra vires* in that an executed contract is valid notwithstanding any contravention of s.68(1) or s.68(2).<sup>34</sup>

**(b) Effect of Sections 66A-68:**

The provisions abolish the doctrine of *ultra vires* by investing in a company an unlimited legal capacity to enter into arrangements with outsiders. Any statement of objects or any restriction on or prohibition of powers in a company's memorandum does not limit this capacity. However, s.68 ensures that the rules of a company relating to objects or powers are given effect to by the company's officers and members without unduly disrupting arrangements that the company may have entered into with outsiders. This balance is struck by the limitation of injunction proceedings in s.68(6)(f) to an injunction restraining a company from entering into an agreement with an outsider.<sup>35</sup> Perhaps the only undesirable effect about these provisions is the annihilation of the concept of implied prohibitions in relation to the observance of the company's internal rules.

**C. Conclusion**

Although the trend in the English Courts of giving the doctrine of *ultra vires* a much wider emphasis would appear to have been checked, such that its ambit is now restricted to describing transactions which are beyond the corporate capacity of the company and not transactions which are merely in abuse of the powers of the company, the necessity of moderating the doctrine by statute still remained.<sup>36</sup> In recent times, amendments to the *Companies Code* in this area of the law have been designed to abolish the doctrine of *ultra vires* and protect outsiders dealing in good faith with a company against any assertion that the company lacked the necessary capacity. Whilst it would appear that the 1983 Amending Legislation failed to achieve these aims, the introduction of ss 66A — 68 under the 1985

32. This was the situation in *Rolled Steel Products Ltd v. British Steel Corporation supra* n.8.

33. 67 E.R. 189.

34. See Explanatory Memorandum to the 1985 Amending Legislation, para. 211.

35. *Ibid.* at para. 190.

36. See T.E. Cain: *Ultra Vires in 1984, supra* n. 1.

Amending Legislation now ensures that a company has full capacity to enter into arrangements with outsiders.

Notwithstanding the enactment of s.37(1A), many companies incorporated prior to 1 January 1984 will not see it as essential that they exercise the option of removing their existing objects clauses. Further, insofar as companies incorporated after that date are concerned, it is conceivable that members, creditors and debenture-holders may opt to place some limitations upon the company. In these situations, any statement of objects or any restriction on or prohibition of powers in a company's memorandum may now generally be considered as a matter relating to the internal rules of the company and the enforceability thereof.