

The Doctrine of *Ultra Vires*: Commendable or Condemnable!

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Abstract

This study investigates principally the doctrine of *Ultra Vires* in the English law. It aims at crystalizing the ramifications of applying this act to the English Commercial Law throughout several eras, taking into account the impact of abiding by the *Ultra Vires* act on the parties involved in the concerned transactions; i.e. the concerned shareholders and creditors. Furthermore, the study attempts to decipher the puzzling matter which concludes whether the doctrine in question must be cherished or perished in the English legal system.

Keywords: *Ultra Vires*, commercial law, limited liability, memorandum of association, shareholder, company law

1. Introduction

A bewildering case arose on the grounds of the English legal system courts in 1953. Owners of a limited company named *Re Jon Beauforte* located in London, took the initiative to alter its main activities from manufacturing ladies' dresses into synthesizing wooden products; i.e. practicing another activity clause indicating by "veneer panels productions".¹

Highlighting this activity alternation in the company's Memorandum of Association (MOA) brings the attention to that the company has drastically changed its ultimate activities from x to z. To accomplish the company's goals, the owners, i.e. contractors, did sign new contracts to establish a new factory for veneers, including new object clause for comprising the veneers purchase in addition to coke. However, the company's change went a bolt from the blue due to the fact that the new enterprise of veneer panels went into liquidation.²

The judges then could not issue a verdict for the contractors involved in the company's liquidation since the transaction was '*Ultra Vires*' the contractual capacity of the company's memorandum of association. Henceforth, the judges could not provide a piece of proof beyond a reasonable doubt. This vexing judgement has been a wakeup call for a novel act to be legislated in the English legal system.³

The expression "*Vires*" has its etymology from the Latin origins which denotes "beyond the powers of". To underline "ultra" indicates "beyond" in contrary to the prefix "intra", meaning within which is employed in the expression "*Intra Vires*" as an opposite to *Ultra Vires*. In the abovementioned incident of the company, the *Ultra Vires* act was employed, which will be the mere focus of this study, to denote shortly for a company to not go beyond the object clause, and if so its act will be defined as void and null.⁴

2. Rationale and Problem of the Study

The rationale behind conducting this study is to cull a judicial-based review on the validity of the *Ultra Vires* doctrine in the English legal system. The study outlines a two-fold problem. First, it depicts thoroughly the silver line behind the chequered influence of the doctrine in question. Furthermore, the commercial legal aspects have been a quite problematic area for researchers since the focus is mainly on investigating the macro-level legal aspects of commercial law like codification, unification, and evolution of a particular law; nonetheless, the focus relegates the micro-level legal aspects related to the commercial law acts and rules to a minor position.

3. Purpose of the Study and Research Questions

From a theoretical point of view, the researcher intends to construe practically what is meant by the *Ultra Vires* doctrine within the context of commercial law, and the company law in particular. From a practical perspective, the present study aims at revealing the extent to which the *Ultra Vires* act to be reconstructed or abolished from the current legal English system where it is involved. To achieve these purposes, the researcher attempts to

answer these questions:

1. To what extent does the *Ultra Vires* act have an impact on the efficiency of limited liability clause outcomes?
2. To what extent is the company's contractual capacity reliable for the company's shareholders and other concerned bodies?
3. According to the resulted impact, does the *Ultra Vires* act need an ultra-renovation or innovation?

4. Significance of the Study

The significance of this study arises from its endeavours to shed the lights on a vexing legal issue having different remarks on the corporate law context. Getting familiarized with such remarks paves the way for jurisdictions to better grasping of the rule of *Ultra Vires* by company's shareholders and, hence, better application by jurisdictions if needed. Such knowledge and indulge in this doctrine open the spaces in front of other European countries to absorb, stimulate, and then apply the best shots of the English *Ultra Vires*-oriented experience to their legal systems.

5. Review of Related Literature

The doctrine of *Ultra Vires* has been characterized by its own standards. A limited body of research has been conducted to shed the light on some aspects of this chequered doctrine. Starting by Zhen Si (2011) who tackles a special sort of *Ultra Vires* rule in the context of company law; such an act is confined to the power of companies' directors. From his point of view, Si states that the principal of *Ultra Vires* changes overtime and as the decision-making process of a by company is limited to the management but not the shareholders, it is necessary to control this authority by issuing the *Ultra Vires* act of company's directors. The study reveals that the abovementioned sort of act has a pivotal impact on the company's involved three parties, especially when suing to the court in case of tort or defeat.

Ding's study (2009) investigates the suggestion of reform of the *Ultra Vires* doctrine in China's courts. The researcher focuses the attentive ramifications occurring for the abolishment of the *Ultra Vires* doctrine in the western legal system. Concerning these problems and economic mishaps, it is unraveled the need to adopt this doctrine in China and launch the general principle abiding by it in all companies to define its legal influence on directors, shareholders, and creditors.

In a similar vein, Mei (2003) conducts the first study on the Chinese context to figure out the availability of applying the *Ultra Vires* doctrine to the Chinese system. For accomplishing the study purposes, the researcher has done a systematic analysis on the *Ultra Vires* dimensions in terms of corporation contexts henceforth, the study concludes with revealing the importance of legislating the *Ultra Vires* act in the Chinese corporate law.

Rabb (2003) holds a study on the mixing question related to seemingly-synonymous concepts: *Ultra Vires* and illegality. The researcher's main aim behind this study is to investigate the use, or to be more accurate, the misuse of *Ultra Vires* act or illegal acts in the English company law. By examining different cases and some in the US courts, the researcher concludes that with regard to the *Ultra Vires* vs. illegality concept, the *Ultra Vires* act must be abandoned totally and equated with illegality.

Introducing the related literature has shown that there is no study until now to investigate the *Ultra Vires* doctrine in relation to its impact from different dimensions. This study, in particular, aims to highlight the vitality of such a doctrine and to what extent its presence is needed.

6. Methodology

To meet the study purposes, the researcher employs the descriptive analytical method where he reviews the pronounced act in relation to the amendments it necessitates with regard to the ramifications of the pundit's calls and judgements needs.

7. Discussion

7.1 The *Ultra Vires* Doctrine: Between Innovation and Renovation

It is ordinarily common that the corporate law indulges in different transactions and the process-motive of them; i.e. the objects which are the core concern of transactional deal. A company, henceforth, to undergo any sort of deal must establish a Memorandum of Association through which it ratifies several articles, top of them is assigned to the object clause⁵. Here, it comes the role of the *Ultra Vires* act which simply obliges the stakeholders not to act beyond the powers of the company unless objects are listed on the object clause of the MOU. This notion ties with the line with the emergence of the Limited Liability Act.⁶

Foreshadowing on the emergence of the *Ultra Vires* act, such an act is deemed to the juridical surface line by line with the introduction of the Limited Liability Act. In 1855, the need raised in England for a strict act to protect the rights and interests of the creditors involved in a company's transaction. This need prompts the emergence of the limited liability property which confines the use of company's objects by the creditors to the objects only defined in the company's MOA object clause.⁷

The defined object clause was purely included in the contractual capacity of the MOA so far in the Limited Liability 1856 Act. Nonetheless, a dim shadow of the capacity was failed to reflect the light of clarity as a sort of ambiguity controls the situation over the object clause in question.⁸

Until 1875, the perplexing situation was resolved after years later to the issuance of the Company 1862 Act which stipulates that "no alternations shall be made by any company in the -conditions contained in the memorandum of association". The House of Lord decision on the *Ashbury carriage & Iron Co. v. Riches* case⁹ has been a turning point over the *Ultra Vires* doctrine history. With regard to the case, the House of Lord has stated that the said company's contract was *Ultra Vires* the object clause pronounced in the MOA; thus, any transaction for the new object was considered null and void.

It is, thus, in connection to the aforementioned case that the *Ultra Vires* rule has been resolved after which the Limited Liability Act has been innovated. Quoting section 12 in the company Act of 1948, it has made clear that the contractual capacity status by which no alternations shall be made on the object clause included in the MOU as :

"...If that is the purpose for which the corporation is established... it is a mode of incorporation that contains 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 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."¹⁰

The renovation of the *Ultra Vires* doctrines on the English legal system ground has paved the way for the role of theory to be applied in a two-fold manner. Firstly, in accordance to the sovereignty power of the Constitutional Law Parliament, the country, by issuing such a rule, grants powerful authority over the commercial delegated bodies.¹¹ In addition, the rule works practically on the side of investors to avoid the unauthorized cases of company's funds.¹²

From innovation to renovation, the *Ultra Vires* doctrine journey has never been to cease up. As a doctrine, the natural subsequence to be witnessed in the concerned rule, sometimes, is a particular gap or defect; accordingly, the rule in question is exposed to revision and recognised then for supervision. Nonetheless, this is not the case for the *Ultra Vires* rule; what had happened is that its renovated starting point alters the situation into a seemingly-end point. After the English company law courts had issued their verdict on the *Ashbury Carriage Company's* case¹³, the reaction towards such a rule faced two directions.

a. English Courts:

No wonder that the courts recognised the cons of the *Ultra Vires* rule while dealing with several transaction-based cases. Hence, their role has been confined to cope with the doctrine's rigors throughout primarily two methods either by manipulating varied legal interpretations, to validate transactions or by interpreting the object clause in accordance to what is called the *ejusdem generis* rule, which lists names of property or livings in specific statements referring to them in general.¹⁴

b. The Company's Itself:

1. The Company's Management:

The company's directors reacted against the *Ultra Vires* rule in an attempt to seek for its pragmatic demise. For accomplishing this desire, company's managers avoid the rule through:

- Introducing a wide range of businesses in the object clause contained in the MOA.
- Incorporating the "all power purposes clause" in the memorandum for justifying the addition of any sort of business to the company.
- Classifying all objects added in the object clause as "main objects" of the company.

2. The Company's Shareholders and Third Parties:

It is seen that the application of the *Ultra Vires* rule creates somehow hardships for the company's shareholders. Generally speaking, this rule has an ample influence to ineffectively safeguard the shareholders' assets and on

the expense of the third-party property's risks.

Examining the *Ashbury Railway Carriage Company's* case¹⁵, the jurisdictions at that time should look at some critical points that have been key lost as critics claim. One of these elements, in addition to the shareholders' property, is the protection of social property, which involves safeguarding the third parties' dealings with the company. When the House of Lord has issued the *Ultra Vires* rule then in accordance to the Limited Liability shareholders desire to gain while investing their shares in a company. However, this sort of protection enhances avoidable risks over another kind of protection which is namely related to the social obligation; which is the responsibility of the shareholders towards the third parties' investment with a company. Behaving at the expanse of the limited liability impedes the role of third parties in other words, their role becomes a sort of an individual protection exposed to any event of commercial illusory.

7.2 The *Ultra Vires* Doctrine: Commendable or Condemnable

To make the truth permissible, the shareholders' limited liability and the third-party social obligation are equally important. For considering this balance, the vexing criticized point on the *Ultra Vires* might be reformed in another way. Referring to the contractual capacity contained in the object clause, it is advisable to enhance the liability scope of the third-party operations in a company. In other words, it is to give a liberal interpretation for the transaction to be *Intra Vires* the object clause between the third party and shareholders. To clarify the status, the courts have provided legal interpretations for the *Ultra Vires* rule as illustrated below:¹⁶

- If some property is acquired by the company on account of the *Ultra Vires* transaction and used by the company to pay its own debts, the supplier of the property on account of the principle of subrogation will step into the shoes of the creditors whose claims have been paid off by the company and acquire their rights against the company.
- If the property acquired by the company on account of an *Ultra Vires* transaction exists in specie or if it can be traced, the person handing it over can recover it from the company.

Again, the juridical attempts have failed to address the abovementioned balance because there are different kinds of contracts where courts must deal with, and such contracts, as the executory contract, are complicated and lack legitimate principle as for the third parties' obligations.¹⁷

The *Ultra Vires* act has undergone divergent developments and amendments to address the third-party dealings. These developments, staging up from Company Act of 1984, have ended up with a fundamental change on the pronounced rule in the Company Act on 2006. To make the story short, Section 39 of CA 2006 states that any act undertaken within the contractual capacity of a company not to be questioned under any case.¹⁸ The said CA 2006 insists on companies to establish MOU for purposes of registration, however, in relation to the object clause contained within the MOU, the act stipulates that it is not a mandatory statement. This is legally interpreted as that any company has its freedom to establish any kind of business whether the area of activity, or object, is mentioned in an object clause or not. To illustrate, the company law allows companies to alter their business from the original ones, the matter which is considered, to some extent, an *Intra Vires* act.¹⁹

Quoting the connotative nature of this section, it thus implies the realm of the *Ultra Vires* doctrine heads to its demise; nonetheless, the remnants still prevail on some companies' regulations, restrictions, and bylaws²⁰ Furthermore, The English common law still recommends its usefulness in a way or another practically.

8. Conclusion

The key concept of the *Ultra Vires* doctrine refers simply to the act stipulating to not act beyond the powers of a company. By issuing this act, the activities of a company are said only to be confined to the object clause it assigns on the MOA. Thus, any activity, or object, *Ultra Vires* the object clause is regarded null and void.

Accompanied by the issuance of the Limited Liability Act, the *Ultra Vires* has emerged dogmatically on the surface of the English legal grounds. Throughout the pragmatic observations in courtrooms and companies, the *Ultra Vires* doctrine has been addressed with a long-term bewildering question: "Is the pronounced question commendable or condemnable?". Throughout examining the influence of the *Ultra Vires* act on the company's management, shareholders, and investors, it was revealed clearly enough that such an act has its own indisputable presence in the company law; however, a retrospective and introspective examination into such presence is vitally needed over time in order to meet the challenge and needs of companies with the courtrooms' cases in relation to the *Ultra Vires* requirements and grasp.

9. Recommendations and Implications for Jurisdictions and Scholars

- Empirical studies must be conducted to check out the up-to-date validity of this doctrine in courtrooms by

designing surveys, interviews, questionnaires, etc...

- More body of research is recommended to focus on the micro-level aspects of the company law.
- Company law acts must be revised in the light of the diachronic or synchronic historical studies which provide objective evidence on the validity of a particular act or its amendment or a section.
- Many countries, involving the oceanic legal system countries, are preferred to legislate the *Ultra Vires* rule in their legal systems as it ensures only the authorized activities of the creditors.

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