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AN ANALYSIS ON THE DOCTRINE OF ULTRA VIRES

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ABSTRACT

This paper provides a comprehensive analysis of the Doctrine of Ultra Vires as outlined in the Companies Act of 2013. It explains the historical context, the necessity, the extent of power, and the overall scope of the doctrine. Furthermore, it delves into the evolutionary path of this doctrine in both the United Kingdom and India, highlighting various measures adopted by business entities to evade its implications. The study also sheds light on exceptions to the doctrine and the consequences of ultra vires transactions.

INTRODUCTION

The word ultra vires was derived from two Latin terms: "ultra," which means beyond, and "vires," meaning power or authority. Therefore, the meaning of the term ultra vires is 'beyond the power or authority of'. In simple words, when a company carries out an act that isn't mentioned in its object clause, it exceeds its legal powers. Such acts are known as an ultra vires act and the company isn't legally permitted to undertake it.

The doctrine applies to all incorporated entities that have a separate legal identity. In contrast, it does not extend to partnership firms or sole proprietorships. A company is formed only to pursue the objectives outlined in its memorandum of association's object clause. The shareholders cannot ratify any act that is ultra vires in nature. No one can ratify any act that goes against the object clause.

HISTORY

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In 1612, the concept of doctrine of ultra vires was first established in United Kingdom. This principle allows individuals to determine the legitimacy of an action. Over time, judges played a crucial role in interpreting and applying the doctrine through various legal cases. In the ***Sutton Hospital case***[2], it was highlighted that the ultra vires doctrine does not extend to actions or transactions involving chartered accountants, despite their status as corporate entities with a distinct legal identity.

In the early 17th century, companies utilised "royal charters" for incorporation, granting them a separate legal identity from their owners. These charters grant corporation rights akin to those held by individuals, including the legal capacity to initiate or face lawsuits even in the absence of a physical form.

During 19th century, as the industrial revolution progressed, the role and scope of corporations expanded. The doctrine evolved to encompass not only acts beyond the company's express powers, but also acts that were impliedly or incidentally ultra vires. As the role and structure of corporations evolved, so did the ultra vires doctrine. It expanded to cover not only acts beyond express power, but also implied or incidental acts. In the 20th century, statutory reforms and modern corporate legislation further shaped the application of the doctrine.

NEED AND SCOPE

Initially, sole proprietorships and partnerships were the predominant business structures, making the doctrine of ultra vires less significant. However, with the passage of time, this doctrine gained importance to safeguard the interests of creditors and shareholders in companies. It ensures that the investment made by the shareholders is utilised solely for the objectives specified in the memorandum of association of a company.

A company must strictly operate within the scope of purposes defined in its object clause. It can only do those acts for which the proposed company has been established. Any action taken by the company that surpasses these authorized objectives is considered ultra vires. This doctrine plays a crucial role in preventing directors from misusing their powers, which diverts from the intended purposes for which the company was established.

[2] (1612) 77 Eng Rep 960.

EVOLUTION IN ENGLAND

The ultra vires doctrine was first established in England through the case of ***Ashbury Railway Carriage and Iron Co. Ltd. v. Riche***[3]**,**by the House of Lords. It involved a company a company which was formed to manufacture and sell railway carriages. Despite this defined purpose, the company entered into a financial agreement with Riche, an external party. Since the memorandum of the company didn't authorise such financial dealings, it later declined to fulfil the contract, arguing that the agreement exceeded its legal powers. Riche sued for breach of contract. The court ruled that the agreement entered into went beyond the objectives stated by the company and therefore was invalid and outside its legal capacity to act. It said that the object clause meant two things:

1. To do only what is mentioned in the object clause;
2. and to not go beyond what is mentioned in the object clause.

In the landmark case of***Attorney General v. Great Eastern Railway Co.***[4]**,** the House of Lords reaffirmed the Ashbury case but emphasised that it should be applied with a sense of practicality. The court further clarified that a company is not strictly confined to the exact words written in the object clause. Instead, it may also engage in activities that are essential to achieve its objectives, naturally connected to them, or reasonably implied by the statute under which it is formed. The 2013 Companies law reflects this flexible approach. While on the one hand, the memorandum must state matters necessary for pursuing the company's goal, on the other hand, actions that are not explicitly mentioned can still be undertaken if they help in furtherance of the company's purpose through a fair and reasonable interpretation.

EVOLUTION IN INDIA

In India, the origin of the doctrine dates back to 1866 in the case of ***Jehangir R. Modi v. Shamji Ladha***[5]**,** wherein High Court of Bombay interpreted the principle in relation to a joint stock company, and based on the facts of the case concluded that "the purchase by the

[3] (1875) LR 7 HL 653.
[4] (1880) 5 AC 473.
[5](1855) 4 Bom. H.C.R. 185

directors of a company on behalf of the company of shares in other joint stock companies, unless expressly authorised in the memorandum, is ultra vires."

In the case of ***A. Lakshmanaswami Mudaliar v. LIC***[6], the Supreme Court made a distinction between the object clause and the powers of the director. In this case, the company's memorandum mandated that its directors allocate part of the company's profits to charitable institutions serving public interests. Acting in accordance with this provision, a director made a donation of Rs. 2 lakhs to a charitable organization. Following the company's acquisition by LIC, concerns emerged over the charitable donations. LIC contended that such donations were beyond the company's intended scope, as the object clause in the memorandum did not explicitly authorise the company to contribute to charitable organizations. Consequently, the court held the act of the director to be ultra vires. The court also said that the powers of directors must be used to further the objects of the company.

The aforementioned Supreme Court ruling establishestwo key principles: first, that a company cannot allocate funds to charitable causes indiscriminately, even if its memorandum permits to do so. Second, it draws a clear line between objects and powers. The company's objectives must be explicitly outlined in the memorandum, this means that there isn't a need to mention the powers. Powers are merely tools to achieve those ends, they are not independent on their own.

The doctrine of ultra vires remains a significant aspect of corporate governance in India, as highlighted by Section 245(1)(a) of the Companies Act. This provision grants company members or depositors to file a case in NCLT when they feel the company's operation are being carried out in a way that harms the interests of its members. In a country experiencing ongoing economic growth, the formation of new companies is crucial for boosting the GDP. The doctrine of ultra vires assumes importance in this context, serving as a protective measure for lenders. By restricting companies to activities within the scope of their object clause, the doctrine ensures that lenders have a guarantee of repayment if companies deviate from their stated objectives. Given the dynamic economic landscape, the doctrine of ultra vires continues to be vital as a safeguard for investors and shareholders. It provides assurance that companies will not misuse their powers, thereby protecting the interests of those who

[6]AIR 1963 SC 1185

invest in them. As the economy evolves, it is evident that the doctrine's relevance and importance will persist, emphasizing its role as a crucial mechanism for maintaining corporate integrity and investor confidence.

AVOIDANCE

There are several ways with the help of which we can get away from the ultra vires doctrine. They are as follows:

- If a company has unlimited list of objects in itsMoA. In the case of ***Cotman v. Brougham***[7]**,** theMoA had 30 sub-clauses, which allowed the company to continue almost all activities which it could perform. This defeated the purpose of the doctrine. To address this issue, courts adopted the "main objects rule" of construction in order to interpret such clauses more narrowly. This can be clearly understood through the case of ***German Date Coffee Co, re.***[8]**,** where a company was established specifically to operate under a German patent for producing coffee from dates. Since that patent was never granted, the company instead acquired a Swedish one and began operations in Hamburg without formal patent protection. The court found that the true underlying purpose of producing coffee in Germany under German patent protection was no longer viable. As that objective had failed, it was fair and reasonable to dissolve the company.
- If a company's memorandum does not have a defined object clause.
- If the object is what its directors deem fit from time to time, this gives a broad scope of interpretation to the object clause.
- If there is a distinction between the main object and the subordinate object in its object clause of the MoA.

CONSEQUENCES OF THE ULTRA VIRES TRANSACTION

Director's Liability: Directors who authorize or engage in ultra vires transactions may be personally liable for any losses incurred by the company or its shareholders. They could be held accountable for breaching their fiduciary duties and may face legal consequences.

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[7] [1918] AC 514.
[8] (1882) 20 Ch. D. 169.

Legal Actions: The company or its shareholders may take legal action to challenge or prevent an ultra vires transaction. This could lead to court proceedings, and the court may order remedies such as rescission (undoing the transaction), damages, or injunctions.

Voidability: In many jurisdictions, ultra vires transactions or contracts are considered void or voidable. This means that the transaction or contract may be deemed invalid, and the company or a party to the transaction or contract may have the option to void it.

Property acquired ultra vires: Even if a company acquires property through an act that falls outside its authorised objectives, it still retains legal rights to that property once the purchase is made. The transaction, though ultra vires, does not invalidate the company's ownership.

Breach of warrant of authority: An agent must operate within their authorized limits; incase they breach their authority they will have personal liability towards third parties for the same. Directors of a company, function as its agents, they are obligated to adhere to the company's authorized powers. If, even unintentionally, an outsider enters into a contract with the company in an area where the company lacks authority, they will be personally accountable to that party for any resulting losses. In the case of ***Weeks v Propert***[9]**,** a railway company advertised an investment opportunity involving debentures. However, the company had already reached the borrowing limit specified in its governing documents, having issued debentures totalling £60,000. Despite this, an individual responded to the advertisement with a loan of £500, which the directors accepted and issued a debenture in return. As the company had exceeded its permitted borrowing power, the transaction was ultimately considered void. In a lawsuit against the directors, it was determined that by advertising the loan, the directors had guaranteed they had the power to borrow, which they didn't actually have. Therefore, they were personally liable for the breach of warranty.

Ultra vires tort: There are two requisites to hold a company liable for a tort

1. The individual must have carried out the wrongful act during their employment. In such cases, the person can be held personally responsible.
2. The action leading to the tort must be one that is permitted under the company's MoA.

[9] (1873) LR 8 C.P. 427

EXCEPTIONS

There are certain exceptions or instances where any action that is ultra vires may be validated:

- **Ratification by Shareholders:** When an action lies within the scope of company's power but exceeds the powers granted to its directors, it can be validated through formal approval by the shareholders.
- **Continued right over property acquired through an ultra vires act:** if the company, through an ultra vires act, acquires property as an investment, it retains rightful ownership over that property. The acquisition is considered valid despite being beyond the company's express powers.
- **Validation through Alteration of Articles:** Acts that are initially ultra vires to the Articles of Association can be legalised by amending or altering the Articles.
- **Validation of Irregular Acts:** Actions carried out in an irregular manner, yet within the company's lawful capacity, may be approved and made valid through shareholder consent.
- **Implied Powers Not Explicitly in Memorandum:** Some powers, though not directly listed in the MoA, are still considered to fall within the company's legitimate power under company law. Such implied powers are considered valid and not ultra vires.
- **Validity of Incidental Consequences:** While applying the aforementioned doctrine, incidental consequences of the relevant act will be deemed valid, unless expressly prohibited by the Companies Act, 2013.

CONCLUSION

Through this research paper we can conclude that the doctrine of ultra vires holds of a lot significance in companies. It acts as a safeguard by restricting a company's actions strictly within the boundaries defined in its object clause. This principle is essential to safeguard the interests of creditors and investors, as it prevents the misuse of their funds for activities beyond the company's stated objectives. Today, while the ultra vires doctrine persists in some form, its strict application has been relaxed in many jurisdictions. Modern corporate laws often provide companies with broad powers, and the doctrine is less rigidly enforced than in the past. However, the importance and significance of this doctrine cannot be ignored just because it is not codified. Therefore, this doctrine is a crucial safeguard to be implemented across all companies, and it will continue to be enforced for the foreseeable future.