



UNDERSTANDING THE DOCTRINE OF ULTRA VIRES UNDER THE COMPANIES ACT, 2013

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Abstract:

Let me start by giving a very simple example regarding the concept- When an Individual is in one's early stages of life like the preteen, then generally the powers of the very Individual are limited and that particular individual is allowed to work within a specified framework of life, beyond which he/ she can't move or perform any task. The case with this doctrine is a much similar one when read with the Companies Act. Any Company can grow old but remains a preteen or a kid that works under the regulation or framework specified in the MOA or the Memorandum of Association.

Keywords:

Vigilance, Companies, illegality, liability, work ambit, powers.

Introduction:

One of the most essential steps in the formation of the company is the preparation of a document called the Memorandum of Association (Hereafter MOA). Section 2 clause 56 of the Companies Act 2013 defines the Memorandum of Association, it is considered to be one of the most important documents that specify the incorporation of the company, the object of the company, registered office of the company, liability clause of the company and the Capital of the Company. These provisions can be altered from time to time but through proper legal

vigilance and this can also be termed as Censoring. So, let me go back to the example that I stated in the abstract, it is pertinent to note here that when a kid cannot perform a task that is not specified for him then this regulation should exist for the companies too.

The very doctrine of Ultra Vires finds its relevance in the object and power clause under the MOA. The object and power clause is necessary for the company as well as its shareholders because off course the capital is vested with the company but the contributions by the shareholders also hold great importance in determining the goodwill that the company enjoys in the market, and with the objects and powers unspecified, there will exist no bar on the acts of the companies.

Secondly, these objects provide a sense of security to the creditors of the company so that they remain assured regarding its financial assets, position and if required then loans also.

Thirdly, it is important for a company also to work within a confined area of corporate interest, so that they're able to maximize the profits, remove the encumbrances from a well-specified plan and utilize the resources properly. And here comes the role of the Doctrine of Ultra Vires, the literal meaning of *Ultra* is Beyond and *Vires* is power. So when something happens to exist beyond the specified power, therefore it is not only the duty of the companies to specify their works in the MOA, but it is also necessary that they don't perform any act that is outside the ambit of the objects and purposes mentioned in the MOA. In the words of *Lord Wrenbury*- it is the function of the MOA, to delimit and identify the objects



in the MOA in such a manner so that the reader can identify the corporate activities in a clear and unambiguous manner¹ and it is further the duty of the Courts to ensure that the company doesn't discretionarily move away from the objects and powers stated in the MOA².

The Doctrine of *Ultra Vires* prescribes the Vigilance, so that companies are unable to use the unfettered powers. It is a doctrine that is followed worldwide to ensure that situations are controlled in a much efficient way.

In a much-simplified sense, it can be said that an *Ultra Vires* Act is a void act and even if the directors of the company wish to ratify the act then they are not allowed to do so and will have to face the consequences of the same.

How this Doctrine Originate?

Much of the attention was not paid to these concepts during the 18th or 19th century because the companies that existed during that period were inferred to be in as an enlarged form of partnership and not as a company per se. Therefore, there didn't exist any kind of authority to support the doctrine of *Ultra Vires* and neither did it had a philosophical part behind it because there were many aspects that were not paid much heed like creditors felt secured. After all, the rule of the partnership was enough to secure their insecurities and also if one looks into the law of partnership then it is evident that cardinal changes cannot be done without the consent or approval of all the partners. This doctrine then was first introduced in relation

to the statutory companies³ but as I said earlier, not much heed was paid because of lack of authority and philosophical support. As mentioned earlier the Doctrine was first recognized by England in 1612.

But after the mid-nineteenth century, this Doctrine gained prominence after the introduction of the principle of Limited Liability in the Partnership Act and due to this, it was possible that the liability of a member can be limited, but this led to another havoc of the creditors' being insecure because the liability got limited and it is these acts that led to the development of this doctrine where the *Ultra Vires* Acts of the companies could be regulated by stating the objects in the MOA.

How this Doctrine was entrenched?

The application of this Doctrine wasn't witnessed till the year 1875 but this lacuna was disgorged by the House of Lords in the case of *Ashbury Railway carriage and Iron Company ltd V. Riche*⁴ where the court validated the applicability of this doctrine to the companies under the Companies Act.

Here in this case, in the MOA of the railway Company under the objects, it was said that the company is entrenched to manufacture or sell or lend on hire railway carriages, wagons, etc..... to carry on the business of mechanical engineers and general contractors.

Then the company entered into a contract with *Riche*, who would give financial support for the development of a railway line. Then the Company rescinded

¹ In the case of *Cotman V. Brougman*, 1918 AC 514.

² *Port Canning & Land Investment Co., re* (1871) 7 Bengal LR 583.

³ Sealy, L.S., "Cases & Materials on Company Law.

⁴ (1875) L.R. 7 H.L. 653.



the contract by terming it *Ultra Vires* and this was challenged by *Riche*. The important issue that was involved here is whether the contract was valid per se and whether can it be ratified by the other members of the concerned Company?

So, the Court unanimously held that it was *Ultra Vires* because the act done was beyond the clauses mentioned in the objects of its MOA. It was stated that the Statement of Object has two-fold operations wherein, on one hand, it states the ambit, scope, and extent of the company and on the other hand, it prohibits that no kind of acts should be done that is beyond that ambit, scope and extent, and that there should be no attempt made to cross or supersede the corporate life that is specified in the MOA.

Here *Riche* contested by using the word 'General Contractors', the court held that this term should be analyzed by perusing the context and the context says that general contractors should be looked at as a connection with Mechanical engineers and if the very term 'general contractors' is not used in the way it is used in the context then it would authorize the company to make contracts with anyone and that will be an *Ultra Vires* act.

After this case, the same House of Lords endorsed the Court's stand on *Ashbury's Case* and the Court cleared the lacuna and said that this Doctrine should be understood in a reasonable manner and should be applied fairly on the incidental objects. Meaning thereby that a company may find it ableness to do an act that is necessary, or; Incidental to the attainment of

its objects, or; an act which is otherwise authorized by the Act.

Is Ultra Vires & Illegal the same:

Many times it is observed that *Ultra Vires* is made similar to the illegal but both the concepts are very different from one another. *Ultra Vires* is an act of a company that is beyond the specified clauses in the MOA under the objects. These acts are per se void even if they're illegal, whereas if there exist any illegal acts and it falls within the object clause then those acts will be void too.

How this doctrine was established in India?

In India, this doctrine was first applied by the Bombay High Court in 1866 in the Case of *Jehangir K. Modi V. Shamji Ladha*⁵, the Court held that the purchase made by any directors of the Company or in the shares in other joint-stock company and if that thing is not expressly specified in the MOA then that would amount to an *Ultra Vires* Act.

But this Doctrine was established and affirmed perfectly after 97 years in the case of *A. Lakshmanaswami Mudaliar V. Life Insurance Corporation of India*⁶, herein the company's directors were authorized to make payments towards any charitable or any benevolent object or general public, general or useful object and in accordance with the resolution, the directors made a payment of 2 lakhs to a trust that was formed to encourage technical and business education. This act of the company was held to be *Ultra Vires* and the reasoning that was given by the court was that the directors cannot choose to spend Company's money on any of the charitable or general objects. The Court said that they can spend money on the promotion of only such

⁵ (1868) 4 Bom. HCR 185.

⁶ AIR 1963 SC 1185.



objects that would prove to be beneficial to the company's objects clause.

There were 2 generic interpretations in the aforementioned Judgment. The first one is that the company's funds cannot be transferred to any kind of charitable purposes even if there exist unrestricted powers specified in the MOA. The Court inferred that the power to make a charity or borrow the same is not an object and even if the powers are specified in the MOA then they should only be effective to give support to the Objects mentioned in the MOA.

So to determine the legitimacy of the grant, in the opinion of Justice Eve in the case of *Lee, Behrens & Co. Ltd, re*⁷ where the legitimacy of such grants can be tested and those are: 1st- Is the transaction incidental to the company's business?; 2nd- Is that transaction done with a bona fide intention?; 3rd- Is it done to promote the benefit and to promote the goodwill of the company?. If these things are in an affirmative sense then the act is not *Ultra Vires* per se.

Analysis of the applicability of this doctrine in Indian Context and comparison.

It is pertinent to recognize a fact that India is a developing country and to improve the GDP growth of the country, the country requires the business class to do its job fairly to contribute towards the GDP growth, but there also exists an obligation to keep a check on the acts of the companies through laws. With the change in time, growth, and opportunities, there exists a need for new companies and new companies generally borrow money from banks. This doctrine

secures the lending institutions from their financial insecurities like a company won't perform actions that are not written in the MOA.

These all things have been reaffirmed by courts in many cases like in the case of *Radhabari Tea Company Private Ltd. V. Mridul Kumar Bhattacharjee and others*⁸, held that any kind of action that is taken by the company or even the board of directors which is outside or beyond the scope mentioned in the MOA then those actions would be *Ultra Vires*. And this thing has been specifically mentioned in Section 245 (1)(a)⁹, wherein actions that are outside the ambit of the Object Clause in the MOA will be censured under the *Doctrine of Ultra Vires*.

It is pertinent to note here that the same Doctrine has been made less effective in the United States by the Model Business Corporation Act, 2002 because of the existence of the Multinational Companies and business houses that brings a lot of GDP to the Country and those companies or houses can exercise or supersede actions that may bring profit for them and the government in the US also want its corporations to grow and foster that will indirectly boom the US' GDP. But the applicability of this doctrine can be witnessed in charitable contributions, political contributions, loans, stock option plans, the power to acquire shares in other corporations, and the power to enter into partnerships.

The Position of this Doctrine in England has been restricted by the European Communities Act 1972, wherein the company can perform the transaction that is approved by its Directors with the other

⁷ (1932) 2 Ch 46.

⁸ 2009 Indlaw Guw 44.

⁹ The Companies Act, 2013.



company and the other party does not possess the obligation to enquire about the same. In such a case and in the later stage, the other party can claim the *Ultra Vires* act because it was acting in good faith but the very company cannot plead the transaction As *Ultra Vires*. So, in England, the doctrine is restricted and not redundant.

Whereas in India, the Law follows the principles laid down in the Ashbury's Case and the doctrine continues to be applied in an unrestricted or modified manner and therefore the transaction is still regarded as void even if the shareholders give their consent.

What are the effects of *Ultra Vires* transactions?

1. Will lead to *Ultra Vires* contracts.
Contracts that fall under the ambit where it appears that the company has performed actions that are beyond the Object clause in the MOA then those contracts cannot be enforced by or against the company.
By considering some of the judicial decisions like *Re, Jon Beufore (London) Ltd.*¹⁰, *S. Sivashanmugham & others V. Butterfly Marketing Private Ltd.*¹¹, etc. certain principles can be inferred like:
 - a. So, if it is found that an *Ultra Vires* act has been committed by both the parties to a Contract then the Court won't interfere in depriving the parties regarding the share that they may have acquired.
 - b. If it appears that the contract can be executed on both sides then no parties can claim the action for its non-performance and such kind of contracts will not be enforceable by either of the party.
 - c. When it appears that the contract can be executed from one side meaning thereby that

one party hasn't performed the contract and that the other party has duly performed its duty then the court will decide on what action can be taken against the party that has received the benefits.

2. Will lead to *Ultra Vires* torts or Crimes.
There are different views to this.
 - a. The first one being that the Doctrine of *Ultra Vires* is applicable only to the contract and property laws and still remains less or ineffective on torts and Crimes.
 - b. The second being that only the company can be held liable for the acts that are done beyond the object clause but it appears that the wrongs committed by the company's employee or its agents on its behalf cannot be termed as binding on the company as their acts are beyond the power and regulation of the company.
 - c. Thirdly, if the same employee or agent commits a tort or a crime then the whole company cannot be held liable even if that act was an activity that was not covered in the object clauses and thus was *Ultra Vires*.
But here comes the interesting part and that is the Company may be held liable for a tort or a crime if the following conditions are met:
 - a. Any kind of tort or crime committed by the agents or officers or directors of the company but most importantly during the course of the employment.
 - b. Any kind of tort or crime committed that is against the clauses mentioned in the Object clause of the MOA.

What are the consequences of *Ultra Vires* Transactions?

The company should refrain from doing *Ultra Vires* transactions because these transactions lead to the following effects:

- a. Injunction.

¹⁰ 1953 Ch. 131.

¹¹ (2001) 105 Comp. Cas. Mad 763.



The members of the company can hold a registered company with registered objects and whenever they observe that any act of *Ultra Vires* is committed then the members of the company can get an Injunction order so that the company doesn't proceed with the very transaction¹².

b. Claim the personal liability of the Directors.

It is an obligation for a company's director to ensure that the company's funds are utilized for a legitimate purpose that is defined in the objects in MOA and members of the director to restore the status quo. In the case of *Jehangir Modi V. Shamji Ladha*¹³, the Bombay High Court held that a shareholder can compel the directors to restore the company's funds that have been employed for the purpose that isn't mentioned in the MOA and its Objects.

c. Breach of Warranty of authority.

It happens to be the duty of an agent to act within the limits and scope prescribed to him/her because if the individual performs an action that is beyond the authority given to him or is something that is beyond the clauses mentioned in the object clause in the MOA and for such kind of breach the individual will be personally liable. Here it is also pertinent to note that the directors of the Company are its agents and if any the director is found in indulging in a thing where the director induces a person to enter into a contract by misusing the person's innocence then that director will be personally liable to compensate for the Loss.¹⁴

d. *Ultra Vires* acquired property.

This concept says that if a company's funds have been employed to purchase or acquire some property then that property must be held to be secure for the company

and the right of the company must prevail. The Madras High Court in the case of *Ahmed Sait V. Bank of Mysore*¹⁵ allowed the company to sue regarding the recovery from the mortgage transaction even when the transaction was *Ultra Vires*. The Court stated that- Property that is legally and formally transferred to a corporation is valid even when the corporation was not authorized or empowered to acquire the very property.

e. *Ultra Vires* Contracts.

In the words of Justice Gray in the case of *Pullman's car Co V. Central Transportation*¹⁶, 'A contract of Corporation which is *Ultra Vires*, that means, is outside the object as defined in its MOA is wholly void and of no legal effect.

Conclusion:

After reading some of the provisions and the Judicial interpretations on the Doctrine of *Ultra Vires*. It can be said very clearly that an *Ultra Vires* act will be void in any condition cannot be ratified even if the directors of the very company wish to ratify. It can be seen that though the Doctrine appears to be stringent, it fulfills the interest of the creditors, investors, as well as of the very Company by preventing it from using the wrong path and confining it to certain operations. The Doctrine keeps a check on the activities of the Directors so that they don't divert themselves from the objects that are set out in the MOA.

So, it is observed that almost every transaction comes under the censorship of the Doctrine of *Ultra Vires*. This article has also tried to explain the positions of the very Doctrine in the legal systems of the United

¹² *Attorney-General V. Great Eastern Railway Co.*, (1880) LR 5 AC 473.

¹³ *Supra note V.*

¹⁴ *Weeks V. Propert*, (1873) LR 8 CP 427.

¹⁵ (1930) 59 MLJ 28.

¹⁶ 35 L Ed 69: 139 US 62 (1891)



States, England, and India. It is worthwhile to notice here that in the year 1945 the English Company Law revision Commission suggested that the very Doctrine should be abolished but on the contrary, there have been arguments in favor of the Doctrine that it is not merely based on the dogmatic approach but it circumscribes the very core issues of the Natural Law theory where the interest of every person is protected.

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