ULTRA VIRES REFORM

By

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The subject of ultra vires with reference to corporation law has so much been treated by courts and writers for more or less a century that it is customary to offer apologies for writing on it again.[1] As early as 1875 Brice wrote a treatise of 665 pages on the doctrine and a monograph was published in 1877.[2] In 1766 Lord Kame's *Principles of Equity* referred to the term, although it was not used in its present meaning.[3] The earliest American court decision referring to the doctrine was rendered in 1804,[4] although the earliest American Supreme Court pronouncement directly considering the point was written only in 1858.[5] The first English decision did not come until 1846.[6] The apology in our case is to warn against the confusion that has marked the experience of most courts and to recommend suitable legislation already adopted in some foreign jurisdictions. It will be seen from what follow that there is a real need for legislation on the subject, considering the Corporation Law as now enforced.

It is consequently understandable that the subject is, perhaps, one of the richest in legal materials in the whole field of corporation law. Some writers, treating the subject lightly, consider the problem primarily one of draftsmanship or conveyancing. The lawyer who writes the purpose clauses of the article of incorporation is to blame if the ultra vires question rears its ugly head.[7] Under

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[1] "It seems to have become customary to launch a new discussion of the doctrine of ultra vires upon a wave of apology. To apologize by saying that the writer has new ideas to offer would be to display both temerity and ignorance, for which there is no apology." Stevens, "A Proposal as to the Codification and Restatement of the Ultra Vires Doctrine," 36 *Yale Law Journal*, 297. "Threshing over old straw is not particularly exhilarating pastime. The writer is aware that the subject matter here proposed is old straw, which has been worn into fine chaff through constant handling." Harno, "Privileges and Powers of a Corporation and the Doctrine of Ultra Vires," 35 *Yale Law Journal*, 18.

[2] G. H. W., "Ultra Vires," 6 *Central Law Journal*, 2.

[3] Frey, "Ultra Vires and Estoppel," 43 *American Law Review*, 81, note 7, at p. 83.

[4] Head v. Providence Ins. Co., 2 Cranch 127.

[5] Pearce v. Madison & Ind. R. Co., 21 How. 441. See Frey, *supra*, note 7, at pp. 82-83.

[6] Coleman v. Eastern Ry. Co., 16 Beav. 1.

[7] "At all events, when a true question of 'ultra vires' is raised under a modern charter, it is generally a proof of poor draftsmanship on the part of the incorporation lawyer." At p. 46. Again, "A modern corporation does not have limited powers; where it acts ultra vires, the usual reason is bad draftsmanship on the part of the lawyer drawing the certificate of incorporation." At p. 48. Berle and Warren, *Cases and Materials on the Law of Business Organization*, 1948. See also "British Corporate Law Reform," 56 *Yale Law Journal*, 1383, 1384; Kahn-Freund, "Companies Act, 1947," 11 *Modern Law Review*, 81, 82; "Company Law and Practice," 89 *The Solicitors' Journal*, 483.

modern general incorporation laws, this observation is not altogether unreasonable. It suggests the importance of the lawyer's job in framing the purpose clauses where the law involved allows one or more purposes not prohibited by law or against public policy. But the suggestion does not strike deep enough into the problem and, perhaps, is no solution at all. The prolixity of the purpose clauses required to evade the application of the ultra vires doctrine would demand an extraordinary imagination and resource from lawyers such as few or none can hope to give. Business demands and practices are dynamic and fluid and future contingencies cannot always be provided for. This last suggests the problem of legal interpretation, in this case no different from statutory construction, from which certainty will always be a matter of degree and ever subjective. The frustrating experience of careful legislators who thought they expressed themselves clearly enough and with whom courts differed in the interpretation of their work will always plague the legal draftsman. Draftsmanship may help in minimizing the problem, but is no single solution.

This is not to say, however, that the abolition of the ultra vires doctrine by legislative fiat does away with the drafting problem. The recent Cohen Report in England which recommended the abolition of the ultra vires doctrine [8] was received with acclaim by some writers because it was thought that the complex purpose clauses of the memorandum of association of an English company would no longer be necessary.[9] Apparently, lawyers regard with profound distaste the task of having to write long purpose clauses the aims of which are "not to specify, not to disclose, but to bury beneath a mass of words, the real object or objects of the company with the intent that every conceivable form of activity shall be found included somewhere" within their terms.[10] But under modern laws modifying or abolishing the ultra vires rule, the purpose clauses would be unnecessary only in determining the rights and obligations of the corporation on the one hand and the third person on the other. They would still be important to delimit the boundaries beyond which the directors may not go, otherwise they may be held liable in a proper suit by shareholders or the corporation or the

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[8] This report was not adopted in the Companies Act, 1947.

[9] "Further, if the *ultra vires* doctrine were abolished for registered companies, the inflated form of the objects clause as in use at present, would be unnecessary and a simple clause of three or four lines could be substituted for the present clause which often is subdivided into thirty or more sub-clauses." Schmitthof, "The Reform of Company Law," 14 *The Solicitor*, 40, 42. "Furthermore, honest trading will be facilitated considerably if it is no longer necessary in dealing with limited companies to examine their memoranda of association, and if the object clause itself reverts to the simple clause at first intended without being overloaded by all sorts of powers which may be thought of by a lawyer with a fertile imagination." Horrwitz, "Company Law Reform and the *Ultra Vires* Doctrine," 62 *Law Quarterly Review*, 66, 75-76.

[10] Cotman v. Grougham (1918), A. C. 514, 523. Consider the following statement of an English Judge: "Therefore, we have here the enumeration of things so large that when I put it to Mr. Cozens-Hardy whether he could say that it would not extend to authorize the company to establish and work a line of balloons passing backwards and forwards between the earth and the moon, he admitted that he could not say that it would not." In re Crown Bank, 44 Ch. Div. 634, 644.

state may come in to demand injunctive relief against the corporation or to dissolve it by quo warranto proceedings.

There is, however, another reason why the ultra vires problem cannot be treated lightly as one of draftsmanship. As a defense, it is available both to the corporation and the third person dealing with it. Indeed, in the early New York case of Steam Navigation Company v. Weed,[11] it was held, though perhaps this is no longer the law,[12] that only the corporation, and not also the third person, could interpose the ultra vires plea. This would show that corporations may not, and for good reasons, be so much interested in getting rid of the problem by expert draftsmanship. We may take notice, at this point, of the paradox of the ultra vires doctrine. Writers, in tracing its origin, ascribed its growth to the popular prejudice against corporations. It was thought a good instrument to limit the extension of corporate powers. We are now abolishing or limiting it, generally by legislation, because it works against the interests of third persons and in favor of corporations. An author[13] very aptly said that the doctrine has operated to give "the benefit to the corporation of the protection of the disabilities of a minor, or of a person *non compos mentis*, while it is well known that corporations are guided by the best of legal skill much more able to understand and interpret the provisions of their charters than the untrained and unsuspicious public. It makes the ordinary citizen guarantee the corporation and its stockholders against exceeding its powers, instead of the corporation and its stockholders themselves assuming that responsibility, as they should." How then may we expect to solve the ultra vires problem by giving the responsibility to the very persons who are hardly interested in getting rid of it? We shall then address ourselves to the problem.

Ultra vires simply means beyond powers. As generally understood it "denotes some act or transaction on the part of a corporation which, although not unlawful or contrary to public policy if done or executed by an individual, is yet beyond the legitimate powers of the corporation as they are defined by the statutes under which it is formed or which are applicable to it, or by its charter or incorporation paper."[14] Acts that are unlawful or contrary to public policy are void in themselves and are not included in the term ultra vires.[15] Our Supreme Court, therefore, in considering as ultra

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[11] 17 Barb. (N.Y.) 378.

[12] See Berle and Warren, *supra*, note 7, at p. 47.

[13] Clarke, *California Corporations*, 1946, p. 94, quoted approvingly by Ballantine on Corporations, 1946, p. 241.

[14] 2 Machen, *Modern Law of Corporations*, sec. 1012, p. 819. See for like definition 5 Halsbury's *Laws of England*, 1910, p. 285; Frey, "Ultra Vires and Estoppel," 43 *American Law Review*, 81, 83; 4 Thompson, *Corporations*, 3d ed., secs. 2825-2827, pp. 525-528; 7 Fletcher, *Cyclopedia of Corporations*, Permanent edition, secs. 3399-3400; 3 Cook, *Corporations*, 7th ed., sec. 667, p. 2160 and notes at p. 2161.

[15] Ballantine on Corporations, 1946, p. 246. See also Machen, *supra;* Thompson, *supra;* Pepper, "The Unauthorized or Prohibited Exercise of Corporate Power," 9 *Harvard Law Review*, 253, 267; Frey, *supra;* Brady, "The Doctrine of Ultra Vires, Its Nature, Elements and Modern Application," 54 *American Law Review*, 535, 537; Cook, *supra;* Fletcher, *supra.*

vires corporate acts violative of public policy erred in using the term.[16]

That the doctrine of ultra vires is a judicial creation and is of modern origin are generally known.[17] It is no part of the common law, nor is there a comparable doctrine in the Institutes of Justinian. Sutton's Hospital [18] says that, apart from the question of forfeiture by the state of corporate privileges, the doctrine has no place in the common law and a corporation has the capacity to bind itself by seal as a natural person. It is no part of German law [19] and is not generally found in Continental jurisprudence.[20] As now applied, ultra vires developed earlier in the United States than in England. American law on the point, therefore, developed very largely in derogation of the common law. The view was taken that incorporation was a privilege and that the charter was enabling rather than limiting. So in Head v. Providence Insurance Co.[21] Chief Justice Marshall said: "The act of incorporation is to them an enabling act; it gives them all the power they possess;. . ." [22]

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[16] Barretto v. La Previsora Filipina, 57 Phil. 649; Government of the P. I. v. El Ahorro Insular, 59 Phil. 199. See also Viuda de Barretto v. La Previsora Filipina, 59 Phil. 212. That illegal acts are not considered under the doctrine of ultra vires, see Ashbury Railway Carriage & Co. v. Riche, L. R. 7 House of Lords 653; East Anglian R. Co. v. Eastern Counties R. Co., 11 C. B. (2 J. Scott) 775; Whitney Arms Co. v. Barlow, 63 N. Y. 62. The distinction between ultra vires transactions and those forbidden by law is important because the liabilities and remedies arising from them are different. Ballantine on Corporations, *supra*.

[17] "This doctrine is a recent innovation." Harno, "Privileges and Powers of a Corporation and the Doctrine of Ultra Vires," 35 *Yale Law Journal*, 18, 21. "Against the arbitrary, judge-invented theory of ultra vires . . ." Townsend, *Ohio Corporation Law*, Perpetual Revised edition, 1940, p. 52. "The doctrine of 'ultra vires' is of comparatively recent date . . . Until within a hundred years not a trace of the modern doctrine of 'ultra vires' is to be found." Wolfman, "'Ultra vires' Acts of Corporations," 43 *American Law Review*, 69, 74. "The doctrine of 'ultra vires,' then, is of purely judicial origin." Frey, "Ultra Vires and Estoppel," 43 *American Law Review*, 81, 82. This article contains a list of English and American cases originating the rule. At pp. 82-83, note 7. "The doctrine of *ultra vires* is of modern growth. Its appearance is a distinct fact, and as a guilding, or rather misleading principle in the legal system of this country (England), dates from about the year 1845, being first prominently mentioned in the cases, in equity, of Colman v. Eastern Counties Railway Company, in 1846 (10 Beav. 1; 16 L. J. [Ch.] 73; and, at law, of East Anglian Railway Company v. Eastern Counties Railway Company (11 C. B. 775; 21 L. J. [C.P.] 23), in 1851." Green's Brice's *Ultra Vires*, 2d ed., 1880, Preface to the first English edition, p. vii. "Thus understood, the doctrine of *ultra vires* is of very modern date, and entirely the creation of the courts. There is no such thing as *ultra vires* in the case of a common law corporation, and it is not enacted in any statute." G. H. W., "Ultra Vires," 6 *Central Law Journal*, 2, 3. See also Scarborough, "Ultra Vires No Defense in Private Contract," 11 *Kentucky Law Journal*, 197, 200; 2 Machen, *Modern Law of Corporations*, 1908, sec. 1026, p. 828; 7 Fletcher, *Cyclopedia of Corporations*, Permanent edition, sec. 3405.

[18] 10 Coke 30, b.

[19] Ballantine, "Proposed Revision of the Ultra Vires Doctrine," 12 *Cornell Law Quarterly*, 453, 458.

[20] Horrwitz, "Company Law Reform and the Ultra Vires Doctrine," 62 *Law Quarterly Review*, 66.

[21] 2 Cranch (1804) 127.

[22] At p. 169.

This principle was carried over in later cases.[23] At about the time of this judicial development, the common law, as applied to corporations created by royal charter, forbade the Crown from denying to them the capacity of natural persons.[24] The courts of England, however, took a different view of corporations formed according to Company Law or special acts of Parliament. They were considered as possessing only a limited capacity in the traditional view of the Supreme Court of the United States.[25] In respect to cor-

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[23] "The company have no rights, except such as are specially granted, and those that are necessary to carry into effect the powers so granted.(15 John. 383)." Woodworth, J., in N. Y. Firemen Insurance Co. v. Sturges, 2 Cow. (N. Y.) 664, 675. ". . . and incorporated companies having no powers but such as are granted or necessarily incident, a company having no such power, express or implied, has no capacity to lend money, of course cannot sue for it." Beach v. Fulton Bank, 3 Wen. (N.Y.) 574, 583. "Now it is the well-settled doctrine of this court, that a corporation created by statute is a mere creature of the law, and can exercise no powers except those which the law confers upon it, or which are incident to its existence." Taney, C. J., in Perrine v. Chesapeake and Delaware Canal Co., 9 How. (U.S.) 172, 184. "The legislature has absolutely marked the limit of their power, and they can not exceed it, under the charter; and if the directors, even with all the stockholders at their side, transcend the limits of the charter, and make contracts foreign to their business, they only act for themselves . . . If this is not so, there are no restrictions or limitations on chartered companies, and they may do anything and everything the directors please, which is not absolutely unlawful." Ellsworth J., in Hood v. The New York and New Haven Railroad Company, 22 Conn. 502, 508. See also Pearce v. Madison & Indiannapolis R. R. Co., 21 How. (U.S.) 441, 443. "We take the general doctrine to be in this country, though there may be exceptional cases and some authorities to the contrary, that the powers of corporations organized under legislative statutes are such and such only as those statutes confer. Conceding the rule applicable to all statutes, that what is fairly implied is as much granted as what is expressed, it remains that the charter of a corporation is the measure of its powers, and that the enumeration of these powers implies the exclusion of all others." Miller, J., in Thomas v. Railroad Co., 101 U.S. 71, 82. See also Central Transportation Co. v. Pullman's Car Co., 139 U.S. 24, 48.

[24] ". . . and so complete is this corporate autonomy that it is unaffected even by a direction contained in the creating charter in limitation of the corporate powers. For the common law has always held that such a direction of the Crown—though it may give the Crown a right to annul the charter if the direction is disregarded—cannot derogate from that plenary capacity with which the common law endows the company, even though the limitation is an essential part of the so-called bargain between the Crown and the corporation." Palmer's *Company Law*, 18th ed., 1948, p. 3, citing Bowen, L. J., in Baroness Wenlock v. River Dee Co., 36 Ch. D. 675 n., and Blackburn, J., in Riche v. The Ashbury Railway Co., L. R. 9 Ex. pp. 224, 255. See also Green's Brice's *Ultra Vires*, 2d ed., 1880, p. 10; "The Treatment of the Doctrine of Ultra Vires in the New Ohio General Corporation Law," 27 *Columbia Law Review*, 594, 595. Canadian law followed this line of development.

[25] "If that is the purpose for which the corporation is established—it is a mode of incorporation which 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 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." Lord Chancellor Cairns in The Ashbury Railway Co. v. Riche, L. R. 7 H. L. 653, 670. See also East Anglian Ry. Co. v. Eastern Counties Ry. Co., 11 C. B. (2 J. Scott) 775; Coleman v. Eastern Ry. Co., 16 Beav. 1; Attorney-General v. Great Eastern Rail. Co., 5 App. Cas. 473; Trevor v. Whitworth, 12 App. Cas. 409; London County Council v. Attorney-General, A. C. 165.

porations organized pursuant to legislative enactments, the English courts, the United States Supreme Court, and some American state courts, therefore, adopted the theory of "limited capacity". But while there is agreement on the view of public policy intended to be served by the "limited capacity" theory, there seemed to be a divergence of view concerning the premise on which the theory itself was based. There was agreement that corporate powers must be circumscribed and so that corporations must be denied the capacity of natural persons. There was widespread fear of corporations in England and in the United States at the time. But while the English courts justified the "limited capacity" theory upon the premise of legislative intention, treating the problem as one of statutory construction,[26] the Supreme Court of the United States [27] and some American state courts based their conclusion upon the "fiction" and "concession" theories of corporate personality.[28] The English House of Lords could have done the same in 1875 in the Ashbury case as the Supreme Court of the United States but did not.[29] But no matter how the theory of "limited capacity" was justified, there seemed a general belief that the ultra vires doctrine was an adaptation of that which traditionally applied to public corporations.[30] Its application to business corporations is, therefore, attacked. It is not our purpose to justify or to discredit this criticism. It can only be said that this is one instance among many where the law advanced or was retarded by conscious borrowing from foreign fields. But if the grounds of public policy are made clear, if we define what we are seeking to accomplish and state the reasons why, the principles born of the conflict would not make slaves of us. It is, to me, idle questioning policies of past history that were shaped according to the demands of the times. If ancestral fears are not borne out by subsequent facts, we are free to innovate. But man must act according as he views the situation in its present lights.

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[26] Sir Frederick Pollock says: "But the English doctrine of ultra vires, as we call it, does not really go back to any ultimate conception as to the nature of a corporate body. It is a doctrine, to use a convenient American term, of constitutional limitations. If the same authority which created a given juristic person, or authorized the constitution of many juristic persons by the performance of certain conditions, has at the same time set bounds to the legal competence of such persons, bounds which are matters of public knowledge, then acts professedly done in their name and exceeding those bounds are nullities . . . The problem is at bottom one of interpretation, to ascertain what was the will of Parliament in the given case or class of cases." "Has the Common Law Received the Fiction Theory of Corporations? 27 *Law Quarterly Review*, 219, 222.

[27] Perrine v. Chesapeake and Delaware Canal Co., *supra;* Dartmouth College v. Woodward, 4 Wheat. (U.S.) 518, 636.

[28] Some writers may be found saying that the basis, like that of English law, is legislative intention.

[29] Pollock, *supra*, at p. 224. Pollock said that English writers, notably Blackstone and Coke, made statements implying the adoption of the "fiction" theory but that this theory was never assimilated into the common law. At p. 219.

[30] City Coal, etc. Co. v. Union Trust Company of Maryland, 140 Va. 600, 605; 3 Cook, *Corporations*, 7th ed., sec. 681, pp. 2229-2230; Smith, "Ultra Vires—A Problem of Sovereignty, " 3 *Res Judicatae*, 28.

The danger only lies, in this as in all other legal problems, in our being guided by phantoms of concept formulations, losing sight of the policies behind them, as if man were designed for them instead of them being formulated by him to support views of public policy. That judicial thinking was in fact, in dealing with the ultra vires problem, guided by concept formulation rather than by an enlightened consideration of the public policies behind them seems borne out not only by the deluge of criticisms from well known writers but by the enactment of laws by several jurisdictions designed to abolish or limit the operation of the doctrine. This brings us to a consideration of the following point.

Section 2 of Act No. 1459 defines a corporation as "an artificial being created by operation of law, having the right of succession and the powers, attributes, and properties expressly authorized by law or incident to its existence." In Cagayan Fishing Development Co., Inc. v. Teodoro Sandiko,[31] in nullifying an agreement entered into on behalf of a corporation which was not in existence at the time of the contract, the Supreme Court, quoting approvingly, said:

> " 'Corporations are creatures of the law, and can only come into existence in the manner prescribed by law.' " [32]

These concepts, taken together, are identical with those of Coke,[33] Blackstone,[34] and Marshall.[35] We have, consequently adopted the "fiction" and "concession" theories of corporate personality. The hypostasis of a reasoning towards the adoption of a strict rule of ultra vires in our jurisdiction is pretty definitely cast. This is all the more a reasonable supposition when we note that our Supreme Court took notice of Central Transportation Co. v. Pullman's Palace Car Co.[36] in the case of Batangas Transportation Co. v. Manila Railroad Company and Public Service Commission.[37]

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[31] 36 O. G. 118.

[32] At p. 1119.

[33] "A corporation aggregate of many is invisible, immortal, and rests only in intendment and consideration of the law . . . They can't commit treason, nor be outlawed, or excommunicate, for they have no souls, neither can they appear in person, but by attorney." Sutton's Hospital Case, 10 Coke 1.

[34] 1 Blackstone's *Commentaries*, pp. 467-468. See also chapter 18.

[35] Dartmouth College v. Woodward, *supra*.

[36] 139 U. S. 24.

[37] 36 O. G. 1226. "The doctrine of ultra vires had its origin in judicial deduction from the fictional conception of corporations as artificial persons, creatures of the law, which have no existence, powers or capacity except those granted by statute . . . The doctrine was not originated to accomplish in scientific fashion the just protection of the legitimate interests and expectations of the various parties concerned, such as the security of third persons in their dealings with corporate representatives, but 'having been once saddled onto the backs of the courts, like Sinbad's Old Man of the Sea, not to be shaken off.'" Ballantine "Proposed Revision of the Ultra Vires Doctrine," 12 *Cornell Law Quarterly*, 453, citing 6 *Central Law Journal*, 24. See also Pearcy, *Missouri Corporation Law*, 1948, p. 93.

The nature of a corporation has been the subject of a lively debate for many centuries and is still being debated today.[37a] Another school of thought clings to the "realist" theory or, as Wormser calls it, the "association" theory. It views the "corporation almost as a natural person and as acquiring an organic character which qualifies it to participate in the life of the state and in the law."[38] It would make no distinction between the capacity of a natural person and that of the corporation, for rights and obligations, in the last analysis, are all creatures of the law. An individual has only as much rights as the law chooses to give him or to recognize in him and so it must be with a corporation. While it is true that the dispute is not altogether verbal nor highly theoretical as to be lacking in practical value,[39] it strikes me as nothing different from other great problems of the law where the jurist is confronted with the matter of choice.[40] Either one or the other theory is important only as the logical basis of a conclusion more or less already formed. And the conclusion in turn is traceable to a definite view of public policy. It is highly probable that the conclusion would be arrived at if one or the other theory were not fashioned, for sure, upon the basis of other suitable premises. It is with this central idea that John Dewey writes. He says:

> "Discussions and concepts may have been in form intellectual, using a full arsenal of dialectical weapons; they have been in fact, where they have any importance, 'rationalizations' of the positions and claims of some party

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[37a] See the following: Wormser, *Frankenstein Incorporated*, 1931, pp. 56-65; Cohen, *Reason and Nature*, 1931, pp. 386-400; Radin, "The Endless Problem of Corporate Personality," 32 *Columbia Law Review*, 643; Warren, "Executed Ultra Vires Transactions," 23 *Harvard Law Review*, 495, 495-497; Machen, "Corporate Personality," 24 *Harvard Law Review*, 253; Colson, "Corporate Personality" 24 *Georgetown Law Journal*, 638; Harno, "Privileges and Powers of a Corporation and the Doctrine of Ultra Vires," 35 *Yale Law Journal*, 13, 14-19; Warren, "Collateral Attack on Incorporation," 21 *Harvard Law Review*, 305, 305-308; Thacker, "Corporate Powers," 9 *Columbia Law Review*, 243; Richards, "The Doctrine of Ultra Vires with a Consideration of Wisconsin Decisions," 3 *Wisconsin Law Review*, 129, 130-133; Ke Chin Wang, "The Corporate Entity Concept (or Fiction Theory) in the Year Book Period," 58 *Law Quarterly Review*, 498; Pollock, "Has the Common Law Received the Fiction Theory of Corporations?" 27 *Law Quarterly Review*, 219; Hogg, "The Personal Character of a Corporation," 33 *Law Quarterly Review*, 76 Laski, "The Personality of Associations," 29 *Harvard Law Review*, 404; Dodd, "Dogma and Practice in the Law of Associations," 42 *Harvard Law Review*, 977; notes in 13 *Cornell Law Quarterly*, 99; 36 *Yale Law Journal*, 254; 28 *Michigan Law Review*, 66; 42 *Harvard Law Review*, 1077.

[38] Wormser, *Frankenstein Incorporated*, 1931, pp. 58-59.

[39] "In the first place no question of this sort can be merely verbal, because words are most potent influences in determining thoughts as well as action. Theoretically we may be free to decide to use a word like personality in any sense we choose, but practically we must recognize that intellectual resolutions cannot rob words of their old flavour or of the penumbra of meanings which they carry along with them in ordinary intercourse." Cohen, *Reason and Nature*, 1931, p. 389. "There are few topics which seem more thoroughly theoretical, but surely no subject can be so termed which is declared by courts to be the basis of their decisions and upon which rights in valuable property have been determined and enormous sums of money distributed." Radin, "The Endless Problem of Corporate Personality," 32 *Columbia Law Review*, 643.

[40] Navarro, "A Word More on Moncado v. People's Court, et al.," 23 *Philippine Law Journal*, 433.

> to a struggle. It is this fact which gives such extraordinary interest to the history of doctrines of juridical personality. Add to this the fact that the intellectual and scientific history of Western Europe is reflected in the changing fortunes of the meanings of 'person' and 'personality,' a history which has both affected and been affected by the social struggles, and the interests and complexity of the doctrines about juridical personality are sufficiently obvious." [41]

The question of choice is presented only because both theories, to be sure, are reasonable [42] and whether one believes in one or the other is a matter of value. If one or both theories were unreasonable, there would be no sense in Radin calling the problem endless. Indeed, some serious scholars, as Holmes and Gray, refused to enter the discussion. It has been pointed out that the only reason for the longevity of the "fiction" theory as a mode of judicial thought in the field of ultra vires was the legal jealousy of corporations and the deep-seated prejudice against them.[43] This discussion would, therefore, indicate that Section 2 of our Corporation Law should be repealed, not only because the trend is the other way, but, and this is the more important reason, it commits us to a theory that allows no flexibility.[44] Under this Section corporate powers should be determined not as questions of statutory construction, as in England law, but as springing from the nature of corporate personality.

As a premise for revision in our country, we should take note of the well-known fact that the judicial authorities in the United States are in a hopeless state of confusion.[45] Not only is this true

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[41] "The Historic Background of Corporate Legal Personality," 35 *Yale Law Journal*, 655, 665.

[42] "The theory (of limited capacity) is consistent and logical, but its practical effect is to circumscribe the power of the court as to make the relief furnished at times inadequate to the occasion." Mason, J., in Harris v. Independence Gas Co., 76 Kan. 750, 752. "The concept of special power is not in itself illogical." Carpenter, "Should the Doctrine of Ultra Vires be Discarded?" 33 *Yale Law Journal*, 49, 58.

[43] Colson, "Corporate Personality," 24 *Georgetown Law Journal*, 638, 652.

[44] There is now no statute in England, Canada or the United States that defines a corporation as our Corporation Law does.

[45] Numerous writers have so stated. See "The Treatment of the Doctrine of Ultra Vires in the New Ohio General Corporation Law," 27 *Columbia Law Review*, 594, 597; Carpenter, "Should the Doctrine of Ultra Vires Be Discarded?" 33 *Yale Law Journal*, 49, 50, 53-54; Stevens, "A Proposal as to the Codification and Restatement of the Ultra Vires Doctrine," 36 *Yale Law Journal*, 297; Harriman, "Ultra Vires Corporation Leases," 14 *Harvard Law Review*, 332, 352; Harno, "Privileges and Powers of a Corporation and the Doctrine of Ultra Vires," 35 *Yale Law Journal*, 13, 23; Clarke, *Handbook of the Law of Private Corporations*, 3d ed., 1916, pp. 205, 233; Ballantine, "Proposed Revision of the Ultra Vires Doctrine," 12 *Cornell Law Quarterly*, 453; Wolman, "'Ultra Vires' Acts of Corporations," 43 *American Law Review*, 69, 70; Ballantine, "Problems in Drafting a Modern Corporation Law," 17 *American Bar Association Journal*, 579, 580; Colson, "The Doctrine of Ultra Vires in United States Supreme Court Decisions," 42 *West Virginia Law Quarterly*, 179; Thompson, "The Doctrine of Ultra Vires in Relation to Private Corporations," 28 *American Law Review*, 876; Katz, "The Illinois Business Corporation Act," 12 *Wisconsin Law Review*, 473, 480; Richards, "The Doctrine of Ultra Vires with a Consideration of Wisconsin Decisions," 3 *Wisconsin Law Review*, 129; Parks, "Ultra

of the general body of doctrine, but it is said that single jurisdictions are much the same. Some propositions are well settled, however, and the confusion admittedly centers on a few vital areas. The settled principles have been enumerated as follows:[46]

> "Even when a corporation assumes to engage in an ultra vires business, responsibility will attach to the corporation for torts committed by its agents, acting within their authority, in the course of that business."
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> "Even though a corporation has acted outside the scope of its authority in taking or holding title to property, the validity of its title cannot be questioned on the ground that the corporation was without authority, in taking or holding the property."
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> "Even though a corporation has acted outside the scope of its authority in making a contract, if the contract has been fully performed on both sides, it will stand as a foundation of rights acquired under it."
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> "When a corporation has acted outside the scope of its authority in making a contract, either the corporation or the other party thereto may set that fact up as a complete defense to any action brought either at law or in equity upon the contract, provided the contract is wholly executory on both sides."
>
> "A non-assenting shareholder, unless estopped or barred by his laches, may be granted an injunction to restrain an act threatened to be done on behalf of a corporation when such act would be beyond the scope of corporate authority."
>
> "The commission by a corporation of an act outside the scope of the authority conferred upon it does not, of itself, put an end to corporate existence, but furnishes a ground for the forfeiture of the charter of the corpora-

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Vires Transactions," 25 *University of Missouri Bulletin*, 3, 7; G. H. W., "Ultra Vires," 6 *Central Law Journal*, 2, 3; "A New Phase of the Doctrine of Ultra Vires," 9 *Central Law Journal*, 463; 18 *Harvard Law Review*, 461, 462; 44 *Harvard Law Review*, 280, 281; Scarborough, "Ultra Vires, No Defense in Private Contract," 11 *Kentucky Law Journal*, 197; Ballantine on Corporations, 1946, p. 241; 2 Machen, *Modern Law of Corporations*, 1908, p. 823; Tompkins, *Law of Private Corporations*, 1904, p. 80; 4 Thompson, *Law of Corporations*, 3d ed,, sec. 2827, pp. 527-528; Colson, "Corporate Personality," 24 *Georgetown Law Journal*, 638, 648; 7 Fletcher, *Cyclopedia of Corporations*, Permanent edition, sec. 3411.

[46] Stevens, "A Proposal as to the Codification and Restatement of the Ultra Vires Doctrine," 36 *Yale Law Journal*, 297, 301-307. Fletcher enumerates the settled rules as follows: (1) "A wholly executory contract, where ultra vires, cannot be enforced, nor can damages be recovered for its breach, except in one state, unless impliedly authorized by recent statutes abolishing or limiting the doctrine of ultra vires." (2) "A contract wholly executed on both sides even though ultra vires, will not be set aside nor interfered with, . . . as between the parties thereto or persons whose rights are derived therefrom." (3) "Recovery may be had on an implied contract for benefits received, where one party has performed and the other party has received the benefits of such performance but refuses to perform on his or its side on the ground of ultra vires, even though the contract is ultra vires." 7 *Cyclopedia of Corporations*, Permanent edition, sec. 3411. See also Ballantine on Corporations, 1946, p. 247.

> tion, or for ousting it from the exercise of the unauthorized powers, upon the state's application in a quo warranto proceeding."

The conflict and confusion are largely confined to contracts which are either wholly performed by one party, or partially performed by one or both parties. The Supreme Court of the United States and a minority of the state courts generally refuse to enforce the contracts. A number of reasons have been advanced to support this stand,[47] but the most important have been those of constructive notice and the limited capacity of corporations. A third person dealing with a corporation is said to have constructive notice of the powers of the corporation. This argument places the corporation and the third person on the same plane, with reference to knowledge of corporate powers, though obviously with flagrant unwisdom. Much was said against this theory of constructive notice [48]

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[47] ". . . because the corporation lacked the power to make the contract, because it was illegal, because the party who dealt with the corporation was charged with notice of the limits of the corporation's power, because the transaction was opposed to the interest of the public that the corporation should not transcend its charter powers, because it violated the rights of creditors, or of stockholders not to have the funds of the corporation risked in enterprises not contemplated in the articles of incorporation." Carpenter, "Should the Doctrine of Ultra Vires Be Discarded?" 33 *Yale Law Journal*, 49, 57. This article contains an illuminating discussion of each of these grounds and finds them unsupportable. See also Stevens, *supra;* Brady, "The Doctrine of Ultra Vires, Its Nature, Elements and Modern Application," 54 *American Law Review*, 535, 537-540; Taylor, *Law of Private Corporations*, 5th ed., 1902, secs. 116-117; 4 Thompson, *Law of Corporations*, 3d ed., sec. 2830; 7 Fletcher, *supra*, sec. 3406. An Australian writer objected as follows: "Discerning members of the public do buy shares in well-established engineering companies for example in reliance upon their judgment that the company has excellent technicians and a sound board to administer such activities—but they might well be pardoned for any uneasiness felt if they knew the company might launch out into the haberdashery business, and it might be poor consolation to them to be told that whilst an improvident contract with importers of soft goods was binding on such company, yet as between themselves and their directors the latter had, in an excess of zeal, committed a breach of contract or trust." 22 *Australian Law Journal*, 25, 27.

[48] "While as a general proposition this is true, yet it must be conceded that this constructive notice is of a very vague and shadowy character. Everyone may have access to the statutes of the states affecting companies incorporated thereunder, and to their articles of incorporation but to impute a knowledge of the probable construction the courts would put upon those statutes and articles of incorporation to determine question raised upon a given contract, is carrying the doctrine of notice to an extent which can only be denominated preposterous." Stone, J., in Denver Fire Insurance Co. v. McClelland, 9 Colo. 11, 22. "A traveller from New York to the Mississippi can hardly be required to furnish himself with the charters of all the railroads on his route, or to study a treatise on the law of corporations." Comstock, J., in Bissel v. Michigan Southern R. Co., 22 N. Y. 258, 281. Stevens said: "The application of the doctrine of constructive notice cannot be supported by analogy to the principle in criminal law that 'everyone is presumed to know the law,' or that 'ignorance of the law is no excuse,' for ultra vires action is not criminal action. It is believed that the doctrine has found its way into corporation law partly through the medium of this false analogy, and partly through an inferred legislative intention . . ." "A Proposal as to the Codification and Restatement of the Ultra Vires Doctrine," 36 *Yale Law Journal*, 297, 323-324. In answer to a statement of Justice Gray in St. Louis Railroad v. Terre Haute Railroad, 145 U. S. 393, 407, that a third person contracting ultra vires with a corporation is in *pari delicto*, Warren said: "This is a ferocious doctrine.

with great insight and it only remains to observe that the paternalistic basis of constructive notice in favor of corporation is, in a way, inconsistent with the companion theory of limited capacity. Limited capacity was designed to restrict corporate powers.[49] Constructive notice, on the other hand, encourages the corporation to commit ultra vires acts. Since the corporation is in a better position to know the extent of its powers than the third person, it is not difficult to understand that the ultra vires doctrine prejudices the latter more than the former. So the doctrine which was designed especially to inhibit corporations has become a weapon for their advantage.

A majority, however, of the state courts adopt a different view and enforce contracts fully executed on only one side or partially performed on one or both sides.[50] The rule is applied to actions both by [51] and against [52] the corporation. The reason most generally advanced are that the contracts are not illegal and that public policy and justice prohibit the unconscionable defense of ultra vires

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Unauthorized corporate action, simply because it is unauthorized, cannot with any propriety be said to be criminal. It is not even illegal, if that adjective is used to connote something which is contrary to law." "Executed Ultra Vires Transactions," 23 *Harvard Law Review*, 495, 507. "In the world's business, businessmen cannot be expected to read and construe the charters of corporations before each contract is made. The charter is practically a matter of private record like the by-laws or articles of partnership." Ballantine, "Proposed Revision of the Ultra Vires Doctrine," 12 *Cornell Law Quarterly*, 453, 458. "It may have been true that it consisted of a great number of such private statutes,—an original charter and a long patchwork of amendments: the obligation, nevertheless, rested upon him of studying this charter and these amendments and finding out their meaning. It was true, that in many cases, the meaning was so obscure or ambiguous that the most astute lawyers could not agree upon it, and that the judges could not come to any decision upon it until after a long wrangle in the consultation room, and then not without the filing of dissenting opinions. Nevertheless the plain businessman was bound, at his peril, to find out the text of the law and to construe it correctly; otherwise if he parted with his labor, his property, or his money to the corporation, he might not be able to get it back. Nay, he was even bound to take notice of its by-laws and modes of doing business." Thompson, "The Doctrine of Ultra Vires in Relation to Private Corporations," 28 *American Law Review*, 376, 385. "The exigencies of ordinary business alone will often prevent a search of corporate records. Should a vendor, before making a sale, examine the charter of his corporate vendee? Should a contractor with a going concern be compelled to do likewise? If such is to be the rule, the burden of doing business with corporations will be intolerable, and the amount of time involved in making the required search alone will frequently prevent the convenient transaction of the business contemplated by the parties." Parks, "Ultra Vires Transactions," 25 *University of Missouri Bulletin*, 3, 21. "This is the worst phase of the rule of ultra vires in Illinois and is nothing short of ridiculous." Hale, "A Field for Corporate Law Revision—Collateral Act," 11 *Illinois Law Review*, 1.

[49] Wolfman, "'Ultra Vires' Acts of Corporations," 43 *American Law Review*, 69, 78; C. G. L., 11 *Illinois Law Review*, 51.

[50] Ballantine on Corporations, 1946, pp. 250-251; Hubbard v. Haley, 96 Wis. 578; Bullen v. Milwaukee Trading Co., 109 Wis. 41.

[51] Bath Gas Light Co. v. Laffy, 151 N. Y. 24.

[52] Perkins v. Trinity Realty Co., 69 N. J. Eq. 723.

from being asserted to escape liability. Estoppel [53] and "general capacity" have also been advanced to sustain the action.

No court, save that of Kansas, is willing to enforce purely executory contracts. One reason for non-enforcement is that "where neither party has acted upon the contract, the only injustice caused by a refusal to enforce it is the loss to the parties of prospective profits, and this is too slight a consideration to weigh against the reasons of public policy for declaring it void and not enforceable." [54] The Supreme Court of Kansas, in Harris v. Independence Gas Co.,[55] however, said: "It might seem reasonable that a system which attempts not only to protect a party to an *ultra vires* contract from actual loss, but, where equity requires it, to insure to him the actual fruits of his bargain, ought for the sake of completeness and symmetry to enable him to insist upon the performance even of a purely executory contract. It certainly seems against conscience that one who has entered into a contract in the expectation of deriving a profit from it may upon discovering the probability of a loss repudiate it and escape responsibility by raising the question of want of corporate capacity." [56] The court then said that "in the absence of special circumstances affecting the matter neither party to even an executory contract should be allowed to effect its enforcement by the plea of *ultra vires*." [57] While some writers say the court did not decide the matter squarely,[58] it did not, however, stop to inquire whether the contract was wholly or partially executory, for it took the position that the result would be the same. So far reaching and novel was the rule announced that a writer referred to it as amounting to judicial legislation.[59]

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[53] Ballantine, *supra*, p. 251. See also Harris v. Independence Gas Co., 76 Kan. 750. The rule, however, is still qualified. "This doctrine of 'estoppel' is generally applied, however, only in instances where the fruits of the *ultra vires* contract have inured to the benefit of the corporation and it has not been applied in instances where the benefit of performance has gone to someone else, or where the plaintiff has simply incurred detriment."

[54] 29 *American and English Encyclopedia of Law*, 49, quoted in Harris v. Independence Gas Co., *supra*.

[55] *Ibid.*

[56] At pp. 753-754.

[57] At p. 768.

[58] See note in Frey, *Cases and Statutes on Business Associations*, 1935, p. 597; Ballantine on Corporations, 1946, p. 249, note 3. "But it is submitted that this case has often been misinterpreted. It involved an attempt to cancel certain portions of a lease which had already been made, hence it was not really an executory contract at all, and the same result would probably have been reached in the majority of jurisdictions in this country." D. H. F., "Ultra Vires as a Defense to Executory Contract Made by Corporation in Violation of Statutory Prohibition," 75 *University of Pennsylvania Law Review*, 454, note at p. 456. Whether a contract, however, is wholly executory or not is debatable. 7 Fletcher, *Cyclopedia of Corporations*, Permanent edition, sec. 3411.

[59] "This doctrine was first advocated in this country by Mr. George Wharton Pepper, of Philadelphia, in an able essay in the Harvard Law Review. If the question were *res integra*, the inclination to take this extreme view of the matter would doubtless be very strong; but at this late day a court which takes this position without any affirmative legislative sanction would seem to be almost if not quite guilty of usurping the functions of the legislature," 2 Machen, *Modern Law of Corporations*, 1908, sec. 1058, pp. 858- 859. Another writer, however, countered: "If that is judicial legislation then one of the things

Owing to the confusion as indicated, to the fact that fear and dislike of corporations had vanished, to the growing feeling that the stability of business transactions between corporations and third persons is of paramount importance to the public welfare, and that the application of the ultra vires doctrine is full of "evils, quibbles and uncertainties";[60] opinion is almost universal that the ultra vires doctrine should be abolished.[61] It was early realized that reform should be accomplished by legislation. The general approach to the problem of revision has been to abolish the two main props of the doctrine, namely, constructive notice and limited capacity. The California law, as will be seen, does not expressly do this, since the legal consequences of the abolition of the doctrine are clearly set forth. The articles of association are considered, though part of the public records, as no longer affording constructive notice to third persons but as only enabling them to make their investigation. Distinction is drawn between "capacity" and "authority" and the word "power" becomes anathema.[62] In its relation with

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we most need is more judicious judicial legislation, though it may be undesirable to have the unjudicious sort." Carpenter, "Should the Doctrine of Ultra Vires Be Discarded?" 33 *Yale Law Journal*, 49, 68.

[60] Ballantine on Corporations, 1946, p. 263.

[61] "As now applied to companies, the ultra vires doctrine serves no positive purpose but is, on the other hand, a cause of unnecessary prolixity and vexation." *Cohen Report*, sec. 12. See also Kahn-Freund, "Company Law Reform," 9 *Modern Law Review*, 235, 236. "In conclusion I say there is no excuse for continued adherence to the doctrine of ultra vires. It is not based upon any sound theory or demand of public policy. It results in confusion, uncertainty and injustice in the law. Considerations of fair dealing, and freedom in business activities are opposed to it." Carpenter, *supra*, at p. 69. See also Pepper, "The Unauthorized or Prohibited Exercise of Corporate Power," 9 *Harvard Law Review*, 253, 267; Davis v. Pacific Studios Corporation, 84 Cal. App. 611, 258 Pac. 440, 441. "It is to be hoped that some day the legislatures of the various states will revise their antiquated corporation laws, and in so doing will apply the pruning knife to the law of ultra vires." C. G. L., 11 *Illinois Law Review*, 51, 55. "This doctrine is neither founded in justice nor in reason. It is of purely historical origin and perpetuates of Bubble Act mentality." Schmithoff, "The Reform of Company Law," 14 *The Solicitor*, 40, 42. See also Adams, "Company Law Reform," 21 *New Zealand Law Journal*, 300; Horwit, "Company Law Reforms and the *Ultra Vires Doctrine*," 62 *Law Quarterly Review*, 66. But see Reese, "*The True Doctrine of Ultra Vires*, 1897, p. 2, who seemed to love the ultra vires doctrine so much that he would not like it nullified. He said in part: "This unbridled pruriency for illegitimate commercial procreation, stimulated by successful efforts in the aggregation of wealth and power at the expense of the public weal, has led corporations to overstep the boundaries designated in their charters within which they are to confine their acts and undertakings, and to enter upon the private preserves reserved for individual industry. To this tendency of corporations to attempt the exercise of unauthorized powers, and to usurp privileges which have not been granted them, must be attributed the evolution by the courts of the wholesome doctrine of *ultra vires*." At p. 26. Mulvey opposes reform as presumably authorizing "that the money of the shareholders subscribed for the purpose of carrying on the business of a real estate company were legally diverted to the business of pressing pants . . ." "The Companies Act," 39 *The Canadian Law Times*, 79, 81. See also Wallace, "Company Law Reforms in Australia," 22 *The Australian Law Journal*, 25.

[62] Stevens on Corporations, 1949, chapter 7, p. 224, uses "Corporate Authority" consistently, thus, rejecting the use of "powers."

third persons the corporation is vested with the capacity of a natural person. Although, in its relation with the state, the shareholders and the officers, the corporation has only as much authority as has been expressly or impliedly conferred upon it by law and the articles of association. These ideas are not, however, revolutionary, for as rules of the common law applicable to royal charter corporations they are of ancient origin. Vermont, in 1915, was the first to deal legislatively with the problem, using the word "authority" instead of "power."[63] The Vermont experiment was, however, preceded by constant agitation by well-known writers on the law of corporations.

The first real attempt at clarifying the ultra vires doctrine in the United States was undertaken with the ninth tentative draft of the Uniform Business Corporation Act. The proposal was as follows:

> "Section 7. *Corporate Capacity and Authority.*—
> Subdivision 1. Every corporation formed under this Act shall be a body politic and shall be deemed to have the general capacities of a natural person, provided, however, that the limits of permissible corporate action shall be those defined and restricted by the articles of incorporation and amendments thereof, and by the provisions of this Act and of the other laws and the constitution of this State.
>
> "Subdivision III. If any act shall have been done by a corporation in excess of its powers, the corporation's lack of power to do such act shall not be inquired into collaterally, provided that the act is one that the corporation might, at the time the act was committed, have been formed under this Act with power to do. Any action by a corporation in excess of its powers may be enjoyed at the suit of any shareholder. The commission by a corporation of any act in excess of its corporate powers shall be a ground for the forfeiture of the corporate existence at the suit of the State, and the directors or officers engaging in such unauthorized corporate action shall be liable to the corporation for any damage suffered thereby in a suit by it, or by a shareholder in case it will not or cannot sue therefor."

The final draft, adopted in 1928, now provides as follows:

> "Section 10. *Effect of Filing or Recording Papers Required to be Filed.*—
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> "The filing or recording of the articles of incorporation, or amendments thereto, or of any other papers pursuant to the provisions of this Act is required for the purpose of affording all persons the opportunity of acquiring knowledge of the contents thereof, but no person dealing with the corporation shall be charged with constructive notice of the contents of any such articles or papers by reason of such filing or recording."

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[63] Secs. 4919 and 4923, *Vermont General Laws*, 1917.

"Section 11. *Corporate Capacity and Corporate Authority; the Same Distinguished.*—

"I. A corporation which has been formed under this Act, or a corporation which existed at the time this Act took effect and of a class which might be formed under this Act, shall have the capacity to act possessed by natural persons, but such a corporation shall have authority to perform only such acts as are necessary or proper to accomplish its purposes and which are not repugnant to law."[64]

Indiana,[65] Idaho,[66] and Washington [67] have laws similar to the California,[68] Illinois,[69] Kansas,[70] Louisiana,[71] Michigan,[72] Ohio,[73] Uniform Act.

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[64] Above provisions are the same as those proposed by Stevens in "A Proposal as to the Codification and Restatement of the Ultra Vires Doctrine," 36 *Yale Law Journal*, 297, 328.

[65] Sec. 25–202(a), Burns Annotated Statutes, 1933. See Dix, "The Indiana General Corporation Act," 5 *Indiana Law Journal*, 107.

[66] Sec. 30–114, Idaho Code, Tit. 30.

[67] Secs. 3803-10 and 3803-11, Washington Corporation Act, Tit. 15, Remington Revised Statutes of Washington, 1931, as amended and supplemented. Washington adopted the Uniform Business Corporation Act.

[68] Sec. 803 provides: "(a) The statement in the articles of the objects, purposes, powers, and authorized business of the corporation constitutes, as between the corporation and its directors, officers, or shareholders, an authorization to the directors and a limitation upon the actual authority of the representatives of the corporation. Such limitations may be asserted in a proceeding by a shareholder or the State, to enjoin the doing or continuation of unauthorized business by the corporation or its officers, or both, in cases where third parties have not acquired rights thereby, or to dissolve the corporation, or in a proceeding by the corporation or by the shareholders suiting in a representative suit, against the officers or directors of the corporation for violation of their authority.

"(b) No limitation upon the business, purposes, or powers of the corporation or upon the powers of the shareholders, officers, or directors, or the manner of exercise of such powers, contained in or implied by the articles or by Part 9 of this division shall be asserted as between the corporation or any shareholder and any third person.

"(c) Any contract or conveyance made in the name of a corporation which is authorized or ratified by the directors, or is done within the scope of the authority, actual or apparent, given by the directors, except as their authority is limited by law other than by Part 9 of this division, binds the corporation, and the corporation acquires rights thereunder, whether the contract is executed or wholly or in part executory.

"(d) This section applies to contracts and conveyances made by foreign corporations in this State and to all conveyances by foreign corporations of real property situated in this State." California Corporations Code.

[69] Sec. 8 provides: "No act of a corporation and no conveyance or transfer of real or personal property to or by a corporation shall be invalid by reason of the fact that the corporation was without capacity or power to do such act or to make or receive such conveyance or transfer, but such lack of capacity or power may be asserted:

"(a) In a proceeding by a shareholder against the corporation to enjoin the doing of any act or acts or the transfer of real or personal property by or to the corporation. If the unauthorized acts or transfer sought to be enjoined are being, or are to be, performed or made pursuant to any contract to which the corporation is a party, the court may, if all of the parties to the contract are parties to the proceeding and if it deems the same to be equitable, set aside and enjoin the performance of such contract, and in so doing shall allow to the corporation or the other parties, as the case may be, compensation

for the loss or damage sustained by either of them which may result from the action of the court in setting aside and enjoining the performance of such contract, but anticipated profits to be derived from the performance of the contract shall not be awarded by the court as a loss or damage sustained.

"(b) In a proceeding by the corporation, whether acting directly or through a receiver, trustee, or other legal representative, or through shareholders in a representative suit, against the officers or directors of the corporation for exceeding their authority.

"(c) In a proceeding by the State, as provided in this Act, to dissolve the corporation, or in a proceeding by the State to enjoin the corporation from the transaction of unauthorized business." The Business Corporation Act.

[70] Sec. 17–4101 provides: "No limitation on the exercise of the authority of the corporation shall be asserted in any action between the corporation and any person except by or on behalf of the corporation against a director or an officer or a person having actual knowledge of such limitation. And no person dealing with the corporation shall be charged with constructive notice of the contents of the articles of incorporation merely from the fact that such articles of incorporation have been filed or recorded." General Corporation Code, General Statutes, 1939.

[71] Sec. 1091 provides: "The filing and recording of articles and other documents pursuant to this act are required for the purpose of affording all persons the opportunity of acquiring knowledge of the contents thereof, but no person dealing with a corporation shall be charged with constructive notice of the contents of any such articles or document by reason of such filing or recording."

Sec. 1092 provides: "I. A corporation which has been formed under this act, or a corporation which existed at the time this act took effect and of a class which might be formed under this act, shall have the capacity to act possessed by natural persons, but such a corporation shall have authority to perform only such acts as are necessary or proper to accomplish its purposes as expressed or implied in the articles or that may be incidental thereto, and which are not repugnant to law." Business Corporation Act, General Statutes, 1939.

[72] Sec. 450.9 provides: "The filing of the articles or any other papers pursuant to the provisions of this act is required for the purpose of affording all persons the opportunity of acquiring knowledge of the contents thereof, but no person dealing with the corporation shall be charged with or be entitled to assert constructive notice of the contents of any such articles or papers by reason of such filing except shareholders, officers and directors of the corporation and except as provided in subsection 3 of section 4 of this act."

Sec. 450.11 provides: "The plea of ultra vires shall not be made by anyone except by (1) the corporation in an action between it and a director or officer thereof or a person having actual knowledge of the ultra vires character of the act or (2) by either party in an action between a shareholder and the corporation. The foregoing provision shall be construed as a limitation on the power of a corporation.

"The plea of ultra vires shall not be made by any foreign corporation or any other party in any action brought in this state except (1) between such corporation and a director or officer thereof or a person having actual knowledge of the ultra vires character of the act or (2) by either party in an action between a shareholder and the corporation." General Corporation Act, Public Acts, 1931, No. 327.

[73] Sec. 8623-8 provides: "1. Every corporation shall have authority to sue and be sued . . .

"2. In carrying out the purposes stated in its articles and subject to any limitations prescribed by law or in its articles, every corporation shall have authority: (Powers enumerated).

"4. No lack of, or limitation upon, authority of a corporation shall be asserted in any action except (a) by the state in an action by it against the corporation, or (b) on behalf of the corporation against a director, an officer or any shareholder as such, or (c) by a shareholder as such or by or on behalf of the holders of a class of shares against the corporation, a director, an officer or any shareholder as such, or (d) in an action involving an alleged overissue

Oklahoma,[74] Pennsylvania,[75] and Minnesota [76] have enacted more elaborate laws on the subject. Expressly by some of these statutes and impliedly in others the articles of incorporation shall be consi-

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of shares. This paragraph shall extend to any action brought in this state upon any contract made in this state by any foreign corporation."

Section 8623-9 provides: "The filing and recording of articles and other certificates pursuant to this act is required for the purpose of affording all persons the opportunity of acquiring knowledge of the contents thereof, but no person dealing with a corporation shall be charged with constructive notice of the contents of any such articles or paper by reason of such filing or recording." General Corporation Act, 1927. Sec. 8623-8 was amended effective Sept. 10, 1949.

[74] Sec. 18 provides: "All corporations shall have and possess general capacity and want of such capacity shall never be made the basis of any claim on defense at law or in equity."

Sec. 28 provides: "a. The articles of incorporation of every domestic corporation shall constitute an agreement between and among the corporation, its directors, officers, and shareholders, defining and limiting the scope of the corporate purposes to be exercised by them within the general capacity granted.

"b. If any such corporation, its directors, officers, and/or shareholders shall exceed such authority, or shall by fraudulent acts engage such corporation in any act, contract, or undertaking beyond the purposes of such corporation as expressed in the articles of incorporation, or in fraud of it or its shareholders, a proceeding may be brought for proper relief by one or more of such parties as plaintiff for the benefit of the corporation and against any other or others of them; provided, that such plaintiff, if a shareholder, shall allege and prove that he was a shareholder at the time of the transaction of which he complains or that his shares devolved upon him by operation of law, and shall also set forth with particularity his efforts to secure from the directors, and, if necessary, from the shareholders, such action as he desires and the reasons for his failure to obtain such action or the reasons for not making such effort; provided, further, that in case third parties have acquired rights by virtue of provisions of Section 29 of this Act, such rights shall not be affected."

Sec. 29 provides: "a. In no event shall it (ultra vires) be asserted in any action that any contract, conveyance, undertaking, or tortious act, executed or executory, is beyond the purposes of a corporation expressed in its articles of incorporation, if:

"(1) Such contract, conveyance, undertaking, or tortious act was authorized or ratified by its board of directors or shareholders;

"(2) With knowledge, actual or constructive, of the facts, the benefits or any part thereof of such transaction have been accepted or retained by the parties so ascertaining; or

"(3) The articles of incorporation of such corporation be ambiguous as to the scope of its corporate purposes and under any reasonable interpretation of the articles of incorporation as relied upon by any third party, or his privy, the transaction in question would have been authorized.

"This Section shall not be construed to validate or prohibit a defense against an illegal or immoral contract, prohibited by law or by the public policy of the State.

"b. Subject to any limitations contained in this Act, the general rules of agency shall be applied in all cases where a corporation is principal, agent, or third party, as between and among such principal, agent, and third parties." Business Corporation Act, 1947.

[75] Sec. 9 provides: "(a) The filing of the articles, or of any other papers or documents, pursuant to the provisions of this act, is required for the purpose of affording all persons the opportunity of acquiring knowledge of the contents thereof, but no person dealing with the corporation shall be charged with constructive notice of the contents of any such articles, papers, or documents by reason of such filing."

Sec. 301 provides: "A business corporation shall have the capacity of natural persons to act, but shall have authority to perform only such acts as

are necessary or proper to accomplish the purpose or purposes for which it is organized, and which are not repugnant to law."

Sec. 303 provides: "No limitation upon the business purpose or purposes, or powers of a business corporation, expressed or implied in its articles or implied by law, shall be asserted in order to defend any action at law or in equity between the corporation and a third person, or between a shareholder and a third person, involving any contract to which the corporation is a party or any right of property or any alleged liability of whatsoever nature; but such limitation may be asserted:

"(1) In an action by a shareholder against the corporation to enjoin the doing of unauthorized acts or the transaction or continuation of unauthorized business. If the unauthorized acts or the business sought to be enjoined are being transacted pursuant to any contract to which the corporation is a party, the court may, if all of the parties to the contract are parties to the suit, and if it deems the same to be equitable, set aside and enjoin the performance of such contract, and in so doing shall allow to the corporation, or the other parties, as the case may be, compensation for the loss or damage sustained by either of them, which may result from the action of the court in setting aside and enjoining the performance of such contract, but anticipated profits to be derived from the performance of the contract shall not be awarded by the court as a loss or damage sustained.

"(2) In an action at law or in equity by the corporation, whether acting through a receiver, trustee, or other legal representative or through shareholders in a representative suit, against the officers or directors of the corporation for exceeding their authority.

"(3) In a proceeding by the Commonwealth, as authorized by law, to dissolve the corporation, or in a proceeding by the Commonwealth to enjoin the corporation from the transaction of unauthorized or unlawful business.

"B. No conveyance or transfer by or to a corporation of property, real or personal, of any kind or description, shall be invalid or fail because in making such conveyance or transfer, or in acquiring the property, real or personal, the board of directors or any of the officers of the corporation, acting within the scope of the actual or apparent authority given to them by the board of directors, have exceeded any of the corporation's purposes or powers.

"C. The provisions of this section shall extend to contracts and conveyances made by foreign corporations of real property situated in this Commonwealth." Business Corporation Law, Act No. 106, L. 1933.

[76] Sec. 301.11 provides: "The filing for record of articles and certificates pursuant to section 301.01 to 301.61 is for the purpose of affording means of acquiring knowledge of the contents thereof, but shall not constitute constructive notice of such contents."

Sec. 301.12 provides: "Every corporation shall confine its acts to those authorized by the statement of purposes in the articles of incorporation and within the limitations and restrictions contained therein, but shall have the capacity possessed by natural persons to perform all acts within or without this State.

"No claim of lack of authority based on the articles shall be asserted or be of effect except by or on behalf of the corporation (a) against a person having actual knowledge of such lack of authority, or (b) against a director or officer.

"The provisions of this section shall not affect:

"(1) The right of shareholders or the State to enjoin the doing or continuing of unauthorized acts by the corporation; but in such case the court shall protect or make compensation for rights which may have been acquired by third parties by reason of the doing of any unauthorized act by the corporation.

"(2) The right of a corporation to recover against its directors or officers for violation of their authority." Business Corporation Act, 1933.

dered a contract among the shareholders, directors and officers, and the corporation. Constructive notice to third persons of the provisions of the articles of incorporation is abolished and general capacity is conferred upon the corporation. The Canadian provincial laws which were enacted earlier than above statutes conferred general capacity to corporations however formed and adopted substantially the same solution to the ultra vires doctrine.[77] It is likewise interesting to note an agitation in New Zealand for a similar solution.[78]

The first noticeable break in policy among the laws cited in the footnotes is in dealing with a third person that had actual knowledge of the want of authority of the corporation to enter into the contract. The California law takes the position that certainty of legal transactions outweighs the necessity of inquiring into the question of knowledge.[79] The Ohio, Illinois,[80] and Pennsylvania[81] laws follow the example of that of California. The Ohio law, however, adopted this policy only on September 10, 1949, when an amendment was enacted to section 8623-8 of the General Corporation Act. Before that time the policy of Ohio was otherwise.[82] Kansas, Michigan, Minnesota, and, perhaps, Oklahoma provide that actual knowledge on the part of the third person of the limitation on corporate powers is a good defense to an action for enforcement of an ultra vires contract. It was, however, suggested that the defense should not be available to the corporation against one with actual knowledge but who has fully performed his part of the contract.[83] In the conflicting policies adopted by these laws then lies the question of choice. The Uniform Business Corporation Act is silent on the point and so are the laws of Indiana and Idaho.[84] The policy of which California is representative seems more desirable. While it is more likely to encourage business transactions, it also protects the corporate interests by holding directors and officers who transcend the limits of corporate authority accountable to the corporation. It,

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[77] See Stevens, "A Proposal as to the Codification and Restatement of the Ultra Vires Doctrine," 36 *Yale Law Journal*, 297, 300, 320-321; Mulvey, "The Companies Act," 39 *The Canadian Law Times*, 79, 80; Thompson, "Are Joint Stock Companies Common Law Corporation?" 42 *The Canadian Law Times*, 143, 147-149.

[78] Adams, "Company Law Reform," 21 *New Zealand Law Journal*, 300.

[79] "Persons dealing with corporations should be enabled to rely on the authority of the directors and should not have to consult attorneys on the frequently difficult question of whether a transaction is intra vires or not or run the risk of proving their ignorance of possible limitations on the authority of the managing board. It is better to eliminate such inquiries." Ballantine, "Problems in Drafting a Modern Corporation Law," 17 *American Bar Association Journal*, 579, 580. See also Ballantine, Sterling and Buhler, *California Corporation Laws*, 1949, pp. 86-87.

[80] Ballantine, "A Critical Survey of the Illinois Business Corporation Act," 1 *The University of Chicago Law Review*, 357, 383.

[81] The Pennsylvania law is similar to that of Illinois.

[82] Townsend, *Ohio Corporation Law*, Perpetual revised edition, 1940, pp. 52-53.

[83] Jennings, "The Minnesota Business Corporation Act," 12 *Wisconsin Law Review*, 422, 429.

[84] Washington, having adopted the Uniform Business Corporation Act, belongs to this group

therefore, imposes a duty of care on the part of directors and officers and discourages collusion between them and third persons On the other hand, opening the door to inquiry of actual knowledge on the part of third persons, would mean not only overemphasizing the corporate interests but an invitation to litigation. It seems more desirable that the law should close this source of litigation by establishing something like a conclusive presumption of lack of knowledge on the part of the third person or, as Ballantine puts it, a conclusive presumption of corporate authority,[85] making all questions arising from the transaction primarily intracorporate. Third persons thus need not fear lest actual knowledge be imputed to them at a subsequent time when the contract would operate to the disadvantage of the corporation. The choice leans heavily in favor of the California plan.

Another conflict of policy is involved in the question whether a shareholder should be allowed to enjoin the enforcement of a corporate contract in some cases. The Illinois law allows the plea of ultra vires to be taken advantage of by a shareholder by means of a suit for injunction against the corporation. The requisites for injunctive relief are stated as follows:

> ". . . If the unauthorized acts or transfer sought to be enjoined are being, or are to be, performed or made pursuant to any contract to which the corporation is a party, the court may, if all of the parties to the contract are parties to the proceeding and if it deems the same to be equitable, set aside and enjoin the performance of such contract, and in so doing shall allow to the corporation or the other parties, as the case may be, compensation for the loss or damage sustained by either of them which may result from the action of the court in setting aside and enjoining the performance of such contract, but anticipated profits to be derived from the performance of the contract shall not be awarded by the court as a loss or damage sustained." [86]

The Pennsylvania and Minnesota [87] laws contain the same provisions. Under this type of statute neither the corporation nor the third

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[85] Ballantine on Corporations, 1946, p. 266.

[86] Sec. 8(a), *supra*. See Little, "The Illinois Business Corporation Act," 28 *Illinois Law Review*, 997, 1003-1004; Tanner, 20 *Chicago-Kent Law Review*, 115, 135, note 64; Katz, "The Illinois Business Corporation Act," 12 *Wisconsin Law Review*, 473, 481; Ballantine, "A Critical Survey of the Illinois Business Corporation Act," 1 *The University of Chicago Law Review*, 357, 381-382; Richardson, "Ultra Vires Under the Illinois Business Corporation Act," 29 *Illinois Law Review*, 1075.

[87] "What is sacrificed in definiteness by these provisions is believed to be compensated for by the fairness and justice to shareholders and third parties alike." Hoshour, "The Minnesota Business Corporation Act," 17 *Minnesota Law Review*, 689, 696. "It is believed that in application, the power is reserved by the Minnesota Act to a court at the suit of the State or a shareholder, to enjoin the doing or continuing of ultra vires acts, will be restricted in the main to situations where (1) not even an executory contract has yet been consummated; or (2) the other party is a director or officer or person with knowledge who would have acquired no enforceable rights as against the corporation either at common law or under the Act; or (3) it appears to the court that the public interest of the state or the financial interests of innocent

party can bring the action, but the corporation can induce a shareholder to do so. No distinction is made between contracts that are wholly executory and those partly performed on one side or both sides. The court, in the exercise of its equitable jurisdiction, may, in its discretion, enjoin enforcement and award damages. On the other hand, the California law provides as follows:

> ". . . Such limitations may be asserted in a proceeding by a shareholder or the State, to enjoin the doing or continuation of unauthorized business by the corporation or its officers, or both, in cases where third parties have not acquired rights thereby. . ."[88]

Under the California law, not even a wholly executory contract may be enjoined by a shareholder or the State for rights of a third party have already intervened. Ohio impliedly follows California,[89] and also does Michigan. The Illinois type of law is defended on the ground of flexibility and attacked because timorous and leaves the solution of the problem uncertain. The uncertainty of solution under the Illinois type of law is very apparent from suggestions made as to its practical application.[90] Moreover, the third party and the corporation may, by secret arrangement with a shareholder, unsettle a contract or render its validity doubtful. It seems, therefore, that the clear-cut solution of the California law is preferrable as best calculated to give certainty to contracts and thus facilitate commercial transactions. While it is true that the right conferred by the Illinois law upon the shareholder is designed for his protection and others of his class so that the corporation may not embark upon a business not contemplated in the articles of incorporation, it is believed that holding the directors and officers liable, where proper, is sufficient.[91]

That the legislative reform of the doctrine of ultra vires should be extended to foreign corporations should be clear and should not, therefore, give rise to dispute. It is expressly extended to them by the California, Michigan, and Pennsylvania laws. Some states impliedly limit the operation of the rule to corporations formed under their laws and thus exclude foreign corporations. The latter policy would place the foreign corporations in a better position than those formed under the laws of the particular jurisdiction. There is no reason for doing this, except, perhaps, to attract within

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shareholders (a) will be more adversely affected by the corporation's performance of its ultra vires obligation than by its payment of damages for breach, and (b) will also outweigh the interest of the other party in the corporation's being permitted to perform, provided further that (c) the interest of the other party is such as may be readily compensated by a measure of damages to be fixed by the court so as to do complete justice in the individual case." Jennings, "The Minnesota Business Corporation Act," 12 *Wisconsin Law Review*, 422, 430-431.

[88] Sec. 803(a), *supra*.

[89] Hoshour, *supra*, at p. 696; note in 44 *Harvard Law Review*, 280, 284, But see Townsend, *Ohio Corporation Law*, Perpetual revised edition, 1940, p. 53.

[90] Jennings, *supra*.

[91] Their liability is based on "negligently engaging in unauthorized acts." They are not liable for honest and reasonable mistakes as to the scope of the corporate authority. Ballantine, Sterling and Buhler, *California Corporation Laws*, 1949, p. 85, note 40.

the jurisdiction the investment of foreign capital. This would mean, however, the development of two sets of law on ultra vires and the consequent prejudice of third persons in respect, at least, to foreign corporations. All the legal vices of ultra vires would then be perpetuated with reference to them. Certainly, a much better form of attraction can be devised without creating injustice and confusion.

This study suggests what must have been obvious, that the California law should be adopted in the Philippines. Equitable, or any word of the same import, is attractive to most men because it touches the vital chords of the human sentiment. But it can mean all things to all men. This is what makes it thoroughly subjective and meaningless. It is well to avoid it in the legislative reform of ultra vires. Business law must be certain and mechanical as far as it is in human power to do so.