

## A Critical Analysis of the Doctrine of Ultra Vires

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### Introduction

The Memorandum of Association (MOA), also referred to as a company's constitution, encompasses the powers, scope of work, and crucial objectives of the company. It serves as a guideline for employees to ensure they understand the boundaries to which they must adhere. Any action taken by the company beyond the powers outlined in the MOA is considered an ultra vires act. The Doctrine of Ultra Vires provides assurance to shareholders and creditors that funds and assets will not be misused for activities outside the scope defined in the company's Memorandum.

This doctrine is foundational in corporate law, stipulating that a company's activities must align with its stated purposes in the Articles of Association, as permitted by the law. Any action or contract undertaken beyond the authority granted to the directors or the company itself is considered void and not legally binding.

In legal terms, Ultra Vires denotes actions performed beyond one's legal authority. The doctrine prevents the company from engaging in trades or using funds for purposes not specified in the Memorandum. The company cannot sue or be sued for actions that are ultra vires. If the company engages in activities outside its authority, it cannot receive payment or reclaim loans associated with those activities. However, an investor can seek an injunction to prevent the company from disposing of funds involved in ultra vires transactions because the investor remains the rightful owner.

In some cases, shareholders may legalize ultra vires actions, such as when they approve actions that exceed the authority of the directors or amend the company's Articles to accommodate such actions. (Garg, n.d.)

### **Meaning of Ultra Vires under Indian Company Law**

As previously mentioned, the term "ultra vires" refers to any action or transaction that exceeds a company's lawful powers. In the realm of company law, a transaction is considered ultra vires if it meets any of the following criteria:

1. It falls outside the scope of the legislation governing companies, specifically the Companies Act of 2013.
2. It goes beyond the powers outlined in the company's Memorandum of Association.
3. It violates the provisions set forth in the company's Articles of Association.
4. It surpasses the authority granted to the directors or officers of the company.

In essence, an ultra vires transaction may occur due to either a lack of capacity or a lack of authority. Lack of capacity arises when a company lacks the legal power to act, either because it exceeds the boundaries set by the Companies Act of 2013 or it contravenes its memorandum or articles.

Conversely, lack of authority pertains to situations where company officers act within the company's objectives but without the proper authorization. In both scenarios, the action would be considered ultra vires, though it would carry different legal consequences, as outlined below. (Ramakrishnan, 2021)

### **Origin of the Doctrine of Ultra Vires**

The principle of ultra vires was initially established in the landmark case of Ashbury Railway Carriage and Iron Co. Ltd. v. Riche, (1878) L.R. 7 H.L. 653, decided by the House of Lords. In this case, the company entered into a contract with M/s. Riche for the financial construction

of a railway line. Subsequently, the directors terminated the contract on the grounds that it exceeded the authority specified in the company's memorandum. Riche then sued the company for damages.

Riche argued that the term "general contracts" in the company's objects clause encompassed all types of contracts, giving the company the power and authority to enter into such agreements. Despite a majority of shareholders ratifying the contract, the company's directors continued to reject its performance, citing its ultra vires nature and the inability of shareholders to ratify such acts.

The House of Lords ruled that the contract was indeed ultra vires the company's memorandum and therefore void. The term "general contracts" was interpreted in conjunction with the preceding words "mechanical engineers," clarifying that it referred only to contracts related to mechanical engineering and did not encompass all types of contracts. Furthermore, the court emphasized that even if every shareholder had ratified the act, it would still be null and void as it contravened the company's memorandum. The memorandum cannot be retroactively amended, and any ultra vires act remains unenforceable. (Sharma, 2021)

### **Ultra Vires the Companies Act, 2013**

It is widely acknowledged that a company's authority is primarily derived from the statute under which it is incorporated. According to Section 2(20) of the Companies Act, 2013 (referred to as "the Act"), a company refers to one incorporated under this Act or any preceding company law. Consequently, a company cannot exceed the powers expressly or implicitly granted to it by the statute.

Section 6 of the Act explicitly states that its provisions take precedence over anything contrary in a company's memorandum, articles, agreements, or resolutions, whether executed or passed before or after the Act's commencement. Additionally, any provision conflicting with the Act is deemed void, emphasizing the supremacy of the Act's principles in company law.

### **Ultra Vires and the Memorandum of Association**

The Memorandum of Association (MOA) serves as the cornerstone of a company's constitution, outlining its fundamental structure. The MOA delineates the company's activities and its external relationships, with particular significance placed on its "objects clause." Mandated by Section 4(1)(c) of the Act, this clause specifies the purposes for which the company is established and any ancillary matters.

The objects clause holds immense importance as it defines the company's *raison d'être* and operational boundaries. Acts falling outside the scope outlined in the MOA are deemed *ultra vires*, rendering them void and incapable of ratification by shareholders.

In the case of *Ashbury Railway Carriage and Iron Company v. Riche*, the company engaged Riche, a railway contracting firm, to finance a railway line construction in Belgium. Subsequently, the company reneged on the contract, citing the absence of railway construction within its objects clause as *ultra vires*.

Riche pursued damages for breach of contract, asserting the contract's validity due to shareholder ratification. However, the House of Lords ruled the contract null and void for being *ultra vires* the company's memorandum, irrespective of shareholder approval.

Therefore, it is imperative to adhere strictly to the objects clause's confines to prevent overstepping the company's prescribed scope of activities.

### **Ultra Vires and the Articles of Association of a Company**

According to Section 5(1) of the Act, the Articles of Association (AOA) of a company outline the internal regulations governing its management. These regulations are crucial for managing the company's internal affairs and defining the rights of its members among themselves.

However, the AOA is subordinate to and bound by the Memorandum of Association (MOA). Any provision in the AOA that exceeds the scope of the MOA is considered *ultra vires*. Since the articles are internal regulations subject to the control of the company's members, they can be amended through proper ratification.

It is noteworthy that in cases where the MOA is ambiguous, the AOA may be referenced for clarification, but not to expand the company's stated objectives.

In the case of *Re. South Durham Brewery Company* ((1875) LR 7 HL 653), the company's memorandum lacked clarity regarding the issuance of shares, but the articles granted the company authority to issue shares of different classes as specified. The court ruled that the articles could clarify the ambiguity in the memorandum.

### **Ultra Vires and the Directors of the Company**

If the directors of a company engage in transactions without proper authority, even if within the scope of the MOA's object clause, such acts are deemed ultra vires the directors but intra vires the company. These acts can be ratified by the company in the appropriate manner. (Ramakrishnan, 2021).

### **Development of the Ultra Vires Doctrine**

*Eley v The Positive Government Security Life Assurance Company, Limited, (1875-76) L.R. 1 Ex. D. 88:*

This case established that the articles do not create a contractual relationship between the company and the plaintiff. While they may bind the directors, they do not form a contract between the plaintiff and the company.

*The Directors, &C., of the Ashbury Railway Carriage and Iron Company (Limited) v Hector Riche, (1874-75) L.R. 7 H.L. 653.*

In this case, a contract for railway construction was deemed ultra vires the company's memorandum. The contract could not be ratified retroactively, even by unanimous shareholder consent, emphasizing the doctrine's strict application.

***Shuttleworth v Cox Brothers and Company (Maidenhead), Limited, and Others, [1927] 2 K.B. 9:***

It was ruled that if a contract is subject to alterations permitted by the articles and such alterations are made in good faith for the company's benefit, they do not breach the contract and remain valid.

***Re New British Iron Company, [1898] 1 Ch. 324:***

Directors were categorized as ordinary creditors during the company's winding-up due to their employment relationship. While articles typically do not constitute a contract between the company and its directors, in this case, they were considered creditors owing to their acceptance of office under the articles.

***Rayfield v Hands and Others, [1957 R. No. 603.]:***

This case involved a shareholder's request to sell shares to the directors, as per the articles. The court clarified that the directors' obligation to buy shares was not as directors but as fellow shareholders.

### **Case Laws on Ultra Vires Doctrine in India**

The concept of ultra vires was established in *Jahangir R. Modi vs Shamji Ladha*, where a shareholder sued directors for unauthorized transactions, successfully holding directors liable without involving the company.

*Lakshmanswamy Mudaliar vs Life Insurance Company* highlighted that directors' charitable donations must align with the company's objects. In this case, the directors' unauthorized donation was held invalid, and they were held personally liable. (Sharma, 2021)

***Fundamental Principles of the Ultra Vires Doctrine:***

1. Shareholders cannot validate an ultra-vires transaction or action, regardless of their desire to do so.

2. In cases where one party fulfills their contractual obligations, the defense of ultra vires is typically barred under the doctrine of estoppel.
3. When both parties fulfill the contract entirely, the contract cannot be challenged on the basis of ultra vires.
4. Any party involved in the transaction has the right to invoke the defense of ultra vires.
5. If a contract is partially executed but not enough to trigger estoppel, legal action can be taken to recover any benefits conferred.
6. The company cannot absolve itself of liability for defaults or torts committed by its agents within the scope of their employment by claiming the act was ultra vires.

### ***Types of Ultra Vires Acts:***

There are three categories of ultra vires acts:

1. Ultra vires the Memorandum or the Company: Actions exceeding the powers granted in the Memorandum's objects clause are termed ultra vires the Memorandum or the company.
2. Ultra vires the Articles but Intra Vires the Company: Actions surpassing the powers defined in the Articles but falling within the scope of the Memorandum's authority are labeled ultra vires the Articles but intra vires the company.
3. Ultra vires the Directors but Intra Vires the Company: Actions by directors that exceed their authority but fall within the company's jurisdiction are considered ultra vires the directors but intra vires the company. Such actions can be ratified by the company, rendering them legally binding. (More, 2023)

### ***Example Illustrating the Doctrine of Ultra Vires***

Question:

ABC Limited's Memorandum of Association outlines the following objectives:

1. Manufacturing, selling, or leasing railway carriages and wagons.

2. Engaging in mechanical engineering and general contracting businesses.
3. Acquiring, leasing, selling, and operating mines.
4. Trading coal, timber, metals, etc., as merchants or agents.

The directors of ABC Limited enter into a contract with XYZ Limited to finance the construction of a railway line in Belgium. Additionally, the company ratifies this action through a special resolution. However, ABC Limited later repudiates the contract, claiming it to be ultra vires. XYZ Limited sues ABC Limited for damages, arguing that the contract falls within the scope of "general contractors" as per the memorandum and has been ratified by shareholders. Is the contract legally valid?

Answer:

Examining ABC Limited's Memorandum of Association, the term "general contractors" must be interpreted within the context of the company's business activities, particularly in connection with mechanical engineering. If this reference is omitted, the company would have broad authority to engage in contracts of any nature (e.g., marine, biotech, etc.). Consequently, the contract between ABC Limited and XYZ Limited for financing a railway line construction in Belgium is deemed null and void. (toppr, n.d.)

### **Effects of Ultra Vires Acts**

An act that violates the law is impermissible, meaning that retrospectively legitimizing an ultra vires act is impossible. Such an act remains forever invalid and lies beyond the scope of the actor's authority as outlined in the company's memorandum.

When the Articles are breached but the corporation is not, it entails activities conducted outside the corporate rights provided by its Articles of Association but within the corporation's responsibility. These actions surpass the Articles' scope but fall within the company's overall jurisdiction.

Acts performed by the corporation that exceed the authority provided in the memorandum are considered ultra vires the memo.



While the administrators may violate their authority, the corporation does not. These are actions taken by the company's administrators that exceed their power but remain within the corporation's broader scope.

### **Can Ultra Vires Acts Be Ratified?**

An ultra vires act cannot be sanctioned by the entire body of shareholders and made binding on the corporation. Even shareholders cannot engage in an ultra vires conduct, which is a fundamental aspect of this legal doctrine.

The Principle Established by Lord Cairns, L.J.

Lord Cairns, L.J. first articulated the principle of law concerning this matter in the case of *Ashbury Railway Carriage & Iron Co. Ltd V. Riche*. In this case, a contract was deemed ultra vires the company, despite subsequent approval by the entire shareholder body.

However, subsequent rulings by the House of Lords have acknowledged that, unless expressly prohibited, a company may undertake acts necessary or incidental to achieving its objectives.

### **Key Cases Illustrating the Doctrine of Ultra Vires**

1. *Ashbury Railway Carriage and Iron Company Ltd. V. Riche* (1875) L.R. 7 H.L. 653:  
In this case, the company's memorandum outlined various objectives, including railway carriage manufacturing and mineral trading. The directors entered a contract to fund a railway line construction in Belgium, later repudiated by the company as ultra vires. The House of Lords affirmed that such an act was null and void, even if approved by shareholders.
2. *Evans v/s Brunner Mond & Company*:  
In this instance, a resolution authorizing surplus funds for scientific research was challenged as ultra vires. The court determined that such spending was incidental to the company's primary goal of chemical manufacturing and thus not ultra vires.

## **Disadvantages of the Doctrine of Ultra Vires**

The Ultra Vires Doctrine serves as a safeguard for shareholders and creditors, yet it also has significant drawbacks. It restricts the company from adjusting its activities as desired by all members and hinders proactive directors from making swift decisions to seize business opportunities. Moreover, the object clause of the Memorandum can be modified by a special resolution, undermining the doctrine's fundamental objective.

In this article, we will explore the various types of ultra vires acts and the repercussions of such transactions.

## **Consequences of Ultra Vires Transactions**

Examining the diverse roles of directors within a company, whether as trustees, organs, or agents, they should bear responsibility for any ultra vires transactions conducted by the company. Consequently, remedies are accessible against both the company and the implicated directors.

## **Injunction to restrain the company**

Members have the right to ensure that a registered company adheres to its registered objectives, enabling them to seek injunctions against any ultra vires actions by the company.

In the case of *Attorney-General v. Great Eastern Rly Co* (1880) 5 AC 473, it was established that any member of a company could obtain an injunction to prevent or halt an ultra vires action.

For instance, in *London County Council v. Attorney General* (1902) AC 165, the council, with statutory authority to operate tramways, was restrained from operating omnibuses in conjunction with tramways. The court ruled that the omnibus operation was not incidental to tramway business and thus could not proceed.

### **Personal Liability of Directors**

Directors, as agents of the company, are obligated to ensure that shareholder funds are utilized solely for legitimate company activities. Any diversion of funds for purposes outside the company's memorandum constitutes an ultra vires act, rendering directors personally liable to rectify it.

In *Jehangir R. Modi v. Shamji Ladha* (1866) 4 Bom HCR 185, the Bombay High Court ruled that a shareholder could sue directors, separately from the company, to recover funds used in unauthorized transactions.

In *Laksmanaswami Mudaliar v. L.I.C.* (AIR 1963 S.C. 1185), the Supreme Court held directors liable for making an unauthorized donation, emphasizing their responsibility for passing resolutions within the company's authorized scope.

### **Liability of Directors for Breach of Warranty of Authority**

Directors, acting beyond their authority, are personally liable for breaching warranty of authority to third parties. In *Weeks v. Propet* (1873) LR 8 CP 427, directors were held liable for issuing debentures without the company's borrowing power.

However, representations of authority must pertain to facts, not law. Misrepresentation of legal matters doesn't constitute breach of warranty.

### **Effect on Property Acquired Under Ultra Vires Contract**

If a company acquires property through an ultra vires contract, its rights over the property remain protected. Courts uphold the company's ownership, despite wrongful acquisition, as the property represents corporate capital.

In *Ayers V South Australian Banking Co.* (1871) LR 3 PC 548, the court affirmed that property legally transferred to a corporation is vested in it, even if acquired beyond its powers.

### **Effect of Ultra Vires Contracts**

Ultra vires contracts are void ab initio and cannot be ratified or validated retroactively. In *Ashbury Railway Carriage & Iron Co. V Riche* (1875) LR 7 HL 653, the court declared that no performance can legitimize an unlawful contract.

### **Effect of Ultra Vires Torts**

While companies aren't liable for ultra vires contracts, they can be held accountable for torts committed by employees within the scope of company activities outlined in the memorandum.

### **Ultra Vires Acts Leading to Crime**

Companies may be liable for crimes or torts committed by officers within the scope of their authority. However, personal liability also applies to officers committing such acts.

### **Conclusion**

The doctrine of ultra vires protects investors and creditors by restricting companies to their stated objectives. However, its application has been criticized for resulting in injustice and lacking a fundamental basis in company law. Despite this, it remains a significant principle in corporate governance. One of the key aims of company law legislation is to safeguard the rightful interests of shareholders and creditors, ensuring they remain protected from potential harm.

To fulfill this goal, the doctrine of ultra vires serves to safeguard the interests of both investors and creditors by restricting a company from engaging in unauthorized transactions. Simultaneously, it prevents third parties from exploiting the doctrine, as they are assumed to be aware of the full scope of the company's powers.

Furthermore, not all ultra vires transactions are automatically deemed void; there are exceptions where transactions can gain validity through ratification. Consequently, the judiciary has played a significant role in integrating the doctrine of ultra vires into company law and clarifying its implications for companies and third parties involved in transactions.

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