Bond Law Review

Volume 16 | Issue 1 Article 4

7-1-2004

Powers, Purposes and Objects: The Protracted Demise of the Ultra Vires Rule

Paul J. Omar

Follow this and additional works at: http://epublications.bond.edu.au/blr

Recommended Citation

Omar, Paul J. (2004) "Powers, Purposes and Objects: The Protracted Demise of the Ultra Vires Rule," *Bond Law Review*: Vol. 16: Iss. 1, Article 4.
Available at: http://epublications.bond.edu.au/blr/vol16/iss1/4

This Article is brought to you by the Faculty of Law at ePublications@bond. It has been accepted for inclusion in Bond Law Review by an authorized administrator of ePublications@bond. For more information, please contact Bond University's Repository Coordinator.

Powers, Purposes and Objects: The Protracted Demise of the Ultra Vires Rule

Abstract
[extract] With the defects in the ultra vires doctrine evident, it is no surprise that there were calls from an early stage for its abolition. It is instructive that in almost all other jurisdictions, predominantly Commonwealth ones, that inherited the ultra vires rule, it has been amended, restricted or avoided in some form. In many of these jurisdictions, the legislatures have gone as far as enacting provisions granting full capacity to corporations. Nevertheless, the reforms that did occur in the United Kingdom did not seem to be effective and frequently raised more questions than they resolved. This was particularly true of the 1972 reforms, which were defective. Although there is a view that the United Kingdom's treaty obligations prevented it from pursuing reforms to the same extent as other jurisdictions, a matter that the Government was conscious of in its review, it now seems that United Kingdom law will at last fall into line with developments outside Europe and seek to abolish the restrictions inherent in the ultra vires rule by granting full capacity to both private and public companies.

Keywords
ultra vires rule, corporate law, United Kingdom

This article is available in Bond Law Review: http://epublications.bond.edu.au/blr/vol16/iss1/4

POWERS, PURPOSES AND OBJECTS: THE PROTRACTED DEMISE OF THE ULTRA VIRES RULE

*By Paul J. Omar**

Introduction

Companies, being essentially creations of law, are governed for the most part by the law, now largely of common law origin and statutory derivation. An important component, nevertheless, of the ordering of relationships within the company is still said to be the contract.[1] While statute increasingly intervenes to regulate the minutiae of corporate life, company lawyers still speak in terms of the nexus of contracts that form the corporate environment and governs its affairs. Where statute is silent, reference may often be made to the pacts and agreements that surround the company and that determine the extent to which members of the company may enforce dealings with each other. As the company constitution is often the reflection of the private contract between its founding shareholders and the basis of future contracts between the company and aspiring investors, this question straddles the divide between private ordering and public intervention through regulation. This divide assumes particular importance in the very acts of promotion that go towards the formation of the company and that are concluded for the greater part before the company comes into being. The most important of these acts is perhaps the location of sponsors and investors keen to participate in the entrepreneurial idea. Unfortunately, history intervenes and the many excesses chronicled during the great age of capitalism combine to form the background to why the courts and legislatures in particular have been keen to ensure that they have control over the contents of the contract in many material respects. In this, the history of the South Sea Bubble plays a part. This unfortunate episode of speculation is said to have had an impact in two areas in particular: first, it returned control over the formation of companies to Parliament, after a heady period in which there was little control over the formation of entrepreneurial ventures and, second, as a consequence, restricted the availability of a low-cost incorporation form until the passing of the *Joint Stock Companies Act* 1844.

Indirectly, the episode also focused attention on the restraint of promoters behaving in ways considered inimical to capitalist progress and laid the foundations for the emergence of various devices to channel the ability of promoters to create companies unfettered by any proper control over their activities. The doctrine of promoter's liability arose to provide control over the pre-formation period as well as where the formation process went awry.

---

* Gray's Inn, Barrister.

1 See P Ireland, *Property and Contract in Contemporary Corporate Theory* (2003) 23 LS 453 for a discussion of the gradual decontractualisation of company law.

Misrepresentation, whether negligent or fraudulent, curbed the enthusiasm of promoters for literary and inexact predictions of the company's worth as an investment vehicle. There was also control over the transfer of benefits arising from promotion activities to the company, which despite problems associated with the ratification of pre-incorporation contracts, generally allow for unfair burdens to be disclaimed. Of course, the most important of the various forms of control was whether the incorporated company encapsulated the pre-formation contract and other associated documents. This was so that investors would be assured that the company was being run according to its constitution and thus in line with what they had expressly authorised. The best way of achieving this was to limit the boundaries of corporate activity through stipulating objects or purposes, so that activity deviating from these purposes could be challenged through the imposition of duties and sanctions for failure to observe them. Subscribers at formation would be able to control this process because of the requirement that they signify their assent to the constitutional documents through signing the memorandum. With respect to future participants, this process becomes useful as it assists in identifying, in advance of any contract, whether the purpose of company matches the investment requirements of the prospective shareholder.

There is an assumption, in light of this, that objects and purposes are useful in the corporate context and that they serve as an economic rationale for the identification of investment opportunities. Nevertheless, as we will see below, this assumption is increasingly doubted and the context in which regulatory intervention occurs seems to rely on other factors. In fact, much of the history of control over the content and extent of these objects seems to be essentially a question of drafting. It is reflective of the conflict between company lawyers, acting so as to further the entrepreneur's desire for freedom of manoeuvre, and the courts, whose views on certainty and protection of the interests involved have focused on limiting this freedom. This is essentially a struggle that has lasted for nearly 150 years and is not yet at an end. Why it has endured this long is the question at the heart of this essay.

A Short History of Speculation

The impact of the South Sea Bubble on the development of this area of law cannot be underestimated. Prior to this episode, which occurred at the beginning of the eighteenth century, charter companies, essentially groupings of merchants to whom a Royal Charter was accorded, had been used since at least the beginning of the fifteenth century to carry out trading activities.[2] Often these charter companies acted with not just the aim of profit, but an avowedly political purpose, in an age when trade was essentially a tool of state diplomacy. The foundation of the East India Company in England in 1599 is a well-known example of how state

2 See H Rajak, *Judicial Control: Corporations and the Decline of Ultra Vires* (1995) 26 Camb LR 9 at 12, citing the charter granted to the Merchant Adventurers' Company in 1505. This was very possibly a reissue of a charter originally granted in 1407.

interests can coincide with business with respect to encouraging overseas exploration and the development of new markets, a pattern that has often been repeated over the subsequent centuries.[3] The difficulty of obtaining charters, however, made this course the preserve of a few while the charters were fairly closely drafted, defining the extent of the privileges and the locations where they were to be exercised as well as the items the subject of the privilege. This might be seen as reflective of the charter concept as applied to mediaeval institutions of Government and the Church, from which the concept of the public corporation derives. While the charter company had its heyday in the second half of the sixteenth century, the expansion in commercial opportunities offered by so-called 'Dutch Finance'[4] in the late seventeenth century may have put pressure on entrepreneurs to develop commercial vehicles not reliant on charters.

The use of joint stock companies, although in existence since at least the sixteenth century, became the preferred vehicle for new incorporations from the late 1680s.[5] Very rapidly, the embryonic stock market of the 1690s became the focus for fraud and the use of 'sham companies' for the enrichment of 'projectors' or entrepreneurs.[6] The proliferation of companies achieved its highest peak in the years immediately preceding the South Sea Bubble, when various companies were formed with an extraordinary variety of purposes in mind, including financial services, new technologies and overseas settlement, each drawing substantial investment from prospective stockholders attracted by the descriptions of these companies in advertisements placed prior to the opening of subscription opportunities.[7] Some of these purposes were so fantastic that legends have been created around them, including that about the company formed 'for carrying on an undertaking of great advantage but no one to know what it is.'[8] With this in mind, it is perhaps not surprising that the most celebrated of these 'bubble companies' should have engendered the interest it did. The South Sea Company was formed in 1711 to take over Government debt, which it converted into shares, receiving from the Government an annual interest payment and a monopoly of trade with Spanish colonies in South America. It proceeded to acquire further debt in 1719.[9] In 1720, the year of its most ambitious project, it was proposed that the company

3 Founded in 1599, the company traded in the East Indies until the Amboyna massacre in 1623. Subsequently profiting from trade in China and India, it built extensive land-holdings in India before becoming absorbed as a semi-autonomous department of the British state until it was abolished in 1857.

4 See E Chancellor, Devil take the Hindmost: A *History of Financial Speculation* (London: Pan Books, 2000) at 32, chronicling a period of intensive financial development in the wake of the Glorious Revolution of 1688-9, which included the creation of the National Debt (1693), the formation of the Bank of England (1694), the introduction of Exchequer Bills (1696) and legislation governing promissory notes (1704).

5 Ibid, at 35.

6 Ibid, at 48.

7 Ibid, at 70-71.

8 Ibid, at 72.

9 Ibid, at 59-60.

acquire the entirety of the National Debt, including annuities, which were to be exchanged for shares in the company.[10] Suffice to say that the scheme was reliant on company shares being traded at levels well above par, in which speculation played an inevitable part by promoting shares at prices that were extreme. It was ironic that the speculative mania attendant on the rise of the bubble companies was viewed by the company itself as undesirable and the directors procured the passing of the *Bubble Act* 1720, which made the establishment of companies other than by Act of Parliament unlawful and, furthermore, prevented existing companies from acting outside the remit of their constitutions.

When demand for other bubble company shares remained steady, the company persuaded the Attorney-General to issue writs of scire facias against three companies that had deviated from the terms of their charters.[11] Eventually, when the company collapsed, the attendant financial scandal, implicating as it did members of Parliament and the Government, and the opprobrium into which companies generally fell conspired to ensure that the terms of the *Bubble Act* remained on the statute book until the next century, hindering the development of financial capitalism and preventing the joint stock company from contributing to the Industrial Revolution.[12] Although other forms of business vehicles thrived, including mutual companies, deed of settlement companies and partnerships, each of these vehicles had their disadvantages.[13] Furthermore, the requirement that companies conducting business obtain Parliamentary approval meant that incorporations were expensive to obtain and tended to be restricted to high-value projects like railways, roads and canals. This development also meant that the statutory company model achieved a certain prominence in the history of company law, displacing the charter company and other devices. This also perhaps explains why later developments in the context of joint stock companies, when eventually their use as a low-cost incorporation form was authorised by the *Joint Stock Companies Act* of 1844, were influenced by those in the statutory context and why there are parallels to be drawn between the constitution of the statutory company, often with strict purposes or objects, and that of the joint stock company.

A 'Compleat' History of Ultra Vires

The Early Years

It is said that charter companies were regarded as enjoying the same legal capacity as the adult at common law.[14] In theory, they were unfettered as regards their transactions, even in areas not expressly authorised by the charter, although they ran the risk that the Crown, displeased by an abuse of this concession, could

10 Ibid, at 62.
11 Ibid, at 82.
12 Ibid, at 90. The Act was not repealed until 1825.
13 See H Rajak, op. cit. at 13.
14 Ibid, at 14, citing the case of Sutton's Hospital (1612) 10 Co. Rep. 1a, 23a.

act so as to revoke the charter.[15] The provision of the statutory model changed matters insofar as the exercise of restraint was concerned. Commentators are united in agreeing that statutory companies came into being at a time of great economic fever, when the laying down of infrastructural works in the shape of canals, railways, roads and services meant that there was a real risk of substantial infringement of private rights, notably the possibility of expropriation of property, which often occurred for the purposes of carrying out these great projects.[16] There seemed to be a reluctance to treat these companies as mere successors in style of the charter company, that is to say to leave them to carry out their tasks without regard to whether their constitutions permitted them free rein to use all means to do so.[17] There were equally concerns about the economic damage potentially inflicted by these companies on competitors and those whose property had been expropriated.[18]

Statutory companies were comparatively rare until the Railway Mania of 1845.[19] However, judgments in the wake of the explosion in their numbers demonstrated that the courts would examine the statutes creating these companies so as to ensure that they adhered to their purposes as well as by closely scrutinising the extent of their powers and resolving disputes with individuals in favour of private rights.[20] Inasmuch as these companies behaved much as we would expect public corporations to do, the doctrine of ultra vires,[21] imported from public law, came to be applied by the courts to restrain activities that deviated from the purposes for which these quasi-public companies were formed. There is a suggestion that applying the doctrine to statutory companies is perfectly understandable given that a limitation on the powers of a body exercising public authority is reasonable and, furthermore, that for bodies conferred with actual, if not de facto, monopolies, the restriction would serve to limit the economic effect

15 Idem. See also L Sealy, *Cases and Materials in Company Law* (London: Butterworths, 2001) at 145, who states that charter companies were only limited in instances where powers had been conferred on them by statute, c.f. Hazell v Hammersmith and Fulham LBC [1992] AC 1 (HL).

16 See R Pennington, *Company Law* (London: Butterworths, 2001) at 105; H Rajak, op. cit. at 15.

17 See H Rajak, op. cit. at 14-15, citing a reference to the comparative novelty of the statutory company and the consequent difficulty in characterising its transactions in *Colman v Eastern Counties Railway Company* (1846) 10 Beav 1 at 13 (per Lord Langdale).

18 Ibid, at 15, citing the judgments in Colman (supra) and *Attorney-General v Great Eastern Railway Company* (1880) 5 App Cas 473.

19 See P Davies, *Gower's Principles of Modern Company Law* (London: Sweet and Maxwell, 1997) at 203 (this edition is preferred to the later 2003 edition because of the in extensor discussion). See also E Chancellor, op. cit. in Chapter 5 for a full account of the canal and railway booms.

20 For illustrations of cases in this regard, see H Rajak, op. cit. at 15 in footnotes 42-43.

21 Lit. 'beyond the powers.'

and extent of any 'rent-seeking bargain' struck by the company with legislators, thus limiting the scope of the company to profit unduly from the concession.[22]

The judgment in Colman, which introduced ultra vires to the law governing statutory companies, couches its rationale in terms of the protection of investors, albeit that the motives prompting the plaintiff to act stemmed from his involvement in rival commercial interests threatened by the proposed extension of activity, not the first or last occasion, it is suggested, where improper purposes formed the root of litigation in this area.[23] This judgment also settled an important issue related to the scope of the doctrine: it was to be a 'wide' view, striking down any activity not expressly authorised by the constitution, as opposed to a 'narrow' view, which would only prohibit those activities already disavowed by the constitution either expressly or where necessarily implied. This resolve in favour of the most extensive view is said to stem from a concern that the activities of the company might cause irreparable damage to economic and other interests,[24] perhaps one of the earliest instances in company law that the extent of regulation was clearly decided according to the balance to be drawn between the private and public interests at stake. Nevertheless, the impact of this dictum was lessened by the understanding that the members of such companies could choose to ratify the offending transaction, thus bringing it within the capacity of the company once more.[25]

The advent of the registered company in 1844, in the wake of the Gladstone Commission of 1841,[26] did not at first raise the issue of capacity. The assumption was made that this type of company, related in form to the partnership model, enjoyed the contractual capacity of the business partnership. This capacity was co-extensive with that of its members and ratification by unanimity of any contractual act was said to be possible.[27] The deed of settlement company, which came into vogue following the passing of the *Bubble Act*, enjoyed a similar partnership-like structure and consequently any question of capacity was decided as for a partnership whose members were free to elect to change the constitutional arrangements applicable to their affairs.[28] There was a view, however, that suggests that companies formed under the *Joint Stock Companies Act* 1844 (UK) were akin to corporations created under statute. Accordingly, questions of capacity should have been decided as in the case of statutory

22 See M Whincop, *An Economic and Jurisprudential Genealogy of Company Law* (Aldershot: Ashgate, 2001) at 65.

23 See H Rajak, op. cit. at 17-18.

24 Ibid, at 18. The issue of 'wide' or 'narrow' constructions continued to bedevil many of the cases that ensued.

25 See P Davies, op. cit. at 203.

26 This Commission was instituted to deal with the problem of certain heavy industries that did not have access to the mechanism of incorporation through Act of Parliament because their petitions were not deemed worthy of Parliament's interest. It recommended the availability of incorporation through registration.

27 See S Griffin, *The Rise and Fall of the Ultra Vires Rule in Corporate Law* (1998) 2 MJLS 5 at 6.

28 See L Sealy, op. cit. at 145.

companies formed under other Acts of Parliament, no logical distinction separating them. Nevertheless, as historical descendants of the unincorporated joint stock companies, where the objects merely served to limit the authority of directors vis-à-vis the shareholders and not third parties, there also seemed to be no reason why registered companies should be treated in a way that would limit their capacity in any form.[29] Despite the level of uncertainty which diametrically opposed views such as these would have engendered, the courts do not seem to have been greatly perturbed.

The problem subsequently arose because the *Limited Liability Act* 1855 (UK), whose enactment was much delayed because it was considered to promote fraud and escape from debt, created the conditions in which it became possible for members of the company to limit their liability towards third parties, an invidious position for creditors to be in. The argument was that, as long as companies retained an unlimited capacity to act, it was perfectly proper for shareholders to elect to change the objects of the company. This was because they bore the risk of contributions to the company in the event of business failure and any change did not necessarily have an impact on creditors other than as part of the ordinary assessment of risk deriving from normal operations of the market. However, to permit unrestricted changes in the business activities of the company in situations where risk had effectively passed to the creditor seemed to be unfair on the creditor. The legislature responded in the shape of the *Joint Stock Companies Act* 1856 (UK), whose passing was stated as being necessary to protect the interests of existing and prospective investors against the misuse of corporate capacity.[30]

The Act replaced the deed of settlement with new constitutional documents called the memorandum and the articles of association. Part of the requirements for the memorandum was that it should contain an objects clause, delineating the purpose for which the company was founded.[31] Once a company formally stated its objects, it became possible for control to be exercised by the courts insofar as a business transaction fell outside the powers the company enjoyed to fulfil these objects. There were, nevertheless, problems with the stipulation, particularly the omission of any faculty to alter the objects once stated or to prohibit amendments, a situation that seemed to undermine the object of the exercise.[32] Some relief came in the shape of the *Companies Act* 1862 (UK), a piece of consolidating legislation that stated conclusively that a company's memorandum could not be altered save in limited instances.[33] Nevertheless, the new Act did not resolve the remaining ambiguity over the scope of the objects clause and whether extensive objects clauses were effective at clearly

29 See R Pennington, op. cit. at 106-107.
30 See S Griffin, op. cit. at 6.
31 This provision is the ancestor of the modern day section 2(1)(c), Companies Act 1985.
32 See S Griffin, op. cit. at 6-7.
33 To effect a change of name or a reorganisation of share capital (Section 12). This restriction remained until the passing of the *Companies (Memorandum of Association) Act* 1890.

communicating the capacity of the company to would be transacting parties.[34] The inevitable result was that the courts would have to provide guidance, which arrived in the shape of the ruling in *Ashbury*.[35]

In *Ashbury*, the company, having obtained a concession granted by the Belgian Government, contracted with Riche, a railway contractor, to build a railway between Anvers and Tournai. Following part performance of the contract and having paid Riche some moneys, the company experienced financial difficulty and sought to palliate this by allowing some of the directors to take over the contract in a personal capacity.[36] When the company wanted to disclaim the contract, Riche sued for breach of contract. The company pleaded lack of capacity rendering the contract void ab initio, pointing to the terms of its own memorandum. Riche counterclaimed that the wording of the memorandum, which used the term 'general contractors' was wide enough to cover the transaction and, further, that the shareholders had approved the contract and accordingly must be taken to have ratified it. The House of Lords was being asked to choose effectively between rival interpretations of the 1862 Act, the first being that companies should be deemed to have all the natural powers unless restricted, a construction similar to that applying to charter companies, and the second, that only those matters expressly or by necessary implication authorised could form the basis of the company's capacity.[37] The House of Lords held that the contract was indeed void as being ultra vires the company and that the ratification, if indeed it could take place, was ineffective.

There were two other consequences of the decision, notably the reliance in the House of Lords on a point of construction using the ejusdem generis rule meant that extensive objects clauses would be construed, not literally, but to give effect to a primary purpose (the substratum of the company) and, further, the decision confirmed that the type of ultra vires to be applied to the company was of the wide variety. This point was of considerable import because of the Act's prohibition on altering the objects clause and seemed to reflect a policy viewpoint that incorporation was a legal privilege to be conceded only in respect of objects

34 See S Griffin, op. cit. at 7.

35 *Ashbury Carriage Company v Riche* (1875) LR 7 HL 653. There had been two previous occasions on which courts considered the ultra vires rule, for which see H Rajak, op. cit. at 21, citing *Taylor v Chichester and Midhurst Railway Company* (1870) LR 4 HL 628 and *Eastern Counties Railway Company v Hawkes* (1855) 5 HLC 331, in both of which the transactions were held within the powers of the company.

36 Presumably, because they were willing to invest when other participants were not, making it impractical for funds to be channelled through the company in the absence of unanimity.

37 See S Griffin, op. cit. at 7-8. See also H Rajak, op. cit. at 21-22 who states that the opposing interpretations rest on the divergent approaches taken by Mr Justice Blackburn, who saw the question from the viewpoint of the common law, and Lord Cairns, who took as his starting point the statute.

specified at the outset.[38] One view of the decision was that the courts recalled abuses stemming from trafficking in obsolete charters following the *Bubble Act* 1720 (UK) and wished to prevent similar abuses in respect of registered (and statutory) companies.[39] Ostensibly there were also elements of a desire to protect various classes of participants, particularly shareholders and creditors, and of public interest.[40] It is possible to see that shareholders, actual or prospective, are protected by the existence of objects which make it possible to ascertain the consequences of any decision to invest and that creditors would be assured that transactions with the company could only be used in connection with the purposes mentioned in documents that are available for inspection.[41]

An argument can be made, nevertheless, that there was no real need to extend rules, which in the context of statutory companies served a useful purpose, to registered companies. Such an extension was inconsistent with the history of private ordering and contractual freedom that characterised the development of the incorporation form in 1844. Although the risk of transactions being declared ultra vires encouraged promoters to make 'credible commitments' to would be transacting partners to avoid transactions lying outside the company's powers, this was not effective inasmuch as parties remained unable to negotiate optimal contracts because of the difficulty in foreseeing changes in circumstances that would require alterations in the nature of business for efficiency purposes. Yet these changes were not possible because the alteration of objects and ratification of transactions not in compliance with the constitution were not possible.[42] *Ashbury* was also an instance where judicial intervention had an undesirable commercial by-product because it permitted the company to evade an obligation by disclaiming capacity to contract thus putting its contractual partner in the worst position possible of being unable to enforce its rights, except in limited instances under restitutionary principles.

It seemed to be an impractical solution because it placed the onus on contracting parties to read the constitutional documents prior to every transaction and satisfy themselves that their contracting partners had the semblance of contractual capacity, a position that was never entirely without its risks. The development of the constructive notice doctrine, deeming that parties were taken to have knowledge of the contents of memoranda, merely added to this.[43] This was

38 See J Farrar and B Hannigan, *Farrar's Company Law* (London: Butterworths, 1998) at 100, where the view is taken that this seems unrealistic as a policy choice because of the faculty given to companies to freely choose their objects.

39 See L Sealy, op. cit. at 145; P Davies, op. cit. at 203.

40 See J Farrar and B Hannigan, op. cit. at 100.

41 See S Griffin, op. cit. at 8, where he argues that this protection is illusory because creditors, unless secured, could not obtain injunctions to restrain ultra vires transactions nor could they apply for winding up based on a failure of the company to adhere to its 'substratum.'

42 See M Whincop, op. cit. at 65.

43 See P Davies, op. cit. at 206-207. For an instance of the notice doctrine applying in a manner that produced an inequitable result, see *Re Jon Beauforte (London) Limited* [1953] Ch 131.

economically inefficient because the company incurred lower information costs in this respect and any benefit to creditors by restraining deviation from the objects was offset by the costs imposed on short-term creditors.[44] It was a decision from the excesses of which the courts were in time to retreat, but not without the occasional rearguard action to deal with the inevitable responses from companies and their advisors keen to mitigate the damaging effects of the doctrine by the judicious use of drafting techniques.

The Retreat from *Ashbury*

The immediate consequence of *Ashbury* was careful consideration in respect of the drafting of objects clauses. The succinct models provided in the Tables annexed to various Companies Acts were eschewed and there instead grew the practice of specifying 'a profusion of all the objects and powers that the ingenuity of [company] advisers could dream up'.[45] This came to be known as the 'exhaustive list syndrome.' In economic terms, this reaction to *Ashbury* is entirely consonant with the 'vitality of private ordering' inherent in the common law and to the role of the corporate lawyer as a 'transaction cost engineer'. Although the initial cost of developing memoranda could be substantial, the impact as a form of marginal transaction cost was low given the spread of the models through the use of precedents.[46] In response, however, the courts would use two techniques to set limits on the proliferation of clauses. The first was to distinguish between objects and powers and to state, in an application of the ejusdem generis rule, that powers could only be used in furtherance of the objects.[47] The second was to locate, even where only objects were concerned, the paragraph which appeared to the courts to contain the main or dominant object and to construe all others as ancillary to this main purpose.[48]

The first technique certainly maintained the primacy of objects and the need to specify them in company documents, but did not necessarily avoid prolix and confusing drafting, as was later stigmatised by Lord Wrenbury in the case of *Cotman*.[49] The second technique is reminiscent of the approach in *Ashbury* with respect to the context in which the substratum rule operated. Both seem, however, to be redundant distinctions to make in light of the decision in *Great Eastern*.[50] In this case, the House of Lords extended the wide view of ultra vires to statutory companies. On the facts, which concerned whether the company had the capacity to undertake a transaction involving the manufacture, sale or lease of railway stock, the court was of a view that the company was expressly empowered by its

44 See M Whincop, op. cit. at 65.
45 See P Davies, op. cit. at 203-204.
46 See M Whincop, op. cit. at 65.
47 See P Davies, op. cit. at 204.
48 See J Farrar, op. cit. at 101, citing the authority of *Re Haven Gold Mining Company* (1882) 20 Ch D 151.
49 *Cotman v Brougham* [1918] AC 514. See below.
50 *Attorney-General v Great Eastern Railway Company* (1880) 5 App Cas 473.

constitution. There, obiter, Lord Selborne LC declared that the doctrine of ultra vires should be:

> …reasonably understood and applied and that whatever may fairly be regarded as incidental to, or consequential upon, these things, which the legislature has authorised, ought not… to be held, by judicial construction to be ultra vires.[51]

Although the distinction between powers and objects dates back to *Cotman*, the use of the 'incidental and consequent' qualification does not seem to materially require that they be distinguished. The point is made that to require, in the case of the pursuit of any particular activity, whether it is a means to an end (a power) or an end in itself (an object) to be identified, would be to give rise to 'commercially damaging distinction[s].'[52] Similarly, with respect to the second technique, this requires that the courts identify what they consider to be the main purpose, which might be a factual exercise, based on evidence, or a fortuitous finding, based on a chance selection.[53]

'Cotman' Clauses

The inevitable response to the advancement of these techniques was the development of what came to be called 'independent objects' or 'Cotman' clauses.[54] This was the device of inserting a clause at the end of the memorandum specifying that each objects clause was to be construed as a separate and independent object and that clauses were expressly stated as not to be treated as ancillary to each other.[55] The case involved the activities of the Essequibo Rubber and Tobacco Estates Company, which agreed to underwrite shares in the Anglo-Cuban Oil Company. When both companies subsequently became insolvent, the respective liquidators, Cotman for Essequibo, Brougham for Anglo-Cuban Oil, went to court

51 Ibid, at 478. There is some question as to whether it is proper to regard this case as authority for the position of registered companies, but the assumption made by most commentators is that this is so and it seems that the practitioners considered it to be such as many responded to it by the development of new drafting techniques.

52 See H Rajak, op. cit. at 24.

53 *Re German Date Coffee Company* (1882) 20 Ch D 169 is an excellent example of the consequences of the disappearance of what the court deemed to be the substratum. There was no evidence that the Swedish patent the company had in fact obtained would have been any the less effective for commercial purposes.

54 See J Farrar and B Hannigan, op. cit. at 102, where the authors trace the development of this practice to Sir Francis Palmer in 1891.

55 A typical clause would read: 'None of the sub-paragraphs of this paragraph and none of the objects therein specified shall be deemed subsidiary or ancillary to any of the objects specified in any other such sub-paragraph, and the Company shall have as full a power to exercise each and every one of the objects specified in each sub-paragraph of this paragraph as though each such sub-paragraph contained the objects of a separate Company.'

to determine whether or not Essequibo should be placed on the list of contributories for the other company, Cotman's argument being that the transaction was ultra vires the company. The House of Lords unanimously held that the transaction was indeed within the capacity of the company. Although the House of Lords disapproved strongly of the independent objects clause,[56] the fact that the Registrar of Companies had granted a certificate of incorporation based on the memorandum was held to conclusively bind the court.[57] Nevertheless, the practice was described as 'pernicious' by Lord Wrenbury and Lord Finlay LC was of the view that the relevant Act, the *Companies (Clauses) Consolidation Act* 1908 (UK), should be amended to prevent what the court saw as an abuse of the legislation. In an instructive passage outlining the struggle between the draftsmen and the court, Lord Wrenbury stated:

> There has grown up a pernicious practice of requiring memoranda of association which under the clause relating to objects contain paragraph after paragraph not delimiting or specifying the proposed trade or purpose, but confusing power with purpose and indicating every class of act which the corporation is to have power to do. The practice is not one of recent growth. It was in active operation when I was a junior at the Bar. After a vain struggle I had to yield to it, contrary to my own convictions. It has arrived now at a point at which the fact is that the function of the memorandum is taken to be, 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 its terms. The present is the very worst case of the kind that I have seen.[58]

A consequence of the case was to again throw into focus the distinction between powers and objects, Lord Wrenbury being of the view that:

> 'Powers are not required to be and ought not to be specified in a memorandum. The Act intended that the company, if it be a trading company, should by its memorandum define the trade, not that it should specify the various acts which it should be within the power of the company to do in carrying on the trade.'[59]

Contention over the distinction between powers and objects persisted for many years. A view might be taken that, while Cotman-style clauses remained in vogue, as indeed they have done till the present day, the confusion between power and object was likely to continue. Increasingly, however, the courts have taken a

---

56 Id, where the authors state that in *Stephens v Mysore Reefs (Kangundy) Mining Company Ltd* [1902] 1 Ch 745 a similar clause had apparently been ignored by Mr Justice Swinfen-Eady.

57 See S Griffin, op. cit. at 10, where he is of the view that the consequences of such an acceptance are that the case impliedly abolished the application of the substratum rule, albeit not through any 'judicial concern for its potentially adverse effect on commercial practice.'

58 *Cotman v Brougham* [1918] AC 514 at 521ff.

59 Ibid, at 522.

pragmatic approach, reminiscent of the technique used by the courts to set limits on the proliferation of clauses in the wake of *Ashbury*. This occurred in *Re Introductions*,[60] where it was held that a faculty to borrow money could not of itself be treated as an object but constituted an incidental power, and in Rolled Steel,[61] where Mr Justice Vinelott opted for a rule of construction, stating that:

> The question whether a stated 'object' is truly an independent object or purpose is always a question of construction. Even borrowing and lending moneys are activities capable of being pursued as independent objects… but commonly, where a sub-clause of the memorandum… states that one of the objects of the company is 'to lend or advance' or 'to borrow and raise' it is artificial to construe the sub-clause as anything other than a power conferred for the furtherance of what are in truth its 'substantive objects' or purposes.[62]

The same question of construction is evident in the case of Re: Horsley,[63] where, in holding that the payment of a pension to a former director could constitute a separate object of the company, Lord Justice Buckley stated that:

> It has now long been common practice to set out in memoranda of association a great number and variety of 'objects', so called, some of which… are by their very nature incapable of standing as independent objects which can be pursued in isolation as the sole activity of the company. Such 'objects' must, by reason of their very nature, be interpreted merely as powers incidental to the true objects of the company.[64]

'Subjective Objects' Clauses

A further development, which some authors state predated Cotman clauses,[65] was what came to be known as the 'subjective objects' clause. This provided, usually by a sub-clause at the end of the recital, that the carrying on of any business which in the view of the directors was beneficial to the company would be authorised.[66] Although an early case expressed doubt that the use of

---

60 *Re Introductions Ltd* [1970] Ch 99. For a critique of this approach, see Lord Wedderburn, Unreformed Company Law (1969) 32 MLR 563.

61 *Rolled Steel Products (Holdings) Limited v British Steel Corporation* [1982] Ch 476.

62 Ibid, at 497.

63 *Re Horsley and Weight Limited* [1982] Ch 442. There is a whole line of authority on corporate gifts and gratuitous transactions of which this case is an example. Authorisation in advance by ordinary resolution and disclosure in the directors' report of political and charitable donations is now required by the new Part XA, *Companies Act* 1985, inserted by the *Political Parties, Elections and Referendums Act* 2000.

64 Ibid, at 445.

65 See J Farrar and B Hannigan, op. cit. at 102, citing *Re Peruvian Railways Company* (1867) 2 Ch App 617.

66 A typical clause would read: 'To carry on any other business or activity of any nature whatsoever which is in the opinion of the directors capable of being advantageously

such a clause came within the prescription of the constituting Act,[67] because of the practice of the Registrar of Companies in accepting memoranda, the courts felt themselves constrained, just as in *Cotman*, in having to accept their essential validity. *Bell Houses*,[68] where the issue at stake was whether commission was payable for information as part of a property development transaction and whether it was ultra vires for the plaintiff to request it, is modern authority for the proposition that these clauses are acceptable, provided that the directors honestly form the view that the advantage in pursuing the transaction is in connexion with and ancillary to the main business of the company.[69] *Bell Houses* is viewed as sounding the death-knell for the ultra vires doctrine, the use of these drafting devices appearing 'to destroy any value that the ultra vires doctrine may have had as a protection for members or creditors; it had become instead merely a nuisance to the company and a trap for unwary third parties.'[70] Subjective objects clauses are now to be frequently found in memoranda, where, juxtaposed to Cotman clauses, they attempt to give the widest latitude to companies to conduct their affairs.

Apart from the battle of the forms, represented by the drafting techniques employed and the responses the courts gave to them, the retreat from *Ashbury* is also represented by the qualification on the use of the ultra vires doctrine to limit this to issues of capacity and not to include the mere exercise of powers by directors, even if wrongful or mistaken. This is reflective in part of the difficulty courts had in distinguishing between objects and powers, but is also the problem generally with ultra vires, in that it is used in a number of related, but distinct, senses to cover questions of capacity, questions of excess of authority by the institutions of the company as well as instances of breach of statutory prohibitions.[71] In particular, the lack of a clear distinction between the first two categories in the early cases led to the characterisation of activities not immediately geared to securing the profitability of the company to be of necessity ultra vires, a position that immediately undermines charitable gifts, political donations and philanthropic gestures. The courts later interpreted ultra vires narrowly to envelop only the question of capacity and left issues of what were in

---

carried on in connection with or ancillary to any business of the Company hereinbefore or hereinafter authorised.'

67 *Re Crown Bank* (1890) 44 Ch D 634.

68 *Bell Houses Limited v City Wall Properties Limited* [1966] 2 All ER 674.

69 There is a view that the court did not in fact formally settle the issue of the subjective clause, for which see P Pettet, Unlimited Objects Clauses? (1981) 97 LQR 15 at 16. However, the judgment of Lord Justice Danckwerts rhetorically asks why the bona fide opinion of directors should not be binding (at 683) and Lord Justice Salmon points to the plain and obvious meaning of the words of the clause, which he refuses to construe any differently (at 687).

70 See P Davies, op. cit. at 204, who suggests that, although companies could readily change their objects, omission to do so could still have fatal consequences for all parties to a transaction.

71 Ibid at 202-203. In *Ashbury*, Lord Cairns suggested the use of the terms ultra vires, extra vires and illegality respectively to distinguish between these categories.

effect excess of authority or illegal exercise of powers to be decided by reference to the ordinary law governing directors' breach of duty to act bona fide in the interests of the company.[72] Substantial agreement is to be found in the view that the abuse of powers doctrine, which was clearly set out in *Re David Payne*,[73] was subsequently misinterpreted and confused with the ultra vires rule in cases beginning with *Re Lee Behrens*,[74] only being resolved at a much later date by the line of authority stemming from *Charterbridge*[75] and including *Rolled Steel*.[76] This episode is illustrative of the unsatisfactory state of the ultra vires doctrine that 'doomed [it] to a slow and sometimes painful demise almost from the time of its strongest judicial support.'[77]

Reform Initiatives and Legislative Responses

In 1945, the Cohen Committee, tasked with the updating of companies legislation that saw the enactment of the Companies Act 1948, proposed that it should be made easier for companies to alter their objects clauses by special resolution.[78] It is argued that this reform failed to protect third parties in situations where alterations to objects had not been made to ensure the company had the requisite capacity, potentially allowing the company itself to set up ultra vires as a bar to its performing the contract.[79] The committee also made the suggestion that the doctrine as a whole should be abolished as regards third parties, by giving the company the powers of a natural person, but would be retained as an internal doctrine, enabling control by the members of the company

72 Ibid at 205. There is in fact an important distinction to be made between these two categories, in that, prior to 1890, ultra vires acts were void and unratifiable, while excess of powers was voidable but ratifiable. Even after 1890, 'ratification' of ultra vires acts was only possible inasmuch as the memorandum could be altered to restate the objects.

73 *Re David Payne* [1904] 2 Ch 608. The issue here was whether a transaction within the company's capacity which ended up pursuing an activity subsequent outside the objects rendered the transaction itself ultra vires.

74 *Re Lee Behrens and Company Limited* [1932] 2 Ch 46. This case concerned a pension held to fall within an implied power to reward employees, but ultra vires because not a bona fide transaction for the benefit of the company.

75 *Charterbridge Corporation v Lloyds Bank* [1970] Ch 62. This involved the plaintiff asking the court to declare that the charge, concede by a third party to the defendants, was ultra vires as being security, not for the third party, but for other companies in a group controlled by the same individual.

76 See the extensive discussion in S Griffin, op. cit. at 11-17. See also P Davies, op. cit. at 205 in footnote 19, where he laments the use by courts of the term ultra vires to describe unlawful reductions of capital (the third use of ultra vires noted above).

77 See H Rajak, op. cit. at 30-31.

78 Report of the Committee on Company Law Amendment (1945) Cmd 6659 at paragraph 12. The proposal became section 5, *Companies Act* 1948 (UK).

79 See S Griffin, op. cit. at 17, where he is of the view that this could occur where the proposed venture becomes unattractive or a burden because of a change in the company's financial circumstances.

to carry on as a feature of the balance of powers between shareholders and directors.[80] This reform was not enacted, ostensibly because the reform was not accompanied by the abolition of the constructive notice doctrine, whose utility the government of the day wished to retain.[81] The Jenkins Committee in 1962 recommended abandonment of the constructive notice rule by the introduction of rules protecting persons dealing with the company in good faith, subjecting liability to actual knowledge of the contents of the memorandum except where the third party 'honestly and reasonably' failed to appreciate the memorandum prevented the company from transacting. Curiously, it did not recommend abolition of the ultra vires doctrine itself.[82]

The Impact of the European Community

Reform in a substantial way had to wait for the United Kingdom's entry into the European Community (later Union). Within the European Union, the primary context for a considerable number of measures in the company law field is provided by the powers in Article 44(2)(g) of the EC Treaty, which are essentially ancillary to the rights of free movement for companies inherent in Articles 43 and 48.[83] Progress on work reliant on this legal basis began early on in the life of the European Community but has tended to concentrate on elements of the framework for company operations, including matters such as issues of share allotment and pre-emption rights, listing particulars, format of accounts and qualification of auditors as well as disclosure of information and there have been to date some nine Company Law Directives in these mainly technical areas. The First Company Law Directive, enacted in 1968,[84] predated the United Kingdom's accession and had to be brought into force by the European Communities Act 1972. The Directive provided that acts done by the organs of a company will bind the company even if the acts are not within the company's objects, except where the acts exceed powers that the law confers or permits to be conferred on those organs.[85] Dealing with the position of third parties, the Directive went on to state that any limitations on the powers of the organs arising under its statutes (articles) or decisions of the competent organs may not be set up as against third parties even where there has been disclosure of the relevant facts.[86] However, individual member states could provide that companies escape liability where they can prove the other party knew or could not have been unaware that the transaction was beyond the company's objects, but that disclosure alone would not

80 See J Farrar and B Hannigan, op. cit. at 108; S Griffin, op. cit. at 17-18.
81 See L Sealy, op. cit. at 146.
82 Report of the Company Law Committee (1962) Cmnd 1749 at paragraph 42.
83 See S Deakin, Regulatory Competition versus Harmonisation in European Company Law, ESRC Centre for Business Research, University of Cambridge Working Paper No. 163 (March 2000) at 5.
84 Council Directive No. 68/151/EEC (OJ 1968 L65/8).
85 Ibid Article 9(1), paragraph 1.
86 Ibid Article 9(2).

constitute sufficient proof of the other party's state of knowledge.[87] The transposition of the Directive's terms into British law through the 1972 Act provided that any transaction decided on by the directors of the company was deemed to lie within the capacity of the company and free from any limitation under the company constitution in favour of any person dealing with the company in good faith.[88] Any party to a transaction with a company was presumed to have acted in good faith unless proof to the contrary was brought and was not bound to enquire into the capacity of the company or into any limitations on the power of directors to bind the company.[89] It is evident that the draftsman of the Act thought that the two sub-sections complied with the terms of the Directive and accordingly effected the abolition of the ultra vires and constructive notice doctrines respectively.[90]

A number of problems, however, were identified and the introduction of the domestic provision was said 'to add a complicated gloss to the ultra vires doctrine.' This was because the section simply acted to protect a limited class of persons dealing with the company, it introduced a requirement of good faith absent from the Directive and it stipulated that the transactions covered must emanate from the directors.[91] This last requirement, in particular, was to ignore the terms of the Directive that spoke only of the organs of the company, a term that encompasses in the civil law, from which the Directive rules derive, any duly mandated representative of the company.[92] Similarly, the use of the terms 'dealings' and 'transaction' was radically different to the terminology in the Directive, preferring 'acts.' It is arguable that the Directive was wider in scope because it covered all acts of the company, not just those in contractual instances, as the domestic law definitions were held to imply.[93] The good faith requirement, although also used in the civil law, did not appear in the final draft of the Directive because of difficulties over differing interpretations between civil law countries familiar with its use and, according to the commentators, is in any event very different from the concept as used in the United Kingdom.[94] The impact of this requirement, in particular, was to bring about the confusion inherent in the decision in *TOSG Trust Fund*,[95] where the judge held that the impact of section 9 was to remove the constructive notice doctrine. Notwithstanding this, he also held

87 Ibid Article 9(1), paragraph 2.
88 Section 9(1), European Communities Act 1972.
89 Ibid section 9(2).
90 See P Davies, op. cit. at 207-208; S Griffin, op. cit. at 20.
91 See J Farrar and B Hannigan, op. cit. at 109. See P Davies, op. cit. at 208, where he stats that the apparent failure of the Directive to protect the company from third parties raising ultra vires against it stems from the lack of such a procedure in the civil law countries concerned.
92 Ibid, at 110, where the authors are of the view that the law in the United Kingdom has never fully accepted the organic theory of company law, as practised in e.g. Germany. See also Article 2 of the Directive.
93 *International Sales and Agencies Limited v Marcus* [1982] 3 All ER 551.
94 See J Farrar and B Hannigan, op. cit. at 110.
95 *Barclays Bank Limited v TOSG Trust Fund Limited* [1984] BCLC 1.

that the requirement for good faith acted so as to prevent a defence, based on no notice being given, from succeeding, where this was tainted with a lack of honesty in the third party's dealings with the company. Commentators are united in stating that the purported reform of ultra vires was highly unsatisfactory.[96] In fact, there are also views suggesting that the transposition of the Directive into domestic law was highly defective.[97] The subsequent consolidation of the law in the *Companies Act* 1985[98] did not change very much and the issue remained outstanding until the enactment of the *Companies Act* 1989 (UK).

The 1989 Reforms

The 1989 reforms came in the wake of a consultative report released by the Department of Trade and Industry in 1986.[99] This report recommended that companies should be given unlimited capacity and should not have to state their objects in the memorandum, thus effectively putting an end to ultra vires. These reforms, based on a comparative analysis of the position in other Commonwealth countries, would have been quite straightforward and would have finally laid the doctrine to rest. Unfortunately, what was to become the *Companies Act* 1989 was an omnibus text, incorporating a number of disparate and unrelated domestic and European matters. Although lobbying by Department of Trade and Industry officials had secured reform of ultra vires as one of the topics to be dealt with by the text, it became clear that the document was poorly organised and failed to provide a coherent structure for the required reforms. It underwent numerous amendments during its progress through Parliament, which was hurried because of the pressures of the impending end to the legislative session. As a result, the final document 'suffered from significant shortcomings'.[100] Nevertheless, the Act attempted to effect two things, first, changes to the structure of corporate capacity through the introduction of what became known as the 'single objects' or 'general trading' clause and, second, the removal of the relics of the ultra vires rule.

The single objects clause was geared towards avoiding the lengthy drafting of objects clauses that had become an art form and which was largely meaningless because of the inclusion of most conceivable powers and objects for the average company rounded off by Cotman and Bell Houses clauses. The section introducing the single objects clause provides that companies may state that their object is to carry on business as a general commercial company. The provision deems that the

---

96 See J Farrar and B Hannigan, op. cit. at 112; J Farrar and M Powles, *The Effect of Section 9 of the European Communities Act* (1973) 36 MLR 270; D Prentice, Section 9 of the European Communities Act (1973) 89 LQR 518.

97 See D Wyatt, *The First Directive and Company Law* (1978) 94 LQR 182.

98 Section 35, Companies Act 1985.

99 Reform of the Ultra Vires Rule: A Consultative Document (1986) DTI, also known as the Prentice Report, after its author Dr (later Professor) Dan Prentice.

100 See B Cheffins, *Company Law: Theory Structure and Operation* (Oxford: Oxford University Press, 1998) at 186-187. See also N Grier, *The Companies Act 1989 – A Curate's Egg* (1995) 16 Co Law 3.

definition will encompass the carrying on of any trade or business whatsoever and that all powers to do things incidental or conducive to the attainment of the object are to be implied.[101] As a species of reform, it stopped short of granting companies full corporate capacity, as it did not avoid the requirement contained in the Act that companies continue to state objects.[102] Some of the reasons advanced for this state that difficulties over the status of charitable companies and public limited companies, the latter being required under the terms of the Second Company Law Directive to have objects,[103] prevented wholesale reform.[104]

The structure of the clause is reminiscent, insofar as the all trades and business element of the section is concerned, of the Bell Houses clausal structure, albeit without the subjective element, and contains a phrase implying all necessary powers that is in accord with the decision in the Great Eastern case. However, most commentators are of the view that this particular reform was ineffective, being of 'limited practical benefit'[105] and only a 'well-meaning attempt'.[106] In fact, there were fears expressed that the clause would just become subsumed into the prolix drafting evident in modern day memoranda by turning up as another clause, perhaps, as in Bell Houses, couched in a subjective fashion by being made dependent on the opinion of the directors.[107] Part of the problem might well be that the clause was regarded as failing to resolve all the difficulties inherent in creating an exhaustive definition of the activities that would be encompassed within its scope.[108] A further view was that the caution of legal advisers, drafting with a view to avoiding litigation, militated against the use of a definition that might throw up challenges precisely because of its simplicity.[109] Nevertheless, it was possible that familiarity over a long period with the concept of the clause and its purpose might well promote its use, with the concomitant benefit of eliminating the use of lengthy objects clauses.[110]

With respect to the relics of ultra vires, the 1989 reforms provided a new formula by stipulating that the validity of any act was not to be called into question on the ground of lack of capacity arising from anything in the company's memorandum. The onus was placed on directors, nevertheless, to observe the

---

101 Section 3A, *Companies Act* 1985 (inserted by section 110, Companies Act 1989). A substituted section 4 of the principal Act simplifies the conditions in which amendments to objects may be made.

102 Ibid, section 2.

103 Article 2(b), Council Directive No. 77/91/EEC (OJ 1977 L26/1).

104 See P Davies, op. cit. at 208-209, who is of the view that the requirement could be generally removed, subject to exceptions for these types of companies.

105 See E Ferran, *Company Law and Corporate Finance* (Oxford: Oxford University Press, 1999) at 90.

106 See L Sealy, op. cit. at 171.

107 See P Davies, op. cit. at 209-210.

108 See S De Gay, *Problems Surrounding Use of the New Single Objects Clause* (1993) 137 SJ 146.

109 See N Grier, *UK Company Law* (Chichester: Wiley, 1998) at 89-91.

110 Ibid, at 90. There seem to be no reliable statistics on the relative incidence of these clauses that would support or counter the above assertion.

limits of the powers in the memorandum in transacting and members of the company could choose either to ratify the offending transaction or to bring proceedings to restrain the act, except where the act was in fulfilment of a prior legal obligation entered into by the company.[111] Commentary on these reforms suggest that, although full capacity was not granted to companies, the new provisions are consonant with those enacted in Canada, where the aim was to limit prolix drafting and to channel ultra vires into becoming solely a question of directors' authority.[112] The reforms are not perfect, some criticism having been emitted about the impact of the provisions which retrace section 9(1) of the *European Communities Act* 1972 and continue to subject protection from a lack of authority by the directors to third parties acting in good faith. Nevertheless, bad faith is not to be implied by mere reason of knowledge of whether the transaction is outside the powers of the directors and third parties are not bound to enquire about any defect in powers.[113] The reforms as a whole are described as 'virtual abolition' of the ultra vires rule, but, although an improvement on the rule prior to the *Companies Act* 1989, still present some disadvantages.[114] The effect is mainly to internalise the doctrine by keeping it as a mechanism for shareholders to enforce obligations by directors to adhere to the terms of the constitution, whilst protecting the interests of third parties contracting with the company. In this, it still served to protect both of these categories against the abuse of powers by directors. Nevertheless, the impact of the provisions on restraint makes it difficult for shareholders to do anything other than obtain an injunction against repetition of the offending act because of the stipulation that protects acts in fulfilment of a prior legal obligation of the company.[115]

The Way Forward

The Company Law Review, which began in 1998, has addressed the questions of ultra vires as part of the overall objective of simplifying the structure of United Kingdom law. This it sets out to do by promoting competitiveness, striking the proper balance between the interests of participants in corporate life so as to promote 'straightforward, cost-effective and fair' regulation, and promoting consistency, predictability and transparency in the law.[116] The final report, released in 2001, recommended that companies should have a single constitutional document. Furthermore, companies should have unlimited capacity

---

111 Section 35, *Companies Act* 1985 (as amended by section 108, Companies Act 1989). Exceptions still remained for acts by charitable companies and those involving dealings with directors.

112 See J Farrar and B Hannigan, op. cit. at 113.

113 Idem, describing the impact of sections 35A and 35B, Companies Act 1985.

114 For a detailed analysis of the reforms, see P Davies, op. cit. at 211-217.

115 Ibid, at 212.

116 *Modern Company Law for a Competitive Economy: Final Report* (2001) DTI at 3 (paragraph 1.3). All review documents are available at < www.dti.gov.uk/cld/review.htm>.

so that third parties would no longer have to be concerned with whether the constitution contained an objects clause. Nevertheless, the proposals would include new provisions clarifying when directors would be deemed to have authority or delegate authority to others to bind the company.[117] The proposed bill, designed to replace the Act of 1985, would include a clause removing the last vestiges of the ultra vires rule and to ensure that challenges could not be brought to the acts of any company on the basis of the powers being exceeded. The intention is that the effect of an illegal act will be governed by the rule or statute that creates the illegality. It is also the intention that companies will no longer be permitted to include objects in a constitution that serve to limit its capacity.[118]

The position of third parties and directors in relation to contracts, currently contained in sections 35A and 35B, will be maintained with some slight amendments removing the good faith requirement and dealing with the issue of ostensible authority.[119] It was very clear in the review that there was a European dimension to the proposals concerning objects clauses, as the report notes the Second Company Law Directive requirements in respect of public companies, while expressing the hope that the Directive could be amended in due course to allow for abolition of objects for these companies. The proposal remains, however, with the aim of abolishing objects as limits on legal capacity for all companies.[120] The White Paper, constituting the Government's response, states that the Government considers both objects clauses and the existence of two separate constitutional documents to no longer serve any useful purpose. While companies could still retain objects,[121] their effect would be limited to internal disputes between directors and members. While members could entrench clauses in the single constitutional document that would be required, protecting clauses deemed of great interest, outsiders doing business with the company would not have to worry about the its contents. [122] The Bill accompanying the White Paper accordingly contains a Clause 1(5) conferring unlimited capacity on the company and a Clause 17 governing the exercise of a company's powers by directors and those mandated on behalf of the company. The enactment of these provisions,

117 Ibid, at 213 and 215 (paragraphs 9.4 and 9.10 respectively). The special position of charitable companies, one of the reasons behind the failure to proceed fully with the recommendations of the Prentice Report as regards corporate capacity, would be safeguarded, there being proposals to introduce a new form of incorporation for these companies.

118 Ibid, at 417 (paragraph 16.5), which goes on to state that section 35, Companies Act would be abolished save for subsection (4) dealing with charitable companies.

119 Ibid, at 427-428 (paragraphs 16.57-16.64).

120 Ibid, in Annexe B at 339. It may be doubtful that this could occur, precisely because the European dimension would militate against unilateral abrogation of a rule that has been harmonised at European level.

121 Presumably, these could not be limitative in nature. Transitional arrangements would also have to be introduced for companies with objects registered under present legislation.

122 *Modernising Company Law* (2002) Cm 5553 at paragraphs 2.2-2.3.

which are expected to occur sometime in 2004-2005, would do much to end the current problems attendant on judicial application of the ultra vires doctrine.

Summary

Ultra vires began as a form of judicial creativity when judges were faced with the need to protect parties to transactions engendered by corporate activity. Companies were at the time comparative novelties and the desire was to seek to protect against the consequences of fraud and particularly the nefarious activities of promoters and entrepreneurs. For that reason, the legislature supplemented the contractual nature of the company with the requirement for objects in the memorandum, to permit parties to ascertain whether the goal of their investment, in the case of shareholders actual or prospective, or the credit they conceded, in the case of creditors, were buttressed by the company's capacity to enter into contracts that embodied their requirements. Creating objects naturally created the conditions in which courts would seek to control adherence to or deviation from them. The sanctions were harsh, rendering contracts in breach of the statutory requirements void and unenforceable. What the courts, however, were to do, would lead unfortunately to a morass of cases with contradictory rulings that served to drown the original aim of the doctrine, to protect, in a sea of qualifications and exceptions that made the position of would-be contracting parties, not to mention that of the company itself, difficult to determine with any certainty. It was a species of Victorian engineering that bolted on to the superstructure devices that obscured underlying features and strained the foundations to breaking point.

The inevitable result was to lead parties to the use of drafting techniques, hoping to mitigate the effects of the law by providing for all eventualities and, progressively, as the courts dealt with examples of these techniques, to developing further techniques to avoid the consequences of challenges to the first set. Judges are said to have relished these challenges because they were unsympathetic to privately developed contracts and provisions and viewed with much scepticism the attempts of parties to avoid what were seen as eminently sensible legislative requirements.[123] This was a game that neither side would win as it was potentially infinite in its extension. Its existence, however, continued to render the situation of parties precarious: though they continued to contract, it was in the hope that there would be no challenges. Those that did occur tended to occur when parties wanted to get out of situations that became unfavourable. Rather than accept the consequences of a bad bargain, they sought to avoid it by pleading incapacity. The tendency of judges, from an early point, to confuse lack of capacity with an abuse of powers by the directors, assisted in permitting the unscrupulous to evade liability. This had a profound effect in creating an inherent instability in transactions.

---

123 See B Cheffins, op. cit. at 296-297.

With the defects in the ultra vires doctrine evident, it is no surprise that there were calls from an early stage for its abolition. It is instructive that in almost all other jurisdictions, predominantly Commonwealth ones, that inherited the ultra vires rule, it has been amended, restricted or avoided in some form.[124] In many of these jurisdictions, the legislatures have gone as far as enacting provisions granting full capacity to corporations.[125] Nevertheless, the reforms that did occur in the United Kingdom did not seem to be effective and frequently raised more questions than they resolved. This was particularly true of the 1972 reforms, which were defective. Although there is a view that the United Kingdom's treaty obligations prevented it from pursuing reforms to the same extent as other jurisdictions,[126] a matter that the Government was conscious of in its review, it now seems that United Kingdom law will at last fall into line with developments outside Europe and seek to abolish the restrictions inherent in the ultra vires rule by granting full capacity to both private and public companies.[127] Paradoxically, it is argued that removing the requirements to state objects will enhance the use of the constitution as a mechanism for control by the shareholders. This is because the tendency for prolix drafting and the inclusion of comprehensive objects prevents effective control when everything is permissible. Thus, the introduction of full capacity together with retained specific objects would allow shareholders to focus on the activities mentioned and enhance any opportunities to use the statutory mechanisms for control and enforcement.[128]

The latest proposals for reform are certainly a long overdue step and will do much to ensure that the company law in this jurisdiction remains up to date and can serve usefully as an example to other jurisdictions seeking to modernise their regulatory regimes for companies with view to competing effectively in the increasingly globalised market. It marks the beginnings of the last stage of the slow death of ultra vires, first predicted in 1966,[129] that may bring to an end this unhappy chapter in British legal history. It will not, however, completely disappear while there remain jurisdictions around the world with legislation inherited or descended from early United Kingdom enactments and common law rules retaining the concept of ultra vires, but its history will be one elsewhere and will no longer concern any but the legal historian or comparative lawyer. In the

---

124 See, inter alia, section 11, *Companies (Guernsey) Law* 1994, article 18, *Companies (Jersey) Law* 1991, section 8, *Companies Act* 1963 (Ireland), section 20, *Companies Act* 1965 (Malaysia), section 17(1), *Companies Act* 1993 (New Zealand), section 25, *Companies Act* 1967 (Singapore), section 36, *Companies Act* 1973 (South Africa).

125 See, inter alia, section 124(1), *Corporations Act* 2001 (Australia), section 16, *Companies Act* 1993 (New Zealand), section 15(1), *Business Corporations Act* 1985 (Canada). See also section 1(3), *Limited Liability Partnerships Act* 2000 grating unlimited capacity to this new type of business vehicle in the United Kingdom.

126 See E Ferran, op. cit. at 93.

127 See L Sealy, op. cit. at 171, where he ask rhetorically whether a statement that the objects of a company are unlimited would comply with the terms of the Second Company Law Directive.

128 See E Ferran, op. cit. at 93-94.

129 See Lord Wedderburn, *Death of Ultra Vires* (1966) 29 MLR 673.

final analysis, if there are any lessons to be drawn from the protracted demise of this subject, it is above all that the task of legislating is an effort that should depend on due consideration being given to the weight of opinion expressed by the many judges, commentators and practitioners whose experience, as here of ultra vires, do much to shape the reforms that are advocated from time to time.