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Corporations

POWERS — ULTRA VIRES — PROBLEMS REMAINING AFTER LEGISLATIVE AND JUDICIAL MODIFICATION OF THE DOCTRINE

Introduction

A literal translation of "ultra vires" is "beyond the powers." As a legal concept, it has application mainly to corporations in testing whether corporate acts are within (intra) or without (ultra) the limited powers granted to the corporation as an artificial creature of the law. A court's conclusion that a particular act is foreign to the purposes for which the corporation was created and, therefore, ultra vires, theoretically makes the action void or voidable. Thus the theory is often employed as a defense for the corporation or other parties involved in a corporate transaction to avoid the legal liabilities attendant to the transaction.

When the rule was strictly applied, the results were often harsh, though the full impact of the rule's logical rigor was averted and softened almost from its inception by the use of estoppel. Even in their search for justice in the individual case, however, most courts were hesitant to violate the precepts of ultra vires; but since its foundations rested upon very questionable assumptions, the strict doctrine has been destined for the legal graveyard. The broadside attack began with a barrage of law review comment¹ which culminated in direct legislative change and indirect judicial disfavor, both of which continue today to contribute to the process of overthrow.

Proceeding upon the premise that any change in a general rule of law requires an adjustment in the conceptual framework of other legal theories that are necessarily related by common factual patterns, it would follow that the destruction of the ultra vires doctrine would have certain effects on the closely interwoven concepts of agency and contract.² It is the purpose of this Note to analyze the consequences of the demise of the ultra vires doctrine in relation to corporate transactions with third parties, and to consider the recent attempts of the courts to digest these results into an established system of legal theory.

I. Background of Legislative and Judicial Modification of The Doctrine

"A corporation, owing its existence to the will of the sovereign, and deriving its powers by grant from that source, can function only in accord with the law creating it."³ This general statement exemplifies a well-established theory of the nature of a corporation's actions and serves as the point of departure for a variety of law concerning acts beyond the corporate powers.⁴ A division of opinion developed early as to the first logical step in the synthesis. A majority of courts concluded that, though a corporation did not have the *authority* to act in certain areas, it did have the *capacity* and, therefore, its ultra vires acts were merely voidable.⁵ The minority asserted that ultra vires acts were void *ab initio* since the corporation had no *power* and, therefore, could have no *capacity* to so act.⁶ This divergence was more pronounced in theory than in practical application.

¹ See bibliography of articles on ultra vires in Stone, *Ultra Vires and Original Sin*, 14 TUL. L. REV. 190, 199, n. 28 (1940).

² An example of this interplay is contained in the common statement of general law that "the corporation can act only through lawful agents authorized and empowered by the charter, stockholders, or board of directors, in the manner provided in its charter, and by-laws, or by statute." *Llano Del Rio Co. v. Anderson-Post Hardwood Lumber Co.*, 79 F. Supp. 382, 390-91 (W.D.La. 1948), *aff'd*, 187 F.2d 235 (5th Cir. 1951).

³ *Jones v. Shreveport Lodge*, 221 La. 968, 60 So. 2d 889, 891 (1952).

⁴ 6 FLETCHER, PRIVATE CORPORATIONS § 2477 (repl. 1950).

⁵ *Bissell v. Mich. Southern Ry.*, 22 N.Y. 258 (1860). See 7 FLETCHER, PRIVATE CORPORATIONS §§ 3473, 3476 (repl. 1950).

⁶ *Trico Electric Cooperative v. Ralston*, 67 Ariz. 358, 196 P.2d 470 (1948), citing at 476 the case usually relied on as containing the rationale for the federal minority rule, *Central Transp. Co. v. Pullman's Palace Car Co.*, 139 U.S. 24 (1891). 7 FLETCHER, PRIVATE CORPORATIONS § 3468 (repl. 1950).

Neither would allow recovery on wholly executory contracts, but both would grant a remedy on partially-executed contracts where benefit had passed; the majority on the theory of estoppel, the minority on the basis of quasi-contract.⁷ While law review comment was conceptually bound to the logical niceties of the two rationales, writers were forceful in questioning the basic foundations of ultra vires.⁸

The first legislative fruits of this agitation against the doctrine occurred in 1915 when a Vermont statute was passed making those ultra vires acts that were authorized or ratified by the board of directors binding on the corporation, if a corporation could have been validly formed under the law to so act.⁹ Since that enactment, four basic types of statutory treatment have evolved:¹⁰

1. Statutes embodying the substance of Sections 10 and 11 of the Uniform Business Corporation Act of 1928.¹¹ The theory behind this law was that first, by codifying in general terms the majority common-law view that corporations have the capacity of natural persons but only the authority to accomplish the purposes contained in their charters, and second, by abolishing the theory that third persons have constructive notice of charter powers, the area would be governed by the general rules of agency law.¹²

2. Statutes having general provisions barring the defense except in cases where the third party had knowledge of the limitations on the charter power.¹³

3. Statutes containing the approach of Section 6 of the Model Business Corporation Act of 1950: "No act of a corporation . . . shall be invalid by reason of the fact that the corporation was without capacity or power to do such act. . . ."¹⁴

⁷ 7 FLETCHER, PRIVATE CORPORATIONS § 3571 (repl. 1950).

⁸ The criticisms generally offered were that the courts, in advancing a fictitious public policy of restricting corporations to acts within their state-created natures, had slighted the public policy of enforcing the obligation of contracts, Carpenter, *Should the Doctrine of Ultra Vires Be Discarded?* 33 YALE L.J. 49, 64 (1923); that shareholder and creditor interests should not be given greater protection against the contract rights of innocent parties than would be afforded by the principles of agency law, Stevens, *A Proposal as to the Codification and Restatement of the Law of the Ultra Vires Doctrine*, 36 YALE L.J. 297, 328 (1927); and that the whole theory was a misinterpretation of legislative intent in creating corporations, UNIFORM BUSINESS CORP. ACT § 11, Comm'rs' Note, 9 U.L.A. 144-45 (1957).

⁹ VT. STAT. tit. 26 § 5789 (1947). See also FLA. STAT. ANN. § 608.50 (1955).

¹⁰ The following classifications are those used in Ham, *Ultra Vires Contracts Under Modern Corporate Legislation*, 46 KY. L.J. 215, 245 (1958). No attempt is made in this Note to discuss the provisions of those statutes relating to shareholder or state actions, but only to those affecting suits between the corporation and third parties.

¹¹ 9 U.L.A. 118 (1957). This is technically a "Model Act" but is referred to as "Uniform" to distinguish it from the Model Act of the American Bar Association.

¹² Comm'rs' Note, 9 U.L.A. 143-50 (1957). The following is a list of such statutes with the dates of enactment in brackets. ID. CODE §§ 30-113, 30-114 (1947) [1929]; IND. STAT. ANN. § 25-202 (Burns repl. 1948) [1929]; KY. REV. STAT. § 271.115 (1956) [1946] (provision for abolition of constructive notice only); LA. REV. STAT. tit. 12 §§ 11, 12 (1950) [1928]; WASH. REV. CODE §§ 23.08.60, 23.80.70 (1951) [1933].

¹³ KAN. GEN. STAT. § 17-4101 (1949) [1939]; MICH. COMP. LAWS § 450.11 (1948) [1931]; MINN. STAT. ANN. §§ 301.11, 301.12 (1947) [1933]; OHIO GEN. CODE ANN. §§ 8623-8, 8623-9 (1934) [1927] (new law enacted in 1955, see note 15 *infra*); Dates of enactment are in brackets.

¹⁴ Prepared by the Committee on Business Corporations of the Section of Corporation, Banking, and Business Law of the American Bar Association, reported in 6 BUS. LAW. No. 1, p. 6 (1950). The following is a list of such statutes with the date of enactment in brackets. ALAS. COMP. LAWS § 36-2A-14 (Supp. 1958) [1957]; D.C. CODE ANN. § 29-905 (Supp. VI 1957) [1954]; ILL. REV. STAT. c. 32 § 157.8 (1957) [1933]; MD. ANN. CODE art. 23 § 124 (1957) [1951]; N.C. GEN. STAT. § 55-18 (Supp. 1957) [1955]; N.D. Sess. Laws 1957, c. 102 § 6; ORE. REV. STAT. § 57.040 (repl. 1957) [1953]; PA. STAT. ANN. tit. 15 § 2852-303 (1958) [1933]; TEX. REV. CIV. STAT., BUSINESS CORP. ACT art. 2.04 (1956) [1955]; VA. CODE ANN. § 13.1-206 (repl. 1956) [1956]; WIS. STAT. §§ 180.06, 180.45 (1)(c) (1955) [1951].

4. Statutes attempting complete abolition of the defense. These statutes are "complete," as opposed to the first three classes in that the possibility of disturbing contract rights of third parties through a shareholder injunction suit is not left open.¹⁵

Though perhaps only one court undertook directly to overthrow *ultra vires*,¹⁶ the principle that *ultra vires* is not favored by the courts or cannot be used to defeat the ends of justice became the general instrument for widening the scope of acts *intra vires*.¹⁷ The importance of judicial disfavor cannot be ignored even in the states having legislation against *ultra vires*, for often the statutes are found inapplicable to the particular corporation or contract involved,¹⁸ and some statutes, notably those following the Uniform Business Corporations Act, are not express in their prohibition of the defense.¹⁹

II. *Common Law Limitations on the Scope of Ultra Vires*

At common law there was a diversity of views on the juristic quality of an *ultra vires* act.²⁰ Under these conditions, when the legislature abolishes *ultra vires* as a defense,²¹ more than a few analytical difficulties²² arise as to the affect of such action on the concept of "illegal contracts." Assuming that the statutes confirm the views of the majority of the courts²³ and legal theorists²⁴ — that acts "merely" *ultra vires* the corporate charter are not also to be considered in the class of illegal acts prohibited by express statute or public policy — the problem still remains as to what corporate acts are expressly prohibited, and, therefore, illegal. These actions would not be affected by the statute abolishing the defense of *ultra vires*.²⁵

Aside from the dichotomy classifying certain wrongful corporate acts as either *ultra vires* or illegal, another distinction was drawn between acts *ultra vires* and those which were merely the irregular exercise of a granted power.²⁶ Despite statutory removal of the *ultra vires* defense, these distinctions remain useful to determine how far such statutes extend in precluding the corporation from defending against its wrongful acts.

Where the officers of a country club contracted to purchase land without fulfilling the statutory requisite of consent by a majority of the members, the Pennsylvania court would not enforce the agreement and held:

15 CAL. CORP. CODE ANN. § 803 (West 1955) [1929]; NEV. REV. STAT. §§ 78.135, 78.035(3) (1955) [1949]; OHIO REV. CODE ANN. § 1701.13 (H) (Page Supp. 1957) [1955], (replacing old law, see *supra* note 13); OKLA. STAT. ANN. tit. 18 § 1.29 (1953) [1947].

16 *Harris v. Independent Gas Co.*, 76 Kan. 750, 92 Pac. 1123 (1907).

17 *Burnett's Lumber & Supply Co. v. Commercial Credit Corp.*, 211 Miss. 53, 51 So. 2d 54 (1951); *Fogelson v. Rackfay Const. Co.*, 195 Misc. 550, 91 N.Y.S.2d 910 (Sup. Ct. 1949).

18 For example, the *ultra vires* section of the Minnesota Business Corp. Act does not necessarily apply to corporations existing at the date of the act. MINN. STAT. ANN. § 301.60 (1953). The California *ultra vires* statute does not apply to a contract made before the statute. *Aitken v. Stewart*, 129 Cal. App. 38, 18 P.2d 988 (1933) (dictum). Special types of corporations are not subject to the *ultra vires* statute contained in general corporation law. 24 *East Sixth St. Corp. v. Co-operative Pure Milk Ass'n*, 79 N.E.2d 239 (C.P. Ohio 1948) (agricultural association).

19 See *Ham*, *supra* note 10, at 234-35.

20 Annot., 1917A L.R.A. 749, 780-82.

21 It must be noted again that many of the statutes are general in nature and do not specifically refer to *ultra vires*.

22 See *Pattison v. Illinois Bankers Life Ass'n*, 360 Ill. 616, 196 N.E. 882 (1935).

23 *Southwestern Gas & Electric Co. v. City of Gilmer*, 123 F. Supp. 11 (E.D. Tex. 1954), *aff'd*, 224 F.2d 794 (5th Cir. 1955); *Stevens v. Boyes Hot Springs Co.*, 113 Cal. App. 479, 298 Pac. 508 (1931).

24 BALLANTINE, CORPORATIONS § 91 (rev. ed. 1946); 7 FLETCHER, PRIVATE CORPORATIONS § 3400 (repl. 1950); STEVENS, CORPORATIONS § 71 (2d ed. 1949).

25 This classification becomes more important with the increase in the amount and complexity of laws governing corporations, especially those laws prohibiting acts which at common law could be considered *ultra vires*.

26 See *Twisp Mining & Smelting Co. v. Chelan Mining Co.*, 16 Wash. 2d 264, 133 P.2d 300 (1943), *cert. denied*, 325 U.S. 837 (1944); 7 FLETCHER, PRIVATE CORPORATIONS § 3402 (repl. 1950); Note, 10 N.Y.U.L.Q. REV. 64, 65 (1932).

[The ultra vires statute providing] in effect, that no conveyance to a nonprofit corporation shall be invalid or fail because the board of directors or officers of the corporation have exceeded any of the corporation's purposes or powers . . . is clearly inapposite [because] . . . the doctrine of 'ultra vires' has application only where the subject matter of the contract is foreign to the purposes for which the corporation was created, not to the improper use of a designated or incidental purpose or power.²⁷

The court cited no authority, but by employing the words "improper use of power," no doubt made reference to the distinction between acts ultra vires and those that are merely irregular exercises of a granted power. The words used, however, are reflective of another related distinction developed by some courts that the mere abuse of power by corporate officials, as opposed to action with total want of power, will not allow the corporation to invoke the ultra vires defense.²⁸ By such distinctions the early courts made a practical division of the concept, thereby limiting the application of the ultra vires defense only to corporate actions with total absence of charter power. While working to the benefit of third parties at common law,²⁹ the distinctions now, as shown by the Pennsylvania case,³⁰ only serve to limit the advantages a third party can gain by statutory abolition of the ultra vires defense, for the new statutes, by virtue of these common law distinctions, bar defenses only to actions with total want of power.

In relying on this distinction to justify exclusion of the ultra vires statute, the court perhaps shied away from classifying the contract as illegal, though it might have done so since the purchase without consent of the members was prohibited by statute. Such a classification would also remove it from the realm of ultra vires theory.³¹ Even if the court did not wish to term it an "illegal" contract, it might have asserted simply that where a specific statute is violated, general principles of interpreting legislative intent control to the exclusion of an ultra vires theory.³² The Pennsylvania court had two legitimate theories on which it could rely:³³ 1) abolition of ultra vires does not apply because improper procedures in exercising a power intra vires are not within its scope; 2) removal of the defense of ultra vires has no effect where an express statute has been violated.³⁴

The second limitation stated above requires further amplification, because even where ultra vires theory is validly applied, there will of necessity always be a remote violation of a statute, since corporate powers are granted under various statutes, and an act outside these specified powers will, by negative implication, be a statutory violation. This fact necessitates a distinction between the nature of the statutory violation involved in an ultra vires act as opposed to the violation involved in an illegal act. The distinction is that the former is one "which does not . . . offend any express statute . . .,"³⁵ or one not "committed in violation of an express statute on a specific subject . . .,"³⁶ while the latter is a direct violation of an express statutory provision. Though this distinction is often drawn, its application frequently varies. The prohibitory form of the statute involved, as opposed to the negative implication of an affirmative grant of power, is not

²⁷ *Schwartz v. Mahoning Valley Country Club*, 382 Pa. 138, 114 A.2d 78, 80 (1955).

²⁸ *Wiley & Foss, Inc. v. Saxony Theatres, Inc.*, 335 Mass. 257, 139 N.E.2d 400 (1957).

²⁹ See ILL. BUSINESS CORP. ACT ANN. 69-71 (2d ed. 1947).

³⁰ For a case in accord with *Schwartz v. Mahoning Valley Country Club*, note 27 *supra*, interpreting statutory consent requirements, see *Jones v. Shreveport Lodge*, 221 La. 968, 60 So. 2d 889, 891 (1952). *But see Texas Co. v. Z. & M. Independent Oil Co.*, 156 F.2d 862 (2d Cir. 1946).

³¹ *Nettles v. Rhett*, 94 F.2d 42 (4th Cir. 1938); *Cass Bank & Trust Co. v. Sheehan*, 97 F.2d 935 (8th Cir. 1938); *Stevens v. Boyes Hot Springs Co.* 113 Cal. App. 479, 298 Pac. 508 (1931).

³² *Vliet, The Oklahoma Business Corporation Act II. A Survey*, 2 OKLA. L. REV. 177, 193-94 (1949).

³³ 1 DAVIES, OHIO CORPORATION LAW 238 (1942).

³⁴ See the dissent in *Kotschevar v. North Fork Township*, 229 Minn. 234, 39 N.W.2d 107 (1949) at 118, 120, criticizing case law on municipal corporations for injecting ultra vires doctrines into situations where they should have no application because express statutory prohibitions are involved. In considering procedural requirements in statutes and by-laws, the distinction between directory and mandatory is made without reference to ultra vires, 7 FLETCHER, PRIVATE CORPORATIONS § 3007 (repl. 1950), though admittedly some courts confuse the issue by including the ultra vires theory. *Id.* at § 3402.

³⁵ *Nettles v. Rhett*, 94 F.2d 42, 46 (4th Cir. 1938).

³⁶ *Southwestern Gas & Elec. Co. v. City of Gilmer*, 123 F. Supp. 11 (E.D. Tex. 1954), *aff'd*, 224 F.2d 794 (5th Cir. 1955).

alone determinative of illegality. A Texas statute entitled "Acts Prohibited"³⁷ is treated as a statute making certain acts ultra vires.³⁸ In a Pennsylvania case, the court refused a taxpayer's action to enjoin a school board from carrying a hail insurance policy with a company prohibited by law from issuing such policies for lack of charter power, holding that, though the statute abolishing ultra vires did not technically apply to insurance companies, the theory of the statute would be applicable.³⁹ The effect given the ultra vires statute in this case compares favorably with an analysis of Michigan cases on insurance contracts before⁴⁰ and after⁴¹ the ultra vires statute in that state.⁴²

An Indiana law says that "no corporation shall make . . . any loan of money . . . to any officer or director. . . ."⁴³ An Indiana court sensibly held that a loan knowingly made to the corporation so that the corporation could loan the money to its president was not void, on the basic reasoning that to hold otherwise would defeat the purpose of the statute, which was to protect the stockholders and creditors from an unwarranted use of corporate funds.⁴⁴ However, the loan from the corporation to the president was treated as an ultra vires act despite the express statutory prohibition.

The solution to this problem of terminology lies in recognizing that when the term "express statute" is used to mark the dividing line between ultra vires and illegality, it is a sliding scale measuring on one side the distance between general and specific prohibition, and on the other, the distance between the public policies of enforcement and avoidance.⁴⁵

Separate laws governing the incorporation of special associations, which make the associations subject to the general business corporation law only to the extent that the latter is not in conflict with any express provision of the special law under which the associations were formed, present another issue focusing on the word "express." An Ohio court, in a somewhat ambiguous opinion, held that the grant of powers to agricultural associations was an "express provision" of the special statute creating the association, so that the law limiting the defense of ultra vires, which was a part of the general corporation law, was not applicable.⁴⁶ California, on the other hand, found that the statute modifying ultra vires was not in conflict with any "express provision" of its law creating agricultural associations.⁴⁷ These cases can possibly be conceptually reconciled by considering the difference in the types of ultra vires statutes involved. While the Ohio statute expressly granted natural capacity with the necessary result that the defense was barred, the

37 TEX. REV. CIV. STAT. art. 1349 (1945).

38 *Pollock Paper & Box Co. v. East Texas Motor Freight Lines*, 145 Tex. 634, 201 S.W.2d 228 (1947), reversing 197 S.W.2d 883 (Tex. Civ. App. 1946). See *Staacke v. Routledge*, 111 Tex. 480, 241 S.W. 994, 998-99 (1922) explaining that general statutory prohibition does not make the act illegal, but only ultra vires.

39 *Downing v. School District*, 360 Pa. 29, 61 A.2d 133 (1948). The rationale employed by the court was that if any losses should occur in the future, the insurance company would be estopped by receipt of premiums to deny the ultra vires nature of the contract. It is submitted that the court overlooked the fact that the suit was brought to enjoin the future operation of the contract which was executory in nature because no benefit of coverage had yet passed to the school board. The court in effect barred the plaintiff from affirmatively asserting ultra vires in the present on the ground that the insurance company would be so barred in the event of loss in the future. In the light of common-law ultra vires rules, this position is erroneous since the school board had not yet received any benefits under the contract. Assuming this was the correct view, the decision in the case actually overthrew the doctrine of ultra vires as it was applied to executory contracts.

40 *Anderson v. Conductors' Protective Assur. Co.*, 266 Mich. 471, 254 N.W. 171 (1934).

41 *Roddis Lumber & Veneer Co. v. American Alliance Ins. Co.*, 330 Mich. 81, 47 N.W.2d 23 (1951).

42 No attempt has been made to analyze the different effects of ultra vires legislation in a state that had followed the majority rule prior to the legislation, as opposed to a state following the minority rule. For example, although the Illinois ultra vires statute does not apply to insurance companies, if it did apply it might not have the same effect that those of Pennsylvania and Michigan had in the above cases, since Illinois precedent has established that such contracts are void because prohibited by statute. *Pattison v. Illinois Bankers Life Ass'n*, 360 Ill. 616, 196 N.E. 882 (1935).

43 IND. STAT. ANN. § 25-212 (1948).

44 *Stadium Realty Corp. v. Dill*, 223 Ind. 378, 119 N.E.2d 893 (1954).

45 See *Staacke v. Routledge*, 111 Tex. 480, 241 S.W. 994, 998-99 (1922).

46 *24 East Sixth St. Corp. v. Co-operative Milk Ass'n*, 79 N.E.2d 239 (C.P. Ohio 1948).

47 *California Canning Peach Growers v. Harkey*, 11 Cal. 2d 188, 78 P.2d 1137 (1938).

California statute, by its terms, bars the defense with the result that natural capacity is factually given the corporation. Thus an application of the Ohio statute could be said to expressly increase the limited grant of powers to the agricultural association and would therefore be in direct conflict with that grant; the terms of the California statute on the other hand would not.

The distinction between those acts of a corporation that are void because against public policy and those merely ultra vires has also defined certain limits on the extension of legislative and judicial disfavor of the doctrine. The Pennsylvania statute did not prevent a court of equity from decreeing a return of pension payments made to a corporation president's widow, since the action was an abuse of discretion constituting waste of company assets;⁴⁸ the Washington statute was ignored in holding a corporation not liable on a promise to pay a hospital bill of a former employee;⁴⁹ and the Michigan statute did not prevent the voidance of a note given for the obligation of a stockholder.⁵⁰ The Pennsylvania statute, however, was held to estop the corporation from pleading ultra vires on a guarantee of an officer's note.⁵¹ Thus, the scope of what is void because against public policy may conflict with an analysis that would bind the corporation on the theory that it is asserting the disfavored defense of ultra vires.

In summary, cases in which a court makes an explicit reference as to why a statute treating ultra vires does not apply are rare. Where an express statute is violated, theories of illegality, intent of the statute, and public policy tend to exclude the ultra vires doctrine. Statutory and judicial disfavor is for the most part manifested in circumstances where the issue is purely whether the act is within or without the chartered purposes and objects of the company.⁵² However, ultra vires theories are occasionally used to grant warranted remedies in situations where illegality concepts⁵³ would be inconsistent with the remedy granted. The softening of old rules,⁵⁴ by rejecting the principle that courts must refuse to look upon an illegal contract, will probably make the distinction grow less important in the future.

III. Effects on Agency Concepts

An "ultra vires act of a corporation" is an apparent contradiction in terms when we consider the generalization that "a corporation can act only through authorized agents."⁵⁵ If an act is ultra vires, then the corporation has no authority to authorize the act of its agent, and since the agent is unauthorized, the act is not the act of the corporation. The answer, of course, is that there are two concepts of authority: one relating to the chartered authority of the corporation as agent of the shareholders or state as principal,⁵⁶ and the other defining the relation of the corporation as principal to its employees as agents.⁵⁷ The first is normally treated within the concept of ultra vires and the second

⁴⁸ Moore v. Keystone Macaroni Mfg. Co., 370 Pa. 172, 87 A.2d 295 (1952).

⁴⁹ Millett v. Mackie Mill Co., 193 Wash. 477, 76 P.2d 311 (1938). *But see* A.M. Castle & Co. v. Public Serv. Underwriters, 198 Wash. 576, 89 P.2d 506 (1939), where indirect benefit estopped the corporation. Though the facts in these cases occurred in 1932, one year before the enactment of the ultra vires statute (see note 12 *supra*), it is a valid assumption that the court felt that the "capacity" statute had no effect on ultra vires, since a subsequent case involving facts occurring after the enactment does not mention the statute, and cites *Millett* as authority; however it held benefit created an estoppel. Union Fruit Producers, Inc. v. Plumb, 1 Wash. 2d 278, 95 P.2d 1033 (1939).

⁵⁰ Pratt v. Valliquette, 338 Mich. 397, 61 N.W.2d 648 (1953) (statute not mentioned).

⁵¹ Strauss v. W.H. Strauss & Co., 330 Pa. 517, 199 Atl. 195 (1938).

⁵² Dwelley v. Tom McDonnell, Inc., 334 Mich. 229, 54 N.W.2d 217 (1952); Nolan v. J. & M. Doyle Co., 338 Pa. 398, 13 A.2d 59 (1940).

⁵³ See Tiedje v. Aluminum Taper Milling Co., 46 Cal. 2d 444, 296 P.2d 554 (1956).

⁵⁴ Red Robin Stores, Inc. v. Rose, 274 App. Div. 462, 84 N.Y.S.2d 685 (1st Dep't 1948).

⁵⁵ Llano del Rio Co. v. Anderson-Post Hardwood Lumber Co., 79 F. Supp. 382, 390-91 (W.D. La. 1948), *aff'd*, 187 F.2d 235 (5th Cir. 1951).

⁵⁶ See Note, 16 IND. L. J. 587, 590 (1941). See discussion of this relationship in South Western R.R. v. Benton, 206 Ga. 770, 58 S.E.2d 905, 919 (dissenting opinion of Atkinson, P.J.), *cert. denied*, 340 U.S. 815 (1950).

⁵⁷ See Comm'rs' Note, UNIFORM BUSINESS CORP. ACT § 11, 9 U.L.A. 147-48 (1957).

within that of common agency authority. Thus, an act can be without authority in the first sense while at the same time it can be factually authorized by the corporation in the second sense.

The court's use of this double concept of authority is inherent in their treatment of cases where issues are separated on the basis of first, whether the act was ultra vires and secondly, whether it was authorized. Thus, it has been held that reliance by another estopped the corporation from asserting the defense of ultra vires on an indemnity contract even if beyond its powers, while at the same time the corporate seal created a presumption that the contract was properly authorized by the corporation.⁵⁸ Similarly, the question of the ultra vires nature of the contract has been considered apart from the question of whether the president had authority to contract.⁵⁹

The California statute apparently precludes defense based on lack of authority in either of the areas by declaring that: "no limitation upon the business, purposes, or powers of the corporation or . . . of the stockholders, officers, or directors, or the manner of exercise of such powers . . . shall be asserted as between the corporation or any shareholder and any third person."⁶⁰ On the other hand, the Uniform Business Corporation Act, which states: "A corporation . . . shall have the capacity to act possessed by natural persons, but such a corporation shall have authority to perform only such acts as are necessary or proper to accomplish its purposes and which are not repugnant to law,"⁶¹ and the Model Business Corporation Act, stating: "No act of a corporation . . . shall be invalid by reason of the fact that the corporation was without capacity or power to do such act . . .,"⁶² both fail to mention the defenses based on lack of *authority* of the corporation or the directors. From these latter two acts, two issues arise.

The first is, that aside from cases where the party had actual knowledge of the charter limitations,⁶³ does the failure to prohibit expressly defenses based on lack of *authority* of the corporation mean that a valid defense can still be raised if presented in these terms? Under the general provisions of these acts it would seem so; thus, an executory contract beyond the charter powers of the corporation in the old ultra vires sense would now be outside its actual authority and, in place of recourse to a statute barring the defense as such, the court would have to go through the agency ritual of finding that the act was within the apparent authority of the corporation in order to bind it. Whether a defense raised in these terms could be offered was left vague and indefinite.⁶⁴ To some, the fact that acts previously ultra vires are now merely "unauthorized," leaves the executory contract unenforceable as before.⁶⁵

But assuming that courts will fail to distinguish between "power," "capacity," and "authority," a second, more valid issue arises. If the scope of authority within which the board of directors may act is set down by the charter,⁶⁶ then what effect does the abolishment of the defense that the act was outside the power, capacity, or authority of the charter have upon the defense when phrased in agency concepts — namely, that the officers or directors acted without authority? Logically, it would seem that the act of the board of directors would become the act of the corporation binding the shareholders as the ultimate principal.⁶⁷ The reasoning would be that since the directors' authority is

⁵⁸ *American Employers' Ins. Co. v. H. G. Christman & Bros. Co.*, 284 Mich. 36, 278 N.W. 750 (1938).

⁵⁹ *Fulton v. Des Jardins*, 67 Wyo. 517, 227 P.2d 240 (1951).

⁶⁰ CAL. CORP. CODE § 803(b) (West 1955).

⁶¹ UNIFORM BUSINESS CORP. ACT § 11, 9 U.L.A. 142 (1957).

⁶² MODEL BUSINESS CORP. ACT § 6, reprinted in 6 BUS. LAW. No. 1, p. 6 (1950).

⁶³ See discussion of Professor Stevens' views in connection with knowledge provisions in Ham, *Ultra Vires Contracts Under Modern Corporate Legislation*, 46 Ky. L. J. 215, 232-33 (1958).

⁶⁴ BALLANTINE, CORPORATIONS 265-66 (rev. ed. 1946).

⁶⁵ See Bennett, *The Louisiana Business Corporation Act of 1928*, 2 La. L. Rev. 597, 607-09 (1940); 44 HARV. L. REV. 280, 283 (1930).

⁶⁶ STEVENS, CORPORATIONS 653 (2d ed. 1949).

⁶⁷ See *O'Neill v. Finnesey*, 299 Pa. 97, 149 Atl. 103 (1930).

co-extensive with the powers of the corporation,⁶⁸ abolishing the defense that an act is in excess of its powers also abolishes the defense that the act is in excess of the directors' authority. Though the wording of the California statute⁶⁹ comes close to making the act of the directors binding on the corporation, which is what Ballantine said it should do,⁷⁰ the majority of the statutes do not expressly spell out this effect. The drafters of the Uniform Business Corporation Act specifically stated that a rigid rule was not wanted, and implied that many issues remained to be solved by treating the shareholders as principals in a relationship governed by agency law.⁷¹

Courts have not responded to the call for development of agency principles, either in voiding contracts⁷² or in enforcing them.⁷³ Yet decisions can be interpreted in the light of relevant agency principles, as the following examples will show.

In line with the view that the authority of the corporation is interchangeable with the authority of the shareholders,⁷⁴ the ultimate ascendancy of agency law in this area would see to be preceded by a merger of the theory of estoppel of the corporation with that of ratification by the shareholders. Whether the shareholders can ratify a merely ultra vires act (but not an illegal one) might be debated, but more than likely it is conceded today that they do have this power.⁷⁵ However, contracts executed on one side only most often meet estoppel of the corporation as barring the defense of ultra vires,⁷⁶ though in small corporations at least, estoppel of the corporation often actually arises by ratification of the shareholders. Thus a court held that although the assignment of a life insurance policy was ultra vires, estoppel lay because of consent of the shareholders.⁷⁷

Benefit to the corporation is often the decisive fact determining the dual issues of the ultra vires nature of the act and the authority of the person executing it. Where the defendant corporation claimed that its president was without authority to contract for the payment of a royalty to the plaintiffs for the use of their clothes pattern, and that the contract was also ultra vires, the corporation was precluded on both issues since the court found that benefit had passed to the corporation under the contract.⁷⁸

Estoppel now hints at making an exit from legal debate in the company of ultra vires. Traditionally, the reasoning was: this contract was ultra vires, but benefit estops the corporation from asserting the defense;⁷⁹ the reasoning now developing is: there was benefit to the corporation, therefore it was not ultra vires in the first place. A Texas court foreshadowed this approach with the statement that if an act "inures to the direct benefit of the corporation and it is executed, it is not, strictly speaking, ultra vires. . . ."⁸⁰ If this theory is extended to its extreme, corporations would be bound on purely executory contracts where benefit could reasonably have been expected to pass.⁸¹ The substitution of agency principles into this formula would convert reasonable expectations of

⁶⁸ *Kolin v. Leitch*, 351 Ill. App. 66, 113 N.E.2d 806 (1953); 2 FLETCHER, CORPORATIONS § 505 (repl. 1950).

⁶⁹ See statute cited note 60, *supra*.

⁷⁰ BALLANTINE & STERLING, CALIFORNIA CORPORATION LAWS § 71 (1949 ed.) (subject of course to limitations of law and public policy).

⁷¹ See Comm'rs' Note, UNIFORM BUSINESS CORP. ACT § 11, 9 U.L.A. 147-48 (1957).

⁷² *Millett v. Mackie Mill Co.*, 193 Wash. 477, 76 P.2d 311 (1938).

⁷³ *Dwellely v. Tom McDonnell, Inc.*, 334 Mich. 229, 54 N.W.2d 217 (1952).

⁷⁴ 1 DAVIES, OHIO CORPORATION LAW 219 (1942).

⁷⁵ *Scharfenstein & Sons v. Item Co.*, 174 La. 794, 141 So. 463 (1932); 7 FLETCHER, PRIVATE CORPORATIONS § 3432 (repl. 1950). *But see* 6 FLETCHER, *op. cit. supra* § 2493.

⁷⁶ 7 FLETCHER, *op. cit. supra* § 3476.

⁷⁷ *Philadelphia Life Ins. Co. v. Crossland-Cullen Co.*, 234 F.2d 780 (4th Cir. 1956), *reversing* 133 F. Supp. 473 (W.D.N.C. 1955). Ultra vires theories become inapplicable in one-man corporations. *Eastern Trust & Banking Co. v. Guernsey*, 144 Me. 135, 65 A.2d 13 (1949); see also *Buice v. Scruggs Equip. Co.*, 194 Tenn. 129, 250 S.W.2d 44 (1952).

⁷⁸ *Alexis, Inc. v. Werbell*, 209 Ga. 665, 75 S.E.2d 168 (1953).

⁷⁹ *A. M. Castle & Co. v. Public Serv. Underwriters*, 198 Wash. 576, 89 P.2d 506 (1939).

⁸⁰ *Temple Lumber Co. v. Miller*, 169 S.W.2d 256, 258 (Tex. Civ. App. 1943).

⁸¹ *Contra, Gardiner Trust Co. v. Augusta Trust Co.*, 134 Me. 134, 182 Atl. 685 (1936).

benefit into a theory whereby a corporation would be bound not only within its implied powers,⁸² but also within what might be termed its apparent powers. Perhaps the framers of some ultra vires statutes contemplated the use of the concept of apparent corporate powers.⁸³ Though it has not been developed even under the statutes, it is possible that it could be evolved by judicial decision. A Texas court reversed a successful defense of ultra vires for failure to raise it in the pleadings.⁸⁴ It went on, however, to approve a finding of the trial court in reference to the unsuspecting third party that

. . . it likewise might be reasonably concluded that the respondent (corporation) received or *anticipated receiving benefits* arising from the operation . . . , and the securing of waybills was reasonably necessary or proper for such operation; and that therefore the obligation was that of the respondent. . . .⁸⁵ (Emphasis added).

It then added its own conclusion that none of the findings indicated that the contract was ultra vires.

A California case decided under an ultra vires statute exhibits a conglomeration of ultra vires and agency theory combining to reach the result that the corporation should be bound.⁸⁶ Despite a finding of the ultra vires nature of the contract, it was found to be factually authorized by the board of directors. The third party was chargeable with knowledge of by-law limitations on the directors' real authority only to the extent that the directors themselves believed and represented it to exist. Then the statute abolishing ultra vires was relied on to support the court's conclusions.

Again, where a theatre corporation contracted for improvements to the premises of another theatre corporation, there was no benefit to the contracting corporation from the transaction, and the Massachusetts court had a difficult time finding an accepted theory to bind the corporation on a seemingly ultra vires act.⁸⁷ It relied on the distinction between an act clearly outside the corporate powers and a mere abuse of the granted powers, in which case the corporation is bound if the third party did not have knowledge. The reasoning in the case is perhaps a forerunner of a type of analysis that would expressly say that "to the innocent plaintiff the act was within the apparent power of the corporation, thereby binding the corporation."

The possibility that the area formerly governed by ultra vires rules will now be governed by agency law casts a perplexing problem on the courts, since the discarded doctrine of ultra vires contains much agency law, and the tripartite relationship of shareholders, directors, and corporation is incapable of being rigidly defined in terms of principal-agent conceptualism. However, with the removal of the state's fictional objection to ultra vires contracts, there does appear to be a gradual merging of ultra vires theory with agency concepts, and an enlarged apparent authority in the directors and officers upon which outside parties can rely. While the old agency relation between the officers and the corporation before stood in respectability watching the downfall of ultra vires, the necessary association of the two now begins to question agency's reputation also:

Where a contract has been executed in whole or in part, the court looks with disfavor upon a defense interposed by the corporation that its officers had no authority to execute it, and particularly is this true, where as here the contract is found to be fair.⁸⁸

⁸² For a definition of implied powers, see *Mutual Bank & Trust Co. v. Shaffner*, 248 S.W.2d 585, 589 (Mo. 1952).

⁸³ 1 DAVIES, OHIO CORPORATION LAW 244 (1942).

⁸⁴ *Pollock Paper & Box Co. v. East Texas Motor Freight Lines*, 145 Tex. 634, 201 S.W.2d 228 (1947), *reversing* 197 S.W.2d 883 (Tex. Civ. App. 1946).

⁸⁵ 201 S.W.2d at 230.

⁸⁶ *California Canning Peach Growers v. Harkey*, 11 Cal. 2d 188, 78 P.2d 1137 (1938).

⁸⁷ *Wiley & Foss, Inc. v. Saxony Theatres*, 335 Mass. 257, 139 N.E.2d 400 (1957). Normally the corporation is allowed to plead ultra vires when, though the other party has executed the contract, no benefits have flowed to the corporation. 7 FLETCHER, PRIVATE CORPORATIONS § 3478 (repl. 1950).

⁸⁸ *Tucson Fed. Savings & Loan Ass'n v. Aetna Investment Corp.*, 74 Ariz. 163, 245 P.2d 423, 428 (1952).

Conclusion

Where before the emphasis in case law was upon the decision of the non-illegality of an ultra vires act, so that a defense to the act might not be sustained, the express abolishment of the ultra vires defense raises a new problem making the old distinction necessary, but from a new point of view. That is, it is necessary to separate those statutory violations which are merely ultra vires from those which are illegal, so that statutes of abolition may have effect only on the first and not mistakenly on the second. From the scarcity of cases deciding that an act was illegal *against* a contention that it was ultra vires only, it may be concluded that plaintiff's lawyers are not advancing statutes abolishing ultra vires into areas assumed to be reserved for illegality principles. With the trend toward more laws governing corporations and more laws specifically prohibiting the defense of ultra vires, the courts may begin to be plagued by such contentions. Though the courts' conclusions may be framed with reference to the illegal or ultra vires nature of the act, the decision will always rest upon the court's view of the purpose of the statute violated and the justness of the remedy attaching to enforceability or voidness in the particular situation.

Where no specific prohibitory statute has been violated, the problems are open to agency analysis. Ordinarily an ascertainable benefit passes which bars the defense of ultra vires, but in cases where benefit is questionable or the contract is purely executory, the courts still can use public policy to void the obligation despite statutory abolition of the ultra vires defense. In the context of agency principles, public policy is another term for the outer limits of an apparent authority of the corporation, its directors, and officers. The courts, however, usually stop at the generalization "public policy" and refuse to refine the law further. But assuming "public policy" is the alias for a wide expansion of the apparent powers of corporations, the interests usually referred to are only the contract rights of innocent third parties. However, it is basic agency law that apparent power rests not necessarily upon what the third party reasonably believed the scope of the power to be, but rather upon some action of the principal, raising an estoppel which precludes him from denying the apparent power.⁸⁹ Though no case was found advancing such a theory, it would seem that the shareholders' very act of incorporation raises an apparent power co-equal with any reasonable act of the directors or officers. Advocates of the traditional concepts of agency law who view the corporate charter as basically a multi-partnership contract may bolt at this, but it seems the modern price to be paid for limited liability.

John E. Kennedy

⁸⁹ MECHEM, *OUTLINES OF THE LAW OF AGENCY* § 94 (4th ed. 1952).